

Ahead of the Curve

November 25, 2016

Market focus this week will on Banxico's minutes

- Banxico's minutes.** Next Thursday at 10:00am EDT, Banco de Mexico will publish the minutes of its monetary policy meeting held back on November 17, in which the board decided to increase by 50bps the reference rate. We believe that the decision to hike rates was unanimous. In addition, we expect discussions during the meeting to have focused on two issues: (1) The depreciation of the Mexican currency and the higher volatility in local markets generated by several geopolitical events, such as the US election results, the expected normalization of the Fed's monetary policy, and the volatility in oil prices; and (2) the deterioration of the balance of risks to inflation in the short and medium term, given the adjustment of relative prices generated by the MXN depreciation.

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Mexico weekly calendar

DATE	TIME (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 28-Nov	9:00am	Unemployment rate	October	%	<u>4.10</u>	--	4.14
		sa		%	<u>3.96</u>	--	3.85
Tue 29-Nov	10:00am	International reserves	25-Nov	US\$ bn	--	--	174.1
Tue 29-Nov	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Jun'26); 10y Udibonos (Dec'25)					
Wed 30-Nov	10:00am	Comercial banking credit	October	% yoy	<u>11.6</u>	--	12.2
		Consumption		% yoy	<u>9.3</u>	--	9.9
		Housing		% yoy	<u>7.1</u>	--	7.7
		Non-banking private firms		% yoy	<u>14.1</u>	--	14.7
Wed 30-Nov		Budget balance	October	MXN bn	--	--	-251.3
Thu 1-Dec	9:00am	PMI's survey (IMEF)	November				
		Manufacturing		index	<u>50.1</u>	--	50.7
		Non-manufacturing		index	<u>51.0</u>	--	51.4
Thu 1-Dec	10:00am	Family remittances	October	US\$ mn	<u>2,306.9</u>	--	2,378.2
Thu 1-Dec	10:00am	Banxico's monetary policy minutes	November				
Fri 2-Dec	10:00am	Banxico's survey of economic expectations	November				

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Unemployment rate in October will stand at 4.1%. On Monday, *INEGI* will publish its employment report for the tenth month of 2016, in which we estimate an unemployment rate of 4.1% nsa, below the 4.55% observed in October 2015. In seasonally-adjusted terms, we believe that the unemployment rate could stand at 3.96%, which implies a 0.11%-pts increase.

It is likely that October's labor market report will reflect the lower growth dynamics of the Mexican economy in the fourth quarter of the year. In particular, the downward trend in public spending has translated in a higher number of unemployed workers, and has already affected private investment projects. We believe that these collateral effects will also have a negative impact in the Mexican labor market. Looking ahead, we believe that the labor market will continue to grow, but at a slower pace given the fiscal cuts that the Federal Government will continue to implement throughout the last quarter of the year.

Weekly government bond auction. On Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 5-year M Bonos (Jun'21), and 10-year Udibonos (Dic'25), 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, November 22, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	29-Dec-16	--	7,000	5.48
3m	2-Mar-17	--	11,000	5.94
6m	25-May-17	--	12,000	6.04
Mbono				
5y	10-Jun-21	6.50	9,500	5.98
Udibonos				
10y	4-Dec-25	4.50	500	3.08

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

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\$359 million amounting to US\$174.1 billion on November 18th. According to Banxico's report, this figure comes mainly as a result of: (1) a US\$470 million reduction in the “others” component, which includes asset revalorization; and a (2) Dollar sale by Pemex to Banxico for US\$445 million. In this context, the Central Bank's international reserves have diminished by US\$2,596 million this year (please refer to the table on the next page).

Banxico's foreign reserve accumulation details

US\$, million

	2015	18/Nov/2016	18/Nov/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	174,136	-359	-2,596
(B) Gross international reserve	177,597	177,765	-67	166
Pemex	--	--	445	3,839
Federal government	--	--	-42	169
Market operations	--	--	0	-5,562
Other	--	--	-470	1,722
(C) Short-term government's liabilities	861	3,624	292	2,762

Source: Banco de México

Banking credit will show a 11.6% yoy increase in October. Banco de Mexico will make available its banking credit report on Wednesday at 10:00am (EST). It is our take that banking credit continued flowing in October. In particular, we estimate an 11.6% yoy expansion in banking credit (in real terms), as a result of increases in the area of 9.3%, 7.1%, and 14.1% yoy in consumer, housing and business credit, respectively.

The MoF's monthly report. On Wednesday, the Ministry of Finance (MoF) will make its monthly finance report available for October. On the revenue side, we will be looking at non-oil tax collection as it provides additional information about domestic demand dynamics. Moreover, markets will focus on the spending side of the report, in order to assess the execution of the fiscal cuts announced by the *MoF*. Finally, it will be important to evaluate the evolution of public sector debt, which currently represents about 48% of Mexico's GDP.

November's PMI surveys. On Thursday, *IMEF* (Mexican Institute of Financial Executives) will publish its PMI business confidence indicators for November. We expect manufacturing PMI at 50.1, marginally below the 50.7 observed in October (seasonally adjusted terms). We believe that the marginal reduction in the manufacturing PMI will be explained by the expectation of lower growth prospects for Mexico's manufacturing sector as a result of the electoral process in the US.

In addition, we believe that the non-manufacturing PMI will stand at 51 points from 51.4 points. In this regard, we believe that the deceleration in the overall economy will translate into a lower economic growth for the construction and services industries, which encompass most of the firms measured in *IMEF's* non-manufacturing survey.

Banxico's minutes. Next Thursday at 10:00am EDT, Banco de Mexico will publish the minutes of its monetary policy meeting held back on November 17, in which the board decided to increase by 50bps the reference rate. We believe that the decision to hike rates was unanimous. In addition, we expect discussions during the meeting to have focused on two issues: (1) The depreciation of the Mexican currency and the higher volatility in local markets generated by several geopolitical events, such as the US election results, the expected normalization of the Fed's monetary policy, and the volatility in oil prices; and (2) the deterioration of the balance of risks to inflation in the short and medium term, given the adjustment of relative prices generated by the MXN depreciation.

Banxico explained in their last monetary policy statement that core inflation has maintained an upward trend derived from the depreciation of the MXN. In addition, the central bank considered that the balance of risks in the short and medium term for inflation deteriorated given that: "[...] if the prevailing uncertainty in the

external environment results in an additional depreciation of the Mexican currency, it could contaminate inflation expectations and could generate second-order effects that adversely affect the price formation process.”

In addition, the central bank also expressed concern regarding the depreciation of the Mexican currency given the recent geopolitical events. In particular the Board Member mentioned that: *“Looking ahead, the Board will closely follow the evolution of all inflation determinants and their medium and long-term expectations, especially the potential pass-through effect of the exchange rate depreciation to prices, without having an implicit FX target. The Board will also be vigilant of the relative monetary position between Mexico and the United States, without neglecting the evolution of Mexico’s output gap.* In this context, the monetary authority justified the 50bps hike in the reference rate as a preventive measure given the events described above.

Looking ahead, we continue to forecast a highly volatile exchange rate market, given: (1) If Trump’s fiscal stimulus does materialize, inflation might be higher and the Fed’s hiking cycle could be faster than our base-case scenario; (2) Trump’s future comments regarding *NAFTA* and the bilateral trade relation; and (3) Oil price volatility. Moreover, we expect a 25bps hike from the Fed in December. In this context, we believe that Banxico will increase the reference rate by 25bps in their next monetary policy meeting on December. However, we do not rule out a 50bps hike if FX volatility increases in the coming weeks.

Family remittances will post a 6.9% yoy expansion in October. Also on Thursday, at 10:00am (EDT), Banxico will make its family remittances monthly data available. We expect Mexican workers living abroad - mainly in the US-, to have sent US\$2,211.6 million to their families in Mexico during October. This would imply a 6.9% yoy expansion, below September’s 15.7% gain.

We believe that the moderate expansion in the flow of remittances will be explained by the electoral process in the US. During the first three weeks of October, Hillary Clinton had a significant advantage over Donald Trump. As a result, the marginal appreciation of the Mexican currency coupled with the higher probability of a Clinton victory encouraged Mexican migrant workers to send a lower flow of remittances. Looking ahead, we continue to believe that given the electoral results, it is likely that the flow of remittances will increase around 15% yoy in the last two months of the year.

Banxico’s survey of economic expectations. Finally on Friday at 10:00am (EST), Banco de Mexico will publish its monthly survey of economic expectations. In our view, market participants' focus will be on four issues: (1) 2016 inflation expectations that currently are at 3.25% (Banorte-Ixe: 3.1%); (2) mid-term inflation expectations—quite important for the central bank's board—that are currently at 3.37% (Banorte-Ixe: 3%); (3) the analysts' assessments of GDP growth for 2016 which stands at 2.1% yoy, marginally above our 2% yoy forecast; and (4) FX estimates given the revisions made by several economists after the US electoral process outcome.

Disclaimer

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