

Ahead of the Curve

May 26, 2017

Market focus this week will be on Banxico's QIR

- Banxico's QIR.** The Bank of Mexico will publish its Quarterly Inflation Report (QIR) for the first 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) Headline and core inflation maintained a higher-than-expected upward trend as a result of the exchange rate depreciation and the new adjustment in energy prices –particularly gasoline prices–, which implies that the balance of risks for inflation has deteriorated; (2) Banxico's inflationary projections depicted in their traditional fan chart, given that the last fan chart presented by Banxico has fallen short of the current inflationary outlook; and (3) Banxico's GDP, labor and output gap projections will be particularly interesting to watch after a board member highlighted the absence of slack in the labor market and the lower probability of a tail-risk event to materialize in the Mexican economy

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
Tue 30-May	10:00am	International reserves	May-26	US\$ bn	--	--	175.1
Tue 30-May	12:30pm	Government weekly auction: 1-, 3-, and 6-months Cetes; 3y MBono (Jun'20); 3y Udibono (Dec'20)					
Tue 30-May	15:30pm	Budget balance	April	MXN bn	--	--	309.1
Wed 31-May	10:00am	Comercial banking credit	April	% yoy	<u>6.5</u>	--	9.3
		Consumption		% yoy	<u>3.6</u>	--	5.4
		Housing		% yoy	<u>3.6</u>	--	5.4
		Non-banking private firms		% yoy	<u>7.7</u>	--	11.5
Wed 31-May	1:30pm	Extraordinary government bond auction: 175, 245, 308 and 357 day Cetes					
Wed 31-May	1:30pm	Banxico's quarterly inflation report	1Q17				
Thu 1-Jun	10:00am	Banxico's minutes of the 18th of May meeting					
Thu 1-Jun	10:00am	Family remittances	April	US\$ mn	<u>2,233.7</u>	--	2,520.4
Thu 1-Jun	10:00am	Banxico's survey of economic expectations	May				
Thu 1-Jun	1:00pm	PMI's survey (IMEF)	May				
		Manufacturing		index	<u>47.2</u>	--	45.0
		Non-manufacturing		index	<u>47.4</u>	--	47.2

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Banking credit will show a 6.5% yoy increase in April. 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 April. In particular, we estimate a 6.5% yoy expansion in banking credit (in real terms), as a result of increases in the area of 3.6%, 3.6%, and 7.7% yoy in consumer, housing and business credit, respectively.

Weekly international reserves report. On Tuesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US\$209 million amounting to US\$175.1 billion. According to Banxico's report, this figure comes mainly as a result of: (1) US\$97 million dollar sales from Banxico to the Federal Government; and (2) A positive revalorization in central bank assets amounting to US\$306 million. In this context, the Central Bank's international reserves have diminished by US\$1.5 billion this year (please refer to the table below).

Banxico's foreign reserve accumulation detail
US\$, million

	2016	May 19, 2017	May 19, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	175,079	209	-1,463
(B) Gross international reserve	178,025	176,245	16	-1,780
Pemex	--	--	-198	-850
Federal government	--	--	-191	-804
Market operations	--	--	0	-2,000
Other	--	--	404	1,874
(C) Short-term government's liabilities	1,483	1,166	-193	-317

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 3-year fixed-rate Mbonos (Jun'20), 3-year inflation-linked Udibonos (Dec'20), in addition to the “more traditional” 1-, 3-, and 12-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 30, 2017)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	29-Jun-17	--	7,000	6.71
3m	31-Aug-17	--	11,000	6.96
6m	23-Nov-17	--	11,500	7.08
M Bono				
3y	11-Jun-20	8.00	8,500	7.01
Udibonos				
3y	10-Dec-20	2.50	800	3.11

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 the fourth 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, particularly given the deceleration in income tax collection seen in the previous report (-4.1% real yoy). Moreover, given the volatile trend in Mexico's crude oil basket price in addition to the appreciation of the Mexican currency, the behavior of oil revenues generated by the Federal Government will be especially 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 50% of Mexico's GDP.

Banxico's QIR. The Bank of Mexico will publish its Quarterly Inflation Report (QIR) for the first 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) Headline and core inflation maintained a higher-than-expected upward trend as a result of the exchange rate depreciation and the new adjustment in energy prices – particularly gasoline prices–, which implies that the balance of risks for inflation has deteriorated; (2) Banxico's inflationary projections depicted in their traditional fan chart, given that the last chart presented by Banxico has fallen short of the current inflationary outlook; and (3) Banxico's GDP, labor and output gap projections will be particularly interesting to watch after a board member highlighted the absence of slack in the labor market and the lower probability of a tail-risk event to materialize in the Mexican economy.

The central bank reiterated in its last monetary policy statement that the factors that they will closely monitor in order to assess its monetary policy are: (1) The pass-through effect of the depreciation of the Mexican peso and increases in energy prices; (2) the relative monetary stance between Mexico and the US; and (3) the evolution of the output gap. In the first case, although we believe that the probability of new waves of high volatility in international financial markets still persists, we believe that the behavior of the exchange rate will be relatively limited throughout the remainder of the year, given Banxico's hiking cycle (375bp from December 2015 and 100bp so far in 2017).

However, we cannot rule out abrupt movements of the currency in the event of unforeseen factors, particularly in regard to geopolitical issues, both nationally and globally. In addition, we expect the Fed to raise the Fed funds rate by at least 50bp in the remainder of 2017. As a result, we continue to expect a 75bps hike in Banxico's reference rate throughout the remainder of the year. For now, we believe that the next movement of Banxico's rate will be 25bp hike in its meeting on June 22.

Extraordinary bond auction. On Wednesday, the Ministry of Finance (MoF) – via Banco de Mexico as its financial agent-, will offer monetary regulation Cetes between 1:30pm and 2:00pm (EDT). The Cetes to be auctioned settle in 175, 245, 308 and 357 days.

Family remittances will post a 2.9% yoy expansion in April. 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\$2,233.7 million to their families in Mexico during April. This would imply a 2.9% yoy expansion.

We believe that the scant expansion in the flow of remittances during April will be explained by a seasonal effect associated with the *Holy Week* that was present in April 2017. During this holiday, there is a significant flow of Mexican migrants with citizenship who visit their relatives in Mexico and make expenditures in our country, which significantly reduces the amount remitted. As a result, we believe that April's remittances income will be significantly lower than March's 15.1% yoy expansion.

Banxico's minutes – Hawkish 25bps hike. Next Thursday at 10:00am (EDT), The Bank of Mexico will publish the minutes of its monetary policy meeting held back on May 18, in which the board decided to increase by 25bps the reference rate. Within the minutes, we expect the discussions during the meeting to have focused on three issues: (1) The upward trajectory of inflation, as a result of the higher pass-through effect of the increase in energy prices and depreciation of the Mexican currency to prices; (2) the absence of slack in the labor market and the lower probability of a tail-risk event to materialize in the Mexican economy; and (3) the conditions in domestic financial markets continued to improve.

In the first case, we believe that Banxico's Board will emphasize that the balance of risks for inflation has deteriorated, as a result of the simultaneity and magnitude of the temporary shocks that inflation has been experiencing, given the increase in energy prices. In the *communiqué*, however, Banxico emphasized that the medium and long term inflation expectations have remained relatively stable. In addition, they estimated that during 2017 inflation will be “... considerably above [Banxico's] upper bound...”, but they anticipate that in 2018 inflation will resume a path of convergence towards the 3% target.

Banxico's Board also highlighted in the last monetary policy statement that the Mexican economy continued to grow at a similar pace to 4Q16. In this context, Banxico also mentioned that there seems to be no slack in the labor market. In addition, while the central bank considers that the risk balance for the Mexican economy has deteriorated, “... there is a perception that the probability of tail risks materializing has diminished...”.

Finally, regarding domestic financial conditions, the central bank said that the domestic markets improved, highlighting the appreciation of the Mexican currency in the face of a reduction in volatility. Regarding the spread of rates between Mexico and the US, the monetary authority commented that it remained relatively stable.

Banxico's survey of economic expectations. Also on Thursday at 10:00am (EDT), Banco de Mexico will publish its monthly survey of economic expectations. The report is particularly relevant considering the latest increase in Banxico's reference rate, which was not discounted by most analysts. As per usual our attention will focus on inflation forecasts for 2017, currently at 5.7% yoy, and medium and long-term inflation expectations, which we expect will remain relatively unchanged.

Moreover, we expect marginal downward revisions to FX forecasts, which we now believe to stand at USD/MXN19.50 by YE17. Additionally, market participants will focus on 2017's GDP (median: 1.7%), where we expect some revisions given the latest data.

May's PMI surveys. Also on Thursday, *IMEF* (Mexican Institute of Financial Executives) will publish its PMI business confidence indicators for May. We expect manufacturing PMI at 47.2, 2.2pts higher than April's figure (seasonally adjusted terms). We believe that growth in the manufacturing PMI during May will be explained by a slight recovery in the new orders and productions sub-components, although we think that the uncertainty regarding the prospects of the Mexican manufacturing industry under Trump's economic policies will continue to weigh on the index.

In addition, we believe that the non-manufacturing PMI will stand at 47.4 points from 47.2 points. Despite May's marginal increase –which will be explained by the recovery in consumer confidence– the headline index will stand well below the 50 points threshold. In this regard, we believe that the lower growth prospects for the overall economy will also translate into a bleaker outlook for the construction and services industries, which encompass most of the firms measured in *IMEF*'s non-manufacturing survey.

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.a.gomez@banorte.com	(55) 1670 - 2247

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