

Ahead of the Curve

June 30, 2017

Market focus this week will be on Banxico's minutes and June's inflation

- **Banxico's minutes.** Next Thursday at 10:00am (EDT), Banco de Mexico will publish the minutes of its monetary policy meeting held back on June 22, in which the board decided to increase by 25bps the reference rate to 7%. Within the minutes, we expect the discussions during the meeting to have focused on two issues: (1) The relative monetary policy stance with the Fed; and (2) the possibility of ending Banxico's hiking cycle.
- **Monthly inflation report (June).** On Friday, at 9:00am, *INEGI* will release its monthly inflation report for June. We are forecasting a 0.30% m/m increase in the headline index, while we expect the core index to rise 0.33% m/m. Inflation during the period in question will be explained by the rise in the prices of goods, mainly processed foods, and other services. Moreover, we also anticipate seeing an some pressures in the prices of other goods

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Mexico weekly calendar

DATE	HOURL (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 3-Jul	10:00am	Family remittances	May	US\$ mn	<u>2,575</u>	--	2,306
Mon 3-Jul	10:00am	Banxico's survey of economic expectations	June				
Mon 3-Jul	1:00pm	PMI's survey (IMEF)	June				
		Manufacturing		index	<u>48.7</u>	--	47.6
		Non-manufacturing		index	<u>51.9</u>	--	52.3
Tue 4-Jul	10:00am	International reserves	30-Jun	US\$ bn	--	--	174.5
Tue 4-Jul	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 10y Mbono (Jun'27); 5y Bondes D					
Wed 5-Jul	9:00am	Gross fixed investment	April	% yoy	<u>-7.9</u>	--	3.9
		Machinery and equipment		% yoy	<u>-3.5</u>	--	12.7
		Domestic		% yoy	<u>3.9</u>	--	11.8
		Imported		% yoy	<u>-7.0</u>	--	13.1
		Construction		% yoy	<u>-10.8</u>	--	-1.7
Wed 5-Jul	9:00am	Consumer confidence	June	index	<u>87.1</u>	--	86.8
Wed 5-Jul	4:30pm	Citibanamex bi-weekly survey of economic expectations					
Thu 6-Jul	10:00am	Banxico's minutes	June				
Fri 7-Jul	9:00am	CPI inflation	June	% m/m	<u>0.30</u>	--	0.15
				% yoy	<u>6.36</u>	--	6.16
		Core		% m/m	<u>0.33</u>	--	0.17
				% yoy	<u>4.86</u>	--	4.78

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Family remittances will post a 4% yoy expansion in May. On Monday, 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\$2,575.2 million to their families in Mexico during May. Even though remittances will probably reach a year high, it will be explained by the *Mother's Day* holiday in Mexico. Usually, Mexican migrant workers tend to send a higher amount to their families during this holiday. In annual terms, this would imply a 4% expansion, below the 7% observed throughout the year.

Banxico's survey of economic expectations. Also on Monday at 10:00am (EDT), Banco de Mexico will publish its monthly survey of economic expectations. The report is particularly relevant considering the latest tone in the monetary policy statement in which the authority mentioned that "...*the actual level of the reference rate is compatible with the process of efficient convergence of inflation to the 3% target...*", which we believe signals the end of the hiking cycle.

Moreover, our attention will focus on inflation forecasts for 2017, currently at 5.9% yoy, and medium and long-term inflation expectations, which we expect will remain relatively unchanged. Moreover, we expect marginal downward revisions to FX forecasts, which we now believe to stand at USD/MXN19.50 by YE17. Additionally, market participants will focus on 2017's GDP (median: 1.7%), where we expect some revisions given the latest data.

June's PMI surveys. Also on Monday, *IMEF* (Mexican Institute of Financial Executives) will publish its PMI business confidence indicators for June. We expect manufacturing PMI at 48.7 (seasonally adjusted terms). We believe that growth in the manufacturing PMI during June will be explained by a slight recovery in the employment and inventories sub-components, despite a marginal decrease in new orders and production. We think that the uncertainty regarding the prospects of the Mexican manufacturing industry under Trump's economic policies will continue to weigh, albeit in a lesser manner, on the index.

In addition, we believe that the non-manufacturing PMI will stand at 51.9points from 52.3 points. It is worth noting that the index rose past the 50pts threshold last month, so we expect a marginal fall as an adjustment. Looking ahead that uncertainty might continue to impact the behavior of the index, although in a reduced manner.

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\$2 million amounting to US\$174.5 billion. According to Banxico's report, this figure comes mainly as a result of: (1) US\$68 million dollar sales from Banxico to the Federal Government; and (2) a positive revalorization in central bank assets amounting to US\$70 million. In this context, the Central Bank's international reserves have diminished by US\$2 billion this year (please refer to the table on the next page).

Banxico's foreign reserve accumulation detail

US\$, million

	2016	Jun 23, 2017	Jun 23, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	174,506	2	-2,035
(B) Gross international reserve	178,025	175,773	-45	-2,253
Pemex	--	--	-136	-677
Federal government	--	--	-40	-1,483
Market operations	--	--	0	-2,000
Other	--	--	130	1,906
(C) Short-term government's liabilities	1,483	1,265	-48	-218

Source: Banco de México

Weekly government bond auction. On Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 10-year fixed-rate Mbonos (Jun'27), 5-year Bondes D, 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 4, 2017)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	03-Aug-17	--	7,000	6.96
3m	05-Oct-17	--	11,000	7.06
6m	04-Jan-18	--	11,500	7.14
Bondes D				
5y	12-May-22	--	3,750	0.19
M Bono				
10y	03-Jun-27	7.50	8,500	7.32

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

We expect a -7.9% yoy contraction in April's GFI. On Wednesday, at 9:00am (EDT), INEGI will publish its gross fixed investment (GFI) report. We anticipate GFI down by 7.9% yoy in April. However, it will be explained by the *Holy Week* calendar effect, which subtracted working days to the annual comparison.

We believe that within the report we will probably see a 3.9% yoy expansion in domestic machinery and equipment. In addition, we expect a 7% contraction in imported machinery and equipment given that trade balance figures showed a similar result for capital goods imports. Finally, we believe that construction spending fell 10.8% yoy, as a result of the above-mentioned calendar effect.

GFI forecasts

% yoy; %-pts

%yoy	Apr-17	Apr-16	Jan-Apr, '17	Jan-Apr, '16
Total	-7.9	2.0	-2.1	0.8
Machinery and equipment	-3.5	2.5	2.8	0.3
Domestic	3.9	8.6	6.9	6.5
Imported	-7.0	-0.2	0.8	-2.4
Construction	-10.8	1.6	-5.2	1.0
Annual contribution	Apr-17	Apr-16	Difference	
Total	-7.9	2.0	-9.9	
Machinery and equipment	-1.4	1.0	-2.3	
Domestic	0.5	1.0	-0.5	
Imported	-1.8	-0.1	-1.8	
Construction	-6.6	1.0	-7.6	

Source: Banorte-Ixe

Consumer confidence will lose ground in June. On Wednesday, at 9:00am (EDT), Banxico and *INEGI* will publish its June's monthly survey on consumer confidence, where we expect a 6.8% yoy contraction, with the index reaching 87.1 points. In seasonally adjusted terms, we expect confidence levels to decrease 1.7% m/m.

We believe that consumer confidence (measured in seasonally adjusted terms) will show a moderate contraction given the upward trend in inflation. In particular, headline inflation reached 6.26% yoy during the first half of June, as a result of the higher pass-through effect of the accumulated depreciation of the Mexican currency to prices and the increase in agricultural goods prices. However, despite the 1.7% fall in the headline index, it is likely that the report will also show that Mexican consumers are discounting a better economic outlook given the recovery of external demand, which will be reflected in consumers' expectations regarding the households and the country's future economic outlook.

Citibanamex Survey: Market participants will focus on inflation and monetary policy forecasts. Also on Wednesday around 3:30pm (EDT) *Citibanamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts' monetary policy assessments given the latest monetary policy statement, where the Central Bank adopted a dovish stance, possibly signaling the end of its hiking cycle. In this regard we are forecasting no more changes in the reference rate through the end of the year.

Furthermore, analysts will also focus on the inflation forecasts for June (to be published on Friday), as well as on CPI estimations for 2017. In addition, *Citibanamex* will also publish consensus' growth and FX forecasts for 2017. In the first case, we do not expect strong revisions to the median GDP forecast. In the second case, we expect some downward revisions to the FX estimates for 2017 after the strong revisions seen in the last survey.

Banxico's minutes – Talking about the possibility of ending the hiking cycle. Next Thursday at 10:00am (EDT), Banco de Mexico will publish the minutes of its monetary policy meeting held back on June 22, in which the board decided to increase by 25bps the reference rate to 7%. Within the minutes, we expect the discussions during the meeting to have focused on two issues: (1) The relative monetary policy stance with the Fed; and (2) the possibility of ending Banxico's hiking cycle.

In the first case, we believe that Banxico's 25bps rate hike was mainly explained by the Fed's 25bps hike in June. However, the central bank did significantly modified the tone of the *communiqué* showing a dovish bias, where they stressed that: “...taking into account the transitory nature of the recent inflationary shocks, the time horizon in which the transmission channels of the monetary policy work, as well as the current forecasts for the Mexican economy, the actual level of the reference rate is compatible with the process of efficient convergence of inflation to the 3% target...”.

In addition, Banxico acknowledged that the balance of risk for inflation didn't show a further deterioration, and highlighted: (1) The restrictive monetary policy implemented since 2015 will continue to influence the behavior of inflation; (2) inflationary pressures derived from the pass-through effect of the depreciation of the Mexican currency to prices, as well as the increase in the prices of energy will fade away in the short run; and (3) the negative output gap, as a result of the downward trend in investment.

Even though we believe that inflation will maintain an upward, albeit a softer trend and will reach a maximum in August (6.5% yoy), we believe that it will converge towards our 5.7% year-end forecast. Since Banxico's Board considers that the impact of the above-mentioned inflationary shocks is temporary, and the current level of the reference rate is consistent with the convergence of inflation to its 3% target, we now believe that the monetary authority will maintain the reference rate at 7% throughout the year.

We also believe that the monetary authority will be able to initiate an easing cycle in 2018, given that inflation will be converging towards the 3% target, as the above-mentioned inflationary shocks fade. However, we believe that the easing cycle will depend on three factors: (1) Continuation of the Fed's monetary policy cycle; (2) the perceived risks with respect to the presidential election of June 2018; and (3) the bias of Banxico's new Governor, who will replace Agustin Carstens in November 30.

Inflation during June will be explained by increases in the prices of processed foods and other services. On Friday, at 9:00am, *INEGI* will release its monthly inflation report for June. We are forecasting a 0.30% m/m increase in the headline index, while we expect the core index to rise 0.33% m/m.

Inflation during the period in question will be explained by increases in the prices of goods, mainly processed foods, and other services. Moreover, we also anticipate some pressures in the prices of other goods.

We forecast inflation to be 18.6bp higher than the observed in same period last year, derived from: (1) 10.1bp from a higher contribution of fresh fruits and vegetables prices (2.5bp vs. -7.7bp in 2016); (2) 7.5bp derived from a higher contribution of meat and egg prices (1.9bp vs. -5.7bp in 2016); (3) -4.6bp stemming from a lower contribution of energy prices (0.1bp vs. 4.7bp in 2016); (4) 2.8bp coming from a higher impact of goods (12.3bp vs. 9.5bp in 2016); and (5) 2.6bp derived from a higher contribution of services prices (12.5bp vs. 9.9bp in 2016), as shown in the table below.

With these results, annual inflation will stand at 6.36% in June, (previous: 6.16% yoy), while core inflation will be at 4.86% (previous: 4.78% yoy). Moving forward, we will be attentive to the evolution of energy prices and the behavior of the exchange rate, as well as the impact they might have on the price formation dynamic.

June inflation by components
% monthly incidence

	2017	2016	Difference
Headline	0.30	0.11	0.19
Core	0.25	0.19	0.05
Goods	0.12	0.10	0.03
Processed foods	0.08	0.06	0.02
Other goods	0.05	0.04	0.01
Services	0.12	0.10	0.03
Housing	0.04	0.04	0.01
Education	0.00	0.01	0.00
Other services	0.08	0.06	0.02
Non-core	0.05	-0.08	0.13
Agricultural	0.04	-0.13	0.18
Fresh fruits and vegetables	0.02	-0.08	0.10
Meat and egg	0.02	-0.06	0.08
Energy and government regulated	0.01	0.05	-0.05
Energy	0.00	0.05	-0.05
Government regulated	0.00	0.00	0.00

Source: Banorte-ixe, INEGI

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