

## Banxico's QIR– Possible reductions to inflation forecasts

August 10, 2015

www.banorte.com  
www.ixe.com.mx  
@ analisis\_fundam

### Gabriel Casillas

Chief Economist and Head of Research  
gabriel.casillas@banorte.com

### Delia Paredes

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

### Alejandro Cervantes

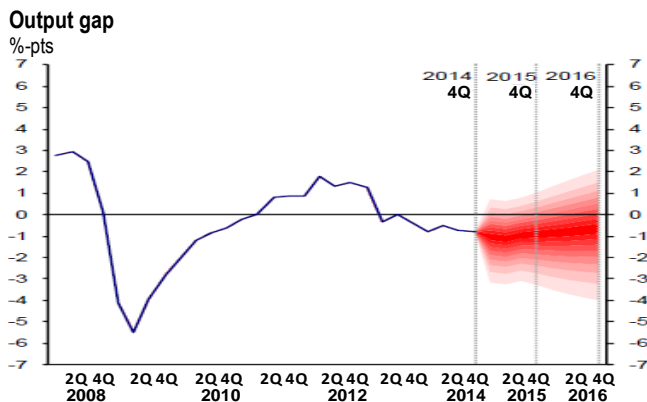
Senior Economist, Mexico  
alejandro.cervantes@banorte.com

- Banxico will publish its *Quarterly Inflation Report (QIR)*, next Wednesday around 1:30pm (EDT)
- In our view, the most important issues that will be discussed are:
  - (1) A downward revision to the central bank's inflation forecast that will be reflected in Banxico's traditional *fan chart*;
  - (2) Banxico's output gap projection; and
  - (3) U.S. Fed's monetary policy normalization
- In our opinion, the QIR will keep the same tone we perceived in the last *communiqué*, in which their attention was focused in the U.S. Fed's hiking cycle despite Mexico's slow growth and lower inflation
- In this context, we believe that Banxico's next movement will be a rate hike (September 21), immediately after the Fed increases its own reference rate (September 17)

**Banxico's QIR – A more pessimistic short-term outlook.** Banco de México will publish its *Quarterly Inflation Report (QIR)* in 2Q15 on Wednesday around 1:30pm (EDT). The release will be accompanied by a press conference led by Governor Carstens. In our view, market participants will focus on three issues: (1) A downward revision to the central bank's inflation forecast that will be reflected in Banxico's traditional *fan chart*; (2) Banxico's output gap projection; and (3) U.S. Fed's monetary policy normalization.

**Downward revision to Banxico's inflation forecast.** In the first case, we believe that the central bank could make a downward revision to its inflation forecast, which could be motivated by the downward trend in inflation since Banxico's last quarterly report. In this context, we highlight that the annual change in prices during July hit a new record low at 2.74% yoy. Moreover, in the last monetary policy announcement, Banxico mentioned that: *"...the pass-through effect of the depreciation of the Mexican currency to prices has been relatively low, reflected mainly in the prices of durable goods, without any second-order effects. Moreover, the reduction in the prices of inputs widely used -such as energy, raw materials and telecommunications services- have also contributed to inflation's favorable performance. Reflecting the above-mentioned factors, expectations for headline and core inflation at year-end 2015 and 2016 have decreased below 3 percent ..."*.

**A negative output gap.** In addition, the central bank has repeatedly highlighted the lower growth dynamics of the Mexican economy. In this context, market participants will examine the timing in which Banxico believes that the output gap will close. In their last QIR, the central bank clearly showed, in their traditional output gap chart, that it will remain open until the end of 2016. Among the factors that could affect the economic dynamism of Mexico, the central bank highlighted: (1) A further weakening of the U.S. economy; (2) new episodes of volatility in financial markets; (3) a further decline in the oil production platform; and (4) weak consumer and business confidence levels. On the positive side, the U.S. economy could improve amid low costs of energy while the outlook could also improve as a result of a favorable outcome in the early stages of implementation of the energy reform



Source: Banco de Mexico

**Relative monetary conditions and exchange rate remain the most important factors in the Mexican monetary authority decision making process.** Members of the board have been very clear in highlighting that they will be paying close attention to the Fed's monetary policy normalization. In its last monetary policy statement, the monetary authority warned that: "...the Fed's actions could have additional repercussions on the exchange rate and inflation expectations...". In this context, Banxico's board of governors will pay particular attention to "... the evolution of the exchange rate, the relative monetary conditions between Mexico and the United States, and the evolution of the slack in the economy...".

**We maintain our view that the central bank's next move will be a hike, immediately after the Fed.** 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's next move will be a rate hike, immediately after the Fed starts its normalization of monetary policy in September 16-17. This implies that the central bank could be raising rates at its next regular meeting on September 21. Recent measures taken by the *Foreign Exchange Commission* give Banxico some leeway to wait for the Fed to hike rates.

**Disclaimer**

The information contained in this document is illustrative and informative so it should not be considered as an advice and/or recommendation of any kind. BANORTE is not part of any party or political trend.

**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
Rey Saúl Torres Olivares	Analyst	saul.torres@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
Víctor 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
Marisol Huerta Mondragón	Equity Research Analyst – Food/Beverages	marisol.huerta.mondragon@banorte.com	(55) 1670 - 1746
José Itzamna Espitia Hernández	Equity Research Analyst – Airports / Cement / Infrastructure / Fibras	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research Analyst – Auto parts	valentin.mendoza@banorte.com	(55) 1670 - 2250
María de la Paz Orozco García	Analyst	maripaz.orozco@banorte.com	(55) 1670 - 2251

**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	Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Jorge de la Vega Grajales	Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Private Banking	lpietrini@ixe.com.mx	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Asset Management	pimentelr@ixe.com.mx	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	International Banking	rvelazquez@ixe.com.mx	(55) 5268 - 9879
Víctor Antonio Roldan Ferrer	Transactional Banking	voldan@ixe.com.mx	(55) 5004 - 1454