

Ahead of the Curve

February 12, 2016

Market focus this week will on Banxico's minutes

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- Banxico's minutes.** On Thursday (10:00am, EST), Banco de Mexico will publish the minutes of its monetary policy meeting held back on February 4th, in which the board decided to leave the reference rate unchanged at 3.25%, as it was widely expected. In our view, discussions during the meeting were focused on two issues: (1) An increased concern about exchange rate pass-through amid the recent wave of volatility in international markets; and (2) the factors behind the deterioration of the balance of risks to growth. Moreover, we believe that the decision was unanimous. We maintain our view that Banxico will continue its hiking cycle right after the Fed's hike in June. While Banxico's central scenario seems to be of economic activity weakness and inflation below target until year-end, the prospects of higher rates in the United States pose a significant risk to exchange rate and inflation levels in Mexico. Given this, we believe that Banxico will continue its hiking cycle right after the Fed's hike in June. However, we do not rule out the possibility that Banxico could anticipate the Fed's hike. Among the risks to be considered, the monetary policy statement highlighted the potentially strong pass-through to inflation. Additionally, the central bank also mentioned the possible risk of a disorderly decompression in the term-premium given the normalization of the Fed's monetary policy. In fact, Banxico emphasized that in order to maintain the strong macro-fundamentals of the Mexican economy, it is necessary to consolidate public finances, continue the implementation of structural reforms, and modify Banxico's monetary policy stance at an appropriate pace balancing internal and external factors. In this regard, and given the recent rebound in the FX -with an accumulated depreciation of 4.2% since February's monetary policy statement-, we believe that the probability of a preemptive hike has increased significantly. In this respect, we argue that if MXN pressures persist, Banxico could hike in March 18 or May 5, even if the Fed stays pat

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- Government weekly auction.** On Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 10-year fixed-rate Mbonos (Mar'26) as well as 5-year Bondes D, in addition to the “more traditional” 1-, 3-, and 6- month zero-coupon Cetes. As usual, the results will be released at 12:30pm (EST)

Mexico weekly calendar

DATE	TIME (EST)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Tue 16-Feb	10:00am	International reserves	12-Feb	US\$ bn	--	--	174.9
Tue 16-Feb	12:30pm	Government weekly auction: 1-, 3- and 6- month Cetes; 10y MBono (Mar'26); 5y Bondes D					
Thu 18-Feb	10:00am	Banxico's minutes of January 4 meeting	January				

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Weekly international reserves report. On Tuesday, at 10:00am (EST), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US\$412mn amounting to US \$175bn on February 5. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by the Central Bank to the Federal Government for US\$42mn; (2) US\$400mn decrease explained by the Banxico's USD ordinary auction with minimum price and US\$356mn by the supplementary auction with minimum price; along with a (3) US\$386mn 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 an accumulated reduction of US\$1,761mn international reserves this year (please refer to the table below).

Banxico's foreign reserve accumulation details

US\$, million

	2015	5/Feb/2016	5/Feb/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,723	175,387	672	-1,348
(B) Gross international reserve	177,584	176,321	-1,225	-1,275
Pemex	--	--	-73	-116
Federal govt	--	--	-1,566	239
Market operations	--	--	-200	-2,006
Other	--	--	614	608
(C) Short-term government's liabilities	861	934	-1,897	73

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 (Mar'26) as well as 5-year Bondes D, 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 (EST).

Auction specifics (Tuesday, February 16, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	17-Mar-16	--	5,500	3.20
3m	19-May-16	--	9,500	3.38
6m	18-Aug-16	--	11,000	3.49
Mbono				
10y	05-Mar-26	5.75	8,000	6.23
Bondes D				
5y	21-Jan-21	--	4,500	0.24

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

Banxico Minutes – Same message as in the last *communiqué*. Next Thursday at 10:00am EST, Banco de Mexico will publish the minutes of its monetary policy meeting held back on February 4th, in which the board decided to leave the reference rate unchanged at 3.25%, as it was widely expected. Even though our base case is that the decision was unanimous, we believe there is a high probability that one member of the board voted in favor of a rate hike in January, given the wave of high volatility at the beginning of the year. In addition, we expect discussions during the meeting to have focused on two issues: (1) An increased concern about exchange rate pass-through amid the recent wave of volatility in international markets; and (2) the factors behind the deterioration of the balance of risks to growth.

The balance of risks for growth deteriorated from the previous meeting. In our view, the tone of the statement with respect to growth was negative. Although Banxico confirmed the strength shown by private consumption – supported by higher employment and low inflation-, the central bank highlighted that exports have lost momentum on the back of the slowdown in external demand. In addition, the central bank recognized that investment has slowed. In this context, Banxico “...*does not expect demand-side pressures on prices...*” and considers that “...*the balance of risks to growth has shown some deterioration compared to previous monetary policy decision...*”.

Exchange rate and volatility, key to inflation. The central bank concluded its last monetary policy statement that cyclical conditions of the Mexican economy show weakness while the outlook for inflation in the short-term has deteriorated due to the base of comparison. Nevertheless, the monetary authority stresses that one of the main risks to the inflation scenario is the fact that “...*exchange rate depreciation could persist given the impact that global financial conditions has had on the exchange rate, contaminating inflation expectations and leading to increases in the prices of non-tradable goods ...*”.

We maintain our view that Banxico will continue its hiking cycle right after the Fed’s hike in June. While Banxico’s central scenario seems to be of economic activity weakness and inflation below target until year-end, the prospects of higher rates in the United States pose a significant risk to exchange rate and inflation levels in Mexico. Given this, we believe that Banxico will continue its hiking cycle right after the Fed’s hike in June.

However, we do not rule out the possibility that Banxico could anticipate the Fed's hike. Among the risks to be considered, the monetary policy statement highlighted the potentially pass-through to inflation from FX depreciation. In addition, the central bank also mentioned the risk of a disorderly decompression in the term-premium given the normalization of the Fed's monetary policy. In fact, Banxico emphasized that in order to maintain the strong macro-fundamentals of the Mexican economy, it is necessary to consolidate public finances, continue the implementation of structural reforms, and modify Banxico's monetary policy stance at an appropriate pace. In this regard, and given the recent performance in the FX -with the Mexican peso accumulating a 4.2% depreciation since February's monetary policy statement-, we cannot rule out the possibility of Banxico acting preemptively (March or May).

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