

Ahead of the Curve

February 15, 2019

Banxico minutes to focus on the deceleration in Mexico's economic activity

- Banxico minutes (February 7th).** In our view, the market will focus on: (1) Discussions about the deceleration of the Mexican economy and its possible effects on the degree of economic slack, the outlook for inflation and monetary policy; (2) comments about recent changes in global monetary policy, particularly the dovish shift of the Federal Reserve and its effect on Mexico's relative monetary policy stance; (3) additional details about downside risks to inflation, which were added again in the statement; and (4) the possibility that slack conditions in the economy widen more than expected. We believe the minutes will reaffirm the less hawkish tone that we perceived in the statement. Nevertheless, the likelihood of comments about potential rate cuts is low, as some market participants could have expected going into the meeting.
- Bi-weekly inflation report (1H-February).** We estimate headline inflation at -0.09% 2w/2w and core at 0.13%, both lower than the previous print. In our view, price dynamics during the period will be driven by an extension of the decline in prices of fresh fruits and vegetables, and limited upside in core goods. Moreover, prices in some components would still be benefitted by lower taxes at the Northern Border. With these results, inflation would drop from 4.37% yoy in January to 3.90%, while the core would decline from 3.68% to 3.38%, both at lows not seen since late 2016.

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Mexico weekly calendar

DATE	TIME (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Tue 19-Feb	10:00am	International reserves	Feb-15	US\$ bn	--	--	175.5
Tue 19-Feb	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Dec'23); 10y Udibonos (Nov'28)					
Tue 19-Feb	3:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 21-Feb	10:00am	Banxico's minutes	February				
Fri 22-Feb	9:00am	CPI inflation	1H-Feb	% 2w/2w	-0.09	--	0.01
				% yoy	3.90	--	4.21
				% 2w/2w	0.13	--	0.16
				% yoy	3.38	--	3.55
		Core					

Source: Banorte; Bloomberg

Proceeding in chronological order...

Weekly international reserves report. Last week, net international reserves fell by US\$12 million, closing at US\$175.5 billion. According to Banxico's report, this figure comes mainly from a negative valuation effect in central bank assets. In this context, the central bank's international reserves have increased US\$718 million during 2019 (please refer to the following table).

Banxico's foreign reserve accumulation detail US\$, million

	2018	Feb 8, 2019	Feb 8, 2019	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	174,793	175,511	-12	718
(B) Gross international reserve	176,384	180,442	424	4,058
Pemex	--	--	257	354
Federal government	--	--	191	3,332
Market operations	--	--	0	0
Other	--	--	-24	372
(C) Short-term government's liabilities	1,592	4,931	435	3,340

Source: Banco de México

Weekly government bond auction. The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent, will offer 5-year fixed-rate Mbonos (Dec'23), 10-year Udibonos (Nov'28), in addition to the “traditional” 1-, 3-, and 6-month zero-coupon Cetes (please refer to the following table). As usual, results will be released at 12:30pm (ET).

Auction specifics (Tuesday, February 19th, 2019)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	21-Mar-19	--	5,000	7.88
3m	23-May-19	--	5,000	8.13
6m	15-Aug-19	--	10,500	8.26
Mbonos				
5yr	07-Dec-23	8.00	9,700	8.44
Udibonos				
10y	30-Nov-28	4.00	800	4.29

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

Citibanamex Survey. Market focus will center on analysts' inflation forecasts for the first half of February (to be published on Friday, February 22nd) along possible adjustments to the downside for the year-end 2019 estimate. Furthermore, it will be important to see monetary policy assessments after the communiqué released on February 7th, which in our view showed a less hawkish tone. We will also be watching forecasts for GDP growth and USD/MXN exchange rate.

Banxico minutes focused on the outlook for growth and its potential impact on inflation and monetary policy. Next Thursday, Banxico will publish the minutes of the monetary policy meeting held on February 7th, 2019. It is worth remembering that this was the first meeting in which Deputy Governors Gerardo Esquivel and Jonathan Heath participated. For details of our views on the release, see: “*Banxico's monetary policy decision – Less hawkish, but not as much as the market expected*”, February 7th, 2019, <[pdf](#)>.

We believe the market will focus on the discussions about the deceleration of the Mexican economy and its possible effects on the degree of economic slack, the outlook for inflation and monetary policy. We reiterate our view of no changes to the reference rate in 2019, staying at 8.25%.

Regarding the former, the central bank recognized the slowdown in 4Q18 GDP in the preliminary print, with the final figure to be released on February 25th. In this respect, industrial production in December, published after the meeting, equates to a contraction of 0.9% yoy in 4Q18 in the secondary sector, weaker than the -0.7% figure of the advanced print. For details, see: “*Industrial activity ended 2018 on a sour note due to weakness in manufacturing*”, February 11th, 2019, <[pdf](#)>. In a similar fashion, we will look for comments about higher slack in the labor market following the increase in the unemployment rate to 3.57% in December from 3.31% in the previous month (using seasonally-adjusted data), a maximum since December 2016.

Along the deceleration at the end of last year, the central bank also mentioned this could continue at the start of 2019. Among the factors supporting their expectation, they included the deceleration of global economic activity, weaker internal demand, and transitory factors in 1Q19 (railway blockades and fuel distribution delays). In particular, it will be important to gauge any hint about the Board’s opinion of their possible combined impact, considering that their current forecast range for GDP this year is at 1.8-2.8% (midpoint: 2.3%). The median estimate in their latest private analysts’ survey is at 1.8% yoy, at the lower end of the range. Considering this information, we think that Banxico will likely adjust lower its projection range in the next *Quarterly Report*, to be published on February 27th. If this downgrade occurs, it would have an effect on the outlook for demand-side pressures for inflation, estimates of the output gap, and the path for monetary policy going forward, among others.

On the other hand, we are also interested in potential discussions about recent changes in global monetary policy, particularly the dovish shift of the Federal Reserve and its effect on Mexico’s relative monetary policy stance. The central bank has maintained this factor as one of the most relevant to keep tracking going forward. In our view, the change in tone by the Fed provides additional room for Banxico to refrain from hiking this year. Moreover, there could be some comments about the possible impact that a reference rate in restrictive territory could have on an already weaker outlook for growth. In spite of this, we continue thinking that the probability of starting a rate cut cycle in 2019 remains low. In this respect, the central bank keeps reiterating the need to maintain a prudent stance due to an environment characterized by a high degree of uncertainty, along the possible persistence of upward risks to inflation and its expectations, in a context in which actual inflation has stayed above the central bank’s target.

We will also look for additional details about downside risks to inflation, which were added again in the statement. In particular, they stated the possibility of lower variation in prices of some goods at the non-core index. In our view, these are most likely related to changes in the pricing policy of electricity and gasoline by the new administration.

Moreover, they included the possibility that slack conditions in the economy widen more than expected. We believe this signals lower concerns about potential demand-side pressures for inflation, even after maintaining the warning of a direct and indirect impact from the recent increase in the minimum wage.

All in all, we believe the minutes will reaffirm the less hawkish tone that we perceived in the statement, mainly as a result of a weaker outlook for growth and recent downward surprises on inflation. Nevertheless, it is our take that the likelihood of comments about potential rate cuts is low, as some market participants could have expected going into the meeting.

We expect still low inflation for the 1st half of February. We estimate the headline at -0.09% 2w/2w, lower than the previous print at 0.01%. In our view, price dynamics in the period will be driven by an extension of the decline in fresh fruits and vegetables. We expect of 3.4% 2w/2w contraction in this component, subtracting 18bps to the headline figure. In this respect, we noted heavy declines in goods such as tomatoes and chillies in our price monitoring, among the most important in this sub-index. Moreover, we expect a negative contribution of 1bp from energy on a decline in LP gas. This would be less than compensated by a marginal increase in low-grade gasoline, with Northern Border states still declining but at a slower pace than in the previous two prints. We anticipate an increase of 0.13% in the core index, below the 0.16% of the 2nd half of January. In our view, goods could still be benefitted by lower taxes, a dynamic observed since the beginning of the year. We expect a contribution of only 3bps from this component, with other services adding 4bps.

With these estimates, inflation drops from 4.37% yoy in January to 3.90%. In our view, this is quite relevant considering that annual inflation would return to Banxico's variability range between 3% +/-1% for the first time since December 2016. This would imply an accumulated decline of 93bps in the annual measure since the end of last year. On the other hand, core inflation would stand at 3.38% from 3.68%, lowest since November 2016. In our view, Banxico would highly welcome if the report is in line with our estimates, particularly as the central bank remains on watch of the risks posed by the limits to the downside at the core level, which have been discussed since last year.

Going forward, we will be focused on energy price dynamics, particularly after their recent decline and considering price caps in electricity and gasoline due to the pricing policy of the new administration. As already mentioned, this could be relevant in the minutes of the latest monetary policy decision. Moreover, we keep watching the behavior of agro, given their higher volatility. Lastly, we will be focused on possible effects due to railway blockades in Michoacan, which could have impacted inventories and therefore their market-clearing price.

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