

Ahead of the Curve

August 26, 2016

Market focus this week will on Banxico's Quarterly Inflation Report (QIR)

- Banxico's QIR.** Banco de Mexico will publish its Quarterly Inflation Report (QIR) for the second quarter of the year 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) Banxico's assessment regarding the probability of higher financial volatility in local markets given geopolitical risks; (2) Banxico's GDP and output gap projections will be particularly interesting to watch after to board members highlighted the uncertainty surrounding its estimation; and (3) Banxico's inflationary projections depicted in their traditional fan charts.
- August's PMI surveys.** On Thursday, *IMEF* (Mexican Institute of Financial Executives) will publish its PMI business confidence indicators for August. We expect manufacturing PMI at 49.4, above the 48.9 observed in July (seasonally adjusted terms), but still below the 50 points threshold. We believe that the marginal growth in the manufacturing PMI during August will be explained by the sluggishness in the US manufacturing sector, coupled with the recent difficulty to import inputs for the manufacturing industry experienced by some Mexican exporters.

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Document for distribution among the general public

Mexico weekly calendar

DATE	HOUR (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 29-Aug	9:00am	Unemployment rate	July	%	<u>4.33</u>	<u>4.00</u>	3.93
		sa		%	<u>4.02</u>	--	3.94
Tue 30-Aug	10:00am	International reserves	26-Aug	US\$ bn	--	--	176.5
Tue 30-Aug	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 30y Mbono (Nov'42); 5y Bondes D					
Tue 30-Aug		Budget balance	July	MXN bn	--	--	-116.6
Wed 31-Aug	10:00am	Comercial banking credit	July	% yoy	<u>11.7</u>	--	12.7
		Consumption		% yoy	<u>10.7</u>	--	11.2
		Housing		% yoy	<u>10.3</u>	--	10.0
		Non-banking private firms		% yoy	<u>13.2</u>	--	14.5
Wed 31-Aug	12:30pm	Banxico's quarterly inflation report	2Q16				
Thu 1-Sep	9:00am	PMI's survey (IMEF)	August				
		Manufacturing		index	<u>49.4</u>	48.5	48.9
		Non-manufacturing		index	<u>52.7</u>		52.4
Thu 1-Sep	10:00am	Family remittances	July	US\$ mn	<u>2,241</u>	2,297	2,306
Thu 1-Sep	10:00am	Banxico's survey of economic expectations	August				
Fri 2-Sep	9:00am	Gross fixed investment	June	% yoy	<u>1.1</u>	-1.2	0.7
		Machinery and equipment		% yoy	<u>1.0</u>	--	2.7
		Domestic		% yoy	<u>9.3</u>	--	11.7
		Imported		% yoy	<u>-2.5</u>	--	-1.3
		Construction		% yoy	<u>1.2</u>	--	-0.6

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Unemployment rate in July will stand at 4.33%. On Monday, *INEGI* will publish its employment report for the seventh month of 2016, in which we estimate an unemployment rate of 4.33% nsa, above the 3.93% observed in June, but below the 4.72% observed in July'15. In seasonally-adjusted terms, we believe that the unemployment rate could stand at 4.02%, which implies a 0.08%-pts increase.

It is likely that July'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. We believe that these collateral effects will also have a negative impact in the Mexican labor market. Looking ahead, we believe that the labor market will continue to grow, but at a slower pace given the fiscal cuts that the Federal Government will continue to implement throughout the second half of the year.

Weekly international reserves report. On Tuesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves fell by US\$109 million amounting to US \$176.5 billion on August 19. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by Banxico to the Federal Government for US\$104 million; along with a (2) US\$5 million reduction due to changes in the valuation of the Central Bank's assets. In this context, the Central Bank's international reserves have diminished by US\$216 million this year (please refer to the table below).

Banxico's foreign reserve accumulation details

US\$, million

	2015	19/Aug/2016	19/Aug/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	176,519	-109	-216
(B) Gross international reserve	177,597	177,920	-2,863	324
Pemex	--	--	237	2,267
Federal government	--	--	-3,188	903
Market operations	--	--	0	-5,562
Other	--	--	87	2,714
(C) Short-term government's liabilities	861	1,401	-2,755	540

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 30-year fixed-rate Mbonos (Nov’42) 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 12:30pm (EDT).

Auction specifics (Tuesday, August 30, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	29-Sep-16	--	5,500	4.23
3m	1-Dec-16	--	9,500	4.38
6m	2-Mar-17	--	11,000	4.58
Mbono				
30y	13-Nov-42	7.75	2,500	6.37
Bondes D				
5y	22-Jul-21	--	3,000	0.23

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

The MoF’s monthly report. On Tuesday, the Ministry of Finance (MoF) will make its monthly finance report available for July. On the revenue side, we will be looking at non-oil tax collection as it provides additional information about domestic demand dynamics. Moreover, markets will focus on the spending side of the report, in order to assess the execution of the fiscal cuts announced by the *MoF*. Finally, it will be important to evaluate the evolution of public sector debt, which currently represents about 48% of Mexico’s GDP.

Banking credit will show an 11.7% yoy increase in July. Banco de Mexico will make available its banking credit report on Wednesday at 10:00am (EDT). It is our take that banking credit continued flowing in July. In particular, we estimate a 11.7% yoy expansion in banking credit (in real terms), as a result of increases in the area of 10.7%, 10.3%, and 13.2% yoy in consumer, housing and business credit, respectively.

Banxico’s QIR. Banco de Mexico will publish its Quarterly Inflation Report (QIR) for the second quarter of the year 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) Banxico’s assessment regarding the probability of higher financial volatility in local markets given geopolitical risks; (2) Banxico’s GDP and output gap projections will be particularly interesting to watch after to board members highlighted the uncertainty surrounding its estimation; and (3) Banxico’s inflationary projections depicted in their traditional *fan charts*.

In the first case, market participants will focus on Banxico's assessment regarding the probability of higher financial volatility in local markets. Within the minutes of the last monetary policy announcement, several board members mentioned that: "*... the monetary policy decision taken by Banxico following the Brexit referendum contributed to the exchange rate appreciation.*" In this context, most board members also highlighted that the flattening of the yield curve after the 50bps hike reflects the stabilization of inflation expectations. Looking forward, most board members highlighted: "*...the probability of higher financial volatility in local markets given geopolitical risks, including the US elections, lower oil prices, and the expectation of the normalization of the Fed's monetary policy.*" In this regard, Banxico's minutes suggest that the central bank believes that preemptive measures –such as the one taken in June–, could be useful to improve the balance of risks for inflation in the event of geopolitical risks that could increase the volatility of local financial markets.

Market participants will also focus on the central bank's assessment regarding growth and output gap projections. Within the last monetary policy announcement, two members highlighted the uncertainty surrounding the estimation of Banxico's output gap. In this regard, one member pointed out that: "*... in addition to possible measurement errors in Mexico's potential GDP, other economic indicators within the labor market, such as the lower unemployment rate and the recent trend in labor's unitary costs, raises questions about the degree of slack that effectively prevails in the economy.*" Moreover, this member also referred to the upward trend in the current account deficit. In this context, he explained that "*...despite the deceleration in [Mexico's] GDP, the imbalance between spending and national income has increased, which suggests that its recent evolution –particularly through the depreciation of the exchange rate– is already a source of demand-side pressures on prices.*"

Finally, we believe that analysts will also focus on Banxico's inflation forecasts, which will be depicted in their traditional *fan charts*. In the last QIR, the central bank projected an inflation 3% throughout the year. However, inflation has been constantly lower than Banxico's projections, and it is likely that the Central Bank will revise down their inflation forecast for the year.

Looking ahead we continue to forecast a highly volatile exchange market that could affect the performance of inflation in the horizon over which monetary policy takes effect, so we anticipate that the central bank will increase the reference rate by 50bps again in September, and then again in December. In addition, it is worth noting that September's meeting will be the last before the US election, an event that could be particularly volatile for the Mexican exchange rate market.

August's PMI surveys. On Thursday, *IMEF* (Mexican Institute of Financial Executives) will publish its PMI business confidence indicators for August. We expect manufacturing PMI at 49.4, above the 48.9 observed in July (seasonally adjusted terms), but still below the 50 points threshold. We believe that the marginal growth in the manufacturing PMI during August will be explained by the sluggishness in the US manufacturing sector, coupled with the recent difficulty to import inputs for the manufacturing industry experienced by some Mexican exporters.

In addition, we believe that the non-manufacturing PMI will stand at 52.5 points from 47.8 points. In this regard, we believe that the recent upward trend in domestic demand, given the recovery in both the labor market and the household's purchasing power, could have triggered a faster growth within the services, which will be reflected in the non-manufacturing PMI.

Banxico's survey of economic expectations. Also on Thursday at 10:00am (EDT), Banco de Mexico will publish its monthly survey of economic expectations. In our view, market participants' focus will be on three issues: (1) 2016 inflation expectations that currently are at 3.2% (Banorte-Ixe: 2.8%); (2) mid-term inflation expectations—quite important for the central bank's board—that are currently at 3.36% (Banorte-Ixe: 3%); and (3) the analysts' assessments of GDP growth for 2016 which stands at 2.3% yoy, in line with our forecast.

Family remittances will post a 0.3% yoy expansion in July. On Thursday, at 10:00am (EDT), Banxico will make its family remittances monthly data available. We expect Mexican workers living abroad -mainly in the US-, to have sent US\$2,241 million to their families in Mexico during July. This would imply a 0.3% yoy expansion.

We believe that the strong expansion in the flow of remittances during the second quarter –which was favored by the significant depreciation of the Mexican currency– affected the amount sent in July, since there wasn't any significant changes in the real income of the Mexican migrant workers.

Looking ahead, given the recent dynamics of the US labor market for Mexican migrants, we believe that the remittances flows will continue to grow above 7% throughout the year. In particular, remittances inflows could increase dramatically as the US elections approaches, if the differential between the Republican and the Democratic Party narrows.

We expect a 1.1% yoy expansion in June's GFI. Finally, on Friday at 9:00am (EDT), *INEGI* will publish its June's gross fixed investment (GFI) report. We anticipate GFI up by 1.1% yoy. We believe that within the report we will probably see a 2.5% yoy contraction in imported machinery and equipment, given that trade balance figures showed a similar decline for capital goods imports. Moreover, we expect a 9.3% growth in domestic machinery and equipment. Finally, we believe that construction spending increased a scant 1.2% yoy derived from the lower public construction spending observed in the latest industrial production figures.

GFI estimates: June 2016

%yoy	Jun-16	Jun-15	Jan-Jun, '16	Jan-Jun, '15
Total	1.1	8.4	0.9	5.5
Machinery and equipment	1.0	22.1	1.2	9.6
Domestic	9.3	15.9	9.0	10.5
Imported	-2.5	24.9	-2.2	9.2
Construction	1.2	0.3	0.8	3.0
Annual contribution	Jun-16	Jun-15	Difference	
Total	1.1	8.4	-7.3	
Machinery and equipment	0.4	8.2	-7.8	
Domestic	1.2	1.9	-0.7	
Imported	-0.7	6.4	-7.1	
Construction	0.7	0.2	0.5	

Source: Banorte-Ixe

Disclaimer

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