

Ahead of the Curve

February 19, 2016

Market focus this week will on GDP report

- GDP (4Q15).** Next Tuesday, at 9:00am (EST), *INEGI* will publish its GDP report for the fourth quarter of 2015, where we expect a 2.5% yoy expansion, in line with the preliminary figure estimated by *INEGI*. As a result, we believe that the Mexican economy probably grew 2.5% in 2015. In seasonally adjusted terms, we expect a 0.6% q/q expansion during 4Q15
- Bi-weekly inflation report.** On Wednesday, at 9:00am, *INEGI* will release its bi-weekly inflation report. We are forecasting a 0.34% 2w/2w increase in the first half of February, above market consensus that is forecasting a 0.22% according to *Bloomberg*. In the core index, we expect an increase of 0.28% 2w/2w, above market consensus (0.26%). Inflation in the first half of February will be explained by pressures on agricultural prices along with higher merchandise prices. Our price monitoring shows sharp increases in some fruits and vegetables such as lemons, chilies and potatoes. In addition, in the merchandise price sub-index, we see pressures in the price of products like beans, oil and dairy products, as well as on the price of personal care products, which could be related to FX pass-through

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Document for distribution among the general public

Mexico weekly calendar

DATE	HOOR (EST)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 22-Feb	9:00am	Retail sales	December	% yoy	<u>6.5</u>	<u>6.2</u>	5.7
Mon 22-Feb	4:30pm	Banamex bi-weekly survey of economic expectations					
Tue 23-Feb	9:00am	GDP	4Q15	% yoy	<u>2.5</u>	<u>2.5</u>	2.6
		(sa)		% q/q	<u>0.6</u>	<u>0.6</u>	0.8
		Primary activities		% yoy	<u>1.0</u>	--	4.1
		Industrial production		% yoy	<u>0.2</u>	--	1.2
		Services		% yoy	<u>3.9</u>	--	3.4
Tue 23-Feb	9:00am	Global economic indicator	December	% yoy	<u>2.7</u>	<u>2.5</u>	2.7
		Primary activities		% yoy	<u>-2.1</u>	--	2.2
		Industrial production		% yoy	<u>0.0</u>	--	0.1
		Services		% yoy	<u>4.1</u>	--	4.2
Tue 23-Feb	10:00am	International reserves	19-Feb	US\$ bn	--	--	174.4
Tue 23-Feb	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Jun'21); 10y Udibonos (Dec'25)					
Wed 24-Feb	9:00am	CPI inflation	1Q Feb	% 2w/2w	<u>0.34</u>	<u>0.22</u>	0.35
				% yoy	<u>3.00</u>	<u>2.88</u>	2.75
		Core		% 2w/2w	<u>0.28</u>	<u>0.26</u>	0.14
				% yoy	<u>2.68</u>	--	2.68
Thu 25-Feb	10:00am	Current Account Balance	4Q15	US\$ mn	<u>-4,200</u>	<u>-7,800</u>	-8,856
Fri 26-Feb	9:00am	Trade balance	January	US\$ mn	<u>-2,386.7</u>	<u>-3,346.5</u>	-926.5
		Total exports		% yoy	<u>-1.2</u>	--	-9.3
		Oil exports		% yoy	<u>-54.0</u>	--	-50.8
		Non-oil exports		% yoy	<u>3.3</u>	--	-6.1
		Total imports		% yoy	<u>-4.0</u>	--	-5.8
Fri 26-Feb	9:00am	Unemployment rate	January	%	<u>4.61</u>	<u>4.40</u>	3.96
		sa		%	<u>4.45</u>	<u>4.32</u>	4.37

Source: Banorte-IXE

Proceeding in chronological order...

Retail sales will post a 6.5% yoy expansion in December. On Monday (February 22) at 9:00am (EST), *INEGI* will publish its retail sales report for December 2015. We anticipate a 6.5% yoy expansion explained by the 20% yoy growth in vehicle sales (*AMIA*), which will have a positive impact on the overall growth rate. Moreover, *ANTAD* total store sales increased 9% yoy in real terms during the period in question, while consumption goods imports -which have a strong correlation with retail sales- posted a 0.7% yoy growth.

Looking ahead, we believe that retail sales performance will continue to show a favorable performance in 1Q16. In particular, private consumption in Mexico will show better growth prospects derived from: (1) An improvement in private banking credit; (2) the recent downward trend in inflation; and (3) the stronger growth dynamics in the Mexican labor market.

Banamex Survey: Market participants will focus on 2016 estimates. On Monday at 4:30pm (EST) *Banamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts' monetary policy assessments after Banxico's rate hike in February. Furthermore, analysts will also focus on the inflation report for 1H-February (to be published on Wednesday, February 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 believe that most economists will discount a lower economic growth for 2016 given the additional fiscal cut announced by the federal government (\$132 billion pesos). In the second case, we expect moderate downward revisions to the FX estimates for 2016.

GDP will show a 2.5% yoy expansion in 4Q15. Next Tuesday, at 9:00am (EST), *INEGI* will publish its GDP report for the fourth quarter of 2015, where we expect a 2.5% yoy expansion, in line with the preliminary figure estimated by *INEGI*. As a result, we believe that the Mexican economy probably grew 2.5% in 2015. In seasonally adjusted terms, we expect a 0.6% q/q expansion during 4Q15.

Taking a look at the breakdown, we believe that the services sector will show a 3.9% yoy expansion, which would be above the 3.4% yoy growth observed in the previous quarter. We highlight that 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 trade has begun to show clear signs of acceleration. 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 2.1% yoy as a result of the lower growth in the U.S. manufacturing sector, which led to a deceleration of Mexico's manufacturing output and exports. Moreover, construction output fell 0.5% yoy, as result of a significant downturn in non-residential construction. However, the current recession in the mining industry (-4.5% yoy) –derived from the significant contraction in Mexico's oil production– has limited the recovery of industrial activity, which we believe grew a scant 0.2% yoy in 4Q15.

We expect a 2.7% yoy expansion in December's IGAE. Also on Tuesday, at 9:00am (EST), *INEGI* will release its monthly global economic indicator for December (monthly proxy for the GDP). We expect a 2.7% yoy expansion of economic activity (0.1% m/m).

As we had mentioned in our last IP report, the null growth in industrial production during December was explained in part by the 2.5% yoy expansion in manufacturing output. Moreover, construction decreased 1.4% yoy as a result of the fall in public investment projects. In this regard, we believe that private construction output will show better growth prospects given the higher expectations that prevail today in most of Mexico's firms regarding the higher growth in domestic demand. Similarly, the recovery of households' purchasing power -given the lower inflation levels and the recovery of the Mexican labor market- has led to a recovery in residential construction which will continue throughout the first quarter of 2016. Finally, given the fall in Mexico's oil production, mining activity posted a 4.8% yoy reduction.

As we already explained in the GDP section, we believe that growth in December was driven by the performance of the service sector, which we forecast at 4.1% yoy. We highlight that trade has begun to show clear signs of acceleration. Finally, for the agricultural sector, we estimate a 2.1% yoy contraction.

Weekly international reserves report. On Tuesday, at 10:00am (EST), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US\$573mn amounting to US \$174.4bn on February 12. 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\$7mn; (2) US\$400mn decrease explained by the Banxico's USD ordinary auction with minimum price and US\$400mn by the supplementary auction with minimum price; along with a (3) US\$234mn increase 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. In this context, the central bank has an accumulated reduction of US\$2,334mn international reserves this year (please refer to the table below).

Banxico's foreign reserve accumulation details

US\$, million

	2015	12/Feb/2016	12/Feb/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	174,401	-573	-2,334
(B) Gross international reserve	177,597	179,797	-1,313	2,201
Pemex	--	--	-839	3,939
Federal govt	--	--	39	235
Market operations	--	--	-756	-3,162
Other	--	--	243	1,189
(C) Short-term government's liabilities	861	5,396	-740	4,535

Source: Banxico

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'21) 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 (EST).

Auction specifics (Tuesday, February 23, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	23-Mar-16	--	5,500	3.23
3m	26-May-16	--	9,500	3.40
6m	18-Aug-16	--	11,000	3.56
Mbono				
5y	10-Jun-21	6.50	8,500	5.53
Udibono				
10y	04-Dec-25	4.50	700	3.22

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 in the first half of February will be explained by pressures on agricultural prices along with higher merchandise prices. On Wednesday, at 9:00am, *INEGI* will release its bi-weekly inflation report. We are forecasting a 0.34% 2w/2w increase in the first half of February, above market consensus that is forecasting a 0.22% according to *Bloomberg*. In the core index, we expect an increase of 0.28% 2w/2w, above market consensus (0.26%).

Inflation in the first half of February will be explained by pressures on agricultural prices along with higher merchandise prices. Our price monitoring shows sharp increases in some fruits and vegetables such as lemons, chilies and potatoes. In addition, in the merchandise price sub-index, we see pressures in the price of products like beans, oil and dairy products, as well as on the price of personal care products, which could be related to FX pass-through.

Nevertheless, we expect this figure to be 23.8bps higher than the observed in same period last year, derived from: (1) 22.4bps stemming from a higher contribution of agricultural prices (13.3bps vs. -9.1 in 2015); and (2) 1.2bps stemming from a lower decline in energy prices (-0.5bps vs. -1.7 in 2015), as shown in the table below.

With these results, annual inflation would be at 3% yoy in the first half of February, from 2.75%, while core inflation would stand at 2.68% yoy, in line with the previous figure.

1H-February inflation by components

% bi-weekly incidence

	Banorte-Ixe	2015	Difference
Total	0.34	0.11	0.24
Core	0.21	0.21	0.00
Goods	0.13	0.13	0.00
Processed foods	0.05	0.01	0.03
Other goods	0.08	0.11	-0.03
Services	0.09	0.08	0.00
Housing	0.02	0.02	0.00
Education	0.01	0.01	0.00
Other services	0.06	0.06	0.00
Non-core	0.13	-0.11	0.24
Agricultural	0.13	-0.09	0.22
Fresh fruits and vegetables	0.10	-0.11	0.20
Meat and egg	0.04	0.02	0.02
Energy and government regulated	0.00	-0.01	0.01
Energy	0.00	-0.02	0.01
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

Current account (3Q15): Banorte-Ixe: -US\$4,200 million; consensus: -US\$7,800mn (range: -US\$8,300mn to -US\$4,200mn); previous: -US\$8,856mn. On Thursday (February 25), at 10:00am, Banxico will publish its balance of payments report for the fourth quarter of the year. We are forecasting a current account deficit of US\$4,200 million. According to already reported trade balance figures, trade deficit amounted to US\$3,939.2 million, while net transfers increased on the back of a more dynamic flow of remittances up 1.6% yoy.

Oil exports will continue to fall in January. On Friday (February 26), at 10:00am (EST), INEGI will make available its trade report for January, where we expect to see a US\$2,386.7 million deficit. On the exports side, we will probably see a 54% yoy contraction of oil exports given the significant fall in oil prices during the period in question. Moreover, non-oil exports could have expanded 3.3% yoy, on the back of a 3.7% expansion in manufacturing exports.

On the imports side, we estimate a 4% yoy contraction in total imports. Taking a look at the breakdown, we estimate that imports of consumption goods decreased 5.4% yoy, while imports of intermediate goods could have fallen 4.2% yoy. Finally, we estimate a 0.8% reduction in capital goods imports.

Unemployment rate in January will stand at 4.61%. Finally on Friday, *INEGI* will publish its employment report for the first month of 2016, in which we estimate an unemployment rate of 4.61% nsa, above the 3.96% observed in December. In seasonally-adjusted terms, we believe that the unemployment rate could stand at 4.45%, which implies a 0.08%-pts expansion.

It is likely that the job creation in January was affected by the fall in confidence among firms given the recent volatility in financial markets. However, we believe that the Mexican labor market will continue to recover derived from recent upward trend in the Mexican economy, which will eventually reduce the level of unemployed workers.

Looking ahead, we are still positive on the outlook regarding the recovery of the economic activity, which will have a significant positive impact on firms' expectations about domestic demand, resulting in a more dynamic labor market.

Disclaimer

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