Ahead of the Curve

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Market focus this week will on Banxico's monetary policy decision

- **Banxico's monetary policy decision next Thursday: On hold… until September.** Next week, Banxico will hold its fifth monetary policy meeting of the year. The monetary policy communiqué will be published on Thursday (July 30) at 2:00pm (EDT). We believe that board members will decide to leave the reference rate at 3%, as it is widely expected. Nonetheless, we believe that Banxico will maintain the tone of the last communiqué in which the main message was that in the absence of inflationary pressures and moderate growth, the board will focus on the time when the Fed will start its hiking cycle

- **June's trade balance.** On Monday (July 27), at 9:00am (EDT), *INEGI* will make its June's trade report available, where we expect to see a US$ 1,280.4 million deficit. On the exports side, we will probably see a 43.2% yoy contraction of oil exports given the significant fall in oil prices. Moreover, non-oil exports could have expanded 4.1%yoy, given the 6.5% yoy estimated growth on vehicle exports. On the imports side, we estimate a 3.7% yoy expansion in total imports. Finally, we estimate a 5% expansion in capital goods imports

Mexico weekly calendar

DATE	HOUR (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 27-Jul	**9:00am**	**Trade balance**	June	US$ mn	-1,280.4	-592.9	-1,017.4
		Total exports		% yoy	-1.4	--	-8.8
		Oil exports		% yoy	-43.2	--	-37.1
		Non-oil exports		% yoy	4.1	--	-5.3
		Total imports		% yoy	3.8	--	-5.5
Tue 28-Jul	**10:00am**	**International reserves**	24-Jul	US$ bn	--	--	191.3
Tue 28-Jul	**12:30pm**	**Government weekly auction: 1-, 3-, and 6-month Cetes; 3y MBono (Dec'18); 3y Udibono (Jun'19)**					
Thu 30-Jul	**2:00pm**	**Banxico's monetary policy decision**	30-Jul	%	3.00	3.00	3.00
Thu 30-Jul	**11:00pm**	**Budget balance (year to date)**	June	MXN bn	--	--	-180.7
Fri 31-Jul	**10:00am**	**Comercial banking credit**	June	% yoy	8.5	--	7.3
		Consumption		% yoy	3.8	--	3.2
		Housing		% yoy	7.7	--	7.1
		Non-banking private firms		% yoy	11.4	--	9.4

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Non-oil exports continue to expand vigorously. On Monday (July 27), at 9:00am (EDT), *INEGI* will make its June's trade report available, where we expect to see a US$ 1,280.4 million deficit. On the exports side, we will probably see a 43.2% yoy contraction of oil exports given the significant fall in oil prices. Moreover, non-oil exports could have expanded 4.1%yoy, given the 6.5% yoy estimated growth on vehicle exports.

On the imports side, we estimate a 3.7% yoy expansion in total imports. Taking a look at the breakdown, we estimate that imports of consumption goods (excluding oil) decreased 6.5% yoy, while imports of intermediate goods (excluding oil) could have grown 5.4% yoy. Finally, we estimate a 5% expansion in capital goods imports.

Weekly international reserves report. On Tuesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US $517mn amounting to US $191.3bn on July 17. 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 $87mn; (2) US $260mn decrease explained by the introduction of Banxico's USD daily auction; along with a (3) US $170mn decrease 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, given that on November 2011, the FEC (Federal Exchange Commission) decided to shut down the options scheme that Banxico also used to accumulate reserves. In this context, the central bank has an accumulated reduction of US $1,936mn international reserves this year (please refer to the table below).

Banxico's foreign reserve accumulation details
US$, million

	2014	17/Jul/2015	17/Jul/2015	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	193,239	191,303	-517	-1,936
(B) Gross international reserve	195,682	192,786	-170	-2,895
Pemex	--	--	363	3,109
Federal govt	--	--	-100	3
Market operations	--	--	-260	-4,724
Other	--	--	-173	-1,283
(C) Short-term government's liabilities	2,443	1,484	347	-959

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 3-year fixed-rate Mbonos (Dec'18) as well as 3-year inflation-linked Udibonos (Jun'19), 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 (EDT).

Auction specifics (Tuesday, July 28, 2015)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	27-Aug-15	- -	5,500	3.01
3m	29-Oct-15	- -	9,500	3.14
6m	21-Jan-16	- -	11,000	3.29
Mbono				
3y	13-Dec-18	8.50	9,000	4.83
Udibono				
3y	13-Jun-19	4.00	850	1.78

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

Monetary policy decision on Thursday: On hold… until September. Next week, Banxico will hold its fifth monetary policy meeting of the year. The monetary policy *communiqué* will be published on Thursday (July 30) at 2:00pm (EDT). We believe that board members will decide to leave the reference rate at 3%, as it is widely expected. Nonetheless, we believe that Banxico will maintain the tone of the last *communiqué* in which the main message was that in the absence of inflationary pressures and moderate growth, the board will focus on the time when the Fed will start its hiking cycle.

Even though Banxico has recognized that private consumption has shown a visible recovery, the board members still believe that the balance of risks for the Mexican economy continues to be negative given that GFI has shown a moderate recovery derived from the lower growth dynamics of the construction sector; and industrial production has been hampered by the reduction in Mexico's oil production, and the temporary slowdown in the U.S. economy, which resulted in a lower performance of manufacturing exports. In terms of inflation, the central bank has declared that the balance of risk has remained stable given that headline inflation will remain below 3% yoy in 2015.

As we have mentioned throughout our previous publications, we believe that an increase in the U.S. reference rate is a sufficient condition to trigger a rate hike in Mexico –despite the fact that economic activity has been sluggish and that inflation could converge to the 3% target this year-, given that the holdings of foreign investors in the short-end of the curve is elevated, making even more relevant the spread between Mexico's reference rate and the *Fed funds* rate. Moreover, in the last monetary policy minutes published in May 14, most board members agreed that taking into account the recent fiscal adjustments and given that inflation expectations are well anchored, acting ahead of the Federal Reserve would have more costs than benefits to Mexico's economic recovery.

Moreover, two weeks ago (July 1) Banxico just updated its monetary policy meeting schedule for 2H15. The aim of these changes was to synchronize monetary policy decisions in Mexico with those of the U.S. Fed, given the importance of the relative monetary policy stance between the two countries. The new dates will allow the Mexican monetary authority to have the latest information on U.S. Fed monetary policy decisions at the time of each meeting.

Modified monetary policy decisions schedule
2H15

Month	FOMC announcement	Banxico New Schedule	Banxico Previous
July	28-29	30	23
September	16-17	21*	3
October	27-28	29	15
December	15-16	17	3

Source: Federal Reserve
*This meeting will take place on Monday, instead of Thursday as it has been the case as of 2015

We maintain our view that the central bank's next move will be a hike, immediately after the Fed. 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's next move will be a rate hike, immediately after the Fed starts its normalization of monetary policy in September 16-17. This implies that the Mexican central bank could be raising rates at its meeting on September 21. In our view, the change in the timing of monetary policy decisions is positive because it eliminates a factor of additional uncertainty to the volatility that might be generated after the Fed decides to start monetary policy normalization.

The MoF's monthly report. Also on Thursday, the Ministry of Finance (MoF) will make its finance report available for the first semester of 2015. On the revenue side, we will be looking at non-oil tax collection as it provides additional information about domestic demand dynamics. Moreover, we will focus on spending dynamics, which will continue to incorporate part of the fiscal cut announced by the MoF in January. Finally, it will be important to evaluate the evolution of public sector debt, which currently represents about 42% of Mexico's GDP.

Banking credit will show a 8.5% yoy increase in June. Banco de Mexico will make available its banking credit report on Friday (July 31) at 10:00am (EDT). It is our take that banking credit continued flowing in June given the significant spike in credit supply from the banking sector. In particular, we estimate a 8.5% yoy expansion in banking credit (in real terms) as a result of increases in the area of 3.8%, 7.7%, and 11.4% yoy in consumer, housing and business credit, respectively.

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