

Ahead of the Curve

June 24, 2016

Market focus this week will on Banxico's monetary policy statement

- Banxico's monetary policy statement.** On Thursday, at 2:00pm, *Banxico* will hold its fourth regular policy meeting of the year. The monetary policy communiqué will be published on Thursday (June 30) at 2:00pm (EDT). We believe that board members will increase the reference rate by 25bps leaving it at 4%. The *Brexit* impact on local markets, so far, has been limited. The Mexican peso has depreciated a scant 0.6%, derived from the confidence generated by the fiscal policies implemented by the Federal Government. Nevertheless, we do acknowledge that the vote in favor of the UK's departure of the European Union could have a potential negative impact on local markets, particularly on the behavior of the Mexican currency. In this regard, we believe that Banxico will increase the reference rate by 25bps.

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Mexico weekly calendar

DATE	HOUR (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 27-Jun	9:00am	Trade balance	May	US\$ mn	<u>-2,155</u>	-2,787	2,080
		Total exports		% yoy	<u>-5.7</u>	--	-7.7
		Oil exports		% yoy	<u>-35.5</u>	--	-30.8
		Non-oil exports		% yoy	<u>-3.3</u>	--	-6.3
		Total imports		% yoy	<u>-2.3</u>	--	-1.6
Tue 28-Jun	9:00am	Unemployment rate	May	%	<u>4.05</u>	3.93	3.80
		sa		%	<u>4.08</u>	-3.96	3.93
Tue 28-Jun	10:00am	International reserves	24-Jun	US\$ bn	--	--	177.3
Tue 28-Jun	12:30pm	Government weekly auction: 1-, 3-, 6- month CETES; 3y Mbono (Dec'19); 3y Udibonos (Jun'19)					
Thu 30-Jun	10:00am	Commercial banking credit	May	% yoy	<u>10.4</u>	--	10.5
		Consumption		% yoy	<u>9.4</u>	--	10.0
		Housing		% yoy	<u>9.0</u>	--	9.8
		Non-banking private firms		% yoy	<u>11.9</u>	--	11.3
Thu 30-Jun	2:00pm	Banxico's monetary policy decision	June		<u>4.00</u>	3.75	3.75
Thu 30-Jun	3:30pm	Budget balance	May	MXN bn	--	--	177.1
Fri 1-Jul	10:00am	Family remittances	May	US\$ mn	<u>2,560.5</u>	--	2,173.40
Fri 1-Jul	10:00am	Banxico's survey of economic expectations					
Fri 1-Jul	1:00pm	PMI's survey (IMEF)	June				
		Manufacturing		index	<u>52.2</u>	--	51.9
		Non-manufacturing		index	<u>51.6</u>	--	51.3

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Oil exports will continue to fall in May. On Monday, at 9:00am (EDT), *INEGI* will make available its trade report for May, where we expect to see a US\$2,1533 million deficit. On the exports side, we will probably see a 35.5% yoy contraction of oil exports given the significant fall in exports and prices during the period in question. Moreover, non-oil exports could have decreased 3.3% yoy, on the back of a 4% drop in manufacturing exports.

On the imports side, we estimate a 2.3% yoy contraction in total imports. Taking a look at the breakdown, we believe that imports consumption goods decreased 4.6% yoy, while imports of intermediate goods could have fallen 1.3% yoy. Finally, we estimate a 6.4% reduction in capital goods imports.

Unemployment rate in May will stand at 4.05%. On Tuesday, *INEGI* will publish its employment report for the fifth month of 2016, in which we estimate an unemployment rate of 4.05% nsa, above the 3.8% observed in April. In seasonally-adjusted terms, we believe that the unemployment rate could stand at 4.08%, which implies a 0.15%-pts increase.

It is likely that the unemployment rate in May will correct part of the artificial decline observed in April. As we mentioned in our last employment report, the 0.24%-pts fall in the unemployment rate during fourth month of the year was partially explained by the higher growth of the domestic demand coupled with the upward trend in the creation of formal jobs. However, we believe that April's significant fall was also explained by the inherent volatility in *INEGI's* monthly survey, which could be corrected in May's figure. Looking ahead, we are still positive on the outlook regarding the recovery of the economic activity, which will have a positive impact on firms' expectations about domestic demand, resulting in a more dynamic labor market.

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\$80mn amounting to US \$177.3 billion on June 17. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by Banxico to the Federal Government for US\$58mn; and (2) US\$22mn reduction 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\$556mn international reserves this year (please refer to the table below).

Banxico's foreign reserve accumulation details

US\$, million

	2015	17/Jun/2016	17/Jun/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	177,291	-80	556
(B) Gross international reserve	177,597	180,529	1,390	2,932
Pemex	--	--	492	2,881
Federal govt	--	--	1,147	3,009
Market operations	--	--	0	-5,562
Other	--	--	-250	2,604
(C) Short-term government's liabilities	861	3,238	1,470	2,376

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 3-year fixed-rate Mbonos (Dec’19), and 3-year inflation-linked Udibonos (Jun’19), 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, June 28, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	28-Jul-16	--	5,500	3.76
3m	29-Sep-16	--	9,500	4.10
6m	22-Dec-16	--	11,000	4.30
Mbono				
1y	11-Dec-19	5.00	7,500	5.27
Udibono				
3y	13-Jun-19	4.00	750	2.27

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

Banking credit will show a 10.4% yoy increase in May. Banco de Mexico will make available its banking credit report on Thursday at 10:00am (EDT). It is our take that banking credit continued flowing in May. In particular, we estimate a 10.4% yoy expansion in banking credit (in real terms), as a result of increases in the area of 9.4%, 9%, and 11.9% yoy in consumer, housing and business credit, respectively.

Banxico’s monetary policy statement – After *Brexit*, we expect a 25bps hike in the reference rate. On Thursday, at 2:00pm, Banxico will hold its fourth regular policy meeting of the year. The monetary policy communiqué will be published on Thursday (June 30) at 2:00pm (EDT). We believe that board members will increase the reference rate by 25bps leaving it at 4%. The *Brexit* impact on local markets, so far, has been limited. The Mexican peso has depreciated a scant 0.6%, derived from the confidence generated by the fiscal policies implemented by the Federal Government. Nevertheless, we do acknowledge that the vote in favor of the UK’s departure of the European Union could have a potential negative impact on local markets, particularly on the behavior of the Mexican currency. In this regard, we believe that Banxico will increase the reference rate by 25bps.

Looking ahead, given Mexico’s moderate economic growth, the absence of significant inflationary pressures, an expanded Flexible Credit Line -adding firepower to potential discretionary interventions if there are direct speculative attacks on the peso-, we believe that the central bank is tied to the U.S. Fed actions, and Banxico’s next move after June’s meeting will be a rate hike, immediately after the Fed continues its normalization process in December 14. This implies that the central bank’s reference rate could be closing this year at 4.25%.

The MoF's monthly report. On Thursday, the Ministry of Finance (MoF) will make its monthly finance report available for May. 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.

Family remittances will post a 16.9% yoy expansion in May. On Friday, 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\$2,560.5 million to their families in Mexico during May. This would imply a 16.9% yoy expansion.

We highlight that the remittances inflows during May will be explained by two factors: (1) A seasonal effect –since Mexican migrant workers tend to remit a larger amount of money in May given *Mother's Day*; and (2) the 7.4% depreciation of the Mexican currency during May. In this regard, we highlight that the flow of remittances in the short-run is very sensitive to high fluctuations in Mexican peso. In particular, a sharp depreciation may encourage Mexican migrant workers to increase their remittances, given that the purchasing power of the amount remitted is greater in Mexico than in the U.S.

Banxico's survey of economic expectations. Similarly, on Friday 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 3.11% (Banorte-Ixe: 2.8%); (2) mid-term inflation expectations—quite important for the central bank's board—that are currently at 3.33% (Banorte-Ixe: 3%); and (3) the analysts' assessments of GDP growth for 2016.

June's PMI surveys. Finally, on Friday, *IMEF* (Mexican Institute of Financial Executives) will publish its PMI business confidence indicators for June. We expect manufacturing PMI at 52.2, above the 51.9 observed in May (seasonally adjusted terms). We believe that manufacturing activity was supported by the recovery of consumer spending in Mexico. In addition, other indicators, such as the formal employment report, continue to show that the manufacturing sector has already initiated its recovery process.

In addition, we believe that the non-manufacturing PMI will stand at 51.6 points from 51.3 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.

Disclaimer

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