

## Ahead of the Curve

We expect Banxico to maintain the reference rate at 8.25%, with a dovish tone on a weak outlook for growth

- Banxico's monetary policy decision (May 16<sup>th</sup>).** We expect the central bank to leave the reference rate unchanged at 8.25%, in line with consensus. Moreover, we believe the tone of the communique will be dovish and do not rule out that the decision will not be unanimous, with Deputy Governor Esquivel voting for a rate cut. In our view, the bias could be slightly more dovish on weakening growth, both in the latest data and the outlook for this year and the next. Nevertheless, relative cautiousness should prevail on prices as current headline and core inflation, along mid-term expectations, have increased at the margin. In our view, information in this monetary policy decision will lay the groundwork for the next rate movement, which we believe will be a rate cut. Despite a somewhat more negative outlook on inflation mostly due to temporary factors, we believe the deterioration in growth, the government's commitment to maintain healthy public finances, and a further strengthening of the financial position of Pemex in the short-term, will help ease some of the Board's concerns on overall risks. Considering this and our expectation of an improving outlook for inflation starting in 3Q19, Banxico could cut further the reference rate on one to two occasions, resulting in total cuts for 2019 between 50 and 75bps

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### Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 14-May	10:00am	International reserves	May-10	US\$ bn	--	--	176.7
Tue 14-May	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y MBono (Sep'24); 10y Udibonos (Nov'28)					
Thu 16-May	2:00pm	Banxico's monetary policy decision	May	%	<u>8.25</u>	8.25	8.25

Source: Banorte; Bloomberg

## Proceeding in chronological order...

**Weekly international reserves report.** Last week, net international reserves increased US\$35 million, closing at US\$176.7 billion. According to Banxico's report, this figure comes mainly from a positive valuation effect in central bank assets. In this context, the central bank's international reserves have increased US\$1.9 billion during 2019 (please refer to the following table).

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

	2018	May 3, 2019	May 3, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	176,696	35	1,903
(B) Gross international reserve	176,384	184,384	154	8,000
Pemex	--	--	41	199
Federal government	--	--	-27	6,128
Market operations	--	--	0	0
Other	--	--	140	1,673
(C) Short-term government's liabilities	1,592	7,688	119	6,097

Source: Banco de México

**Weekly government bond auction.** The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent, will offer 5-year fixed-rate Mbonos (Sep'24), 10-year inflation-linked Udibonos (Nov'28), in addition to the 1-, 3-, and 6-month zero-coupon Cetes (see following table). As usual, results will be released at 12:30pm (ET).

### Auction specifics (Tuesday, May 14<sup>th</sup>, 2019)

	Maturity	Coupon rate, %	To be auctioned <sup>1</sup>	Previous yield <sup>2</sup>
<b>Cetes</b>				
1m	13-Jun-19	--	5,000	8.02
3m	15-Aug-19	--	10,000	8.19
6m	07-Nov-19	--	11,500	8.25
<b>Mbonos</b>				
5y	05-Sep-24	8.00	10,000	7.89
<b>Udibonos</b>				
10y	30-Nov-28	4.00	UDIS 800	3.79

Source: Banorte 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 to maintain the reference rate at 8.25%, with markets focused on the tone and degree of consensus among members.** Next Thursday, Banxico will hold its third monetary policy meeting of 2019, in which we expect the central bank to leave the reference rate unchanged at 8.25%, in line with consensus. We will be focused on the tone of the communique, which we expect to maintain a dovish bias. It is also worth remembering that the latest decision was unanimous, but one member (Deputy Governor Gerardo Esquivel) dissented with the communique because of its restrictive tone and its conclusions about the balance of risks for inflation (which remained characterized to the upside). In this context, we do not rule out that the decision will not be unanimous, with Deputy Governor Esquivel voting for a rate cut.

Considering this, it is our take that the dovish bias will be reaffirmed mainly because of weakening growth, both in the latest data and the outlook for this year and the next. On the contrary, relative cautiousness should prevail in the inflation front as current headline and core inflation, along mid-term expectations, have increased at the margin. Last but not least, financial market performance has been slightly better despite risks still lingering around according to the bank, highlighting Pemex's financial position. In this context, the following table presents the evolution of key variables followed by the central bank since the latest decision on March 28<sup>th</sup>.

**Key economic and financial indicators**

% yoy unless otherwise indicated

	28-Mar-19	Latest
<b>Economic data</b>		
GDP*	1.7	1.3
GDP (% q/q)*	0.2	-0.2
IGAE**	1.3	1.1
Headline inflation	3.94	4.41
Core inflation	3.54	3.87
<b>Survey data***</b>		
GDP growth - 2019	1.63	1.50
GDP growth - 2020	2.00	1.77
Headline inflation - 2019	3.65	3.70
Core inflation - 2019	3.50	3.56
12-month ahead headline inflation	4.10	3.98
Mid-term expectations	3.50	3.55
Long-term expectations	3.50	3.50
<b>Financial data</b>		
USD/MXN	19.34	19.09
10-year spread (Mbono - UST, bps)	560	569
MEXBOL (pts)	42,942	42,629
Mexican oil mix (US\$/bbl)	60.05	62.38
5-year CDS (bps)	127	119

\* Data for 4Q18 and 1Q19, respectively

\*\* Data for January and February, 2019, in the same order

\*\*\* According to the latest available survey of the central bank on the day of the decision

Source: INEGI, Banco de México, Bloomberg

Regarding growth, we think the Board could tilt more dovish even with the balance of risks biased to the downside for quite some time as some of the downside risks seem to be materializing. Externally, they had already warned that trade tensions between the US and China were impacting global growth. In this respect, the US announced today an increase from 10% to 25% in tariffs applied to US\$ 200 billion in imports from the latter country. A trade deal has not been reached in spite of recent signs of an improvement in negotiations, with markets already anticipating a better scenario up to the start of this week. Moreover, China affirmed it may take retaliatory measures. Other risks, such as Brexit, have also not improved significantly in terms of the outlook, while Chinese data have been slightly more positive but mixed overall.

Domestically and according to the minutes, the majority stated that the deceleration in activity was a result of the global slowdown, some weakness in domestic demand, and transitory factors. In our opinion, these are already reflected in *INEGI's* preliminary 1Q19 GDP estimate (see above). Nevertheless, other indicators suggest that weakness could extend further (for details, see: “*Trade balance – Tentative signs of weakness in manufacturing and consumption*”, April 26<sup>th</sup>, 2019, <[pdf](#)>). Issues such as delays in freight transportation crossings at the Northern Border that started on March 29<sup>th</sup>, and the possibility of tariffs on Mexican exports to the US (*e.g.* tomatoes), could have an additional impact despite likely also being transitory in nature. We maintain our GDP forecast at 1.5% yoy, in line with consensus, but with downside risks. According to the central bank’s 4Q18 *Quarterly Report*, GDP for this year would stand in a range of 1.1%-2.1% (mid-point:1.6%).

Despite the deceleration in activity, we believe they will reaffirm their prudent stance as annual inflation has increased modestly since the last decision. In particular, headline and core inflation stood at 4.41% and 3.87% yoy at April-end, respectively, with the former above the upper limit of the variability range around the target. However, it is our take that this was mainly driven by two temporary factors: (1) A seasonal effect due to the timing of the Easter holiday, taking place in April this year vs. March 2018, resulting in an unfavorable base effect; and (2) the lower relative weight of electricity tariffs within the index when compared to the previous year, given methodology changes in CPI.

Survey expectations for year-end 2019 and the medium-term (according to the latest survey from Banxico) have also picked up, while for the long-term stood at 3.50%. In this respect, two members agreed that “...*the behavior of inflation expectations reflects lack of credibility regarding the 3% target...*”. On a more positive note, average annual inflation in 1Q19 printed at 4.1%, exactly at the central bank’s forecast, while the core component ended only 10bps higher at 3.6%. In spite of the latter, the latest minutes showed the majority remains cautious, given that: (1) The decline in headline inflation has been led by non-core prices, which have started to revert (as suggested by most recent dynamics in global oil prices); (2) some concerns are still present about the resistance to the downside of the core component; and (3) upside risks linger around, such as the possibility of exchange rate pressures and the recent increase in the minimum wage. As such, we believe the balance of risks will likely be characterized again as skewed to the upside, although we do not discard a modest improvement based on the Board’s comment that there has been an intensification of some downside risk factors. Our forecast path for inflation is still positive, with our year-end forecast at 3.5%, which supports our view that the central bank will have room cut the reference rate.

All in all, we believe that information related to this monetary policy decision will lay the groundwork for the next rate movement, which we believe will be a rate cut. Despite a somewhat more negative outlook on inflation mostly due to temporary factors, we believe that the deterioration in growth, the government's commitment to maintain healthy public finances, and a further strengthening of the financial position of Pemex in the short-term, will help ease some of the Board's concerns on overall risks. Considering this and our expectation of an improving outlook for inflation starting in 3Q19, Banxico could cut further the reference rate on one to two occasions, resulting in total cuts for 2019 between 50 and 75bps.

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<b>HOLD</b>	<i>When the share expected performance is similar to the MEXBOL estimated performance.</i>
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