# Ahead of the Curve

April 24, 2015

www.banorte.com
www.ixe.com.mx
@analisis_fundam

**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

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

- **Banxico's monetary policy decision next Thursday: Rate unchanged, but same message.** Next week, Banxico will hold its third monetary policy meeting of the year. The monetary policy *communiqué* will be published on Thursday (April 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

- **March's trade balance.** On Monday (April 27), at 9:00am (EDT), *INEGI* will make its March's preliminary trade report available, where we expect to see a US$ 538.2 million deficit. On the exports side, we will probably see a 43.8% yoy contraction of oil exports given the significant fall in oil prices and the reduction in Mexico's oil production. Moreover, non-oil exports could have expanded 12.1% yoy. On the imports side, we estimate a 10.5% yoy increase in total imports

**Mexico weekly calendar**

| DATE | HOUR (EDT) | EVENT | PERIOD | UNIT | BANORTE-IXE | CONSENSUS | PREVIOUS |
|---|---|---|---|---|---|---|---|
| **Mon 27-Apr** | **9:00am** | **Unemployment rate** | March | % | 4.1 | 4.2 | 4.3 |
| | | sa | | % | 4.4 | 4.4 | 4.5 |
| **Mon 27-Apr** | **9:00am** | **Trade balance** | March | US$ mn | -538.2 | 607 | 558.3 |
| | | Total exports | | % yoy | 5.8 | -- | -2.6 |
| | | Oil exports | | % yoy | -43.8 | -- | -46.9 |
| | | Non-oil exports | | % yoy | 12.1 | -- | 4.0 |
| | | Total imports | | % yoy | 10.5 | -- | -1.4 |
| **Tue 28-Apr** | **10:00am** | **International reserves** | 24-Apr | US$ bn | -- | -- | 195.9 |
| **Tue 28-Apr** | **12:30pm** | **Government weekly auction: 1-, 3-, 6-, and 12-month Cetes; 10y MBono (Dec'24); 30y Udibono (Nov'46); 5y Bondes D** | | | | | |
| **Thu 30-Apr** | **10:00am** | **Comercial banking credit** | March | % yoy | 6.1 | -- | 5.7 |
| | | Consumption | | % yoy | 2.9 | -- | 2.6 |
| | | Housing | | % yoy | 6.8 | -- | 6.5 |
| | | Non-banking private firms | | % yoy | 6.9 | -- | 6.6 |
| **Thu 30-Apr** | **2:00pm** | **Banxico's monetary policy decision** | April | | 3.00 | 3.00 | 3.00 |
| **Thu 30-Apr** | **11:00pm** | **Budget balance** | March | MXN bn | -- | -- | -150.7 |
| **Fri 1-May** | | **Banking holiday: Labor Day** | | | | | |

Source: Banorte-IXE; Bloomberg

Document for distribution among the general public

Proceeding in chronological order...

**Financial markets will remain closed in Mexico on Friday.** On the logistics side, it is worth noting that next week Mexico will experience a short week with a banking holiday on Friday (May 1st), as the country observes the Labor Day.

**Unemployment rate in March will stand at 4.11%.** Next Monday, *INEGI* will publish its employment report for the third month of 2015, in which we estimate an unemployment rate of 4.11% nsa, below the 4.32% observed in February. In seasonally-adjusted terms, we believe that the unemployment rate could stand at 4.43%, which implies a monthly fall of 0.1%-pts.

It is likely that the job creation in March was positively affected by better growth dynamics of the economy. In this regard, we believe that the Mexican labor market will continue to recover given the recent upward trend in the Mexican economy, which will eventually reduce the level of unemployed workers.

Looking ahead, we are still positive on the outlook regarding the recovery of the economic activity, which will have a significant positive impact on firms' expectations about domestic demand, resulting in a more dynamic labor market.

**We expect a reduction of oil exports in March.** Also, on Monday (April 27), at 9:00am (EDT), *INEGI* will make its March's preliminary trade report available, where we expect to see a US$ 538.2 million deficit. On the exports side, we will probably see a 43.8% yoy contraction of oil exports given the significant fall in oil prices and the reduction in Mexico's oil production. Moreover, non-oil exports could have expanded 12.1% yoy. In particular, we expect that manufacturing exports could show an 12% yoy expansion.

On the imports side, we estimate a 10.5% yoy increase in total imports. Taking a look at the breakdown, we believe that imports of consumption goods (excluding oil) increased 2.1% yoy, while imports of intermediate goods (excluding oil) could have expanded 7% yoy. Finally, we estimate a 1.5% growth 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 increased by US$1,083mn amounting to US$195.9bn on April 17. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by the Federal Government to the Central Bank for US$953mn; (2) US$260mn decrease explained by the introduction of Banxico's USD daily auction; along with a (3) US$390mn 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, 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 accumulated US$2,671mn of international reserves this year (please refer to the table below).

**Banxico's foreign reserve accumulation details**
US$, million

| | Foreign Reserve Level | Chg | Breakdown: Pemex | Federal govt[1] | Market operations[2] | Other |
|---|---|---|---|---|---|---|
| **2006** | 67,680 | | | | | |
| **2007** | 77,991 | 10,311 | 12,899 | -4,218 | -4,240 | 5,870 |
| **2008** | 85,441 | 7,450 | 22,754 | -5,413 | -18,674 | 8,783 |
| **2009** | 90,838 | 5,397 | 11,529 | 6,573 | -16,246 | 3,541 |
| **2010** | 113,597 | 22,759 | 16,037 | 2,338 | 4,466 | -83 |
| **2011** | 142,475 | 28,878 | 18,692 | 2,439 | 4,614 | 3,134 |
| **2012** | 163,516 | 21,116 | 17,867 | 2,805 | -646 | 1,089 |
| **2013** | 176,522 | 13,063 | 18,100 | -1,251 | 0 | -3,788 |
| **2014** | 193,239 | 16,717 | 14,500 | 2,570 | -200 | -154 |
| **17-Apr-15** | 195,910 | 2,671 | 3,000 | 1,486 | -1,500 | -316 |

Source: Banorte-Ixe, Banco de México; *Year-to-date
1. Includes short-term government's liabilities
2. Includes Banxico's US dollar sales to Mexican financial institutions as well as the Foreign Exchange Commission's USD Put/MXN Call options
*Year-to-date

**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 (Dec'24), 30-year inflation-linked Udibonos (Nov'46), as well as 5-year BondesD, in addition to the "more traditional" 1-, 3-, 6- and 12- month zero-coupon Cetes (please refer to the table below). As usual, the results will be released at 12:30pm (EDT).

**Auction specifics (Tuesday, April 28, 2015)**

| | Maturity | Coupon rate, % | To be auctioned[1] | Previous yield[2] |
|---|---|---|---|---|
| **Cetes** | | | | |
| 1m | 28-May-15 | - - | 5,500 | 2.96 |
| 3m | 30-Jul-15 | - - | 9,500 | 3.08 |
| 6m | 29-Oct-15 | - - | 11,000 | 3.17 |
| 12m | 28-Apr-16 | - - | 11,000 | 3.62 |
| **Mbono** | | | | |
| 10y | 05-Dec-24 | 10.00 | 8,000 | 6.04 |
| **Udibono** | | | | |
| 30y | 08-Nov-46 | 4.00 | 500 | 3.51 |
| **Bondes D** | | | | |
| 5y | 02-Apr-20 | - - | 3,000 | 0.23 |

Source: Banco de México

**Banking credit will show a 6.1% yoy increase in March.** Banco de Mexico will make available its banking credit report on Thursday (April 30) at 10:00am (EDT). It is our take that banking credit continued flowing in March. In particular, we estimate a 6.1% yoy expansion in banking credit (in real terms) as a result of increases in the area of 2.9%, 6.8%, and 6.9% yoy in consumer, housing and business credit, respectively.

**Monetary policy decision on Thursday: Rate unchanged, but same message.** Next week, Banxico will hold its third monetary policy meeting of the year. The monetary policy *communiqué* will be published on Thursday (April 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 begin its hiking cycle.

While the Fed's minutes of the last monetary policy meeting denoted a clear division between the FOMC members about the Fed's normalization process, several participants judged that *"the economic data and outlook were likely to warrant beginning normalization at the June meeting"*. Similarly, the publication of the Fed's next monetary policy decision (April 29) will take place a day before the announcement of Banxico (April 30), so this *bias* to raise rates by several FOMC members will be taken into account in Banxico's next monetary policy decision.

In our view, a rate hike in the U.S. will trigger a similar action from Banxico (current reference rate is at 3% since March 2014). In fact, 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.

Regarding the board's most recent statements, we believe that speeches from Banxico's board members were fully in line with the idea of *waiting* for the Fed's normalization process, to raise rates in Mexico too. Note that several investors commented that with low inflation in Mexico and sluggish growth, the central bank could delay hiking interest rates, even if the Fed begins its normalization process. In this regard, a member of the central bank said that once the Fed raises rates, the central bank will act quickly. Another issue discussed –but in a more informal way among analysts and investors-, was the gap of time between central bank meetings in both countries, particularly around the dates that the Fed is expected to move rates. For example, if the Fed hikes in its June 17 meeting, the next meeting for Banxico's board of governors will take place in July 23, *i.e.* five weeks later. A similar case occurs in September, when the Fed's meeting will take place on the 17$^{th}$, while Banxico´s first meeting after this date is scheduled on October 15$^{th}$, four weeks later. The explicit question from investors was whether the central bank would have to act calling an unscheduled meeting (intra-meeting). In this regard, we believe that while there is no doubt that the central bank has to act as quickly as possible, we believe that the economic situation in Mexico (low inflation and moderate growth), Banxico's credibility and the *Exchange Commission* toolkit, gives the central bank enough leeway to act on scheduled meetings.

To sum up, given that the U.S. Fed will raise the *Fed funds* rate (probably in June), we consider it highly likely that Banxico will also start a hiking cycle (in July), even though inflation in Mexico will be consistently around its 3% target. In this regard, we believe that this will be reflected in two parts of the statement: (1) Greater concern for the pass-through effect of the depreciation of the peso against the dollar to inflation; and (2) they will probably be more empathic about Mexico's relative monetary conditions, in particular to the U.S., given that it is a key factor to decide Mexico's reference rate path. In this context, we acknowledge that given the global deflationary environment, there is a chance that the U.S. Fed might postpone the beginning of its hiking cycle, which in turn, would delay Banxico's hiking cycle.

**The MoF's monthly report.** Finally on Thursday (April 30), the Ministry of Finance (MoF) will make its monthly finance report available. 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 now 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 39.8% of GDP.

**Disclaimer**
The information contained in this document is illustrative and informative so it should not be considered as an advice and/or recommendation of any kind. BANORTE is not part of any party or political trend.

## 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 Godinez | 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 |
| Livia Honsel | Economist, Europe | livia.honsel@banorte.com | (55) 1670 - 1883 |
| Miguel Alejandro Calvo Dominguez | Economist, Regional & Sectorial | miguel.calvo@banorte.com | (55) 1670 - 2220 |
| Rey Saúl Torres Olivares | Analyst, Mexico | saul.torres@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) 5004 - 1275 |
| Victor Hugo Cortes Castro | Equity Research Analyst | victorh.cortes@banorte.com | (55) 5004 - 1231 |
| Marissa Garza Ostos | Senior Equity Research Analyst – Conglomerates/Financials/ Mining/ Chemistry | marissa.garza@banorte.com | (55) 5004 - 1179 |
| Marisol Huerta Mondragón | Equity Research Analyst – Food/Beverages | marisol.huerta.mondragon@banorte.com | (55) 5004 - 1227 |
| José Itzamna Espitia Hernández | Equity Research Analyst – Airports / Cement / Infrastructure / Fibras | jose.espitia@banorte.com | (55) 5004 - 1266 |
| Valentín III Mendoza Balderas | Equity Research Analyst | valentin.mendoza@banorte.com | (55) 5268 - 9000 x 1267 |
| María de la Paz Orozco García | Analyst | maripaz.orozco@banorte.com | (55) 5004 - 5262 |

### Corporate Debt

| | | | |
|---|---|---|---|
| Tania Abdul Massih Jacobo | Director Corporate Debt | tania.abdul@banorte.com | (55) 5004 - 1405 |
| Hugo Armando Gómez Solís | Analyst, Corporate Debt | hugoa.gomez@banorte.com | (55) 5004 - 1340 |
| Idalia Yanira Céspedes Jaén | Analyst, Corporate Debt | idalia.cespedes@banorte.com | (55) 5004 - 1437 |

### Wholesale Banking

| | | | |
|---|---|---|---|
| Armando Rodal Espinosa | Head of Wholesale Banking | armando.rodal@banorte.com | (55) 1670 - 1889 |
| Alejandro Eric Faesi Puente | Managing Director – Global Markets and Institutional Sales | alejandro.faesi@banorte.com | (55) 5268 - 1640 |
| Jorge de la Vega Grajales | Managing Director – Government Banking | jorge.delavega@banorte.com | (55) 5004 - 5121 |
| Luis Pietrini Sheridan | Managing Director – Private Banking | lpietrini@ixe.com.mx | (55) 5004 - 1453 |
| René Gerardo Pimentel Ibarrola | Managing Director – Asset Management | pimentelr@ixe.com.mx | (55) 5268 - 9004 |
| Ricardo Velazquez Rodríguez | Managing Director – International Banking | rvelazquez@ixe.com.mx | (55) 5268 - 9879 |
| Victor Antonio Roldan Ferrer | Managing Director – Transactional Banking | vroldan@ixe.com.mx | (55) 5004 - 1454 |