Ahead of the Curve

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

- **Banxico's monetary policy decision.** Next week, Banxico will hold its second regular policy meeting of the year. The monetary policy *communiqué* will be published on Friday (March 18) at 3:00pm (EDT). We highlight that this will be the first monetary policy meeting after Banxico's Board of Governors decided to increase by 50bps the reference rate in an extraordinary meeting held back in February 17. We believe that board members will remain on hold, leaving the reference rate at 3.75%. However, we do expect a neutral tone in the *communiqué* on four fronts: (1) The 50bps hike in the reference rate during Banxico's extraordinary meeting should not be taken as a sign of a tightening cycle; looking ahead, Banxico's monetary policy will be subject to both external and internal factors; (2) the Mexican economy continues to show a weak growth; (3) the balance of risks for inflation in the short term remains slightly negative; and (4) the higher probability that the FOMC will decide to delay its normalization process until June

- **Aggregate demand (4Q15).** On Friday, INEGI will publish its aggregate supply and demand report for 4Q15, where we believe aggregate demand increased 2.8% yoy, vs. the 3.6% yoy expansion observed in 3Q15. Taking a look at the breakdown, we expect a 4.1% yoy increase in private consumption, while we estimate a scant 0.6% yoy expansion for gross fixed investment. However, we believe that government spending will likely show a moderate 2.3% yoy growth. With these figures, we believe that aggregate demand increased 3.4% throughout 2015

Mexico weekly calendar

DATE	TIME (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Sun 13-Mar		Daylight Saving Time begins in US					
Tue 15-Mar	11:00am	International reserves	11-Mar	US$ bn	--	--	176.1
Tue 15-Mar	1:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 30y Mbono (Nov'42); 5y Bondes D					
Fri 18-Mar	10:00am	Aggregate Demand	4Q15	% yoy	2.8	3.2	3.6
		Private consumption		% yoy	4.1	--	2.9
		Government consumption		% yoy	2.3	--	1.1
		Gross-fixed investment		% yoy	0.6	--	4.1
Fri 18-Mar	1:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Jun'21); 10y Udibonos (Dec'25)					
Fri 18-Mar	3:00pm	Banxico's monetary policy decision	March	%	3.75	3.75	3.75
Fri 18-Mar	5:30pm	Banamex bi-weekly survey of economic expectations					

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Logistics – U.S. is back to daylight saving time. On Sunday, the U.S. will begin its *Daylight Savings Time* (DST). However, Mexico's Daylight Saving Time period will not begin until April 3 which implies that Mexico City will have a two-hour difference with *Eastern Daylight Time* (EDT).

Weekly international reserves report. On Tuesday, at 11:00am (EST), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US$82mn amounting to US $176.1bn on March 4. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by Banxico to the Federal Government for US$153mn; along with a (2) US$235mn 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. In this context, the Central Bank has an accumulated reduction of US$638mn international reserves this year (please refer to the table below).

Banxico's foreign reserve accumulation details
US$, million

	2015	4/Mar/2016	4/Mar/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	176,097	82	-638
(B) Gross international reserve	177,597	178,254	-1,465	657
Pemex	--	--	-400	1,904
Federal govt	--	--	-1,313	2,857
Market operations	--	--	0	-5,562
Other	--	--	248	1,458
(C) Short-term government's liabilities	861	2,156	-1,547	1,295

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 30-year fixed-rate Mbonos (Nov'42) as well as 5-year Bondes D, in addition to the "more traditional" 1-, 3-, and 6- month zero-coupon Cetes (please refer to the table below). The results will be released at 1:30pm (EDT).

Auction specifics (Tuesday, March 15, 2016)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	14-Apr-16	- -	5,500	3.78
3m	16-Jun-16	- -	9,500	3.93
6m	15-Sep-16	- -	11,000	4.05
Mbono				
30y	13-Nov-42	7.75	2,500	6.86
Bondes D				
5y	21-Jan-21	- -	4,500	0.24

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 estimate a 2.8% yoy expansion in aggregate demand (AD) during 4Q15. On Friday, *INEGI* will publish its aggregate supply and demand report for 4Q15, where we believe aggregate demand increased 2.8% yoy, vs. the 3.6% yoy expansion observed in 3Q15.

Taking a look at the breakdown, we expect a 4.1% yoy increase in private consumption, while we estimate a scant 0.6% yoy expansion for gross fixed investment. However, we believe that government spending will likely show a moderate 2.3% yoy growth. With these figures, we believe that aggregate demand increased 3.4% throughout 2015.

Weekly government bond auction. On Friday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 5-year fixed-rate Mbonos (Jun'21) as well as 10-year inflation-linked Udibonos (Dec'25), in addition to the "more traditional" 1-, 3-, and 6- month zero-coupon Cetes (please refer to the table below). The results will be released at 1:30pm (EDT).

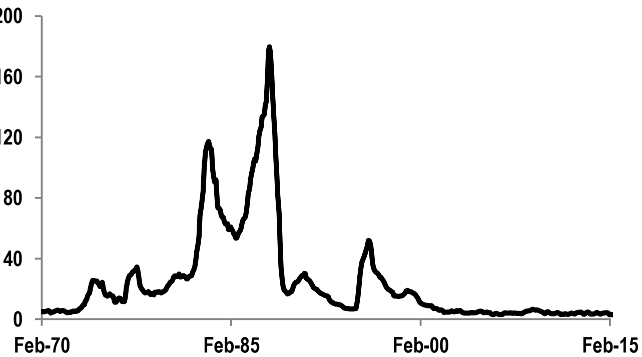
Monetary policy decision on Friday: A neutral stance, until the Fed's hike in June. Next week, Banxico will hold its second regular policy meeting of the year. The monetary policy *communiqué* will be published on Friday (March 18) at 3:00pm (EDT). We highlight that this will be the first monetary policy meeting after Banxico's Board of Governors decided to increase by 50bps the reference rate in an extraordinary meeting held back in February 17. We believe that board members will remain on hold, leaving the reference rate at 3.75%. However, we do expect a neutral tone in the *communiqué* on four fronts: (1) The 50bps hike in the reference rate during Banxico's extraordinary meeting should not be taken as a sign of a tightening cycle; looking ahead, Banxico's monetary policy will be subject to both external and internal factors; (2) the Mexican economy continues to show a weak growth; (3) the balance of risks for inflation in the short term remains slightly negative; and (4) the higher probability that the FOMC will decide to delay its normalization process until June.

In their last Quarterly Inflation Report (QIR), Banxico highlighted, among other things, that the Mexican economy maintained a moderate growth during the last quarter of 2015. In particular, Banxico mentioned that Mexico's economic growth was supported by the upward trend in private consumption. In particular, the central bank explained that the recovery in consumption was explained by the better growth dynamics of the labor market trends, low inflation, higher banking credit, and the recent growth in remittances inflows. However, the monetary authority mentioned that there were several factors that could affect Mexico's economic growth such as: (1) A delay in the recovery of the U.S. industrial sector; (2) a further decline international oil prices which could lead to an additional fiscal cut; (3) new episodes of volatility in financial markets derived from China's economic growth and the uncertainty regarding the Fed's next hike.

In addition, Banxico mentioned that headline inflation will increase this year given the following factors: (1) The fading of favorable supply shocks that took place in 2015; (2) price adjustments given the depreciation of the Mexican currency; (3) the change in the MoF's policy of the determination of gasoline prices, which implies higher prices during the second and third quarters, but lower during the first and fourth quarters.

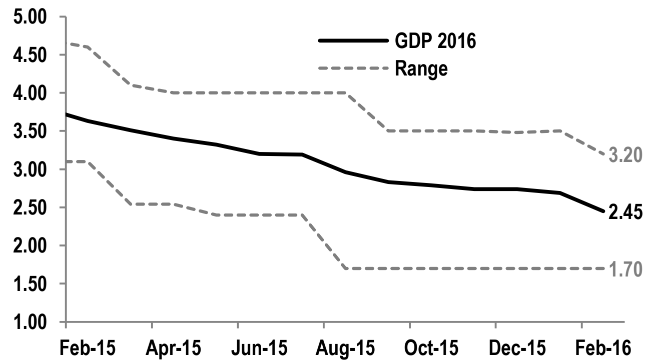
Given Mexico's slow economic growth, the absence of significant inflationary pressures and the Fed's current monetary policy, common sense would dictate that Banxico should not raise the reference rate, until the Fed continues its hiking cycle. Inflation is contained (refer to the chart on the left), and Mexico's economic growth expectations for 2016 have been continuously revised downwards (refer to chart on the right). Moreover, the current situation of low crude oil prices given Mexico's heavy dependence on oil revenue (~25%), the government's commitment to reduce the fiscal deficit to 0.5% of GDP in 2016, and the new fiscal regulations that will affect the accounts of Mexico's federal entities and municipalities, will translate into a lower public spending, hindering 2016 GDP's growth below 3%.

CPI
% yoy



Source: INEGI

Evolution of 2016 GDP growth expectations
% yoy



Source: Banxico Survey of Economic Expectations

In the first policy statement issued by the Fed, the FOMC decided not to change its monetary stance in order to keep the Fed Funds rate between 0.25% and 0.50%. In the statement, as well as comments made by several voting members, we perceive a more dovish tone. While the Fed has been very clear that the hiking cycle will be "gradual," it seems that the complex external environment, characterized by high volatility, the decline in oil prices, and the strong appreciation of the dollar will push the Fed to postpone the next rate hike at least until June.

In our opinion, Banxico's latest QIR maintained the tone we have already discussed previously, in the sense that after Banxico's 50bps rate hike, the central bank is tied to the U.S. Fed actions. In this regard, we believe that Banxico's next move will be a rate hike, immediately after the Fed continues its normalization of monetary policy in June 15. This implies that the central bank could be raising rates at its next regular meeting on June 30.

***Banamex* Survey: Market participants will focus on analysts' monetary policy assessments.** On Friday at 5:30pm (EDT) *Banamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts' monetary policy assessments right after Banxico's monetary policy announcement earlier in the day. Furthermore, analysts will also focus on March's first half inflation forecast (to be published on Wednesday, March 23), as well as on CPI estimations for 2016 and 2017. Moreover, we expect moderate downward revisions to the economic growth estimates for 2016.

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