

Ahead of the Curve

August 10, 2018

Market focus this week will be on Banxico's minutes

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- Banxico's minutes (August).** Next Thursday at 10:00am (ET), Banco de México will publish the minutes of its August 2nd meeting, in which its Board decided to maintain the reference rate at 7.75%. In our opinion, this decision was accompanied by a less hawkish communiqué. Even though the statement still leaves room for the central bank to keep hiking the reference rate, we do not believe it to be necessary for the time being, given that risks to the outlook seem to be contained. In this regard, we expect the minutes to show the discussions among board members around the three main factors that they attention when setting policy: (1) The potential pass-through from exchange rate volatility to prices; (2) the relative monetary policy stance with the US; and (3) the slack in the economy. Looking ahead, even though we anticipate that Banxico will leave the reference rate unchanged in the next 18 months, we continue to consider that the bias is skewed for a further rate hike.

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Document for distribution among the general public

Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 14-Aug	10:00am	International reserves	Aug-10	US\$ bn	--	--	173.3
Tue 14-Aug	12:30pm	Government weekly auction: 1-, 3-, 6-, 12-month CETES; 30y Mbono (Nov'47); 30y Udibonos (Nov'47); 5y Bondes D					
Wed 15-Aug	1:30pm	Extraordinary bond auction: 182, 252, and 336-day CETES					
Thu 16-Aug	10:00am	Banxico's Minutes					

Source: Banorte; Bloomberg

Proceeding in chronological order...

Weekly international reserves report. On Tuesday, at 10:00am (ET), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US\$49 million amounting to US\$173.3 billion. According to Banxico's report, this figure comes mainly as a result of a positive valuation effect in central bank assets. In this context, the central bank's international reserves have increased by US\$485 million during 2018 (please refer to the following table).

Banxico's foreign reserve accumulation detail

US\$, million

	2017	Aug 3, 2018	Aug 3, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	173,287	49	485
(B) Gross international reserve	175,450	176,697	48	1,247
Pemex	--	--	-2	-567
Federal government	--	--	14	794
Market operations	--	--	0	0
Other	--	--	36	1,020
(C) Short-term government's liabilities	2,648	3,410	-1	762

Source: Banco de México

Weekly government bond auction. In addition, on Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent–, will offer 30-year fixed-rate Mbonos (Nov'47), 30-year inflation-linked Udibonos (Nov'46), 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 12:30pm (ET).

Auction specifics (Tuesday, August 14th, 2018)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	13-Sep-18	--	7,000	7.74
3m	15-Nov-18	--	11,000	7.89
6m	14-Feb-19	--	11,500	7.95
12m	18-Jul-19	--	12,500	8.19
Bondes D				
5y	06-Jul-23	--	5,000	0.15
M Bono				
30y	07-Nov-47	8.00	3,000	7.72
Udibono				
30y	08-Nov-46	4.00	UDIS 400	3.82

Source: Banorte 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

Extraordinary government bond auction. On Wednesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent–, will offer 182-, 252-, and 336-day Cetes. The auction will take place at 1:30pm (ET).

Banxico's minutes. Next Thursday at 10:00am (ET), Banco de México will publish the minutes of its August 2nd meeting, in which its Board decided to maintain the reference rate at 7.75%. In our opinion, this decision was accompanied by a less hawkish *communiqué*. Even though the statement still leaves room for the central bank to keep hiking the reference rate, we do not believe it to be necessary for the time being, given that risks to the outlook seem to be contained.

In this regard, we expect the minutes to show the discussions among board members around the three main factors that they attention when setting policy: (1) The potential pass-through from exchange rate volatility to prices; (2) the relative monetary policy stance with the US; and (3) the slack in the economy.

In the first case, we consider that the 7.2% appreciation of the exchange rate since June 21st (Banxico's last hike), has reduced the likelihood of a negative pass-through effect to prices. Even though we have seen a rebound in inflation in the last bi-weekly prints (from 4.4% in the second half of April to 4.77 in the second half of July), we consider this effect to be transitory, and explained by two factors: (1) An increase in the international price of gasoline as a result of the holiday period in the US, which has been reflected in our country -despite the smoothing process made through fiscal stimulus to the excise tax-; and (2) a rebound in the prices of fruits and vegetables, which after having fallen 15.5% from the second half of December 2017 to the first half of June, these have increased 5.6% in a month. We believe that once these factors dissipate, inflation will continue with its convergence towards our 4.3% estimate at the end of the year.

As for the Federal Reserve, we did not observe much changes in its latest monetary policy statement (published on August 1st), which still leads us to believe that the Fed can increase the reference rate twice more in the remainder of the year (25bps each). This could put pressure on Banxico to increase the rate. However, considering that since December 2015 the Fed has hiked the Fed Funds range by 175bp while Banco de México has raised its rate by 475bp, we think that the Mexican monetary authority might not have to follow its peer in the US.

Finally, one of the most important topics in the last monetary policy statement were on economic growth, in which Banxico appears to be less concerned about the slack in the economy, as well as the possible impact it could have on the price formation process. In this regard, economic growth during the 2Q18 was 2.7% yoy, but when using seasonally adjusted figures growth was only 1.6% yoy. With this results, economic output first half of 2018 grew 2% yoy (non-seasonally adjusted figures).

Looking ahead, even though we anticipate that Banxico will leave the reference rate unchanged in the next 18 months, we continue to consider that the bias is skewed for a further rate hike. In our opinion this would materialize in the event of increased volatility in USD/MXN –given a significant depreciation of the peso and with EM currencies not showing a similar behavior–, or if inflation does not come down as we estimate. Moreover, the probability of a rate hike would be even higher if the new administration proposes a budget to Congress that implies a larger public deficit, although we believe this has a low probability of occurring given the firm commitment we have observed from officials.

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