

Ahead of the Curve

Banxico to maintain the reference rate at 8.25%, with economic activity still weak

- Banxico's monetary policy decision (March 28th).** We expect Banco de México to maintain the reference rate unchanged at 8.25%, in line with consensus. We believe the monetary policy statement will show a *dovish* bias relative to the previous communiqué, but relatively similar to the latest Quarterly Report. In our view, the most important factors to be discussed include: (1) The recent *dovish* shift of the Fed, and its implications for global and local monetary policy; (2) the evolution of economic activity, expecting that the central bank will maintain local growth risks as skewed to the downside; and (3) the decline in headline inflation, but still cautious as the core component maintains its resistance to the downside. In our view, the communiqué will be consistent with our expectation that Banxico will start an easing cycle as soon as June, when we expect a 25bps rate cut
- Economic activity indicator (January).** After null growth in December, we forecast a slight 0.8% yoy increase. In the monthly comparison, we expect the contraction to extend for a second month in a row, posting a 0.2% decline after dipping 0.4% in December. As already published, industrial activity fell 0.9% yoy, partly influenced by the slowdown at the end of last year, but also likely impacted by supply chain disruptions and weak global manufacturing. We expect services at 1.6%, higher than the previous 0.9%. If our forecast materializes, it would be consistent with our view that activity resented recent idiosyncratic drivers coupled with a less favorable global backdrop, an environment that we believe could extend at least to the first half of the year

March 22, 2019

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Document for distribution among the general public

Mexico weekly calendar

DATE	HOOR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS	
Mon 25-Mar	10:00am	Global economic indicator (sa)	January	% yoy	<u>0.8</u>	--	0.0	
				% m/m	<u>-0.2</u>	--	-0.4	
				Primary activities	% yoy	<u>1.0</u>	--	4.7
				Industrial production	% yoy	<u>-0.9</u>	--	-2.5
				Services	% yoy	<u>1.6</u>	--	0.9
Tue 26-Mar	10:00am	Retail sales	January	% yoy	<u>1.5</u>	--	-1.3	
		sa		% m/m	<u>2.6</u>	--	-3.2	
Tue 26-Mar	11:00am	International reserves	Mar-22	US\$ bn	--	--	176.0	
Tue 26-Mar	1:30pm	Government weekly auction: 1-, 3-, 6-, 12-month CETES; 10y Mbono (May'29); 30y Udibonos (Nov'46); 5y Bondes D						
Wed 27-Mar	10:00am	Trade balance	February	US\$ mn	<u>303.5</u>	--	-4,809.6	
				Total exports	% yoy	<u>3.9</u>	--	5.6
				Oil exports	% yoy	<u>-6.0</u>	--	-12.4
				Non-oil exports	% yoy	<u>4.7</u>	--	7.1
				Total imports	% yoy	<u>5.7</u>	--	6.0
Wed 27-Mar	10:00am	Unemployment rate	February	%	<u>3.42</u>	--	3.57	
				sa	%	<u>3.52</u>	--	3.49
Thu 28-Mar	3:00pm	Banxico's monetary policy decision	April	%	<u>8.25</u>	8.25	8.25	
Fri 29-Mar	11:00am	Comercial banking credit	February	% yoy	<u>5.7</u>	--	5.5	
				Consumption	% yoy	<u>2.0</u>	--	1.8
				Housing	% yoy	<u>5.5</u>	--	5.3
				Non-banking private firms	% yoy	<u>7.1</u>	--	6.9
Fri 29-Mar	4:30pm	Budget balance	February	MXN bn	--	--	-42.7	

Source: Banorte; Bloomberg

Proceeding in chronological order...

Economic activity to remain weak in January amid negative shocks. After null growth in December, we forecast a slight 0.8% yoy increase in the *Economic Activity Indicator* (IGAE). In the monthly comparison (using seasonally adjusted figures), we expect the contraction to extend for a second month in a row, posting a 0.2% decline after dipping 0.4% previously.

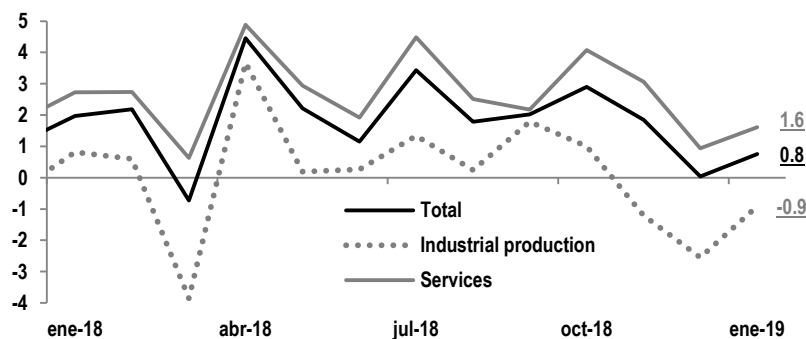
As already published, industrial activity fell 0.9% yoy (+0.6% m/m), partly influenced by the slowdown at the end of last year but also likely impacted by supply chain disruptions –including delays in fuel distribution, strikes in Tamaulipas, and railway blockades in Michoacán– and weak global manufacturing, with this latter sector edging up 1.3%. Mining fell 10.5%, while construction rebounded to 1.7%.

Moreover, within services we believe these transitory shocks could have impacted relatively more the transportation sector. In this context, related components within IMEF’s PMI indices, such as manufacturing deliveries, posted a significant decline in the month. In addition, formal employment growth in this sector kept decelerating and is advancing at its slowest pace since September 2014 at 3.1% yoy. Dynamism in retail sales could be stronger, with several indicators pointing to a rebound relative to December (and as detailed in the following section). Considering these, we expect services at 1.6% yoy (0.2% m/m), higher than the previous 0.9% but quite below the 2.7% average pace of the last twelve months.

If our forecast materializes, it would be consistent with our view that activity indeed resented recent idiosyncratic drivers, coupled with a less favorable global backdrop, an environment that we believe could extend at least to the first half of the year.

IGAE

% yoy (nsa)



Source: INEGI, Banorte

Retail sales in January likely stronger. We estimate a 1.5% yoy increase, significantly above the -1.3% of the previous month, which was the weakest in a year. In seasonally-adjusted terms, we expect a 2.6% m/m expansion. Data released so far suggests performance was better when compared to the previous month, in spite of uncertainty about the impact that fuel distribution delays may have had, both directly in indirectly (in terms of the willingness to go out).

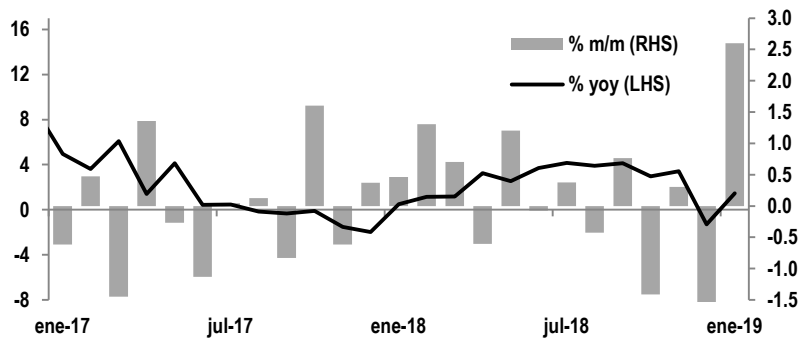
In particular, auto sales inched up 1.8% yoy, its first positive print since the beginning of 2017, along an improvement at the margin in same-store sales in annual terms at both Walmart and ANTAD. It is worth remembering that starting this year, info from the latter organization will not include Walmart's sales, which made up around 40 % of the total according to press reports.

Other indicators were also more positive, including non-oil consumption imports at +0.6% yoy. Another factor that could have a favorable effect is the strong increase of 2.5% in real wages, which could have been benefitted by the minimum wage hike at the start of the year. Last but not least, the unemployment rate recovered when compared to December, falling to 3.49% from 3.56%.

Going forward, we believe retail sales could remain resilient in spite of more modest economic growth. In particular, even with the relative delay in the implementation of government transfers programs that we had already accounted for as a supportive factor, positive growth in payrolls and remittances, along lower inflation, will likely continue helping this sector.

Retail sales

% yoy (nsa), % m/m (sa)



Source: INEGI, Banorte

Weekly international reserves report. Last week, net international reserves grew by US\$278 million, closing at US\$176.0 billion. According to Banxico's report, this figure comes mainly from a positive valuation effect in central bank assets. In this context, the central bank's international reserves have increased US\$1.3 billion during 2019 (please refer to the following table).

Banxico's foreign reserve accumulation detail

US\$, million

	2018	Mar 15, 2019	Mar 15, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	176,045	278	1,253
(B) Gross international reserve	176,384	181,509	132	5,125
Pemex	--	--	-99	129
Federal government	--	--	-40	3,999
Market operations	--	--	0	0
Other	--	--	272	996
(C) Short-term government's liabilities	1,592	5,464	-146	3,872

Source: Banco de México

Weekly government bond auction. The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent, will offer 10-year fixed-rate Mbonos (May’29), 30-year inflation-linked Udibonos (Nov’46), 5-year Bondes D, in addition to the “traditional” 1-, 3-, 6-, and 12-month zero-coupon Cetes (please refer to the following table). As usual, results will be released at 12:30pm (ET).

Auction specifics (Tuesday, March 26th, 2019)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	25-Apr-19	--	5,000	8.15
3m	27-Jun-19	--	5,000	8.09
6m	26-Sep-19	--	10,500	8.19
12m	27-Feb-20	--	13,000	8.20
Bondes D				
5y	29-Feb-24	--	5,500	0.14
Mbonos				
10y	31-May-29	8.50	10,200	8.49
Mbonos				
30y	08-Nov-46	4.00	UDIS 450	4.16

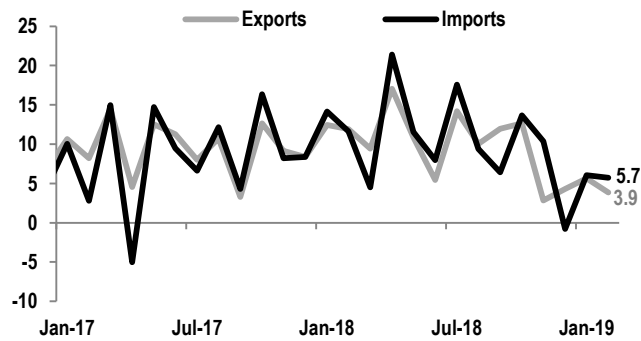
Source: Banorte with data from Banco de México 1. Except for Udibonos, which are expressed in UDI million, everything else is expressed in MXN million. 2. Yield-to-maturity reported for Cetes, Mbonos and Udibonos

Trade balance could feel the impact of recent domestic shocks. We expect a US\$330.5 million surplus in February, which is typically a positive month. Despite of the positive balance, exports could be relatively more impacted when compared to imports due to supply chain disruptions during the month. Exports are expected at 3.9% yoy, below the 5.6% observed in January, while imports could pick up 5.7%.

Regarding the oil balance, we anticipate a US\$ 1,579.5 million deficit, improving at the margin relative to the previous figure of -US\$ 2,104.1 million. It is worth mentioning that this would be mostly driven by an improvement in exports, falling only 6% when compared to -12.4% in January. On the other hand, imports would increase by 1.9%. Despite of this, challenges to the sector remain quite high, with the 12-month rolling deficit estimated at almost US\$ 24 billion.

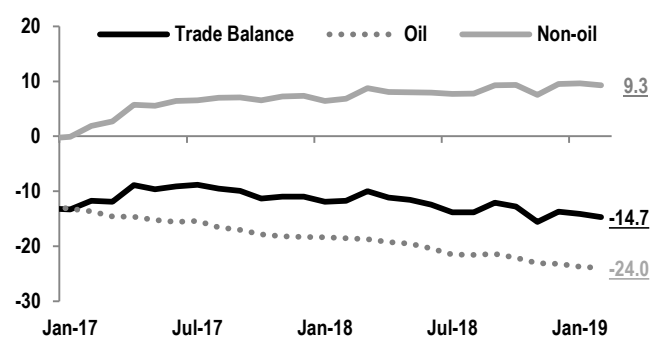
Going to the non-oil balance, we expect a US\$ 1,910.0 million surplus. As stated in the report of the previous month, we believe that the effect of supply disruptions that started in January could be felt more forcefully this month. In this respect, we anticipate a expansion of only 2.6% yoy in auto exports, impacted by the latter effect but also exacerbated by plant adjustments by several companies, according to *AMIA*. Additionally, non-auto exports would grow 5.9%, significantly lower than the 9% advance of the previous print. Regarding imports, we anticipate less dynamism in both intermediate- and capital- goods, growing 7.6% and 1.2%, respectively. In particular, this could be driven by the relatively weak performance in activity at the end of last year and the first months of 2019, apart from some payback after surging in the previous month. On the other hand, we forecast better performance in consumption goods, growing 1.5%. With these figures, the 12-month rolling surplus would reach US\$ 9,271.3 million.

Exports and Imports
% yoy



Source: INEGI, Banorte

Trade balance
US\$ billion, 12-month rolling sum



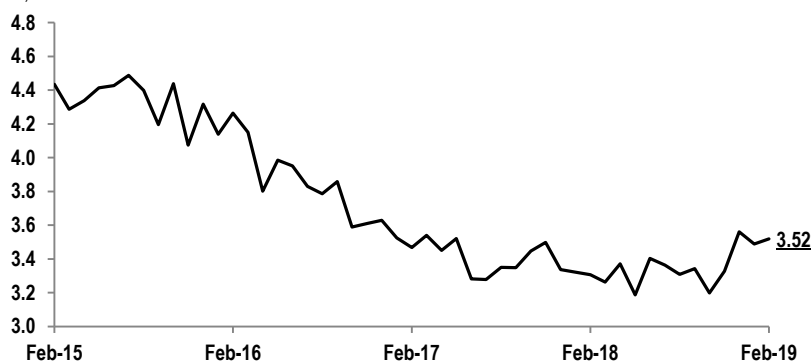
Source: INEGI, Banorte

Higher unemployment rate at the margin. We estimate the unemployment rate at 3.52% sa in February, a slight pickup relative to the 3.49% of the previous month, which was lower than market consensus.

In our opinion, this slight increase will be driven by the persistent deceleration in the pace of formal job creation. In this respect, total employee growth declined further in the month to 3.1% yoy, adding nine consecutive months moderating and at its lowest since 2014. It is also worth mentioning that employment in services was weaker according to the IMEF index, which could be related to a lagged effect from supply chain disruptions during the first month of the year. Nevertheless, manufacturing activity seems to have had a better performance in the same month, which could help compensate for the latter.

All in all, we expect a slight increase in the unemployment rate in coming months, reiterating our view that it has already reached its cyclical low. Despite the fact that economic data in January so far has been better than market expectations, it is still consistent with a moderation in activity, which coupled with the likely prospect of lower global growth, will likely impact overall employment levels.

Unemployment rate
%, sa



Source: INEGI, Banorte

We forecast Banxico to maintain the reference rate at 8.25%, with a dovish bias relative to the previous decision. We believe that Banco de México will leave the reference rate unchanged at 8.25% in its monetary policy meeting on Thursday, in line with consensus. In particular, we expect that the monetary policy statement to show a dovish bias relative to the previous communiqué, but will be relatively similar to the latest *Quarterly Report* (published on February 27th). As usual, the statement will assess current economic, financial and inflation conditions, both globally and domestically.

We expect discussions on the recent shift in the stance of the Fed, which lowered its expectation for the midpoint of the *fed funds* rate from 2.875% to 2.375%, implying no further increases for the rest of the year. It is worth noting that the decision was more dovish than expected, also with new information in this direction regarding balance sheet normalization and macroeconomic estimates. Given that Banxico has maintained the relative stance with the US as a key factor to keep monitoring, it is our take that this development will support the recent shift to a more dovish bias as we have perceived in the central bank's communications.

In addition, there could be some comments regarding the global slowdown in economic activity, focusing on China and the US. Within the latter, some comments may address the improvement in the trade relation between these countries, which could signal an improvement for global trade in the second half of the year. Domestically, we believe the discussion will center on economic activity, particularly considering that the *IGAE* for January will already be published by the time of the meeting. Given our expectation that the print will still be in contraction territory on a monthly basis (-0.2%), we believe that the balance of risks to growth will remain to the downside. In this context, there could also be some more information about the recent supply shocks and its economic impact, after comments from the central bank in its regional report.

On inflation, we think the Board will mention the downward trend that the headline index has posted since the start of the year, reaching 3.95% yoy in the first half of March, slightly above the upper threshold of the target range. Despite this improvement, we expect attention to stay in the core component, coming in at 3.51%. Regarding the latter, it seems that the resistance to the downside remains a prevalent factor, leading to further discussions in the meeting. In addition, analysts' inflation expectations have remained largely unchanged, with expectations for the medium-term marginally improving at 3.50% in February from 3.53% in the previous month. Market-based measures have improved only slightly since the last decision, likely prompting the central bank to maintain the risks on inflation as skewed to the upside even if the improvement at the non-core level has extended.

With regards to other drivers, we also expect some mention of the recent revision of Mexico's credit outlook from *S&P Global Ratings* from 'stable' to 'negative' while leaving the rating at BBB+, with these change also including Pemex. Despite of the latter, it should be noted that the effect in financial markets have largely dissipated, as both the Mexican currency and local bonds have benefited from the perception of a more dovish Fed.

All in all, we believe that the communique will be consistent with our expectation that the slowdown in economic activity, which we forecast at +1.5% yoy for the year, coupled with a downward trend in inflation (Banorte: 3.5%), will allow Banxico to start an easing cycle as soon as June, when we expect a 25bps rate cut. Moreover, we reiterate our view that the central bank could cut the reference rate an accumulated of 50-75bps during 2019.

Banking credit will show a 5.7% yoy increase in February. It is our take that credit to the non-financial sector continued flowing. In particular, we estimate a 5.7% yoy expansion in real terms as a result of a 2.0% increase in consumer credit, coupled with a 5.5% and 7.1% expansion in mortgages and corporate credit, in the same order.

MoF's public finance report (February). In this report, attention will center on the public balance figures for the second month of 2019. It should be noted that the public deficit as of the end of January stood at –MXN\$42.7bn, better than the MXN\$70.3bn expected deficit. In addition, attention will focus on revenue and spending figures, especially when compared to the 2019 Budget. Finally, we will also look into public debt figures, which as of January stands at MXN\$10.5tn (as measured by the HBPSBRs).

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HOLD	<i>When the share expected performance is similar to the MEXBOL estimated performance.</i>
SELL	<i>When the share expected performance is lower than the MEXBOL estimated performance.</i>

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