

Ahead of the Curve

February 16, 2018

Market focus this week will be on Banxico's minutes and 4Q17's GDP

- Banxico's Minutes (February).** Next Thursday at 10:00am (ET), Banco de Mexico will publish the minutes of its monetary policy meeting held back on February 8, in which the board unanimously decided to increase by 25bps the reference rate to 7.5%. We expect discussions during the meeting to have focused on the tightness in both the Mexican economy and the labor market, the focus on the goal of monetary policy, and the balance of risks for inflation. Moreover, we believe the board members will also highlight the recent behavior of the MXN, as well as the relative monetary stance between Mexico and the US.
- Gross domestic product (4Q17 F).** On Friday, *INEGI* will publish its revised GDP report for the fourth quarter of 2017, where we expect a 1.65% yoy expansion, marginally below the 1.8% preliminary figure reported by *INEGI*. As a result, we believe that the Mexican economy probably grew 2.1% in 2017. In seasonally adjusted terms, we expect a 0.74% quarterly growth. Taking a look at the breakdown, we believe that services will continue to show a favorable performance (2.7% yoy). However, we expect a 1% yoy contraction in the industrial sector.

www.banorte.com
@analisis_fundam

Alejandro Cervantes

Senior Economist, Mexico
alejandra.cervantes@banorte.com

Francisco Flores

Economist, Mexico
francisco.flores.serrano@banorte.com

Document for distribution among the general public

Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 20-Feb	10:00am	International reserves	16-Feb	US\$ bn	--	--	173.8
Tue 20-Feb	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Jun'22); 10y Udibonos (Nov'28)					
Tue 20-Feb	3:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 22-Feb	9:00am	CPI inflation	1H-Feb	% 2w/2w	<u>0.31</u>	--	0.31
				% yoy	<u>5.56</u>	--	5.55
		Core		% 2w/2w	<u>0.31</u>	--	0.24
				% yoy	<u>4.34</u>	--	4.56
Thu 22-Feb	10:00am	Banxico's minutes	February				
Fri 23-Feb	9:00am	GDP	2017	% yoy	<u>2.1</u>	--	2.3
Fri 23-Feb	9:00am	GDP	4Q17	% yoy	<u>1.65</u>	--	1.8
		(sa)		% q/q	<u>0.74</u>	--	0.9
		Primary activities		% yoy	<u>6.9</u>	--	4.2
		Industrial production		% yoy	<u>-1.0</u>	--	-0.7
		Services		% yoy	<u>2.7</u>	--	2.6
Fri 23-Feb	9:00am	Global economic indicator	December	% yoy	<u>1.53</u>	--	1.51
		(sa)		% m/m	<u>0.8</u>	--	0.7
		Primary activities		% yoy	<u>8.2</u>	--	8.9
		Industrial production		% yoy	<u>-0.7</u>	--	-1.5
		Services		% yoy	<u>2.3</u>	--	2.6
Fri 23-Feb	10:00am	Current account	4Q17	US\$ bn	<u>-3.5</u>	--	-5.6

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 declined by US\$194 million amounting to US\$172.8 billion. According to Banxico's report, this figure comes mainly as a result of a negative valuation effect in central bank assets. In this context, the Central Bank's international reserves have decreased by US\$5 million during 2018 (please refer to the table on the following page).

Banxico's foreign reserve accumulation detail

US\$, million

	2016	Feb 13, 2018	Feb 13, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	172,797	-194	-5
(B) Gross international reserve	175,450	177,585	-623	2,135
Pemex	--	--	343	-381
Federal government	--	--	-613	2,906
Market operations	--	--	0	0
Other	--	--	-352	-390
(C) Short-term government's liabilities	2,648	4,788	-429	2,140

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 5-year fixed rate Mbonos (Jun'22), 10-year inflation-linked Udibonos (Nov'28), 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 (ET).

Auction specifics (Tuesday, February 6, 2018)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	22-Mar-18	--	8,000	7.50
3m	24-May-18	--	11,000	7.61
6m	16-Aug-18	--	11,500	7.78
M Bono				
5y	09-Jun-22	6.50	8,500	7.46
Udibonos				
10y	30-Nov-28	4.00	UDIS 700	3.62

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

Citibanamex Survey: Market participants will focus on inflation and monetary policy forecasts. On Tuesday around 3:30pm (ET) *Citibanamex* will release its bi-weekly survey of economic expectations, where focus will be on analysts' inflation forecasts for the first half of February (to be published on February 22). Furthermore, attention will be on monetary policy assessments, given the 25bps increase in the reference rate which took place on February 8.

In addition, the survey will also contain forecasts for growth and FX estimations. In the first case, we do not expect strong revisions to the median GDP forecast for 2018. In the second case, we expect marginally downward revisions given the latest performance of the Mexican peso.

Inflation during the first half of February will be explained by increases in the prices of energy, particularly gasoline. On Thursday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of February. We are forecasting a 0.31% 2w/2w increase in the headline index, while we expect the core index to rise in the same magnitude.

Inflation during the period in question will be mainly explained by increases in the price of energy, particularly gasoline. However, these will be mitigated by a fall in the prices of fresh fruits and vegetables.

We forecast inflation to be 2bps lower when compared to the same period of last year, derived from: (1) 10bps from a smaller contribution of other goods (6bps vs. 16bps in 2017); (2) 8bps from a greater impact of energy (14bps vs. -1bps in 2017); (3) 5bps stemming from a lesser contribution of processed foods (3bps vs. 5bps in 2017); (4) 3bps derived from a greater impact of other services (10bps vs. 7bps in 2017) and (5) 3bps due to a larger contribution of meat and egg (3bps vs. 0bps in 2017), as shown in the table below.

With these results, annual inflation will stand at 5.56% in the first half of February, marginally higher than the 5.55% seen in January. Moreover, we forecast core inflation at 4.34% yoy (previous: 4.56% yoy). Moving forward, we will focus on the evolution of energy prices and the behavior of agricultural prices, and the impact they might have in Mexico's CPI.

1H-February inflation by components

% Bi-weekly incidence

	2018 P	2017	Difference
Headline	0.31	0.33	-0.02
Core	0.23	0.35	-0.12
Goods	0.09	0.24	-0.15
Processed foods	0.03	0.08	-0.05
Other goods	0.06	0.16	-0.10
Services	0.14	0.11	0.03
Housing	0.03	0.03	0.00
Education	0.01	0.01	0.00
Other services	0.10	0.07	0.03
Non-core	0.08	-0.01	0.09
Agricultural	-0.05	-0.08	0.03
Fresh fruits and vegetables	-0.08	-0.08	0.00
Meat and egg	0.03	0.00	0.03
Energy and government regulated	0.13	0.07	0.07
Energy	0.12	0.04	0.08
Government regulated	0.01	0.03	-0.01

Source: Banorte, INEGI

Banxico's minutes – Hawkish tone justifying the 25bps hike. Next Thursday at 10:00am (ET), Banco de Mexico will publish the minutes of its monetary policy meeting held back on February 8, in which the board unanimously decided to increase by 25bps the reference rate to 7.5%. We expect discussions during the meeting to have focused on seven issues: (1) The tightness in both the Mexican economy and the labor market, which in turn could result in greater inflationary pressures; (2) given the economic cycle, as well as the persistence of high inflation, monetary policy should act in order to prevent second-round effects; (3) the balance of risks for inflation maintains an upward bias in an environment with a *“high degree of uncertainty”*; (4) short-term inflation expectations continued to deteriorate due to the recent trend of non-core inflation; (5) Banxico's new forecast that headline inflation will converge to its 3% target during the first quarter of 2019 (previous: 4Q18); (6) despite the appreciation of the Mexican peso during 2018, volatility prevails; and (7) the relative monetary stance between Mexico and the US.

We keep our call for an additional 25bps hike on April 12, following a 25bps Fed hike on March 21. In addition, we do not rule out a further increase if uncertainty persists before the presidential elections (1st of July). In this context, we consider that the central bank could increase the reference rate again by 25bps during the June 21st meeting, just after a 25bps hike from the FOMC (June 13). Looking ahead, and as volatility due to the aforementioned factors starts to dissipate, it is likely that the Central Bank could cut rates by 50bps in the second half of 2018.

Mexico's GDP will stand at 1.65% yoy in 4Q17. On Friday, *INEGI* will publish its revised GDP report for the fourth quarter of 2017, where we expect a 1.65% yoy expansion, marginally below the 1.8% preliminary figure reported by *INEGI*. As a result, we believe that the Mexican economy probably grew 2.1% in 2017. In seasonally adjusted terms, we expect a 0.74% quarterly growth.

Taking a look at the breakdown, we believe that services will continue to show a favorable performance (2.7% yoy) driven by the above-trend growth in banking credit, and the expansion of the Mexican formal labor market.

By contrast, we expect a 1% yoy contraction in the industrial sector derived from the 3-year recession in the mining sector and the reduction in construction output given the contraction in public investment projects. However, manufacturing output continues to gain momentum as a result of the higher external demand.

We expect a 1.53% yoy expansion in December's IGAE. On Friday, and in addition to the GDP report, *INEGI* will also release its monthly global economic indicator for December (GDP monthly proxy), where we expect a 1.53% yoy expansion, marginally above November's 1.51% growth.

As we had mentioned in our last report, IP's contraction in December was explained by the 7.7% yoy fall in mining output, given the decline in oil production in the Gulf of Mexico. In addition, manufacturing output fell 0.1% yoy, as a result of a contraction in 12 of its 21 sub-indices. In particular, we highlight the 21.2% yoy reduction in vehicle production. However, year-to-date, manufacturing output increased 2.9% in 2017. By contrast, construction increased 3.6% yoy in December, as a result of the 7.5% expansion in building projects, whereas public civil engineering construction projects declined 5.5% yoy, given the austerity program implemented by the Federal Government.

Moreover, we believe that services will show a moderate 2.2% yoy expansion, as a result of the positive trend in the formal labor market coupled with an above-trend growth in banking credit.

Decrease in the current account deficit. Next Friday, at 10:00am, Banco de Mexico will release its balance of payments report for the fourth quarter of last year. We are forecasting a US\$3.5bn deficit in the current account. According to data already released, trade balance during the period in question amounted to -US\$1,823.8 million, while net transfers increased as a result of 8.2% y/y increase in remittances.

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, Mexico	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 Senior Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Strategist 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	Technical Analysis	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Equity Research – Conglomerates / Financials/ Mining / Petrochemicals	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Equity Research – Airlines / Airports / Cement / Infrastructure / REITs	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research – 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	Senior, Corporate Debt	hugo.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@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.rolan.ferrer@banorte.com	(55) 5004 - 1454