

# Ahead of the Curve

March 24, 2017

Market focus this week will be on Banxico's monetary policy announcement

- **We expect a 25bps hike in Banxico's reference rate.** On Thursday, Banxico will announce its monetary policy decision at 3:00pm (EDT), where we expect a 25bps rate hike. Thus, the new reference rate will stand at 6.5%. We believe that the key variables for Banxico will be: (1) The Fed's 25bps hike; (2) the recent upward trend in inflation as a result of the increase on gasoline prices and the pass-through effect of the depreciation of the Mexican currency to prices; (3) and the deterioration of inflation expectations.
- **We forecast a 1.6% growth in January's economic activity.** On Monday, *INEGI* will release its monthly global economic indicator for January (GDP monthly proxy), where we expect a 1.6% yoy expansion. We believe that Mexico's economic growth will be explained by a 0.1% contraction in industrial production, coupled with a 2.6% yoy increase in services output.

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

**Alejandro Cervantes**  
Senior Economist, Mexico  
alejandro.cervantes@banorte.com

**Francisco Flores**  
Economist, Mexico  
francisco.flores.serrano@banorte.com

Document for distribution among the general public

## Mexico weekly calendar

DATE	HOUR (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 27-Mar	10:00am	<b>Trade balance</b>	February	US\$ mn	<u>100.2</u>	-500	-3,294
		Total exports		% yoy	<u>9.7</u>	--	11.4
		Oil exports		% yoy	<u>68.0</u>	--	74.4
		Non-oil exports		% yoy	<u>8.2</u>	--	8.5
		Total imports		% yoy	<u>6.4</u>	--	10.0
Mon 27-Mar	10:00am	<b>Global economic indicator (sa)</b>	January	% yoy	<u>1.6</u>	1.9	2.1
		Primary activities		% m/m	<u>-0.4</u>	--	0.4
		Industrial production		% yoy	<u>4.2</u>	--	4.9
		Services		% yoy	<u>-0.1</u>	--	-0.6
				% yoy	<u>2.6</u>	--	3.3
Tue 28-Mar	10:00am	<b>Unemployment rate sa</b>	February	%	<u>3.63</u>	3.51	3.59
				%	<u>3.70</u>	3.65	3.57
Tue 28-Mar	11:00am	<b>International reserves</b>	24-Mar	US\$ bn	--	--	174.8
Tue 28-Mar	1:30pm	<b>Government weekly auction: 1-, 3-, 6-, 12-month CETES; 30y Mbono (Nov'42); 30y Udibonos (Nov'46); 5y Bondes D</b>					
Thu 30-Mar	3:00pm	<b>Banxico's monetary policy decision</b>	March	%	<u>6.50</u>	6.50	6.25
Thu 30-Mar	4:30pm	<b>Budget balance</b>	February	MXN bn	--	--	-29.6
Fri 31-Mar	11:00am	<b>Comercial banking credit</b>	February	% yoy	<u>6.7</u>	--	7.9
		Consumption		% yoy	<u>5.4</u>	--	6.6
		Housing		% yoy	<u>4.4</u>	--	5.6
		Non-banking private firms		% yoy	<u>7.3</u>	--	8.5

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

**We expect a 1.6% yoy expansion in January's IGAE.** On Monday *INEGI* will release its monthly global economic indicator for January (GDP monthly proxy), where we expect a 1.6% yoy expansion. We believe that Mexico's economic growth will be explained by a 0.1% contraction in industrial production, coupled with a 2.6% yoy increase in services output.

As we had mentioned in our last report, IP's contraction in January was partially explained by the 9.8% yoy reduction in mining activity, as a result of the significant contraction in Mexico's oil production, and the lower investment in Mexico's drilling projects. Moreover, construction output posted a 1% contraction, as a result of the 11.1% reduction of public civil engineering construction projects given the fiscal cuts implemented by the Federal Government. By contrast, manufacturing output grew 4.3% yoy.

In addition, we believe that the 2.6% yoy estimated expansion in services will be explained by the lower growth dynamics in domestic demand. In this regard, most of January's indicator for consumption, like *ANTAD*'s retail sales and consumer confidence- suggest that Mexican households spent less, which will be reflected in the services sub-index.

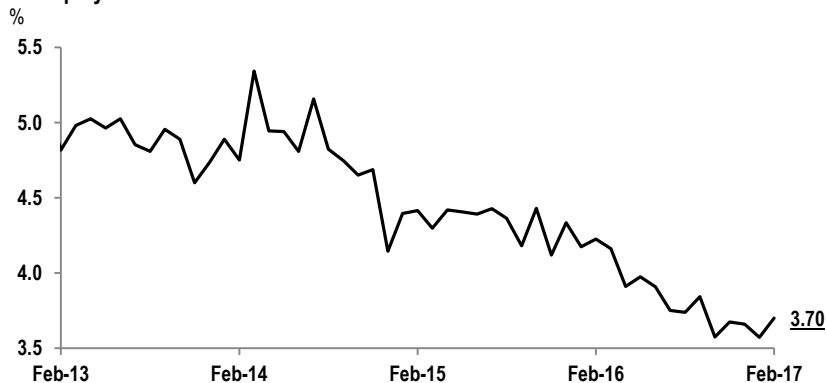
**Exports will show a significant recovery.** On Monday at 10:00am (EDT), Banxico and *INEGI* will also make available its preliminary trade report for February, where we expect to see a US\$110.2 million surplus. On the exports side, we will probably see a 68% yoy expansion of oil exports as a result of the higher prices for the Mexican crude oil basket. In addition, non-oil exports could have increased 8.2% yoy, on the back of a 7.5% hike in manufacturing exports.

On the imports side, we estimate a 6.4% yoy expansion in total imports, as a result of the increase in oil related imports. However, taking a look at the breakdown, we believe that non-oil consumption goods imports decreased 8.6% yoy, while imports of intermediate goods could have increased 6.3% yoy. Finally, we estimate a 1.5% expansion in capital goods imports.

**Unemployment rate in February will stand at 3.63%.** On Tuesday, *INEGI* will publish its employment report for the second month of 2017, in which we estimate an unemployment rate of 3.63% nsa, below the 4.15% observed in February 2016. In seasonally-adjusted terms, we believe that the unemployment rate could stand at 3.7%, which implies a 0.13%-pts increase.

It is likely that February's labor market report will reflect the lower growth dynamics of the Mexican economy. In particular, the downward trend in public spending has translated in a higher number of unemployed workers, and has already affected private investment projects. In addition, we believe that February's report will also reflect the lower growth dynamics of the formal labor market as a result of the uncertainty surrounding Trump's policies on the Mexican economy.

#### Unemployment rate



Source: INEGI

**Weekly international reserves report.** On Tuesday, at 11:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US\$301 million amounting to US\$174.8 billion. According to Banxico's report, this figure comes mainly as a result of: changes in valuation of the Central Bank's assets. In this context, the Central Bank's international reserves have diminished by US\$1.7 billion this year (please refer to the table below).

#### Banxico's foreign reserve accumulation detail

US\$, million

	2016	Mar 17, 2017	Mar 17, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	174,825	301	-1,717
(B) Gross international reserve	178,025	177,331	-159	-694
Pemex	--	--	164	155
Federal government	--	--	-598	-71
Market operations	--	--	0	-2,000
Other	--	--	274	1,222
(C) Short-term government's liabilities	1,483	2,506	-460	1,023

Source: Banco de México

**Weekly government bond auction.** On Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 30-year fixed-rate Mbonos (Nov'46), as well as 30-year inflation-linked Udibonos (Nov'42), and 5-year Bondes D, in addition to the “more traditional” 1-, 3-, 6-, and 12-month zero-coupon Cetes (please refer to the table below). As usual, the results will be released at 1:30pm (EDT).

**Auction specifics (Tuesday, March 28, 2016)**

	Maturity	Coupon rate, %	To be auctioned <sup>1</sup>	Previous yield <sup>2</sup>
<b>Cetes</b>				
1m	27-Apr-17	--	7,000	6.32
3m	29-Jun-17	--	11,000	6.58
6m	28-Sep-17	--	11,500	6.75
12m	1-Mar-18	--	11,500	6.92
<b>M Bono</b>				
30y	07-Nov-47	8.00	3,000	7.71
<b>Udibonos</b>				
10y	08-Nov-46	4.00	300	3.84
<b>Bondes D</b>				
5y	17-Mar-22	--	4,500	0.19

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

**We expect a 25bps hike in Banxico’s reference rate.** On Thursday, Banxico will announce its monetary policy decision at 3:00pm (EDT), where we expect a 25bps rate hike. Thus, the new reference rate will stand at 6.5%. We believe that the key variables for Banxico will be: (1) The Fed’s 25bps hike; (2) the recent upward trend in inflation as a result of the increase on gasoline prices and the pass-through effect of the depreciation of the Mexican currency to prices; (3) and the deterioration of inflation expectations.

In the first case, we believe that an increase in the U.S. reference rate is a sufficient condition to trigger a rate hike in Mexico -despite the fact that economic activity has been sluggish-, given that the holdings of foreign investors in the short-end of the curve is elevated. In this regard, given that Mexico continues to be a small and open economy, Banxico does not manage the reference rate in absolute terms, but -given the global influence of the U.S. monetary policy- it only sets the spread between Mexico’s rate and the U.S. *Fed funds* rate. Thus, after the Fed’s 25bps hike, almost independently of Mexico’s economic cycle and inflation, Banco de Mexico “*will have to maintain*” the differential between the interest rates in both countries.

In the second case, Banxico will also justify the 25bps hike in order to limit the inflationary impact generated by the increase in gasoline prices and the changes in relative prices of goods with respect to services, as a result of the pass-through effect of the depreciation of the Mexican currency to prices, although Banxico will probably recognize that the latter effect will be lower as a result of the recent appreciation of the Mexican currency. Finally, the increase will also be justified by the deterioration of inflation expectations in the short and medium term, following the increase in inflation resulting from the gradual liberalization of gasoline prices.

Looking ahead, we believe Banxico will increase the reference rate again by 25bp in September and December, in tandem with the Fed. Moreover, we think the Central Bank will increase an additional 25bp throughout the year due to different risk factors, which we believe are: (1) Inflationary pressures derived from a greater pass-through effect or significantly higher energy prices; (2) geopolitical risk events, such as the Presidential elections in Europe, particularly France; and (3) uncertainty related to 2018’s political process.

**The MoF's monthly report.** On Thursday, the Ministry of Finance (MoF) will make its monthly finance report available for the second month of the year. On the revenue side, we will be looking at non-oil tax collection as it will provide additional information about domestic demand dynamics. However, given the upward trend in Mexico's crude oil basket price, the behavior of oil revenues generated by the Federal Government will be specially relevant

In addition, markets will focus on the spending side of the report, in order to assess the execution of the fiscal cut announced by the *MoF* in Mexico's Fiscal Budget for 2017. Finally, it will be important to evaluate the evolution of public sector debt, which currently represents around 49% of Mexico's GDP.

**Banking credit will show a 6.7% yoy increase in February.** Finally, on Friday Banco de Mexico will make available its banking credit report on Friday at 10:00am (EDT). It is our take that banking credit continued flowing in February. In particular, we estimate a 6.7% yoy expansion in banking credit (in real terms), as a result of increases in the area of 5.4%, 4.4%, and 7.3% yoy in consumer, housing and business credit, respectively.

**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
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
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@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	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