Ahead of the Curve

May 13, 2016

Market focus this week will be on INEGI's GDP report

www.banorte.com
www.ixe.com.mx
@analisis_fundam

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

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

Saúl Torres
Analyst, Mexico
saul.torres@banorte.com

- **GDP's report (1Q16).** Next Friday, at 9:00am (EDT), *INEGI* will publish its GDP report for the first quarter of 2016, where we expect a 2.6% yoy expansion, marginally below the 2.7% growth reported in *INEGI*'s preliminary GDP report. However, we highlight that the annual growth rate will be affected by a seasonal effect, given that the *Holy Week* holidays subtracted two working days in March. Controlling for this calendar effect, the Mexican economy probably grew 2.8% yoy in 1Q16

- **Banxico's minutes.** Next Thursday at 10:00am (EDT), Banco de Mexico will publish the minutes of its monetary policy meeting held back on May 5th, in which the board decided to leave the reference rate unchanged at 3.75%, as it was widely expected. We believe that the decision was unanimous, and that the discussions during the meeting focused on three issues: (1) The Mexican economy observed a higher growth in 1Q16, but the balance of risks for the global economy has deteriorated; (2) the short and medium-term balance of risks for inflation has remained unchanged; and (3) the embedded risks of the accommodative stance of several central banks to the financial system, and acknowledged that they cannot rule out other episodes of increased volatility

Mexico weekly calendar

DATE	TIME (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Tue 17-May	**10:00am**	**International reserves**	13-May	US$ bn	--	--	177.7
Tue 17-May	**12:30pm**	**Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Jun'21); 10y Udibonos (Dec'25)**					
Thu 19-May	**10:00am**	**Banxico's minutes of May 5 meeting**					
Fri 20-May	**9:00am**	**GDP**	1Q16	% yoy	2.6	2.6	2.5
		(sa)		% q/q	0.7	0.7	0.5
		Primary activities		% yoy	4.7	--	2.7
		Industrial production		% yoy	0.5	--	0.2
		Services		% yoy	3.5	--	3.7
Fri 20-May	**9:00am**	**Global economic indicator**	March	% yoy	1.5	1.4	4.1
		(sa)		% m/m	0.1	--	0.2
		Primary activities		% yoy	5.3	--	3.7
		Industrial production		% yoy	-2.0	--	2.6
		Services		% yoy	2.7	--	5.0
Fri 20-May	**4:30pm**	**Banamex bi-weekly survey of economic expectations**					

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Weekly international reserves report. On Tuesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US$237mn amounting to US $177.7bn on May 6. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by Banxico to the Federal Government for US$49mn; along with a (2) US$188mn decrease 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 accumulated US$996mn international reserves this year (please refer to the table below).

Banxico's foreign reserve accumulation details
US$, million

	2015	6/May/2016	6/May/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	177,731	-237	996
(B) Gross international reserve	177,597	180,232	-1,887	2,635
Pemex	--	--	-525	2,527
Federal govt	--	--	-112	2,360
Market operations	--	--	0	-5,562
Other	--	--	-1,250	3,310
(C) Short-term government's liabilities	861	2,501	-1,649	1,639

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 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 (EDT).

Auction specifics (Tuesday, May 17, 2016)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	16-Jun-16	- -	5,500	3.77
3m	18-Aug-16	- -	9,500	3.85
6m	10-Nov-16	- -	11,000	3.88
Mbono				
5y	10-Jun-21	6.50	7,500	5.28
Udibono				
10y	04-Dec-25	4.50	650	3.07

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 minutes – Same message as in the last *communiqué*. Next Thursday at 10:00am (EDT), Banco de Mexico will publish the minutes of its monetary policy meeting held back on May 5th, in which the board decided to leave the reference rate unchanged at 3.75%, as it was widely expected. We believe that the decision was unanimous, and that the discussions during the meeting focused on three issues: (1) The Mexican economy observed a higher growth in 1Q16, but the balance of risks for the global economy has deteriorated; (2) the short and medium-term balance of risks for inflation has remained unchanged; and (3) the embedded risks of the accommodative stance of several central banks to the financial system, and acknowledged that they cannot rule out other episodes of increased volatility.

According to Banxico's last *communiqué,* the balance of risks for global growth deteriorated, with a lower growth in the U.S. despite the recovery of the labor market and the higher levels of consumer confidence. In the Eurozone and Japan, Banxico mentioned that the economy has observed a modest recovery the despite the ECB and the BoJ's accommodative monetary policy stance. In Mexico, economic activity posted a higher growth in 1Q16. However, external demand continues to be stagnant, while gross domestic investment has shown a week performance. In this context, the central bank *"…does not expect demand-side pressures on prices...."* and considers that there is still slack in the economy.

Banxico also explained that inflation recently reached 2.6% yoy, where core inflation has maintained a moderate, but upward trend given the adjustment of relative prices as a result of the exchange rate depreciation. However, Banxico emphasized that the pass-through effect of the FX depreciation to prices has been limited, and they expect inflation to end the year around 3%yoy. Regarding the volatility of financial markets, the central bank highlighted that *"... the accommodative monetary stance implemented by several central banks in advanced economies [...] could pose significant risks to the stability of the international financial system".* In this context, Banxico acknowledged that they cannot rule out other episodes of increased volatility.

We continue to believe that Banxico's next move will be a 25bps rate hike in June 30th, right after the Fed does so in its FOMC meeting of June 15. Nevertheless, we do not rule out the possibility of Banxico hiking more than twice this year, if there is strong evidence of FX pass-through on inflation and/or there is a new episode of high volatility.

GDP will show a 2.6% yoy expansion in 1Q16. Next Friday, at 9:00am (EDT), *INEGI* will publish its GDP report for the first quarter of 2016, where we expect a 2.6% yoy expansion, marginally below the 2.7% growth reported in *INEGI*'s preliminary GDP report. However, we highlight that the annual growth rate will be affected by a seasonal effect, given that the *Holy Week* holidays subtracted two working days in March. Controlling for this calendar effect, the Mexican economy probably grew 2.8% yoy in 1Q16.

Taking a look at the breakdown, we believe that the services sector will show a 3.5% yoy expansion, which would be marginally below the 3.7% yoy growth observed in the previous quarter. However, the lower growth will be simply explained by the above-mentioned calendar effect. In this regard, 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 accelerated. 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 a scant 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 increased 2% yoy, as result of a significant downturn in non-residential construction, and the recovery in private housing construction. However, the current recession in the mining industry (-3.3% yoy) –derived from the significant contraction in Mexico's oil production– has limited the recovery of industrial activity, which we believe grew a scant 0.4% yoy in 1Q16.

We expect a 1.5% yoy expansion in March's IGAE. Also on Friday, at 9:00am (EDT), *INEGI* will release its monthly global economic indicator for March (monthly proxy for the GDP). We expect a 1.5% yoy expansion of economic activity (0.1% m/m). However, and as it will be the case for the GDP figure, March's annual growth rate will be affected by a seasonal effect, given that the *Holy Week* holidays subtracted two working days in its annual comparison. Controlling for this calendar effect, the Mexican economy probably grew 3.3% yoy in March.

As we had mentioned in our last IP report, the 0.3% yoy growth in industrial production during March (calendar-adjusted figures) was explained in part by the moderate 2.2% yoy expansion in manufacturing output. Moreover, construction increased 1.7% yoy as a result of the fall in public investment projects and a moderate growth in private construction. Finally, given the fall in Mexico's oil production, mining activity posted a 5.1% yoy reduction.

As we already explained in the GDP section, we believe that growth in March was driven by the performance of the service sector, which we forecast at 4.2% yoy (calendar-adjusted figures). We highlight that trade has begun to show clear signs of acceleration. Finally, for the agricultural sector, we estimate a 5.3% yoy expansion.

***Banamex* Survey: Market participants will focus on monetary policy forecasts.** Finally, on Friday at 4:30pm (EDT) *Banamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts' monetary policy assessments given the neutral tone in Banxico's latest monetary policy statement. Furthermore, analysts will also focus on the inflation report for the first half of May (to be published on Tuesday, May 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 do not expect strong revisions to the median GDP forecast. In the second case, we expect moderate downward revisions to the FX estimates for 2016.

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 Godinez	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
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
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
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
Corporate Debt			
Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Analyst, Corporate Debt	hugoa.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.ceballos@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
Víctor Antonio Roldan Ferrer	Head of Corporate Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454