

Ahead of the Curve

October 7, 2016

Market focus this week will on *Banxico's* minutes

- **Banxico's minutes.** Next Thursday at 10:00am EDT, Banco de Mexico will publish the minutes of its monetary policy meeting held back on September 29, in which the board decided to increase by 50bps the reference rate. We believe that the decision to hike rates was unanimous. In addition, we expect discussions during the meeting to have focused on two issues: (1) The depreciation of the Mexican currency and the higher volatility in local markets generated by several geopolitical events, such as the electoral process in the US, the expected normalization of the Fed's monetary policy, and the volatility in oil prices; and (2) the deterioration of the balance of risks to inflation in the short and term, given the adjustment of relative prices generated by the MXN depreciation

- **Industrial Production (August).** On Wednesday at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 0.2% yoy reduction in total output during August, after the 1% contraction in July. Taking a look at the breakdown, manufacturing production could post a 1.1% yoy increase

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Document for distribution among the general public

Mexico weekly calendar

DATE	TIME (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 10-Oct		Wage negotiations	September	%	<u>4.0</u>	--	4.4
Tue 11-Oct	10:00am	International reserves	7-Oct	US\$ bn	--	--	175.8
Tue 11-Oct	12:30pm	Government weekly auction: 1-, 3-, 6-, and 12-month Cetes; 30y MBono (Nov'42); 30y Udibono (Nov'46); 5y Bondes D					
Wed 12-Oct	9:00am	Industrial production	August	% yoy	<u>-0.2</u>	0.3	-1.0
		(sa)		% m/m	<u>-0.1</u>	--	0.3
		Mining		% yoy	<u>-6.6</u>	--	-6.3
		Utilities		% yoy	<u>5.8</u>	--	5.9
		Construction		% yoy	<u>0.9</u>	--	-0.1
		Manufactures		% yoy	<u>1.1</u>	--	-0.2
Thu 13-Oct	10:00am	Banxico's minutes	September				

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

September's wage negotiations. On Monday, the Ministry of Labor (STPS) will make its contractual wage negotiations monthly data available. We anticipate workers to have negotiated an annual average wage increase of 4% in September, below the 4.2% average observed year-to-date. In this regard, we believe that September's figure was mainly driven by the increase in wages within the *Technical Education Workers Syndicate*, coupled with revisions by labor unions of the private sector.

Weekly international reserves report. On Tuesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves fell by US\$103 million amounting to US \$175.8 billion on September 30. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by Banxico to the Federal Government for US\$157 million; along with a (2) US\$54 million increase due to changes in the valuation of the Central Bank's assets. In this context, the Central Bank's international reserves have diminished by US\$904 million this year (please refer to the table below).

Banxico's foreign reserve accumulation details

US\$, million

	2015	30/Sep/2016	30/Sep/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	175,831	-103	-904
(B) Gross international reserve	177,597	180,499	-1,128	2,903
Pemex	--	--	-693	5,553
Federal government	--	--	-121	-55
Market operations	--	--	0	-5,562
Other	--	--	-314	2,966
(C) Short-term government's liabilities	861	4,668	-1,025	3,807

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 30-year fixed-rate Mbonos (Nov'42), 30-year inflation-linked Udibonos (Nov'46), as well as 5-year BondesD, 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 (EDT).

Auction specifics (Tuesday, October 11, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²	
Cetes					
	1m	01-Nov-16	--	5,500	4.70
	3m	12-Jan-17	--	9,500	4.84
	6m	12-Apr-17	--	11,000	5.07
	12m	14-Sep-17	--	10,000	4.87
Mbono					
	30y	13-Nov-42	7.75	2,000	6.29
Udibono					
	30y	08-Nov-46	4.00	400	3.36
Bondes D					
	5y	20-May-21	--	3,000	0.21

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

We expect a 0.2% yoy contraction in August's industrial output. On Wednesday at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 0.2% yoy reduction in total output during August, after the 1% contraction in July.

Taking a look at the breakdown, manufacturing production could post a 1.1% yoy increase, explained by: (1) the 0.2% yoy contraction in the US manufacturing sector (NAICS); (2) the 13.9% yoy increase in Mexico's vehicle production; (3) the 5.2 points reduction in the production sub-index within *IMEF's* PMI survey; and (4) the 4.8% yoy growth in manufacturing exports.

In addition, the 0.2% yoy contraction in industrial output during August will be also explained by the poor performance of mining activity. In this regard, we expect a 6.6% yoy contraction derived from lower oil production and the reduction in the extraction of other minerals. Finally, we believe that construction output will show a moderate 0.9% increase given the lower growth in private construction investment projects, coupled with the reduction in public infrastructure spending, given the recent fiscal cuts implemented by the Federal Government.

Industrial production estimates: August 2016

%yoy	Aug-16	Aug-15	Jan-Aug, '16	Jan-Aug, '15
Total	-0.2	1.2	0.3	1.1
Mining	-6.6	-6.0	-4.5	-6.4
Utilities	5.8	3.6	4.6	4.2
Construction	0.9	2.5	1.8	3.8
Manufacturing	1.1	3.5	1.1	3.0
%m/m sa	Aug-16	Jul-16	Difference	
Total	-0.1	0.3	-0.4	
Mining	-0.7	-0.4	-0.3	
Utilities	0.8	0.4	0.4	
Construction	0.2	-0.3	0.5	
Manufacturing	0.0	0.8	-0.8	

Source: Banorte-Ixe

Banxico's minutes. Next Thursday at 10:00am EDT, Banco de Mexico will publish the minutes of its monetary policy meeting held back on September 29, in which the board decided to increase by 50bps the reference rate. We believe that the decision to hike rates was unanimous. In addition, we expect discussions during the meeting to have focused on two issues: (1) The depreciation of the Mexican currency and the higher volatility in local markets generated by several geopolitical events, such as the electoral process in the US, the expected normalization of the Fed's monetary policy, and the volatility in oil prices; and (2) the deterioration of the balance of risks to inflation in the short and term, given the adjustment of relative prices generated by the MXN depreciation.

Banxico explained in their last monetary policy statement that core inflation has maintained an upward trend derived from the depreciation of the MXN. In addition, the central bank considered that the balance of risks in the short term for inflation deteriorated given that: *"[...] derived from the uncertainty associated with the already described external environment, we can't rule out that the Mexican currency will continue to depreciate, which could affect inflation expectations."*

In addition, the central bank also expressed concern regarding the depreciation of the Mexican currency given the recent geopolitical events. In particular the Board Member mentioned that: *"Looking ahead, the volatility in international and domestic financial markets could increase. In particular, the possible consequences of the electoral process in the United States could have strong implications for Mexico. In this uncertain environment, the Fed is expected to continue its normalization policy, while there's the possibility of a higher volatility in oil prices."*

In this context, the monetary authority justified the 50bps hike in the reference rate as a preventive measure given the events described above. In particular, Banxico's Board commented that: *"[...] in order to contribute to the strengthening of Mexico's macroeconomic framework, the Central Bank has decided to carry out an adjustment in its monetary stance, in order to keep inflation and inflation expectations well anchored, which in turn will contribute to greater financial stability."*

Looking ahead, we continue to forecast a highly volatile exchange rate market, given: (1) The US elections; (2) the volatility in oil prices; and (3) the expectation of a 25bps hike in the Fed's fund rate in December. To the above-mentioned factors, we add the higher risk of an impending crisis at Deutsche Bank.

Regarding the US election, our base case scenario is that Hillary Clinton will win the elections, thus we believe that Banxico will increase by 25bps the reference rate in December to 5% (vs our previous 50bps hike call). However, if Donald Trump wins the election, we believe that Banxico will probably increase by 75bps the reference rate at its November, and then again at December's meeting to 6.25%. If the US election yields a controversial result for any of the presidential candidates, we believe that Banxico will probably wait until December to adjust the monetary policy

The minutes of this meeting will be published on October 13, and the next monetary policy announcement will take place on the 17th of November, 9 days after the US election

Disclaimer

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