

Ahead of the Curve

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

- Monetary policy announcement (May 17).** On Thursday, Banxico will announce its monetary policy decision at 1:00pm (ET), where we expect the monetary authority to maintain the reference rate unchanged at 7.5%. In addition, we expect a significantly more hawkish tone than in the press release and the minutes of the last monetary policy meeting. We consider that the Board will elaborate on three issues in particular: (1) The recent behavior of the Mexican currency; (2) the relative monetary stance between Mexico and the US; and (3) the recent trajectory of inflation. Considering these factors, we think that the Board has space to adopt a “wait and see” approach before raising the reference rate again, although we recognize that going ahead the scenario will be difficult to evaluate. In this regard, we anticipate that Banxico will increase the reference rate by 25 bps at the June 21 meeting. Looking ahead, and as volatility due to the electoral process and the renegotiation of NAFTA starts to dissipate, it is likely that the Central Bank could cut rates by 50bps in the second half of 2018.

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Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 15-May	10:00am	International reserves	May-11	US\$ bn	--	--	173.0
Tue 15-May	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y MBono (Dec'23); 10y Udibonos (Nov'28)					
Thu 17-May	2:00pm	Banxico's monetary policy decision	May	%	7.50	7.50	7.50

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 decreased by US\$8 million amounting to US\$173.1 billion. According to Banxico’s report, this figure comes mainly as a result of a negative valuation effect in central bank assets. In this context, the Central Bank’s international reserves have increased by US\$258 million during 2018 (please refer to the table below).

Banxico's foreign reserve accumulation detail

US\$, million

	2017	May 4, 2018	May 4, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	173,060	-8	258
(B) Gross international reserve	175,450	177,723	1,127	2,273
Pemex	--	--	165	-543
Federal government	--	--	148	1,666
Market operations	--	--	0	0
Other	--	--	814	1,150
(C) Short-term government's liabilities	2,648	4,663	1,135	2,015

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 5-year fixed rate Mbonos (Dec’23), 10-year inflation-linked Udibonos (Nov’28), in addition to the “more traditional” 1-, 3-, and 6-month zero-coupon Cetes (please refer to the table on the following page). As usual, the results will be released at 12:30pm (ET).

Auction specifics (Tuesday, May 15, 2018)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	14-Jun-18	--	7,000	7.52
3m	16-Aug-18	--	11,000	7.73
6m	08-Nov-18	--	11,500	7.76
M Bono				
5y	07-Dec-23	8.00	8,500	7.21
Udibono				
10y	30-Nov-28	4.00	UDIS 700	3.72

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's monetary policy announcement. On Thursday, Banxico will announce its monetary policy decision at 1:00pm (ET), where we expect the monetary authority to maintain the reference rate unchanged at 7.5%. In addition, we expect a significantly more hawkish tone than in the press release and the minutes of the last monetary policy meeting.

Since the last monetary policy decision, the Mexican peso depreciated considerably, reaching a maximum level on May 8 (7.6%), in an environment of dollar strength and heightened uncertainty regarding Mexico's electoral process and the renegotiation of NAFTA, which has started to dissipate in the last days of the week, with the peso reaching levels close to 19.4 USD/MXN. It should be noted that a disorderly behavior of the peso could lead to an impact on both domestic prices and inflation expectations.

In addition, in its last communication, Banco de Mexico alluded extensively to the possibility of the Fed implementing a more restrictive monetary policy than expected, emphasizing the disruption that this could have on investment flows, specifically in emerging economies. In this context, we believe that Banxico will reinforce the importance of the relative monetary stance between Mexico and the US.

However, inflation has continued to surprise on the downside, standing at 4.55% yoy in April from the 6.77% observed in December 2017. Similarly, of the last eight bi-weekly prints published by *INEGI*, six have stood below consensus expectations, confirming the favorable performance of the indicator. In addition, it should be noted that in the last meeting's minutes some members of the Board of Governors alluded that the bias for inflation remains tilted to the downside, however "*... this bias is less pronounced with respect to the previous monetary policy decision ...*".

Considering these factors we think that the Board has space to adopt a "*wait and see*" approach before raising the reference rate again, although we recognize that going ahead the scenario will be difficult to evaluate. In this regard, we continue to expect that Banxico will increase the reference rate by 25 bps in the 2Q18, which implies a hike at the June 21 meeting.

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