

# Ahead of the Curve

June 15, 2018

Market focus this week will be on Banxico's monetary policy decision and inflation for the first half of June

www.banorte.com  
@ analisis\_fundam

**Francisco Flores**  
Economist, Mexico  
francisco.flores.seirano@banorte.com

- **Banxico's monetary policy decision (June 21).** On Thursday, Banco de México will announce its monetary policy decision at 1:00pm (ET), where we expect the monetary authority to hike the reference rate in 25bps to 7.75%. In addition, we expect a hawkish tone, similar to the one seen in the latest *Quarterly Report* and the minutes of the last monetary policy meeting. In this sense, we consider that such decision will be based on three factors: (1) The recent depreciation of the exchange rate; (2) the 25bps increase in the Fed Funds rate; and (3) the risks surrounding the institution's central scenario, derived both from the renegotiation of NAFTA and the electoral process
- **Bi-weekly inflation report (1H-June).** On Friday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of June. We are forecasting a 0.16% 2w/2w increase in the headline index, while we expect the core index to edge up 0.13% 2w/2w. Inflation during the period in question will be mainly explained by the increase in energy prices, particularly gasoline. In addition we also expect pressures from goods prices. However, these will be partially offset by a lower contribution from fresh fruits and vegetables. With these results, annual inflation will stand at 4.56% in the first half of June, higher than the 4.51% seen in May

Document for distribution among the general public

## Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 19-Jun	10:00am	International reserves	15-Jun	US\$ bn	--	--	173.3
Tue 19-Jun	12:30pm	Government weekly auction: 1-, 3-, 6-, 12-month CETES; 20y Mbono (Nov'38); 30y Udibonos (Nov'47); 5y Bondes D					
Wed 20-Jun	9:00am	Aggregate Demand	1Q18	% yoy	<u>2.6</u>	--	3.0
		Private consumption		% yoy	<u>2.4</u>	--	2.5
		Government consumption		% yoy	<u>1.5</u>	--	-0.2
		Gross-fixed investment		% yoy	<u>1.5</u>	--	-2.4
Wed 20-Jun	3:30pm	Citibanamex survey of economic expectations					
Thu 21-Jun	2:00pm	Banxico's monetary policy decision	June	%	<u>7.75</u>	7.75	7.50
Fri 22-Jun	9:00am	CPI inflation	1H Jun	% 2w/2w	<u>0.16</u>	0.18	0.26
				% yoy	<u>4.56</u>	--	4.55
		Core		% 2w/2w	<u>0.13</u>	0.17	0.16
				% yoy	<u>3.65</u>	--	3.69
Fri 22-Jun	9:00am	Global economic indicator	Apr	% yoy	<u>4.5</u>	4.2	-0.8
		Primary activities		% yoy	<u>6.1</u>	--	7.0
		Industrial production		% yoy	<u>3.8</u>	--	-3.7
		Services		% yoy	<u>4.8</u>	--	0.4

Source: Banorte; Bloomberg

Proceeding in chronological order...

**Weekly international reserves report.** On Tuesday, at 10:00am (ET), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US\$26 million amounting to US\$173.3 billion. According to Banxico's report, this figure comes mainly as a result of a positive valuation effect in central bank assets. In this context, the Central Bank's international reserves have increased by US\$474 million during 2018 (please refer to the following table).

**Banxico's foreign reserve accumulation detail**

US\$, million

	2017	Jun 8, 2018	Jun 8, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	173,276	26	474
(B) Gross international reserve	175,450	177,578	-272	2,128
Pemex	--	--	-23	-538
Federal government	--	--	-118	1,581
Market operations	--	--	0	0
Other	--	--	-131	1,085
(C) Short-term government's liabilities	2,648	4,302	-298	1,654

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 20-year fixed rate Mbonos (Nov'38), 30-year inflation-linked Udibonos (Nov'46), 5-year Bondes D, 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 (ET).

**Auction specifics (Tuesday, June 26, 2018)**

	Maturity	Coupon rate, %	To be auctioned <sup>1</sup>	Previous yield <sup>2</sup>
<b>Cetes</b>	19-Jul-18	--	9,000	7.62
1m	20-Sep-18	--	12,500	7.90
3m	20-Dec-18	--	11,500	7.99
6m	23-May-19	--	12,500	7.94
12m				
<b>Bondes D</b>	04-May-23	--	5,000	0.16
5y				
<b>M Bono</b>	18-Nov-38	8.50	2,000	7.89
20y				
<b>Udibono</b>	08-Nov-46	4.00	UDIS 400	3.86
30y	19-Jul-18	--	9,000	7.62

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

**We estimate a 2.6% yoy expansion in aggregate demand during 1Q18.** On Wednesday at 10:00am (ET), *INEGI* will publish its aggregate supply and demand report for the first quarter of 2018, where we believe aggregate demand increased 2.6% yoy, below the 3% yoy expansion observed in the previous quarter. Taking a look at the breakdown, we expect a 2.4% yoy increase in private consumption, while we estimate a 1.5% yoy growth for gross fixed investment. Moreover, we believe that government spending will likely show a 1.5% yoy increase given the increase in electoral spending.

**Citibanamex Survey.** Also on Wednesday, around 4:30pm (ET) *Citibanamex* will release its bi-weekly survey of economic expectations, where market focus will be on analysts' inflation forecasts for the first half of June (to be published on June 22). Furthermore, attention will be on monetary policy assessments, particularly on Banxico's monetary decision taking place on Thursday. In addition, the survey will contain forecasts for growth and FX. In the first case we do not expect changes to the 2018 figure. However, MXN estimates might be revised upward given the recent behavior of the Mexican peso.

**Banxico to hike the reference rate by 25bps.** On Thursday, Banco de México will announce its monetary policy decision at 1:00pm (ET), where we expect the monetary authority to hike the reference rate in 25bps to 7.75%. In addition, we expect a hawkish tone, similar to the one seen in the latest *Quarterly Report* and the minutes of the last monetary policy meeting. In its last monetary policy statement, Banxico highlighted that it will remain vigilant to potential pass-through of exchange rate fluctuations on prices, the relative monetary policy stance vs. U.S., and the conditions of slack in the Mexican economy.

In the first case, the central bank has emphasized the risks to its central scenario both for growth inflation. In this regard, the main ones are: (1) The renegotiation of the NAFTA; (2) the electoral process; (3) the fiscal reform in the US and its impact on Mexico; and (4) the volatility in international financial markets amid an adverse socio-political environment.

In this regard, since the last monetary policy decision, the Mexican peso has depreciated 4.9%, reaching levels around USD/MXN 20.70, as a result of generalized dollar strength as well as the increase in uncertainty regarding the renegotiation of NAFTA and Mexico's electoral process.

Regarding the relative monetary stance vs. the U.S., the Fed not only increased its reference rate by 25 bps at its last meeting –in line with market expectations– but alluded to a faster normalization of monetary conditions, estimating two additional increases in the remainder of 2018, one more than previously forecasted.

Regarding the conditions of slack in the economy, the output gap presented by Banxico in its *Quarterly Report* would seem to indicate that this is practically zero, and when excluding oil production, it is already in positive territory. In this regard a greater narrowing in the conditions of slack, coupled with higher pressures of energy prices and a disorderly behavior of the Mexican peso could lead to an impact on both domestic prices and inflation expectations.

Considering these factors we think that Banco de México will increase the reference rate by 25bps to 7.75% to bolster its position against these risks and ensure that inflation continues to converge to its 3% target.

**Inflation during the first half of June will be explained by an increase in energy prices, particularly gasoline.** On Friday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of June. We are forecasting a 0.16% 2w/2w increase in the headline index, while we expect the core index to edge up 0.13% 2w/2w.

Inflation during the period in question will be mainly explained by the increase in energy prices, particularly gasoline. In addition we also expect pressures from goods prices. However, these will be partially offset by a lower contribution from fresh fruits and vegetables.

We forecast inflation to be 1bp above the figure seen in 2017 as a result of: (1) a greater impact of energy prices (8bps vs. 2bps in 2017); (2) a smaller participation from agricultural goods (-2bps vs. 0bps in 2017); (3) a lesser contribution of other services (3bps vs. 5bps in 2017); and (4) a negative impact of goods (5bps vs. 6bps in 2017), as shown in the table below.

With these results, annual inflation will stand at 4.56% in the first half of June, higher than the 4.51% seen in May. Moreover, we forecast core inflation at 3.65% yoy (previous: 3.69% yoy). Moving forward, we will focus on the evolution of energy prices and the behavior of agricultural prices, and the impact they might have in Mexico's CPI.

**1H-June inflation by components**

% Bi-weekly incidence

	2018 F	2017	Difference
Headline	0.16	0.15	0.01
Core	0.10	0.13	-0.03
Goods	0.05	0.06	-0.02
Processed foods	0.03	0.04	-0.01
Other goods	0.02	0.02	-0.01
Services	0.05	0.07	-0.01
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.03	0.05	-0.02
Non-core	0.06	0.02	0.04
Agricultural	-0.02	0.00	-0.02
Fresh fruits and v egetables	-0.03	0.00	-0.03
Meat and egg	0.01	0.00	0.01
Energy and government regulated	0.08	0.02	0.06
Energy	0.08	0.02	0.06
Government regulated	0.00	0.00	0.00

Source: Banorte, INEGI

**We expect a 4.5% yoy expansion in April's IGAE.** Finally on Friday, *INEGI* will release its monthly global economic indicator for April (GDP monthly proxy), where we expect a 4.5% yoy growth, given that the figures will be affected by a calendar effect which increased working days in the annual comparison, given that the Easter holiday took place in March (vs, April in 2017).

As we had mentioned in our last report, the 3.8% expansion in industrial production during April was mostly explained by the 6.7% increase in construction output as well as the 5.6% growth in manufacturing. However, mining posted a 5.2% decline given the contraction in oil and gas production

Moreover, we believe that services will show a 4.8% yoy expansion (nsa figures), considering that recent reports have shown positive figures as a result of the positive trend in the formal labor market coupled with an above-trend growth in banking credit. However, the figure will be higher than the ones seen in previous months considering the before mentioned calendar effect.

**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
Katía Celina Goya Ostos	Senior, Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Miguel Alejandro Calvo Domínguez	Economist, Regional	miguel.calvo@banorte.com	(55) 1670 - 2220
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