

## Banxico's operating surplus locks in this year's MoF fiscal consolidation goals

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- Banco de Mexico announced its operating surplus, which in 2016 amounted to MXN535.3bn (≈US\$28.5bn)
- From this amount, MXN\$321.7bn (≈US\$17.1bn) were transferred to the Federal Government yesterday
- According to Article 19a of the *Federal Budget and Fiscal Responsibility Law*, the government has to allocate 70% to reduce public debt
- This implies that the historical balance of the public sector borrowing requirements could decrease to 49.2% in 2017 from the 50.2% projected in *2017 Economic Package*
- The rest of the operating surplus transferred to the government will be allocated to the Stabilization Funds
- In our opinion, this allocation will be in line with the commitment shown by the Federal Government with sound public finances
- Positive reaction of the local fixed-income market as the expectation about lower amounts to be sold next quarter and buyback of securities has marked up
- Peso could extend gains as risk premium continues going lower, Banxico supports carry and short-term risks wane

### Gabriel Casillas

Chief Economist and Head of Research  
gabriel.casillas@banorte.com

### 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

### Fixed income and FX Strategy

### Alejandro Padilla

Head Strategist – Fixed-Income and FX  
alejandro.padilla@banorte.com

### Juan Carlos Alderete, CFA

FX Strategist  
juan.alderete.macal@banorte.com

### Santiago Leal

Analyst Fixed Income and FX  
santiago.leal@banorte.com

**Banxico determined its operating surplus for the fiscal year 2016.** Banxico announced its net income for 2016, which amounted to MXN535.3bn (≈US\$28.5bn). From this amount, the board of governors decided to allocate MXN6.6bn (≈US\$350.6mn) to increase the capital reserve to achieve a target of MXN125.3bn (≈US\$6.7bn) in capital plus reserves. In addition, Banxico decided to increase the asset valuation reserve by MXN207.1bn (+US\$11bn) to a total of MXN268bn (≈US\$14.3bn). Taking these factors into account, the operating surplus amounted to MXN321.7bn (≈US\$17.1bn), which was transferred to the Federal Government yesterday in accordance with Article 55 of the *Law of Banco de México*.

**From this amount, 70% will be allocated to reduce public debt.** According to Article 19a of the *Federal Budget and Fiscal Responsibility Law*, at least 70% (≈ MXN225.2bn) should be allocated to the amortization of public debt of the Federal Government and/or reducing the amount of funding needed to cover the approved deficit.

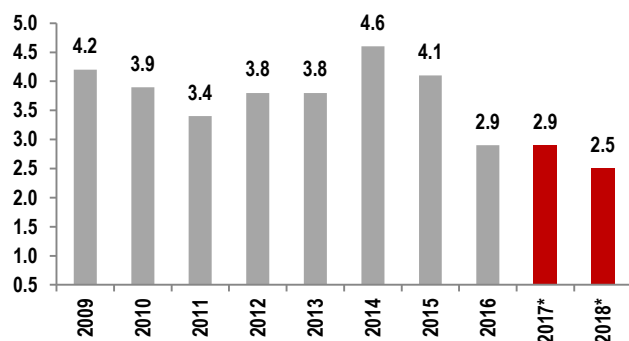
**Lower than expected HBPSBR.** In this regard, and making the assumption that the Federal Government will reach its goal of fiscal revenues within the Revenue Law and Fiscal Budget, the historical balance of public sector borrowing requirements (HBPSBR) for this year would be reduced by one percentage point of GDP to 49.2%, thanks to the operating surplus.

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**The rest of the operating surplus will be allocated to the stabilization funds.**

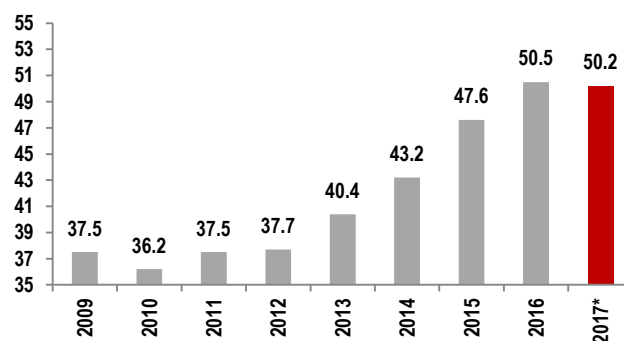
The remaining amount (around MXN96.5bn) will be deposit in Federal Stabilization Funds. In this regard, we highlight that Federal Stabilization Funds can only be used to cover a shortfall of income and/or to purchase the *MoF*'s oil and gasoline hedging program. We highlight that some of the assumptions incorporated into the HBPSBR target are: (1) A year-end exchange rate of 18.62 pesos per dollar; (2) a 2.5% growth for the Mexican economy; and (3) a USD\$42/bbl average price for the Mexican crude oil basket. In this context, although the prospects for the Mexican economy have changed substantially since the approval of the 2017 budget package, we believe that the government will be able to reach its fiscal targets owing in part to Banxico's operating surplus.

**Public sector borrowing requirements**  
% of GDP



Source: MoF

**Historical balance of public sector borrowing requirements**  
% of GDP



Source: MoF

*From our fixed income and FX strategy team*

**Positive reaction of the local fixed-income market as the expectation about lower amounts to be sold next quarter and buyback of securities has marked up.** The Mexican yield curve extended early gains by 10bps following the announcements from *Banco de México* and *Hacienda* (MoF) regarding the central bank's operating surplus. The amount of MXN321.6bn was higher than the MXN238.1bn from last year. More details in our research note "*Banxico's Operating Surplus – Positive for the Markets and Awaiting Pemex's Longer-Run Details*" <[pdf](#)> published on April 16<sup>th</sup>, 2016. The favorable reaction of the fixed-income market is backed by the expectations of lower amounts to be sold in 2Q17, with the issuance calendar to be released in the next days this week. Last year, the government reduced the total amount by MXN17.4bn ("*No surprises in the reduction of issuance amounts from the MoF*" <[pdf](#)>, April 29<sup>th</sup>, 2016). Under current conditions, we could expect a reduction in total amount to be issued in coming quarters by MXN20bn. In addition, in 2016 the Federal Government implemented a buyback strategy considering short-term securities for a total amount of MXN97.9bn few weeks after the operating surplus announcement ("*Banxico's buyback auction results*" <[pdf](#)>, May 4<sup>th</sup>, 2016). The MoF highlighted inside its communiqué the following: "*at least 70% will be used to buyback debt or to reduce the future financing needs, or a combination of both*". This suggests that at least MXN225.2bn from the MXN321.7bn received could be destined to a similar strategy (reduction of debt issuance or buyback operations), or even we acknowledge the possibility of a buyback of short-term foreign currency denominated UMS. Overall, this scenario is positive for short- and mid-term securities. In this regard, we hold our positive view for the belly of the Mbonos curve, with an attractive valuation for long positions in Mbonos Jun'22, Dec'23 and Dec'24.

**Peso could extend gains as risk premium continues going lower, Banxico supports carry and short-term risks wane.** The Mexican peso extended gains, going from around 18.80 to 18.74 per dollar as an immediate reaction, accumulating a 1.5% appreciation today. Similar to the rates market, this should add to market confidence about the government's fiscal stance and targets, which could reduce the currency risk premium. Based on our measure, this premium has fallen from a YTD high around 448bps at the beginning of the year to 401bps. Despite this hefty correction, it remains higher than the three-month average seen before the US election around 325bps, suggesting that there is still some room for an additional compression if global risk appetite remains elevated. Coupled with our expectation of Banxico's 25bps rate hike tomorrow, we believe MXN could stay well bid in coming days, possibly testing a key support zone around 18.50 (psychological) and 18.46 per dollar (October 2016 low), with a break lower opening the way towards the September 2016 low of 18.28 and a Fibonacci level at 18.22.

**Track of the latest fixed-income trade recommendations**

Trade idea	Entry	Target	Stop-loss	Closed	Status	P/L	Initial date	End date
5y 10y TIE-IRS steepener	28bps	43bps	18bps	31bps	Closed	Profit <sup>2</sup>	15-Feb-17	15-Mar-17
5y 10y TIE-IRS steepener	35bps	50bps	25bps	47bps	Closed	Profit	5-Oct-16	19-Oct-16
Long Mbono Jun'21	5.60%	5.35%	5.80%	5.43%	Closed	Profit	13-Jul-16	16-Aug-16
Long Udibono Jun'19	1.95%	1.65%	2.10%	2.10%	Closed	Loss	13-Jul-16	16-Aug-16
Receive 1-year TIE-IRS (13x1)	3.92%	3.67%	4.10%	3.87% <sup>1</sup>	Closed	Profit	12-Nov-15	8-Feb-16
Long spread 10-year TIE-IRS vs US Libor	436bps	410bps	456bps	410bps	Closed	Profit	30-Sep-15	23-Oct-15
Receive 9-month TIE-IRS (9x1)	3.85%	3.65%	4.00%	3.65%	Closed	Profit	3-Sep-15	18-Sep-15
Spread TIE 2/ 10 yrs (flattening)	230bps	200bps	250bps	200bps	Closed	Profit	26-Jun-15	29-Jul-15
Long Mbono Dec'24	6.12%	5.89%	6.27%	5.83%	Closed	Profit	13-Mar-15	19-Mar-15
Relative-value trade, long 10-year Mbono (Dec'24) / flattening of the curve								
Pay 3-month TIE-IRS (3x1)	3.24%	3.32%	3.20%	3.30%	Closed	Profit	29-Jan-15	29-Jan-15
Pay 9-month TIE-IRS (9x1)	3.28%	3.38%	3.20%	3.38%	Closed	Profit	29-Jan-15	29-Jan-15
Pay 5-year TIE-IRS (65x1)	5.25%	5.39%	5.14%	5.14%	Closed	Loss	4-Nov-14	14-Nov-14
Long Udibono Dec'17	0.66%	0.45%	0.82%	0.82%	Closed	Loss	4-Jul-14	26-Sep-14
Relative-value trade, long Mbonos 5-to-10-year								
Receive 2-year TIE-IRS (26x1)	3.75%	3.55%	3.90%	3.90%	Closed	Loss	11-Jul-14	10-Sep-14
Receive 1-year TIE-IRS (13x1)	4.04%	3.85%	4.20%	3.85%	Closed	Profit	6-Feb-14	10-Apr-14
Long Udibono Jun'16	0.70%	0.45%	0.90%	0.90%	Closed	Loss	6-Jan-14	4-Feb-14
Long Mbono Jun'16	4.47%	3.90%	4.67%	4.06%	Closed	Profit	7-Jun-13	21-Nov-13
Receive 6-month TIE-IRS (6x1)	3.83%	3.65%	4.00%	3.81%	Closed	Profit	10-Oct-13	25-Oct-13
Receive 1-year TIE-IRS (13x1)	3.85%	3.55%	4.00%	3.85%	Closed	Flat	10-Oct-13	25-Oct-13
Long Udibono Dec'17	1.13%	0.95%	1.28%	1.35%	Closed	Loss	9-Aug-13	10-Sep-13
Receive 9-month TIE-IRS (9x1)	4.50%	4.32%	4.65%	4.31%	Closed	Profit	21-Jun-13	12-Jul-13
Spread TIE-Libor (10-year)	390bps	365bps	410bps	412bps	Closed	Loss	7-Jun-13	11-Jun-13
Receive 1-year TIE-IRS (13x1)	4.22%	4.00%	4.30%	4.30%	Closed	Loss	19-Apr-13	31-May-13
Long Udibono Jun'22	1.40%	1.20%	1.55%	0.97%	Closed	Profit	15-Mar-13	3-May-13
Receive 1-year TIE-IRS (13x1)	4.60%	4.45%	4.70%	4.45%	Closed	Profit	1-Feb-13	7-Mar-13
Long Mbono Nov'42	6.22%	5.97%	6.40%	5.89%	Closed	Profit	1-Feb-13	7-Mar-13
Long Udibono Dec'13	1.21%	0.80%	1.40%	1.40%	Closed	Loss	1-Feb-13	15-Apr-13
Receive 1-year TIE-IRS (13x1)	4.87%	4.70%	5.00%	4.69%	Closed	Profit	11-Jan-13	24-Jan-13
Receive TIE Pay Mbono (10-year)	46bps	35bps	54bps	54bps	Closed	Loss	19-Oct-12	8-Mar-13
Spread TIE-Libor (10-year)	410bps	385bps	430bps	342bps	Closed	Profit	21-Sep-13	8-Mar-13
Long Udibono Dec'12	+0.97%	-1.50%	+1.20%	-6.50%	Closed	Profit	1-May-12	27-Nov-12
Long Udibono Dec'13	+1.06%	0.90%	+1.35%	0.90%	Closed	Profit	1-May-12	14-Dec-12

1. Carry +roll-down gains of 17bps

2. Closed below target and before the proposed horizon date due to changes in market conditions that have differed from our expectations.

**Track of the latest FX trade recommendations\***

Trade Idea	Entry	Target	Stop-loss	Closed	Status	P/L*	Initial Date	End date
Long USD/MXN	14.98	15.50	14.60	15.43	Closed	Profit	20-Mar-15	20-Apr-15
Short EUR/MXN	17.70	n.a.	n.a.	16.90	Closed	Profit	5-Jan-15	15-Jan-15
Tactical trade: Long USD/MXN	14.40	n.a.	n.a.	14.85	Closed	Profit	15-Dec-14	5-Jan-15
Tactical trade: Long USD/MXN	13.62	n.a.	n.a.	14.11	Closed	Profit	21-Nov-14	3-Dec-14
Short USD/MXN	13.21	n.a.	n.a.	13.64	Closed	Loss	10-Sep-14	26-Sep-14
Tactical trade: Short EUR/MXN	17.20	n.a.	n.a.	17.03	Closed	Profit	27-Aug-14	4-Sep-14
USD/MXN call spread**	12.99	13.30	n.a.	13.02	Closed	Loss	6-May-14	13-Jun-14
Directional short USD/MXN	13.00	12.70	13.25	13.28	Closed	Loss	31-Oct-13	8-Nov-13
Limit short USD/MXN	13.25	12.90	13.46	--	Cancelled	--	11-Oct-13	17-Oct-13
Speculative short USD/MXN	12.70	12.50	13.00	13.00	Closed	Loss	26-Jul-13	21-Aug-13
Short EUR/MXN	16.05	15.70	16.40	15.69	Closed	Profit	29-Apr-13	9-May-13
Long USD/MXN	12.60	12.90	12.40	12.40	Closed	Loss	11-Mar-13	13-Mar-13
Long USD/MXN	12.60	12.90	12.40	12.85	Closed	Profit	11-Jan-13	27-Feb-13
Tactical limit short USD/MXN	12.90	12.75	13.05	--	Cancelled	--	10-Dec-12	17-Dec-12

\* Total return does not consider carry gain/losses

\*\* Low strike (long call) at 13.00, high strike (short call) at 13.30 for a premium of 0.718% of notional amount

Source: Banorte-Ixe

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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
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251

**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