# Ahead of the Curve

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**Market focus this week will be on Banxico's monetary policy announcement and January's inflation**

- **Monetary policy announcement (February 8).** On Thursday, Banxico will announce its monetary policy decision at 1:00pm (ET), where we expect a 25bps hike in the reference rate, which will stand at 7.5%. We highlight that the meeting will be held in full session for the first time since November 2017, given that it will be the first meeting where Irene Espinosa will participate as a member of Banxico's Board. We believe that the main concern will continue to be inflation.
- **Monthly inflation report (January).** On Thursday, at 9:00am, *INEGI* will release its monthly inflation report for January. We are forecasting a 0.49% m/m increase in the headline index, while we expect the core index to rise 0.26% m/m. Inflation during the period in question will be mainly explained by increases in the price of energy, particularly gasoline. However, these will be mitigated by a fall in the prices of fresh fruits and vegetables as well as airfares and tourism services



**Mexico weekly calendar**

| DATE | HOUR (ET) | EVENT | PERIOD | UNIT | BANORTE | CONSENSUS | PREVIOUS |
|---|---|---|---|---|---|---|---|
| Tue 6-Feb | 9:00am | **Consumer confidence** | January | index | 86.9 | -- | 88.6 |
| Tue 6-Feb | 9:00am | **Gross fixed investment** | November | % yoy | -5.0 | -- | -2.6 |
| | | Machinary and equipment | | % yoy | -0.1 | -- | -0.9 |
| | | Domestic | | % yoy | -6.6 | -- | -8.2 |
| | | Imported | | % yoy | 4.7 | -- | 5.0 |
| | | Construction | | % yoy | -8.5 | -- | 4.0 |
| Tue 6-Feb | 12:30pm | **Government weekly auction: 1-, 3-, 6-month CETES; 3y Mbono (Jun' 20); 3y Udibonos (Dec'20)** | | | | | |
| Tue 6-Feb | 4:30pm | **Citibanamex bi-weekly survey of economic expectations** | | | | | |
| Wed 7-Feb | 10:00am | **International reserves** | Feb-2 | US$ bn | -- | -- | 173.2 |
| Thu 8-Feb | 9:00am | **CPI inflation** | January | % m/m | 0.49 | -- | 0.59 |
| | | | | % yoy | 5.50 | -- | 6.77 |
| | | Core | | % m/m | 0.26 | -- | 0.42 |
| | | | | % yoy | 4.53 | -- | 4.87 |
| Thu 8-Feb | 2:00pm | **Banxico's monetary policy decision** | February 8 | % | 7.50 | -- | 7.25 |
| Fri 9-Feb | | **Wage negotiations** | January | % | 4.7 | -- | 5.2 |
| Fri 9-Feb | 9:00am | **Industrial production** | December | % yoy | -0.2 | -- | -1.5 |
| | | (sa) | | % m/m | 1.2 | -- | -0.1 |
| | | Mining | | % yoy | -6.6 | -- | -8.5 |
| | | Utilities | | % yoy | 5.0 | -- | 3.1 |
| | | Construction | | % yoy | -1.3 | -- | -5.7 |
| | | Manufactures | | % yoy | 2.2 | -- | 2.4 |

Source: Banorte; Bloomberg

### Proceeding in chronological order...

**On Monday, financial markets will remain closed in Mexico.** On the logistics side, and before we start with next week's description, we highlight that next week, Mexico will have a short week with a banking holiday on Monday (February 5), as the country observes the $101^{th}$ Anniversary of the Mexican Constitution.

**We expect a significant recovery in consumer confidence during January.** On Tuesday, at 9:00am (ET), Banxico and *INEGI* will publish its monthly survey on consumer confidence, where we expect a 26.8% yoy expansion, with the index reaching 86.9 points. However, the annual variation would be explained simply by a base effect, since consumer confidence posted a significant 26% drop in January 2017, following the election of Donald Trump. In seasonally adjusted terms, we expect confidence levels to increase 0.9% m/m.

We believe that the 0.9% increase in consumer confidence (seasonally adjusted figures) will be explained by: (1) The significant appreciation of the Mexican currency during January; (2) the growth momentum in the Mexican labor market; and (3) inflation's downward trend. In this regard, headline inflation in the first half of January stood at 5.51% yoy from the 6.77% observed in December.

**We expect a 5% yoy contraction in November's GFI.** On Tuesday at 9:00am (ET), *INEGI* will publish its November's gross fixed investment (GFI) report. We anticipate GFI down by 5% yoy. We believe that within the report we will probably see a 4.7% yoy expansion in imported machinery and equipment, given that trade balance figures showed a similar increase for capital goods imports.

However, we expect a 6.6% contraction in domestic machinery and equipment. Finally, we believe that construction spending fell 8.5% yoy given that construction output within the industrial production report showed a similar result.

**GFI estimates: November 2017**
% yoy; %-pts; %m/m

| %yoy | Nov-17 | Nov-16 | Jan-Nov, '17 | Jan-Nov, '16 |
|---|---|---|---|---|
| Total | -5.0 | 2.8 | -1.8 | 1.2 |
| Machinery and equipment | -0.1 | 1.9 | 2.1 | 2.8 |
| Domestic | -6.6 | 0.4 | 0.7 | 7.0 |
| Imported | 4.7 | 3.1 | 3.1 | -0.1 |
| Construction | -8.5 | 3.4 | -4.6 | 0.0 |
| **Annual contribution** | **Nov-17** | **Nov-16** | **Difference** | |
| Total | -5.0 | 2.8 | -7.8 | |
| Machinery and equipment | 0.0 | 0.8 | -0.9 | |
| Domestic | -1.2 | 0.1 | -1.2 | |
| Imported | 1.1 | 0.8 | 0.4 | |
| Construction | -5.0 | 2.0 | -6.9 | |
| **%m/m sa** | **Nov-17** | **Oct-17** | **Difference** | |
| Total | -2.4 | -0.5 | -1.9 | |
| Machinery and equipment | -1.4 | -4.0 | 2.6 | |
| Domestic | -1.8 | -3.9 | 2.2 | |
| Imported | -0.2 | -3.4 | 3.1 | |
| Construction | -3.6 | 1.1 | -4.6 | |

Source: Banorte

**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 (Jun'20), 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, February 6, 2018)**

| | Maturity | Coupon rate, % | To be auctioned[1] | Previous yield[2] |
|---|---|---|---|---|
| **Cetes** | | | | |
| 1m | 08-Mar-18 | - - | 9,000 | 7.24 |
| 3m | 10-May-18 | - - | 12,000 | 7.43 |
| 6m | 02-Aug-18 | - - | 11,500 | 7.64 |
| **M Bono** | | | | |
| 3y | 11-Jun-20 | 8.00 | 8,500 | 7.54 |
| **Udibonos** | | | | |
| 3y | 20-Dec-20 | 2.50 | UDIS 950 | 3.50 |

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 Wednesday, at 10:00am (ET), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US$173 million amounting to US$173.2 billion. According to Banxico's report, this figure comes mainly as a result of a positive valuation effect in central bank assets. In this context, the Central Bank's international reserves have increased by US$393 million during 2018 (please refer to the table on the following page).

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

| | 2016 | Jan 26, 2018 | Jan 26, 2018 | Year-to-date |
|---|---|---|---|---|
| | Balance | | Flows | |
| International reserves (B)-(C) | 172,802 | 173,195 | 173 | 393 |
| (B) Gross international reserve | 175,450 | 178,677 | -465 | 3,227 |
| Pemex | -- | -- | -472 | -703 |
| Federal government | -- | -- | -265 | 3,625 |
| Market operations | -- | -- | 0 | 0 |
| Other | -- | -- | 271 | 305 |
| (C) Short-term government's liabilities | 2,648 | 5,483 | -638 | 2,835 |

Source: Banco de México

***Citibanamex* Survey: Market participants will focus on inflation and monetary policy forecasts.** On Tuesday around 3:30pm (ET) *Citibanamex* will release its bi-weekly survey of economic expectations, where focus will be on analysts' inflation forecasts for January (to be published on February 8). Furthermore, attention will be on monetary policy assessments, given that the first monetary policy meeting will take place also on February 8.

In addition, the survey will also contain forecasts for growth and FX estimations. In the first case, we do not expect strong revisions to the median GDP forecast for 2018. In the second case, we expect downward revisions given the latest performance of the Mexican peso.

**Inflation during January will be explained by increases in the prices of energy, particularly gasoline.** On Thursday, at 9:00am, *INEGI* will release its monthly inflation report for January. We are forecasting a 0.49% m/m increase in the headline index, while we expect the core index to rise 0.26% m/m.

Inflation during the period in question will be mainly explained by increases in the price of energy, particularly gasoline. However, these will be mitigated by a fall in the prices of fresh fruits and vegetables as well as airfares and tourism services.

We forecast inflation to be 121bps lower when compared to the same period of last year, derived from: (1) 96bp from a smaller contribution of energy (123bps vs. 26bps in 2017); (2) 9bps from a lower impact of other services (-6bps vs. 4bps in 2017); (3) 8bps stemming from a lesser contribution of other goods (6bps vs. 13bps in 2017); and (4) 7bps due to a smaller impact of processed foods (12bps vs. 19bps in 2017), as shown in the table in the next page.

With these results, annual inflation will stand at 5.5% in January, significantly lower than the 6.77% seen in December 2017. Moreover, we forecast core inflation at 4.53% yoy (previous: 4.87% yoy). It is worth noting that the fall in annual inflation will be explained by a base effect given the drastic increase in energy prices in 2017. Moving forward, we will focus on the evolution of energy prices and the behavior of agricultural prices, and the impact they might have in Mexico's CPI.

**January inflation by components**
% Monthly incidence

| | 2018 P | 2017 | Difference |
|---|---|---|---|
| Headline | 0.49 | 1.70 | -1.21 |
| Core | 0.19 | 0.44 | -0.25 |
| Goods | 0.18 | 0.32 | -0.15 |
| Processed foods | 0.12 | 0.19 | -0.07 |
| Other goods | 0.06 | 0.13 | -0.08 |
| Services | 0.02 | 0.11 | -0.10 |
| Housing | 0.05 | 0.05 | 0.00 |
| Education | 0.02 | 0.03 | -0.01 |
| Other services | -0.06 | 0.04 | -0.09 |
| Non-core | 0.29 | 1.26 | -0.96 |
| Agricultural | -0.02 | -0.08 | 0.06 |
| Fresh fruits and vegetables | -0.09 | -0.12 | 0.04 |
| Meat and egg | 0.07 | 0.04 | 0.03 |
| Energy and government regulated | 0.32 | 1.35 | -1.03 |
| Energy | 0.26 | 1.23 | -0.96 |
| Government regulated | 0.05 | 0.11 | -0.06 |

Source: Banorte, INEGI

**Banxico's monetary policy announcement – We expect an additional 25bps hike.** On Thursday, Banxico will announce its monetary policy decision at 1:00pm (ET), where we expect a 25bps hike in the reference rate, which will stand at 7.5%. We highlight that the meeting will be held in full session for the first time since November 2017, given that it will be the first meeting where Irene Espinosa will participate as a member of Banxico's Board.

We believe that the main concern will continue to be inflation. Despite that the annual rate of the headline CPI fell from 6.7% in December 2017 to 5.51% in the first half of January, it continues at significantly high levels. In fact, inflation has already had an impact on the Mexican households consumption decisions, reflected in the contraction of durable and non-durable sales.

In this regard, Banxico's last *communiqué* had a strong hawkish bias. All members considered that the balance of risks for inflation has deteriorated given the recent supply-side shocks. In this context, one member commented that said balance is "*overwhelmingly negative*". In addition, all board members emphasized that given the simultaneity and magnitude of the shocks, as well as the high inflationary levels, the main challenge for Banxico is to keep inflation expectations anchored in the medium and long term.

In addition, one member mentioned that: *"…it is likely that given the high levels of inflation, its persistence and its inherent risks –depending on the behavior of prices and their outlook in the coming months–, it will probably be necessary to increase the reference rate again, possibly as soon as the next monetary policy meeting [February 8]…"*. Some members also commented that under the actual environment: *"the current monetary policy stance is not congruent with a convergent trajectory of inflation towards the 3% target at the end of 2018"*. Another member also emphasized that the relative monetary stance between Mexico and the US should not be weakened, at least until certain risks –such as the renegotiation of NAFTA and the uncertainty around the 2018 electoral process– have dissipated.

Although the last monetary policy statement and the minutes suggest a 25bps increase in Banxico's reference rate during February's meeting, we believe that the significantly more hawkish tone of Banxico's Board alludes towards two additional 25bps rate hikes during the first half of 2018. Looking ahead, and as volatility due to the above-mentioned factors starts to dissipate, it is likely that the central bank could cut rates by 50bps in the second half of 2018

**Wage negotiations will climb 4.6% during January.** On Friday, the Ministry of Labor (MoL) will publish the contractual wage negotiations for January. We expect workers to have negotiated an average increase of 4.6%, below the 5.3% seen in December. This figure will be mainly explained by a greater dynamism in the negotiations of the private sector, which averaged 5.1% in 2017. It is worth noting that the 10.4% minimum wage increase came into effect during the previous month, which might continue to influence other salary negotiations. On the other hand, the syndicates of several higher education institutions negotiated increases below 4%. Looking ahead, we believe that negotiations will remain relatively high due to the minimum wage increase in late 2017 and the persistence of high inflation levels.

**We expect a 0.2% yoy contraction in December's industrial output.** On Friday at 9:00am (ET), *INEGI* will release its monthly industrial production report. We anticipate a 0.2% yoy contraction in total output during December, after the 1.5% contraction in the previous month. Taking a look at the breakdown, manufacturing production could post a moderate 2.2% yoy expansion, as a result of the scant 1.6% increase in vehicle production.

In addition, industrial output during December will be also explained by: (1) The 1.3% yoy contraction in construction output, as a result of the lower growth in private construction investment projects, given the uncertainty surrounding Mexico's economic and political environment; and (2) the poor performance of mining activity, where we estimate a 6.6% yoy reduction.

**Industrial production estimate: December 2017**
% yoy nsa; % m/m sa

| % yoy | Dec-17 | Dec-16 | 2017 | 2016 |
|---|---|---|---|---|
| Total | -0.2 | -0.3 | -0.6 | 0.4 |
| Mining | -6.6 | -8.4 | -9.7 | -4.1 |
| Utilities | 5.0 | 0.1 | 0.2 | 0.1 |
| Construction | -1.3 | -1.0 | -1.6 | 2.0 |
| Manufacturing | 2.2 | 3.3 | 3.1 | 1.5 |

| %m/m sa | Dec-17 | Nov-17 | Difference |
|---|---|---|---|
| Total | 1.2 | -0.1 | 1.6 |
| Mining | 0.9 | 0.1 | 0.8 |
| Utilities | 2.3 | 5.7 | -3.4 |
| Construction | 1.9 | -1.2 | 3.1 |
| Manufacturing | 1.3 | 0.6 | 0.7 |

Source: Banorte

**GRUPO FINANCIERO BANORTE S.A.B. de C.V.**

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