

Ahead of the Curve

April 29, 2016

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

- Banxico's monetary policy decision.** Next week, Banxico will hold its third regular policy meeting of the year. The monetary policy *communiqué* will be published on Thursday (May 5) at 2:00pm (EDT). We believe that board members will remain on hold, leaving the reference rate at 3.75%. However, we expect a neutral tone in the *communiqué* given that: (1) The Mexican economy continues to show a moderate growth, despite the higher-than-expected growth in 1Q16; (2) the balance of risks for inflation in the short term remains unchanged; and (3) the higher probability that the FOMC will decide to delay its normalization process until June
- Consumer confidence.** On Friday, at 9:00am (EDT), Banxico and *INEGI* will publish its April's monthly survey on consumer confidence, where we expect a 1.4% yoy contraction, with the index reaching 90 points. However, in seasonally adjusted terms, we expect confidence levels to increase 0.5% m/m

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Mexico weekly calendar

DATE	HOUR (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 2-May	10:00am	Family remittances	March	US\$ mn	<u>2,400</u>	--	2,093
Mon 2-May	10:00am	Banxico's survey of economic expectations	April				
Tue 3-May	10:00am	International reserves	29-Apr	US\$ bn	--	--	177.7
Tue 3-May	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 3y Mbono (Dec'19); 3y Udibonos (Jun'19)					
Tue 3-May	1:00pm	PMI's survey (IMEF)	April				
		Manufacturing		index	<u>51.7</u>	--	51.6
		Non-manufacturing		index	<u>51.0</u>	--	50.8
Wed 4-May	9:00am	Gross fixed investment	February	% yoy	<u>4.4</u>	4.2	0.1
		Machinery and equipment		% yoy	<u>9.1</u>	--	-2.5
		Domestic		% yoy	<u>7.1</u>	--	8.3
		Imported		% yoy	<u>10.1</u>	--	-7.0
		Construction		% yoy	<u>1.7</u>	--	1.7
Wed 4-May	9:00am	Private consumption	February	% yoy	<u>7.1</u>	--	4.5
Thu 5-May	2:00pm	Banxico's monetary policy decision	May		<u>3.75</u>	3.75	3.75
Fri 6-May	9:00am	Consumer confidence	April	index	<u>90.0</u>	-	89.2
Fri 6-May	4:30pm	Banamex bi-weekly survey of economic expectations					

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Family remittances will post a 6.5% yoy expansion in March. On Monday, at 10:00am (EDT), Banxico will make its family remittances monthly data available. We expect Mexican workers living abroad -mainly in the US-, to have sent US\$2,400 mn to their families in Mexico during March. This would imply a 6.5% yoy expansion.

We believe that remittances in March will benefit from the U.S. labor market. In particular, during the first quarter of the year, the number of employed Mexican migrants in US without citizenship fell by 94,233 workers. However, the number of employed Mexican immigrants with citizenship increased by 400,762 workers (seasonally adjusted figures estimated by Banorte-Ixe using US Census Bureau's Data Ferret nsa figures), which probably implies that the Mexican migrant population in the U.S. without citizenship has accelerated the process to acquire its citizenship given the primary presidential elections outcomes for the Republican Party. This would suggest that the Mexican migrant population in the U.S. could substantially increase their remittances flows to Mexico amid the presidential election.

Banxico's survey of economic expectations. On Monday at 10:00am (EDT), 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 3.31% (Banorte-Ixe: 2.8%); (2) mid-term inflation expectations—quite important for the central bank's board—that are currently at 3.36% (Banorte-Ixe: 3%); and (3) the analysts' assessments of GDP growth for 2016

Weekly international reserves report. On Tuesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US\$13mn amounting to US \$177.7bn on April 22. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by Banxico to the Federal Government for US\$34mn; along with a (2) US\$21mn 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 accumulated US\$916mn international reserves this year (please refer to the table below).

Banxico's foreign reserve accumulation details

US\$, million

	2015	22/Apr/2016	22/Apr/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	177,652	-13	916
(B) Gross international reserve	177,597	180,309	1,160	2,712
Pemex	--	--	483	3,068
Federal govt	--	--	43	2,451
Market operations	--	--	0	-5,562
Other	--	--	634	2,755
(C) Short-term government's liabilities	861	2,657	1,172	1,796

Source: Banco de México

Weekly government bond auction. 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, May 3, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	02-Jun-16	--	5,500	3.76
3m	04-Aug-16	--	9,500	3.83
6m	27-Oct-16	--	11,000	3.88
Mbono				
3y	11-Dec-19	5.00	7,500	5.06
Udibono				
3y	13-Jun-19	4.00	750	2.09

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

April’s PMI surveys. On Tuesday, *IMEF* (Mexican Institute of Financial Executives) will publish its PMI business confidence indicators for April. We expect manufacturing PMI at 51.7, marginally above the 51.6 observed in March (seasonally adjusted terms). We believe that manufacturing activity was supported by the recovery of consumer spending in Mexico.

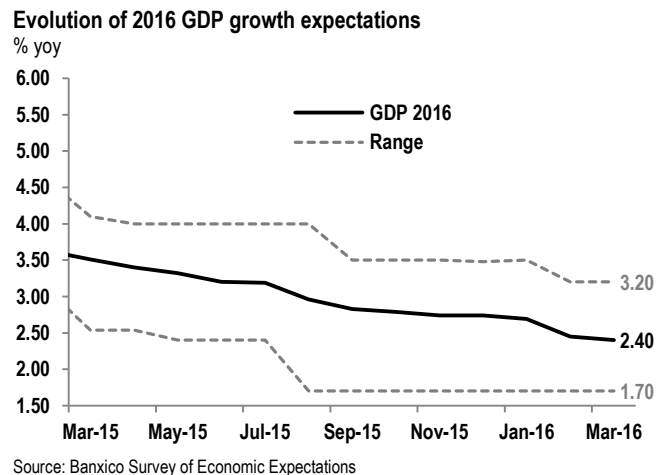
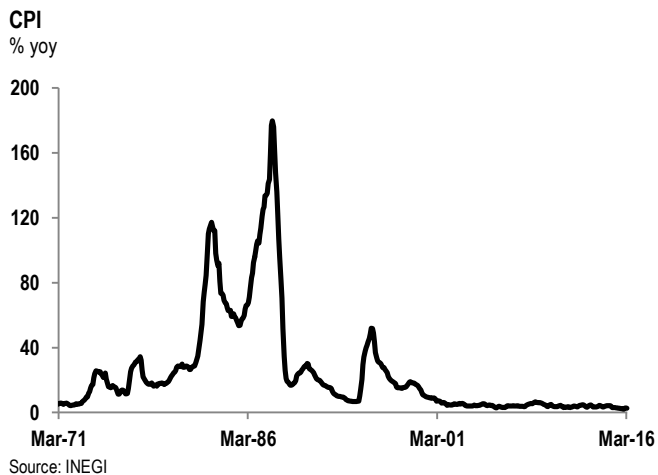
In addition, we believe that the non-manufacturing PMI will stand at 51 points from 50.8 points. In this regard, we believe that the recent upward trend in domestic demand, given the recovery in both the labor market and the household’s purchasing power, could have triggered a faster growth within the services, which will be reflected in the non-manufacturing PMI.

We expect a 4.4% yoy expansion in February’s GFI. On Wednesday at 9:00am (EDT), *INEGI* will publish its February’s gross fixed investment (GFI) report. We anticipate GFI up by 4.4% yoy. We believe that within the report we will probably see a 10.1% yoy expansion in imported machinery and equipment given that trade balance figures for February showed a similar growth for capital goods imports. Moreover, we expect a 7.1% growth in domestic machinery and equipment. Finally, we believe that construction spending could increase 1.7% yoy derived from the higher construction spending observed in the latest industrial production figures.

Monetary policy decision on Thursday: A neutral stance, until the Fed hikes in June. Next week, Banxico will hold its third regular policy meeting of the year. The monetary policy *communiqué* will be published on Thursday (May 5) at 2:00pm (EDT). We believe that board members will remain on hold, leaving the reference rate at 3.75%. However, we expect a neutral tone in the *communiqué* given that: (1) The Mexican economy continues to show a moderate expansion, despite the higher-than-expected growth in 1Q16; (2) the balance of risks for inflation in the short term remains unchanged; and (3) the higher probability that the FOMC will decide to delay its normalization process until June.

In the last GDP report published by *INEGI*, the Mexican economy grew 2.7% yoy, above consensus estimate of 2.4%. The higher-than-expected growth of the Mexican economy was supported by the upward trend in private consumption given the better growth dynamics in labor markets, low inflation, higher banking credit, and the recent growth in remittances inflows. However, several factors affected Mexico's economic growth on the downside such as a delay in the recovery of the U.S. industrial sector; and the deceleration in public investment projects given the fiscal cuts announced by the Federal Government for 2016. In addition, headline inflation will marginally increase this year given the following factors: (1) The fading of favorable supply shocks that took place in 2015; (2) price adjustments given the depreciation of the Mexican currency; (3) the change in the MoF's policy of the determination of gasoline prices, which implies higher prices during the second and third quarters, but lower during the first and fourth quarters.

Given Mexico's moderate economic growth, the absence of significant 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 contained (refer to the chart on the left), and Mexico's economic growth expectations for 2016 have been continuously revised downwards (refer to chart on the right). Moreover, the current situation of low crude oil prices given Mexico's heavy dependence on oil revenue (~22%), 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%.



In the last FOMC statement, the US Fed decided not to change its monetary stance in order to keep the Fed Funds rate between 0.25% and 0.50%. In the *communiqué*, we perceived a less dovish stance, particularly in regard with the FOMC's view of the external environment. The statement also acknowledged the strength of the labor market despite slower economic growth in 1Q16. The Fed also recognized that private consumption decelerated, although real income has grown at a robust pace, and consumer confidence remains at relatively high levels. In this context, we continue to think that the next upward movement will take place at June's meeting, supported by the labor market recovery and a less volatile external environment, coupled with the recent upward trend in prices.

In our opinion, after Banxico's 50bps rate hike in February 17, the central bank is still tied to the U.S. Fed actions. In this regard, we believe that Banxico's next move will be a rate hike, immediately after the Fed continues its normalization of monetary policy in June 15. This implies that the central bank could be raising rates at its next regular meeting on June 30.

Consumer confidence will marginally recover in April. On Friday, at 9:00am (EDT), Banxico and *INEGI* will publish its April's monthly survey on consumer confidence, where we expect a 1.4% yoy contraction, with the index reaching 90 points. However, in seasonally adjusted terms, we expect confidence levels to increase 0.5% m/m.

We believe that consumer confidence (measured in seasonally adjusted terms) will show a moderate growth given the appreciation of the Mexican currency, which will be reflected in a higher growth of consumer's expectations regarding the country's present and future economic outlook. Moreover, April's 0.5% increase will be also explained by the moderate levels of inflation, which will translate in an expansion of the purchasing power component.

Banamex Survey: Market participants will focus on monetary policy forecasts. On Thursday at 4:30pm (EDT) *Banamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts' monetary policy assessments given the recent neutral tone in the last FOMC statement. In this regard, we highlight that Banxico has emphasized several times that Mexico's monetary policy is tied to the Fed's policy.

Furthermore, analysts will also focus on the inflation report for April (to be published on Monday, May 10), 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 do not expect strong revisions to the median GDP forecast. In the second case, we expect moderate downward revisions to the FX estimates for 2016.

Disclaimer

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