Ahead of the Curve

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Market focus this week will be on Banxico's minutes and inflation for the first half of April

- **Banxico's Minutes (April).** Next Thursday at 10:00am (ET), Banco de Mexico will publish the minutes of its monetary policy meeting held back on April 12, in which the board unanimously decided to maintain the reference rate at 7.5%. We expect discussions during the meeting to have focused on four issues: (1) The recent appreciation of the Mexican currency after the last monetary policy meeting, which explained the upward shift in short-run interest rates and the lower interest rates in the medium and long part of the curve; (2) the balance of risks for inflation continued to observe an upward bias; however, headline inflation maintained a downward trend reaching 5.04% in March from 5.55% in January; (3) the Mexican economy continues to face significant risk factors, despite the higher investment and the marginal recovery in industrial production; hence the balance of risks for growth maintains a downward bias; and (4) the relative monetary stance between Mexico and the US.

- **Bi-weekly inflation report (1H-Apr).** On Tuesday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of April. We are forecasting a 0.30% 2w/2w fall in the headline index, while we expect the core index to advance 0.06% 2w/2w. Inflation during the period in question will be mainly explained by the start of the summer discounts in electricity tariffs, as well as an additional fall in fresh fruits and vegetables prices. However, these will be partially offset by a higher contribution from other goods.

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 23-Apr	**9:00am**	**Economic activity IGAE**	February	% yoy	2.3	2.0	2.15
		Primary activities		% yoy	8.7	--	-0.7
		Industrial production		% yoy	0.7	--	0.9
		Services		% yoy	2.8	--	2.9
Tue 24-Apr	**9:00am**	**CPI inflation**	1H Apr	% 2w/2w	-0.30	-0.28	0.01
				% yoy	4.75	4.76	4.90
		Core		% 2w/2w	0.06	0.07	0.05
				% yoy	3.69	--	4.02
Tue 24-Apr	**10:00am**	**International reserves**	Apr-20	US$ bn	--	--	173.4
Tue 24-Apr	**12:30pm**	**Government weekly auction: 1-, 3-, 6-, and 12-month Cetes; 10y MBono (Jun'27); 30y Udibono (Nov'46); 5y Bondes D**					
Wed 25-Apr	**9:00am**	**Retail sales**	February	% yoy	-0.8	1.0	0.5
		sa		% m/m	0.2	--	-0.2
Thu 26-Apr	**10:00am**	**Unemployment rate**	March	%	3.01	3.13	3.21
		sa		%	3.33	--	3.30
Thu 26-Apr	**10:00am**	**Banxico's minutes**	March				
Fri 27-Apr	**9:00am**	**Trade balance**	March	US$ mn	751.8	528.0	1,062.4
		Total exports		% yoy	9.9	--	12.3
		Oil exports		% yoy	37.6	--	36.6
		Non-oil exports		% yoy	8.6	--	10.8
		Total imports		% yoy	7.7	--	11.6

Source: Banorte; Bloomberg

Proceeding in chronological order...

We expect a 2.3% yoy expansion in February's IGAE. On Monday, *INEGI* will release its monthly global economic indicator for February (GDP monthly proxy), where we expect a 2.3% yoy expansion, marginally above January's 2.15% growth.

As we had mentioned in our last report, the marginal expansion in industrial production during February was mostly explained by the 4.5% yoy increase in construction output as a result of the 7.7% expansion in building projects, whereas civil engineering construction projects declined 7.2% yoy. By contrast, mining output edged-down 5.7% yoy, given the 6.8% reduction in oil and gas production. In addition, manufacturing output increased a scant 0.9% yoy, as a result of the 39.3% yoy reduction in the fabrication of oil and carbon-based products coupled with the 6.2% contraction in the production of electric equipment. Nevertheless, vehicle production increased 6.5% yoy, while the fabrication of machinery and equipment posted a 5.7% yoy expansion.

Moreover, we believe that services will show a 2.8% yoy expansion, as a result of the positive trend in the formal labor market coupled with an above-trend growth in banking credit.

Inflation during the first half of April will be explained by the start of the summer discounts in electricity tariffs. On Tuesday, at 9:00am, *INEGI* will release its bi-weekly inflation report for the first half of April. We are forecasting a 0.30% 2w/2w fall in the headline index, while we expect the core index to advance 0.06% 2w/2w.

Inflation during the period in question will be mainly explained by the start of the summer discounts in electricity tariffs, as well as an additional fall in fresh fruits and vegetables prices. However, these will be partially offset by a higher contribution from other goods.

We forecast inflation to be 15bps below the figure seen in 2017 as a result of: (1) a lesser contribution of other services (0bps vs. 8bps in 2017); (2) a greater impact of energy (-34bps vs. -41bps in 2017); (3) a smaller participation of processed foods (1bps vs. 6bps in 2017); (4) a lesser contribution of agricultural goods (-1bps vs. 5bps in 2017); and (5) a smaller impact of other goods (4bps vs. 5bps. in 2017), as shown in the table on the following page.

With these results, annual inflation will stand at 4.75% in the first half of April, lower than the 5.04% seen in March. Moreover, we forecast core inflation at 3.69% yoy (previous: 4.02% yoy). Moving forward, we will focus on the evolution of energy prices and the behavior of agricultural prices, and the impact they might have in Mexico's CPI.

1H-April inflation by components
% Bi-weekly incidence

	2018 F	2017	Difference
Headline	-0.30	-0.15	-0.14
Core	0.04	0.20	-0.15
Goods	0.05	0.12	-0.07
Processed foods	0.01	0.06	-0.05
Other goods	0.04	0.05	-0.02
Services	0.00	0.08	-0.09
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	-0.02	0.07	-0.09
Non-core	-0.34	-0.35	0.01
Agricultural	-0.01	0.05	-0.05
Fresh fruits and vegetables	-0.02	0.01	-0.03
Meat and egg	0.01	0.04	-0.03
Energy and government regulated	-0.33	-0.40	0.07
Energy	-0.34	-0.41	0.07
Government regulated	0.01	0.02	-0.01

Source: Banorte, INEGI

Weekly international reserves report. On Tuesday, at 10:00am (ET), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US$120 million amounting to US$173.4 billion. According to Banxico's report, this figure comes mainly as a result of a positive valuation effect in central bank assets. In this context, the Central Bank's international reserves have increased by US$595 million during 2018 (please refer to the table below).

Banxico's foreign reserve accumulation detail
US$, million

	2017	Apr 13, 2018	Apr 13, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	173,397	120	595
(B) Gross international reserve	175,450	177,085	625	1,635
Pemex	--	--	197	-447
Federal government	--	--	90	1,070
Market operations	--	--	0	0
Other	--	--	338	1,011
(C) Short-term government's liabilities	2,648	3,687	504	1,039

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 10-year fixed rate Mbonos (Jun'27), 30-year inflation-linked Udibonos (Nov'46), 5-year Bondes D, in addition to the "more traditional" 1-, 3-, 6-, and 12-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, April 24, 2018)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	24-May-18	- -	7,000	7.45
3m	26-Jul-18	- -	11,000	7.63
6m	25-Oct-18	- -	11,500	7.60
12m	28-Mar-19	- -	12,500	7.80
Bondes D				
5y	09-Mar-23	- -	5,000	0.17
M Bono				
10y	03-Jun-27	7.50	9,000	7.52
Udibonos				
30y	08-Nov-46	4.00	UDIS 400	3.93

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

Retail sales will post a 0.8% yoy contraction in February. On Wednesday at 9:00am (ET), *INEGI* will publish its retail sales report for February, where we anticipate a 0.8% yoy contraction, below the 0.5% expansion observed in January.

We believe that retail sales contraction will be mainly explained by the 7.2% reduction in vehicle sales. In addition, *ANTAD* same store sales posted a 1.3% yoy decrease in real terms. By contrast, non-oil consumption goods expanded 4.7% yoy, which will partially compensate the fall in vehicle and *ANTAD* sales.

The unemployment rate in March will stand at 3.01%. On Thursday, *INEGI* will publish its unemployment report for the third month of 2018, in which we estimate an unemployment rate of 3.01% nsa, below the 3.21% observed in February. However, in seasonally adjusted terms, we believe that the unemployment rate could stand at 3.33% which implies a 0.03%-pts increase from last month's figures.

We believe that the marginal increase in the unemployment rate (seasonally adjusted) will be explained by statistical variation given the design of the survey. However, it will remain at significantly low levels, continuing to show the strength of the Mexican labor market.

Banxico's minutes – Dovish tone justifying the 25bps hike. Next Thursday at 10:00am (ET), Banco de Mexico will publish the minutes of its monetary policy meeting held back on April 12, in which the board unanimously decided to maintain the reference rate at 7.5%. We expect discussions during the meeting to have focused on four issues: (1) The recent appreciation of the Mexican currency after the last monetary policy meeting, which explained the upward shift in short-run interest rates and the lower interest rates in the medium and long part of the curve; (2) the balance of risks for inflation continued to observe an upward bias; however, headline inflation maintained a downward trend reaching 5.04% in March from 5.55% in January; similarly core inflation stood at 4.02% in March from 4.56 in January; (3) the Mexican economy continues to face significant risk factors, despite the higher investment and the marginal recovery in industrial production; hence the balance of risks for growth maintains a downward bias; and (4) the relative monetary stance between Mexico and the US.

We consider that the central bank's communication improved considerably with April's *communiqué*, given that the monetary authority is now comparing inflation's actual trajectory with Banxico's forecasts published in the last quarterly report. Similarly, we highlight the reduction in the number of pages. We believe that these changes add to the greater accountability effort of this new Board.

Looking ahead, we maintain our call that year-end reference rate will stand at 7.25%. In addition, we continue to expect a 25bps hike in 2Q18, although our level of conviction has decreased, given the favorable behavior of the exchange rate, as a result of the lower uncertainty regarding NAFTA's renegotiation prospects.

Strong recovery in vehicle exports. Finally, on Friday at 9:00am (ET), Banxico and *INEGI* will make available their preliminary trade report for March, where we expect to see a US$751.8 million surplus.

On the exports side, we will probably see a 37.6% yoy expansion of oil exports as a result of the higher prices for the Mexican crude oil basket (32.3% yoy). In addition, non-oil exports could have increased 8.6% yoy, on the back of a 8% hike in manufacturing exports.

On the imports side, we estimate a 7.7% yoy expansion in total imports, as a result of the increase in oil related imports. However, taking a look at the breakdown, we believe that non-oil consumption goods imports increased 2.8% yoy, while imports of intermediate goods could have increased 5.7% yoy. Finally, we estimate a 16.3% expansion in capital goods imports.

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