

Ahead of the Curve

August 25, 2017

Market focus this week will be on Banxico's QIR and July's trade balance report

- **Banxico's QIR (2Q17).** Banco de Mexico will publish its *Quarterly Inflation Report (QIR)* for the second 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 accumulated exchange rate depreciation and the new adjustment in energy prices –particularly gasoline prices–; (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
- **Trade balance (July).** On Monday at 9:00am (EDT), Banxico and INEGI will make available its preliminary trade report for July, where we expect to see a US\$2.47 billion deficit. On the exports side, we will probably see an 11.8% yoy expansion of oil exports. In addition, non-oil exports could have increased 11.6% yoy. On the imports side, we estimate a 12.9% yoy expansion in total imports, as a result of the increase in oil related imports

www.banorte.com
www.ixe.com.mx
@analisis_fundam

Alejandro Cervantes

Senior Economist, Mexico
alejandrocervantes@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
Mon 28-Aug	9:00am	Trade balance	July	US\$ mn	-2,470.4	-1,071.0	61.5
		Total exports		% yoy	11.6	--	11.5
		Oil exports		% yoy	11.8	--	10.4
		Non-oil exports		% yoy	11.6	--	11.5
		Total imports		% yoy	12.9	--	9.5
Tue 29-Aug	10:00am	International reserves	Aug-25	US\$ bn	--	--	173.1
Tue 29-Aug	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 20y Mbono (Nov'36); 5y Bondes D					
Wed 30-Aug	12:30pm	Banxico's quarterly inflation report	2Q17				
Wed 30-Aug		Budget balance	July	MXN bn	--	--	141.9
Thu 31-Aug	10:00am	Comercial banking credit	July	% yoy	6.5	--	7.1
		Consumption		% yoy	3.1	--	3.7
		Housing		% yoy	2.9	--	3.3
		Non-banking private firms		% yoy	8.7	--	9.2
Fri 1-Sep	9:00am	PMI's survey (IMEF)	August		2,389	2,382	2,417
		Manufacturing		index			
		Non-manufacturing		index			
Fri 1-Sep	10:00am	Family remittances	July	US\$ mn	51.9	51.5	51.5
Fri 1-Sep	10:00am	Banxico's survey of economic expectations	August		51.7	52.0	53.0

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Exports will continue to recover. On Monday at 9:00am (EDT), Banxico and INEGI will make available its preliminary trade report for July, where we expect to see a US\$2.47 billion deficit. On the exports side, we will probably see an 11.8% yoy expansion of oil exports as a result of the higher prices for the Mexican crude oil basket (12.8% yoy), despite the lower volume of exports. In addition, non-oil exports could have increased 11.6% yoy, on the back of an 11.6% hike in manufacturing exports.

On the imports side, we estimate a 12.9% yoy expansion in total imports, as a result of the increase in oil related imports. However, taking a look at the breakdown, we believe that non-oil consumption goods imports edged-up to 13.1% yoy, while imports of intermediate goods could have increased 14.9% yoy. Finally, we estimate a 2.1% expansion in capital goods imports.

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\$67 million amounting to US\$173.1 billion. According to Banxico's report, this figure comes mainly as a result of: (1) US\$117 million dollar sales from Banxico to the Federal Government; and (2) a positive revalorization in central bank assets amounting to US\$50 million. In this context, the Central Bank's international reserves have diminished by US\$3.5 billion this year (please refer to the table on the next page).

Banxico's foreign reserve accumulation detail

US\$, million

	2016	Aug 18, 2017	Aug 18, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	173,062	-67	-3,479
(B) Gross international reserve	178,025	174,454	-740	-3,571
Pemex	--	--	-497	-626
Federal government	--	--	-218	-3,689
Market operations	--	--	0	-2,000
Other	--	--	-26	2,744
(C) Short-term government's liabilities	1,483	1,395	-673	-92

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 20-year fixed-rate Mbonos (Nov'36), 5-year Bondes D, 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, August 29, 2017)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²	
Cetes					
	1m	28-Sep-17	--	7,000	6.92
	3m	30-Nov-17	--	11,000	7.10
	6m	01-Mar-18	--	11,500	7.15
Bondes D					
	5y	14-Jul-22	--	3,750	0.16
M Bono					
	20y	20-Nov-36	10.00	2,500	7.13

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

Banxico’s QIR. Banco de Mexico will publish its Quarterly Inflation Report (QIR) for the second 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 accumulated exchange rate depreciation and the new adjustment in energy prices –particularly gasoline prices–; (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.

The central bank reiterated in its last monetary policy announcement that the balance of risks for inflation remained unchanged. However, most board members acknowledged that the slack in the labor market has been narrowing, which could eventually impact inflation dynamics. We believe that the GDP fan charts depicted in Banxico’s QIR will also reflect the tightening of the output gap. In addition, the majority of members also alluded to the restrictive monetary stance implemented by Banxico since December 2015, which they noted has a lagged effect on inflation. We believe that this subject will be thoroughly explained in one of Banxico’s “grey boxes”.

In our view, we expect Banxico to remain on hold for the remainder of the year, as we estimate that inflation will peak in August at 6.5% yoy to then converge to our 5.7% in year-end. Looking ahead, we believe that Banxico could start an easing cycle in the second half of 2018 (August) as inflation will start to converge towards the 3% and most of the uncertainty of the scenario will be significantly reduced by then. We believe that Banxico has room to reduce the reference rate between 150-200bps over the next two years from which 100bps could take place in 2018.

The MoF's monthly report. Additionally, on Wednesday, the Ministry of Finance (MoF) will make its monthly finance report available for the seventh 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 behavior, particularly given the volatile dynamics in income tax collection seen in the year. Moreover, given the increase in Mexico's crude oil basket price during July, the behavior of oil revenues generated by the Federal Government will be particularly 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 43.9% of Mexico's GDP.

Banking credit will show a 6.5% yoy increase in July. 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 July. In particular, we estimate a 6.5% yoy expansion in banking credit (in real terms), as a result of increases in the area of 3.1%, 2.9%, and 8.7% yoy in consumer, housing and business credit, respectively.

Family remittances will post a 6.3% yoy expansion in July. 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\$2389.4 million to their families in Mexico during July. This would imply a 6.3% yoy expansion.

We believe that the flow of remittances will be mainly explained by the Trump's anti-migration policy. The employment of Mexican migrants with citizenship has increased by 520,877 workers during the first seven months of the year, while the number of Mexican migrant workers without citizenship – which account for the main source of remittances in our country–, has decreased by 73,796 during the same period.

As we have mentioned in our recent publications, Trump's current anti-migration policy has been reflected in a greater flow of remittances to Mexico, despite the fact that labor opportunities for Mexican migrants without citizenship have become scarcer. In this context, we believe that this phenomenon will continue to explain the flow of remittances in the coming months.

Banxico's survey of economic expectations. Also on Friday, at 10:00am (EDT), Banco de Mexico will publish its monthly survey of economic expectations. Our attention will focus on monetary policy forecasts, given the tone shown in minutes of the last monetary policy committee.

Moreover, we will be looking into inflation forecasts for 2017, currently at 6% yoy (Banorte-Ixe: 6.2%), as well as medium and long-term inflation expectations, which we expect will remain relatively unchanged. Moreover, we expect marginal downward revisions to FX forecasts, which we continue to forecast to stand at USD/MXN18.10 by YE17. Additionally, market participants will focus on 2017's GDP (Median: 2%; Banorte-Ixe: 1.9%), where we expect some revisions given the latest data.

August's PMI surveys. Also on Friday, *IMEF* (Mexican Institute of Financial Executives) will publish its PMI business confidence indicators for August. We expect manufacturing PMI at 51.9 (seasonally adjusted terms). We believe that the expansion in the manufacturing PMI during August will be explained by an increase in the deliveries and employment sub-components, despite a marginal decrease in new orders and production. We think that the uncertainty regarding the prospects of the Mexican manufacturing industry under Trump's economic policies will continue to weigh, albeit in a lesser manner, on the index.

In addition, we believe that the non-manufacturing PMI will stand at 51.7 points from 53 points. We consider that some negative results, particularly regarding commercial activities, such as retail sales, will adversely impact August's results.

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