

Ahead of the Curve

Market focus this week will on Banxico's monetary policy announcement and October's industrial production

- Banxico's monetary policy announcement.** On Thursday, Banxico will announce its monetary policy decision at 2:00pm (EST), where we expect a 25bps rate hike. Thus, the new reference rate will stand at 5.5% from 5.25%. We believe that the key variable for Banxico will be the 25bps increase that the Fed will probably implement at December's meeting, given that Banxico's rate hike will take place just a day after the Fed continues normalizing rates in the United States. We believe that the Board will justify the increase, given the importance of Mexico's relative monetary conditions, particularly with the U.S., despite Mexico's low economic growth.
- Industrial production (October).** Industrial production will fall 1.6% yoy. On Monday at 9:00am (EST), *INEGI* will release its monthly industrial production report. We anticipate a 1.6% yoy reduction in total output during October, after the 1.3% contraction in September. Taking a look at the breakdown, we believe that manufacturing production could post null growth. In addition, we expect a 10.1% yoy of mining activity. Finally, we believe that construction output will show a moderate 1.6% expansion given the lower growth in private construction investment projects, coupled with the reduction in public infrastructure spending.

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

Delia Paredes

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

Alejandro Cervantes

Senior Economist, Mexico
alejandro.cervantes@banorte.com

Francisco Flores

Economist, Mexico
francisco.flores.serrano@banorte.com

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Mexico weekly calendar

DATE	TIME (EST)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 12-Dec	9:00am	Industrial production	October	% yoy	<u>-1.6</u>	-0.8	-1.3
		(sa)		% m/m	<u>-0.5</u>	-0.1	0.1
		Mining		% yoy	<u>-10.1</u>	--	-9.7
		Utilities		% yoy	<u>1.2</u>	--	2.0
		Construction		% yoy	<u>1.6</u>	--	1.0
		Manufactures		% yoy	<u>0.0</u>	0.7	0.4
Tue 13-Dec	12:30pm	Government weekly auction: 1-, 3-, and 6-month Cetes; 3y MBono (Dec'19); 3y Udibono (Jun'19)					
Wed 14-Dec	10:00am	International reserves	9-Dec	US\$ bn	--	--	174.1
Thu 15-Dec	2:00pm	Banxico's monetary policy decision		%	<u>5.50</u>	5.50	5.25
Fri 16-Dec	10:00am	Banxico's survey of economic expectations	December		-		

Fuente: Banorte-IXE; Bloomberg

Proceeding in chronological order...

We expect a 1.6% yoy contraction in October's industrial output. On Monday at 9:00am (EST), *INEGI* will release its monthly industrial production report. We anticipate a 1.6% yoy reduction in total output during October, after the 1.3% contraction in September.

Taking a look at the breakdown, we believe that manufacturing production could post null growth, explained by: (1) the 0.2% yoy expansion in the US manufacturing sector (NAICS, original figures); (2) the scant 0.5% yoy increase in Mexico's vehicle production; and (3) the 6.1% yoy contraction in manufacturing exports.

In addition, the 1.6% yoy contraction in industrial output during October will be also explained by the poor performance of mining activity. In this regard, we expect a 10.1% yoy reduction derived from lower oil production and the reduction in the extraction of other minerals. Finally, we believe that construction output will show a moderate 1.6% expansion given the lower growth in private construction investment projects, coupled with the reduction in public infrastructure spending, as a result of the recent fiscal cuts implemented by the Federal Government.

Industrial production estimates: October 2016

%yoy	Oct-16	Oct-15	Jan-Oct, '16	Jan-Oct, '15
Total	-1.6	0.1	-0.1	1.2
Mining	-10.1	-3.7	-5.8	-4.6
Utilities	1.2	2.7	3.2	2.3
Construction	1.6	1.0	1.5	3.4
Manufacturing	0.0	1.0	1.0	2.6
%m/m sa	Oct-16	Sep-16	Difference	
Total	-0.5	0.1	-0.6	
Mining	-1.3	-1.6	0.3	
Utilities	-0.2	-0.3	0.0	
Construction	0.0	1.4	-1.4	
Manufacturing	-0.7	-0.1	-0.5	

Source: Banorte-Ixe

Weekly government bond auction. Also on Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 3-year fixed-rate Mbonos (Dec’19), as well as 3-year inflation-linked Udibonos (Jun’19), 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, December 13, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	12-Jan-17	--	7,000	5.59
3m	16-Mar-17	--	11,000	5.85
6m	08-Jun-17	--	12,000	6.07
Mbono				
3y	11-Dec-19	5.00	9,500	6.57
Udibono				
3y	16-Jun-19	4.00	850	3.20

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

Weekly international reserves report. On Wednesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US\$14 million amounting to US \$174.1 billion on the 2nd of December. According to Banxico’s report, this figure comes mainly as a result of changes in the valuation of the Central Bank’s assets. In this context, the Central Bank’s international reserves have diminished by US\$2,671 million this year (please refer to the table below).

Banxico's foreign reserve accumulation details

US\$, million

	2015	2/Dec/2016	2/Dec/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	174,064	-14	-2,671
(B) Gross international reserve	177,597	175,027	-1,029	-2,570
Pemex	--	--	-635	1,988
Federal government	--	--	-65	-594
Market operations	--	--	0	-5,562
Other	--	--	-329	1,663
(C) Short-term government's liabilities	861	963	-1,015	101

Source: Banco de México

We expect a 25bps hike in Banxico’s reference rate. On Thursday, Banxico will announce its monetary policy decision at 2:00pm (EST), where we expect a 25bps rate hike. Thus, the new reference rate will stand at 5.5% from 5.25%. We believe that the key variable for Banxico will be the 25bps increase that the Fed will probably implement at December’s meeting, given that Banxico’s rate hike will take place just a day after the Fed continues normalizing rates in the United States. We believe that the Board will justify the increase, given the importance of Mexico’s relative monetary conditions, particularly with the U.S., despite Mexico’s low economic growth.

However, we can't rule out completely a 50bps increase given the deterioration in inflationary expectations generated by: (1) The higher pass-through effect from the depreciation of the Mexican currency to prices, and (2) the potential impact of the 9.6% increase in the minimum wage to the price dynamics. In the first case, even though Mexico's headline CPI index has remained below Banxico's 3% target, we believe that the balance of risks for inflation has deteriorated as a result of the higher pass-through effect from the depreciation of the MXN to prices. In addition, the depreciation of the MXN since Donald Trump's victory could generate additional pressure not only on the consumer price index, but on medium and long-term inflation expectations.

In addition, on December 1st, the National Commission of Minimum Wages (*CONSASAMI*), announced an increase in minimum wages for 2017. With this revision, the minimum wage will amount to MXN 80.04 per day, which implies a 9.9% increase. In this regard, the central bank will probably mention within the monetary policy *communiqué* that next year's inflation will partly reflect the increase in the minimum wage, although it will probably not have an impact on medium and long-term inflation expectations.

While Banxico's central scenario seems to be of lower economic growth, the prospects of a depreciated currency in Mexico coupled with higher rates in the United States pose a significant risk to inflation levels and expectations in Mexico. Looking ahead, we believe that Banxico will follow the Fed in its monetary tightening cycle. In this context, we expect Banxico and the Fed to hike 50bps in 2017, with Banxico's reference rate ending next year at 6%.

Banxico's survey of economic expectations. Finally on Friday, 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 and 2017 inflation expectations that currently are at 3.4% and 4%, respectively (Banorte-Ixe: 3.35% and 4.3%); (2) mid-term inflation expectations—quite important for the central bank's board—that are currently at 3.39% (Banorte-Ixe: 3%); and (3) the analysts' assessments of GDP growth for 2016 and 2017, given the recent downward revisions made by several economists, including us (currently at 2.1% and 1.8%, respectively; Banorte-Ixe: 2% and 1.1%).

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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, National	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 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
José Itzamna Espitia Hernández	Equity Research Analyst – Airlines / Airports / Cement / Infrastructure / Fibras	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research Analyst – Auto Parts/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250

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