

Ahead of the Curve

January 29, 2016

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

- Banxico's monetary policy decision.** Next week, Banxico will hold its first policy meeting of the year. The monetary policy *communiqué* will be published on Thursday (February 4) at 2:00pm (EST). We believe that board members will remain on hold, leaving the reference rate at 3.25%. However, we do expect a slightly more dovish tone in the *communiqué* on three fronts: (1) The Mexican economy continues to show a moderate growth; (2) The balance of risks for inflation remains positive; and (3) The higher probability that the FOMC will decide to delay the its normalization process until June
- Consumer confidence.** On Friday, at 9:00am (EST), Banxico and *INEGI* will publish its January's monthly survey on consumer confidence, where we expect a 0.8% yoy contraction, with the index reaching 90.4 points. Moreover, in seasonally adjusted terms, we expect confidence levels to decrease 0.9% m/m

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

Gabriel Casillas
Chief Economist and Head of Research
gabriel.casillas@banorte.com

Delia Paredes
Executive Director of Economic Analysis
delia.paredes@banorte.com

Alejandro Cervantes
Senior Economist, Mexico
alejandro.cervantes@banorte.com

Document for distribution among the general public

Mexico weekly calendar

DATE	HOUR (EST)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 1-Feb		Banking holiday: Mexico's Constitution Day					
Tue 2-Feb	10:00am	Family remittances	December	US\$ mn	<u>1,984.8</u>	<u>2,127.3</u>	1,888
Tue 2-Feb	10:00am	Banxico's survey of economic expectations	January				
Tue 2-Feb	12:30pm	Government weekly auction: 1-, 3-, 6-, 12- month CETES; 30y Mbono (Nov'42); 30y Udibono (Nov'46); 5y Bondes D					
Tue 2-Feb	1:00pm	PMI's survey (IMEF)	January				
		Manufacturing		index	<u>51.3</u>	--	50.7
		Non-manufacturing		index	<u>50.2</u>	--	49.2
Wed 3-Feb	10:00am	International reserves	29-Jan	US\$ bn	--	--	174.7
Thu 4-Feb	9:00am	Gross fixed investment	November	% yoy	<u>0.5</u>	<u>0.5</u>	1.0
		Machinery and equipment		% yoy	<u>6.2</u>	--	5.1
		Domestic		% yoy	<u>7.2</u>	--	6.2
		Imported		% yoy	<u>5.7</u>	--	4.6
		Construction		% yoy	<u>-2.8</u>	--	-1.6
Thu 4-Feb	2:00pm	Banxico's monetary policy decision	February	%	<u>3.25</u>	<u>3.25</u>	3.25
Fri 5-Feb	9:00am	Consumer confidence	January	index	<u>90.4</u>	<u>90.6</u>	93.0
Fri 5-Feb	4:30pm	Banamex bi-weekly survey of economic expectations					

Source: Banorte-IXE

Proceeding in chronological order...

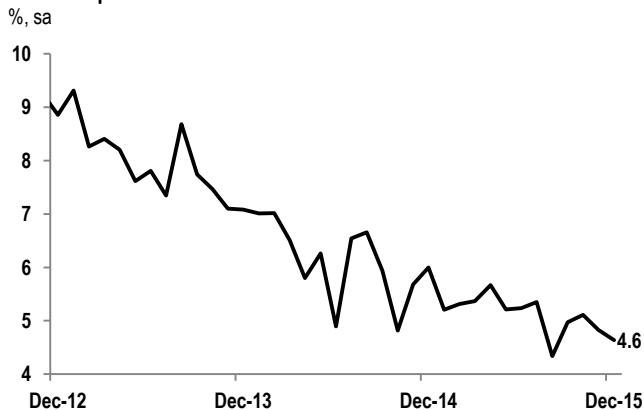
On Monday, financial markets will remain closed in Mexico. On the logistics side, and before we start with next week's description, we highlight that next week, Mexico will have a short week with a banking holiday on Monday (February 1), as the country observes the 99th Anniversary of the Mexican Constitution.

Family remittances will post a 11.2% yoy contraction. On Tuesday, at 10:00am (EST), Banxico will make its family remittances monthly data available. We expect Mexican workers living abroad -mainly in the US-, to have sent US\$1,984.8 mn to their families in Mexico during December. This would imply a 11.2% yoy contraction.

We believe that the reduction in remittances inflows during December will reflect a statistically high base of comparison, since the remittances inflows in December 2014 were influenced by the significant depreciation of the Mexican currency (+20.4% annually).

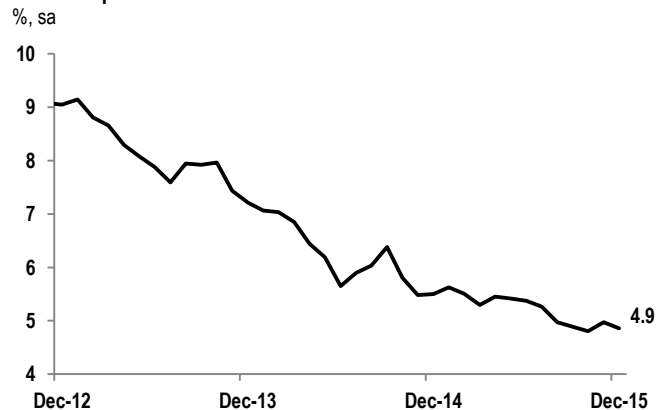
In this context, it is likely that remittances will continue its upward trend in 1Q16 supported by the better growth dynamics of the Mexican immigrant labor force in the U.S. Analyzing the recent figures from the Current Population Survey, the unemployment rate for Mexican illegal and legal immigrants has fallen significantly in the last semester (refer to the charts below) which implies that we will probably continue to see an upward trend in these inflows.

Unemployment rate for Mexican illegal migrant workers without citizenship



Source: Banorte-IXE, US Census Bureau

Unemployment rate for Mexican legal migrant workers without citizenship



Source: Banorte-IXE, US Census Bureau

Banxico’s survey of economic expectations. Also on Tuesday, at 10:00am (EST), 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 3.32% (Banorte-Ixe: 2.8%); (2) mid-term inflation expectations—quite important for the central bank's board—that are currently at 3.38% (Banorte-Ixe: 3%); and (3) the analysts' assessments of GDP growth for 2016 given the revisions made by several economists (currently at 2.74%; Banorte-Ixe: 2.7%).

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 (EST).

Auction specifics (Tuesday, February 2, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	03-Mar-16	--	5,500	3.14
3m	05-May-16	--	9,500	3.34
6m	04-Aug-16	--	11,000	3.44
12m	02-Feb-17	--	11,000	3.58
Mbono				
30y	13-Nov-42	7.75	2,500	6.90
Udibono				
30y	08-Nov-46	4.00	450	3.94
Bondes D				
5y	21-Jan-21	--	4,500	0.24

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

January’s PMI surveys. Also on Tuesday, *IMEF* (Mexican Institute of Financial Executives) will publish its PMI business confidence indicators for January. We expect manufacturing PMI at 51.3, above the 50.7 observed in December (seasonally adjusted terms). We believe that manufacturing activity was supported by the recovery of consumer spending in Mexico and the significant depreciation of the MXN.

Moreover, we believe that the non-manufacturing PMI will stand at 50.2 points from 49.2 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.

Weekly international reserves report. On Wednesday, at 10:00am (EST), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US\$529mn amounting to US \$174.7bn on January 22. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by the Central Bank to the Federal Government for US\$207mn; (2) US\$200mn decrease explained by the Banxico's USD ordinary auction with minimum price and US\$200mn by the supplementary auction with minimum price; along with a (3) US\$78mn increase 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 an accumulated reduction of US\$2,020mn international reserves this year (please refer to the table below).

Banxico's foreign reserve accumulation details
US\$, million

	2015	22/Jan/2016	22/Jan/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,723	174,703	-529	-2,020
(B) Gross international reserve	177,584	177,534	1,178	-50
Pemex	--	--	-61	-43
Federal govt	--	--	2,003	1,806
Market operations	--	--	-800	-1,806
Other	--	--	35	-7
(C) Short-term government's liabilities	861	2,831	1,707	1,969

Source: Banco de México

We expect a scant 0.5% yoy expansion in November's GFI. On Thursday at 9:00am (EST), *INEGI* will publish its November's gross fixed investment (GFI) report. We anticipate GFI up by a scant 0.5% yoy. We believe that within the report we will probably see a 5.7% yoy expansion in imported machinery and equipment given that trade balance figures for November showed a similar growth rate. Moreover, we expect a 7.2% growth in domestic machinery and equipment. However, we believe that construction spending could fall 2.8% yoy derived from the lower construction spending observed in the latest industrial production figures.

Gross fixed investment estimates

% yoy	Nov-15	Nov-14	Jan-Nov, '15	Jan-Nov, '14
Total	0.5	5.5	4.2	2.6
Machinery and equipment	6.2	10.2	9.0	5.2
Domestic	7.2	15.5	8.9	4.2
Imported	5.7	7.7	9.0	5.6
Construction	-2.8	3.0	1.2	1.1

Annual contribution	Nov-15	Nov-14	Difference
Total	0.5	5.5	-5.0
Machinery and equipment	2.3	3.6	-1.3
Domestic	0.9	1.7	-0.8
Imported	1.4	1.9	-0.5
Construction	-1.8	1.9	-3.7

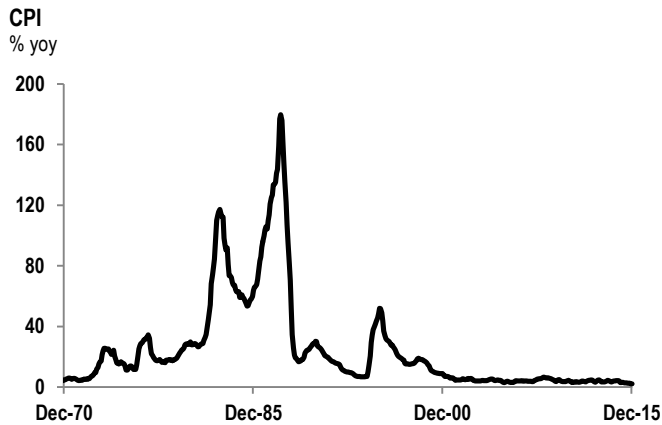
%/m sa	Nov-15	Oct-15	Difference
Total	-1.0	0.6	-1.6
Machinery and equipment	0.0	1.1	-1.1
Domestic	4.1	4.8	-0.7
Imported	-2.5	-0.4	-2.1
Construction	-0.9	0.7	-1.6

Source: INEGI, Banorte-Ixe

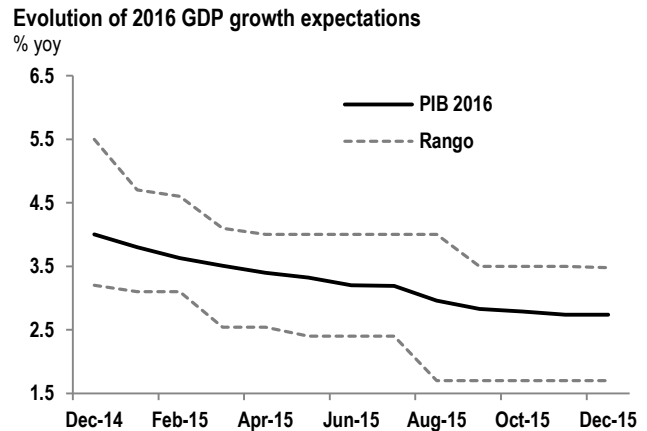
Monetary policy decision on Thursday: A slightly more dovish stance suggests a rate hike in June. Next week, Banxico will hold its first policy meeting of the year. The monetary policy *communiqué* will be published on Thursday (February 4) at 2:00pm (EST). We believe that board members will remain on hold, leaving the reference rate at 3.25%. However, we do expect a slightly more dovish tone in the *communiqué* on three fronts: (1) The Mexican economy continues to show a moderate growth; (2) The balance of risks for inflation remains positive; and (3) The higher probability that the FOMC will decide to delay the its normalization process until June.

Given Mexico's slow economic growth, the absence of inflationary pressures and the Fed's current monetary policy, common sense would dictate that Banxico should not raise the reference rate, until the Fed continues its hiking cycle. Inflation is at historically low levels (refer to the chart on the left), and even though Mexico's economic growth has been higher, growth expectations for 2016 have been continuously revised downwards (refer to chart on the right).

Similarly, Mexico's economic outlook is not that encouraging for 2016. The current situation of low crude oil prices given Mexico's heavy dependence on oil revenue (~25%), the government's commitment to reduce the fiscal deficit to 0.5% of GDP in 2016, and the new fiscal regulations that will affect the accounts of Mexico's federal entities and municipalities, will translate into a lower public spending, hindering 2016 GDP's growth below 3%.



Source: INEGI



Source: Banxico Survey of Economic Expectations

In the first policy statement issued by the Fed, the FOMC decided not to change its monetary stance in order to keep the Fed Funds rate between 0.25% and 0.50%. In the statement, we perceive a more dovish tone. While the Fed has been very clear that the hiking cycle will be “gradual,” it seems that the complex external environment, characterized by high volatility, the decline in oil prices, and the strong appreciation of the dollar will push the Fed to postpone the next rate hike at least until June.

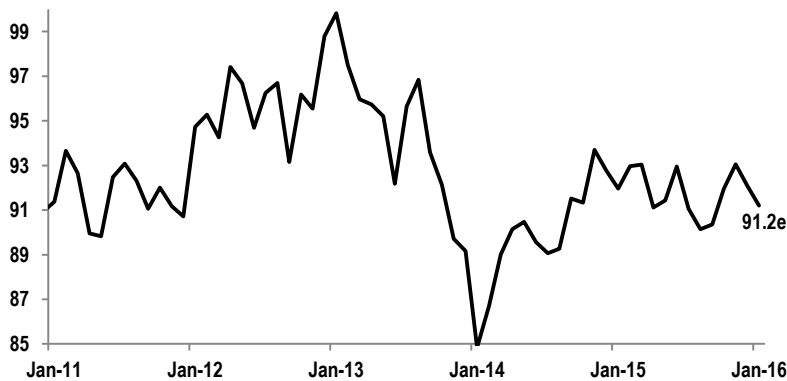
In an interview for Bloomberg in Davos, Governor Agustin Carstens was questioned about whether the central bank may adopt a different monetary stance from the Fed. In this regard, Carstens highlighted the importance of distinguishing between economic external and internal factors. In the first case, the currency movement may destabilize inflation expectations and could motivate an increase in Banxico’s reference rate. However, the current dynamics of the Mexican economy, which has been characterized lately by moderate growth, is consistent with the monetary stance taken by Banxico. In this context, and considering that some of the exchange rate volatility is generated by the interest rate differential between Mexico and the US, Carstens said that “*it is essential to follow the Fed*”.

We maintain our view that Banxico will continue its hiking cycle right after the Fed’s hike in June. While Banxico’s central scenario seems to be of economic activity weakness and inflation below target until year-end, the prospects of higher rates in the United States pose a significant risk to exchange rate and inflation levels in Mexico. Given this, we believe that Banxico will continue its hiking cycle right after the Fed’s hike in June.

Consumer confidence will fall given the depreciation of the Mexican currency. On Friday, at 9:00am (EST), Banxico and *INEGI* will publish its January's monthly survey on consumer confidence, where we expect a 0.8% yoy contraction, with the index reaching 90.4 points. Moreover, in seasonally adjusted terms, we expect confidence levels to decrease 0.9% m/m.

We believe that consumer confidence (measured in seasonally adjusted terms) will falter given the significant depreciation of the Mexican currency, which will be reflected in a decline of consumer's expectations regarding the country's present and future economic outlook. However, January's fall will be limited, given the favorable performance of inflation, which will translate in a higher growth for the purchasing power component.

Consumer confidence
index, sa



Source: INEGI

Banamex Survey: Market participants will focus on monetary policy assessments. Finally, on Friday at 4:30pm (EST) *Banamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts' monetary policy assessments after Banxico's monetary policy decision on Thursday.

Furthermore, analysts will also focus on January's inflation forecast (to be published on Tuesday, February 9), as well as on CPI estimations for 2016 and 2017. Moreover, *Banamex* will also publish consensus' growth and FX forecasts for 2016-17. In the first case, we believe that most economists will discount a marginally lower economic growth for 2016 given the recent volatility in oil prices and its potential impact on Mexico's public finances. In the second case, we expect moderate upward revisions to the FX estimates for 2016.

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
Rey Saúl Torres Olivares	Analyst	saul.torres@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 Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Analyst 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	Equity Research Analyst	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Senior Equity Research Analyst – Conglomerates/Financials/ Mining/ Chemistry	marissa.garza@banorte.com	(55) 1670 - 1719
Marisol Huerta Mondragón	Equity Research Analyst – Food/Beverages	marisol.huerta.mondragon@banorte.com	(55) 1670 - 1746
José Itzamna Espitia Hernández	Equity Research Analyst – Airports / Cement / Infrastructure / Fibras	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research Analyst – Auto parts	valentin.mendoza@banorte.com	(55) 1670 - 2250
María de la Paz Orozco García	Analyst	maripaz.orozco@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	Analyst, Corporate Debt	hugo.gomez@banorte.com	(55) 1670 - 2247
Idalia Yanira Céspedes Jaén	Analyst, Corporate Debt	idalia.cespedes@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