

Ahead of the Curve

May 25, 2018

Market focus this week will be on Banxico's Quarterly Report and Minutes of the latest monetary policy decision

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- **Banxico's Quarterly Report (1Q18).** Banco de Mexico will publish its Quarterly Report (QR) for the first quarter of 2018 on Wednesday around 1:30pm (ET). The release will be accompanied by a press conference led by Governor Diaz de Leon. In our opinion, market participants will be particularly attentive to three issues: (1) Inflation forecasts; (2) Banco de Mexico's perspective on the lack of slack in the Mexican economy; and (3) the traditional research boxes that probably will elaborate on different issues currently affecting the Mexican economy.
- **Banxico's Minutes (May).** Next Thursday at 10:00am (ET), Banco de Mexico will publish the minutes of its monetary policy meeting held back on May 17, in which the board unanimously decided to maintain the reference rate at 7.5%. We expect discussions during the meeting to have focused on four issues: (1) The depreciation of the Mexican currency, explained both by external factors -which were also observed in other EM currencies-, as well as by domestic factors; (2) the appropriate monetary policy response in the face of a possible adjustment in the real exchange rate -particularly in the event of a paradigm shift (i.e. a failed NAFTA renegotiation or a deterioration of the fiscal outlook)-; (3) the recent favorable performance of inflation, which despite being in line with the central bank's expectations, its balance of risks maintains an upward bias; and (4) the uncertainty around the growth prospects of the Mexican economy.

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Document for distribution among the general public

Mexico weekly calendar

DATE	HOURL (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 28-May	9:00am	Unemployment rate	April	%	<u>3.22</u>	3.20	2.94
		sa		%	<u>3.27</u>	3.25	3.24
Tue 29-May	10:00am	International reserves	May-25	US\$ bn	--	--	172.9
Tue 29-May	12:30pm	Government weekly auction: 1-, 3-, and 6-months Cetes; 3y MBono (Dic'21); 3y Udibono (Dec'20)					
Wed 30-May	1:30pm	Banxico's quarterly report	1Q18				
Wed 30-May	15:30pm	Budget balance	April	MXN bn	--	--	-91.9
Thu 31-May	10:00am	Comercial banking credit	April	% yoy	<u>6.7</u>	--	5.7
		Consumption		% yoy	<u>3.2</u>	--	3.1
		Housing		% yoy	<u>2.8</u>	--	2.8
		Non-banking private firms		% yoy	<u>9.4</u>	--	9.0
Thu 31-May	10:00am	Banxico's minutes					
Fri 1-Jun	10:00am	Family remittances	April	US\$ mn	<u>2,446.8</u>	2,450.0	2,620.6
Fri 1-Jun	10:00am	Banxico's survey of economic expectations	May				
Fri 1-Jun	1:00pm	PMI's survey (IMEF)	May				
		Manufacturing		index	<u>52.2</u>	52.1	51.7
		Non-manufacturing		index	<u>52.6</u>	52.4	52.4

Source: Banorte; Bloomberg

Proceeding in chronological order...

The unemployment rate in April will stand at 3.22%. On Monday, *INEGI* will publish its unemployment report for the fourth month of 2018, in which we estimate an unemployment rate of 3.22% nsa, above the 2.94% observed in March. However, in seasonally adjusted terms, we believe that the unemployment rate could stand at 3.27% which implies a 0.03%-pts increase from last month's figures.

We believe that the marginal increase in the unemployment rate (seasonally adjusted) will be explained by the statistical variation given the design of the survey. However, it will remain at significantly low levels.

Weekly international reserves report. On Tuesday, at 10:00am (ET), Banco de Mexico will release its weekly balance report. Last week, net international reserves fell by US\$198 million amounting to US\$172.9 billion. According to Banxico's report, this figure comes mainly as a result of a negative valuation effect in central bank assets. In this context, the Central Bank's international reserves have increased by US\$111 million during 2018 (please refer to the table below).

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

	2017	May 18, 2018	May 18, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	172,913	-198	111
(B) Gross international reserve	175,450	177,196	-623	1,746
Pemex	--	--	-146	-796
Federal government	--	--	-166	1,898
Market operations	--	--	0	0
Other	--	--	-311	644
(C) Short-term government's liabilities	2,648	4,283	-425	1,635

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'21), 3-year inflation-linked Udibonos (Dec'20), 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 (ET).

Auction specifics (Tuesday, May 29, 2018)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	28-Jun-18	--	7,000	7.51
3m	30-Aug-18	--	11,000	7.77
6m	22-Nov-18	--	11,500	7.86
M Bono				
3y	09-Dec-21	7.25	8,500	7.40
Udibono				
3y	10-Dec-20	2.50	UDIS 950	3.67

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

Banxico's Quarterly Report. Banco de Mexico will publish its *Quarterly Report (QR)* for the first quarter of 2018 on Wednesday around 1:30pm (ET). The release will be accompanied by a press conference led by Governor Diaz de Leon.

In our opinion, market participants will be particularly attentive to three issues: (1) Inflation forecasts; (2) Banco de Mexico's perspective on the economy's slack; and (3) the traditional "grey boxes" that probably will elaborate on different issues currently affecting the Mexican economy.

In the previous report, Banxico published, for the first time, point-estimates for inflation. In this sense, the average inflation for the first quarter of the year was at 5.3% yoy, below the 5.5% yoy forecast. Considering the latest prints, we would expect a downward revision for the second quarter forecast and to the rest of the trajectory.

Regarding the slack of the Mexican economy, we expect Banxico to update the different measures introduced in the last report that suggested the output gap was practically closed. Moreover, the output gap excluding oil production now shows that this gap has turned positive.

MoF's monthly report. Also on Wednesday, the Ministry of Finance (MoF) will release its monthly finance report available for the fourth month of the year. On the revenue side, we will be looking at non-oil tax collection, as it will provide additional information about domestic demand behavior. Moreover, considering the increase in oil prices compared to last year, the behavior of oil revenues generated by the Federal Government will be particularly relevant.

In addition, markets will focus on the spending side of the report, in order to assess the execution of the fiscal budget for 2018. Finally, it will be important to evaluate the evolution of public sector debt, which currently represents around 43% of Mexico's GDP.

Banking credit will show a 6.7% yoy increase in April. Banco de Mexico will make available its banking credit report on Thursday at 10:00am (ET). It is our take that banking credit continued flowing in April. In particular, we estimate a 6.7% yoy expansion in banking credit (in real terms), as a result of increases in the area of 3.2%, 2.8%, and 9.4% yoy in consumer, housing and business credit, respectively.

Banxico's minutes – Hawkish tone amid FX volatility. Next Thursday at 10:00am (ET), Banco de Mexico will publish the minutes of its monetary policy meeting held back on May 17, in which the board unanimously decided to maintain the reference rate at 7.5%.

We expect discussions during the meeting to have focused on four issues: (1) The depreciation of the Mexican currency, explained both by external factors - which were also observed in other EM currencies-, as well as by domestic factors; (2) the appropriate monetary policy response in the face of a possible adjustment in the real exchange rate –particularly in the event of a paradigm shift (*i.e.* a failed NAFTA renegotiation or a deterioration of the fiscal outlook)– ; (3) the recent favorable performance of inflation, which despite being in line with the central bank’s expectations, its balance of risks maintains an upward bias; and (4) the uncertainty around the growth prospects of the Mexican economy.

It is worth mentioning that since this meeting the changes in the communication policy of the Central Bank came into effect, with the publication of the monetary policy statement in both English and Spanish. Likewise, if the decision had not been unanimous, the voting intention of the Board Members would have been published in this document.

Family remittances will post a 6.2% yoy expansion in April. On Friday, at 10:00am (ET), Banxico will make its family remittances monthly data available. We expect Mexican workers living abroad -mainly in the US-, to have sent US\$2,446.8 million to their families in Mexico during April. This would imply a 6.2% yoy expansion.

We believe that the remittances inflows will be explained by the positive growth dynamics in the US economy, which has fostered a higher job creation for Mexican migrant workers and an increase in real wages. Looking ahead, we believe that the flow of remittances will be mainly explained by the above-trend growth in the US labor market and Trump’s anti-migration policy.

Banxico’s survey of economic expectations. Also on Friday, at 10:00am (ET), Banco de Mexico will publish its monthly survey of economic expectations. Market focus will be on inflation forecasts for 2018, which as of last survey stand at 3.98% (Banorte: 4.3%), as well as inflation expectations for the medium and long term. Moreover, attention will also be on monetary policy forecasts, particularly on its path for 2018, given that the forecast for YE18 currently stands at 7.5%. Additionally, we will be looking into 2018’s GDP forecast, which we expect at 2.5% (consensus: 2.3%). Furthermore, we expect marginal upward revisions to FX forecasts, and we will be particularly attentive to its trajectory throughout the next twelve months.

May's PMI surveys. Finally, on Friday, *IMEF (Mexican Institute of Financial Executives)* will publish its PMI business confidence indicators for May. We expect the manufacturing PMI at 52.2 points (seasonally adjusted figures), above April's 51.7 pts. We believe that the recovery in the manufacturing PMI during the month will be explained by a slight pickup in the production and new orders components.

Regarding the non-manufacturing PMI, we believe that it will stand at 52.6 points, up from 52.4 points in April (seasonally adjusted figures). We consider that the increase will be explained by an increase in new orders and production, given the recovery in private demand in the first months of the year.

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