Ahead of the Curve

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Market focus this week will on Banxico's monetary policy decision

- **Banxico's monetary policy decision next Thursday: A slightly more dovish wait for the Fed.** Next week, Banxico will hold its seventh monetary policy meeting of the year. The monetary policy *communiqué* will be published on Thursday (October 29) at 3:00pm (ET). We believe that board members will remain on hold, leaving the reference rate at 3%. However, we do expect a slightly more dovish tone in the *communiqué* on two fronts: (1) Express that the balance of risks for inflation has improved; and (2) the higher probability that the FOMC will decide to delay the beginning of its normalization process. All in all, we continue to believe board members will reiterate that in the absence of inflationary pressures and moderate growth, the board will continue to monitor the relative monetary conditions vs. the U.S. It is our take that the tone of the statement will provide support to our call that Banxico will start its hiking cycle once the Fed begins its own normalization of monetary policy

- **IGAE (August).** On Monday, at 10:00am (ET), *INEGI* will release its monthly global economic indicator for August (GDP monthly proxy), where we expect a 2.5% yoy expansion. We believe that IGAE's growth during the eighth 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% yoy. As we had mentioned in our last IP report, the 1% yoy expansion in industrial production during August was explained in part by the 3.1% yoy growth in manufacturing output. We also believe that the 3.5% yoy estimated expansion in services will be explained by the recovery in private consumption

Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Sun 25-Oct		**Daylight Savings Time ends in Mexico**					
Mon 26-Oct	**10:00am**	**Global economic indicator**	August	% yoy	2.5	2.4	2.0
		Primary activities		% yoy	0.5	--	0.0
		Industrial production		% yoy	1.0	--	0.7
		Services		% yoy	3.5	--	2.8
Tue 27-Oct	**10:00am**	**Trade balance**	September	US$ mn	-2,872.3	-1404.2	-2,782
		Total exports		% yoy	-5.0	--	-6.8
		Oil exports		% yoy	-55.7	--	-48.3
		Non-oil exports		% yoy	1.0	--	-1.6
		Total imports		% yoy	4.9	--	-1.9
Tue 27-Oct	**11:00am**	**International reserves**	23-Oct	US$ bn	--	--	178.2
Tue 27-Oct	**1:30pm**	**Government weekly auction: 1-, 3-, and 6-month Cetes; 20y MBono (Nov'34); 5y Bondes D**					
Thu 29-Oct	**3:00pm**	**Banxico's monetary policy decision**	October	%	3.00	3.00	3.00
Fri 30-Oct	**11:00am**	**Comercial banking credit**	September	% yoy	9.0	--	8.8
		Consumption		% yoy	4.7	--	4.5
		Housing		% yoy	10.1	--	9.8
		Non-banking private firms		% yoy	8.3	--	10.7
Fri 30-Oct	**10:30pm**	**Budget balance (year to date)**	September	MXN bn	--	--	-407.4

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Logistics – The Daylight Savings Time comes to an end. As of Sunday, there will now be a two-hour difference with respect to EST (instead of the usual one hour difference), as Daylight Savings Time will end on Sunday in Mexico. This two-hour difference will last only for one week as the United States will also end DST on next Sunday (Nov 1).

We expect a 2.5% yoy expansion in August's IGAE. On Monday, at 10:00am (ET), *INEGI* will release its monthly global economic indicator for August (GDP monthly proxy), where we expect a 2.5% yoy expansion. We believe that IGAE's growth during the eighth 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% yoy.

As we had mentioned in our last IP report, the 1% yoy expansion in industrial production during August was explained in part by the 3.1% 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 second half of the year given: (1) The significant recovery in external demand, particularly from the U.S.; (2) Mexico's manufacturing exports will show solid growth given the recent and significant depreciation of the Mexican currency; and (3) 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 2H15. However, IP's headline figure was also affected 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* August's retail sales report showed that consumers' spending is gaining momentum, whereas formal job creation has observed a significant recovery in the last 5 months.

Car exports will falter in September. On Tuesday (October 27), at 10:00am (ET), *INEGI* will make available its trade report for September, where we expect to see a US$2,872 million deficit. On the exports side, we will probably see a 55.7% yoy contraction of oil exports given the significant fall in oil prices during the period in question. Moreover, non-oil exports could have expanded 1% yoy, on the back of a 1.8% expansion in manufacturing exports.

On the imports side, we estimate a 4.9% yoy expansion in total imports. Taking a look at the breakdown, we estimate that imports of consumption goods decreased 6% yoy, while imports of intermediate goods could have grown 6.9% yoy. Finally, we estimate a 5.5% expansion in capital goods imports.

Weekly international reserves report. On Tuesday, at 11:00am (ET), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US$1,089mn amounting to US $178.2bn on October 16. According to Banxico's report, this figure comes mainly as a result of: (1) A US$1,000mn decrease explained by the introduction of Banxico's USD daily auction without minimum price and US$200mn with minimum price; along with a (2) US$111mn 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$15,020mn international reserves this year (please refer to the table below).

Banxico's foreign reserve accumulation details
US$, million

	2014	16/Oct/2015	16/Oct/2015	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	193,239	178,219	-1,089	-15,020
(B) Gross international reserve	195,682	179,530	-2,150	-16,152
Pemex	--	--	-881	2,977
Federal govt	--	--	-152	-1,143
Market operations	--	--	-1,230	-18,005
Other	--	--	112	20
(C) Short-term government's liabilities	2,443	1,311	-1,062	-1,132

Source: Banco de México

Weekly government bond auction. Also on Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 20-year fixed-rate Mbonos (Nov'34) as well as 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 1:30pm (ET).

Auction specifics (Tuesday, October 27, 2015)

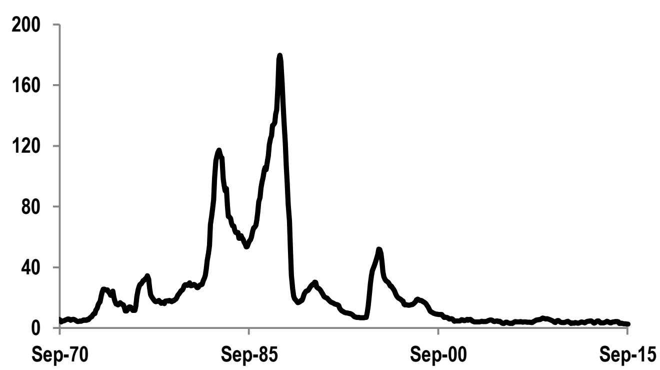
	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	26-Nov-15	- -	5,500	3.04
3m	28-Jan-16	- -	9,500	3.13
6m	28-Apr-16	- -	11,000	3.26
Mbono				
20y	23-Nov-34	7.75	3,000	6.72
Bondes D				
5y	24-Sep-20	- -	5,000	0.21

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

Banxico's monetary policy decision next Thursday: A slightly more dovish wait for the Fed. Next week, Banxico will hold its seventh monetary policy meeting of the year. The monetary policy *communiqué* will be published on Thursday (October 29) at 3:00pm (ET). We believe that board members will remain on hold, leaving the reference rate at 3%. However, we do expect a slightly more dovish tone in the *communiqué* on two fronts: (1) Express that the balance of risks for inflation has improved; and (2) the higher probability that the FOMC will decide to delay the beginning of its normalization process. All in all, we continue to believe board members will reiterate that in the absence of inflationary pressures and moderate growth, the board will continue to monitor the relative monetary conditions vs. the U.S. It is our take that the tone of the statement will provide support to our call that Banxico will start its hiking cycle once the Fed begins its own normalization of monetary policy.

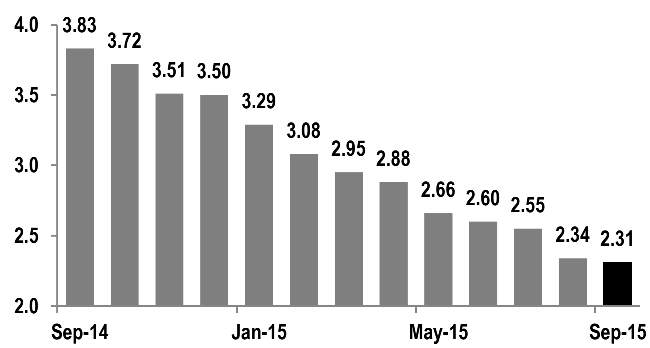
Given Mexico's slow economic growth, the absence of inflationary pressures and the Fed's current monetary policy, common sense would dictate that Banxico should not raise the reference rate, until the Fed begins its hiking cycle. Inflation is at historically low levels (refer to the chart on the left), and even though Mexico's economic growth has been higher in 2015, growth expectations have been continuously revised downwards (refer to chart on the right). Similarly, Mexico's economic outlook is not encouraging in 2016. The current situation of low crude oil prices given Mexico's heavy dependence on oil revenue (~25%), the government's commitment to reduce the fiscal deficit to 0.5% of GDP in 2016, and the new fiscal regulations that will affect the accounts of Mexico's federal entities and municipalities, will translate into a lower public spending, hindering 2016 GDP's growth below 3%.

CPI
% yoy



Source: INEGI

Evolution of 2015 GDP growth expectations
% yoy



Source: Banxico Survey of Economic Expectations

We maintain our view that the central bank will continue to wait for the Fed to begin its own normalization of monetary policy. While Banxico's central scenario seems to be of economic activity weakness and inflation below target until year-end, the prospects of higher rates in the United States pose a significant risk to exchange rate and inflation levels in Mexico. Given this, we believe that Banxico will start its hiking cycle when the Fed begins its own normalization of monetary policy next December.

Banking credit will show a 9% yoy increase in September. Banco de Mexico will make available its banking credit report on Friday (October 30) at 11:00am (ET). It is our take that banking credit continued flowing in September given the significant spike in credit supply from the banking sector. In particular, we estimate a 9% yoy expansion in banking credit (in real terms) as a result of increases in the area of 4.7%, 10.1%, and 8.3% yoy in consumer, housing and business credit, respectively.

The MoF's quarterly report. On Friday, the Ministry of Finance (MoF) will make its finance report available for the first nine months of 2015. On the revenue side, we will be looking at non-oil tax collection as it provides additional information about domestic demand dynamics. Moreover, we will focus on spending dynamics, which will continue to incorporate part of the fiscal cut announced by the MoF in January. Finally, it will be important to evaluate the evolution of public sector debt, which currently represents about 42% of Mexico's GDP.

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BANORTE IXE

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