# Ahead of the Curve

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Market focus this week will on Banxico's Quarterly Report

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- **Banxico's Quarterly Report (3Q15).** Banco de México will publish its Quarterly Inflation Report (QIR) for 3Q15 on Wednesday around 1:30pm (EST). The release will be accompanied by a press conference led by Governor Carstens. In our view, market participants will focus on two issues: (1) Any clues regarding Banxico's monetary policy; and (2) Banxico's output gap projection

- **IMEF (October).** On Monday, *IMEF* (Mexican Institute of Financial Executives) will publish its PMI business confidence indicators. We expect manufacturing PMI at 50.9 in October, above the 50.1 observed in September (seasonally adjusted terms). We believe that manufacturing activity was supported by the recovery of consumer spending in Mexico and the significant depreciation of the MXN. However, we believe that the strong recovery in retail sales might have affected the "inventories" component. Moreover, we believe that the non-manufacturing PMI will stand at 50.2 points

**Mexico weekly calendar**

| DATE | HOUR (EST) | EVENT | PERIOD | UNIT | BANORTE-IXE | CONSENSUS | PREVIOUS |
|---|---|---|---|---|---|---|---|
| **Mon 2-Nov** | | **Banking Holiday: Mexico´s All Souls' Day celebration** | | | | | |
| **Mon 2-Nov** | **1:00pm** | **PMI's survey (IMEF)** | October | | | | |
| | | Manufacturing | | index | 50.9 | 49.8 | 50.1 |
| | | Non-manufacturing | | index | 50.2 | -- | 49.3 |
| **Tue 3-Nov** | **10:00am** | **Family remittances** | September | US$ mn | 2,058.4 | 2,145.8 | 2,266 |
| **Tue 3-Nov** | **10:00am** | **Banxico's survey of economic expectations** | October | | | | |
| **Tue 3-Nov** | **12:30pm** | **Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Jun'21); 10y Udibono (Dec'25)** | | | | | |
| **Wed 4-Nov** | **9:00am** | **Gross fixed investment** | August | % yoy | 4.8 | 3.8 | 4.6 |
| | | Machinary and equipment | | % yoy | 11.2 | -- | 9.3 |
| | | Domestic | | % yoy | 10.8 | -- | 9.6 |
| | | Imported | | % yoy | 11.4 | -- | 9.1 |
| | | Construction | | % yoy | 0.9 | -- | 1.7 |
| **Wed 4-Nov** | **10:00am** | **International reserves** | 30-Oct | US$ bn | -- | -- | 176.9 |
| **Wed 4-Nov** | **1:30pm** | **Banxico's Quarterly Report** | 3Q15 | | | | |
| **Thu 5-Nov** | **4:30pm** | **Banamex bi-weekly survey of economic expectations** | | | | | |
| **Fri 6-Nov** | **9:00am** | **Consumer confidence** | October | index | 89.0 | 90.1 | 90.6 |

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

**Logistics - Back to the usual one-hour difference and Day of the Dead.** On Sunday, the U.S. will end Daylight Savings Time (DST). As a result, Mexico City will go back to the usual one-hour difference with EST. Moreover, next week Mexico will have a short week with a banking holiday on Monday (November 1), as the country observes the *Day of the Dead* holiday.

**October's PMI surveys.** On Monday, *IMEF* (Mexican Institute of Financial Executives) will publish its PMI business confidence indicators. We expect manufacturing PMI at 50.9 in October, above the 50.1 observed in September (seasonally adjusted terms). We believe that manufacturing activity was supported by the recovery of consumer spending in Mexico and the significant depreciation of the MXN. However, we believe that the strong recovery in retail sales might have affected the "inventories" component.

Moreover, we believe that the non-manufacturing PMI will stand at 50.2 points. In this regard, we believe that the recent upward trend in domestic demand, given the recovery in both the labor market and the household's purchasing power, could have triggered a faster growth within the services in October, which will be reflected in the non-manufacturing PMI.

**Family remittances will post a 4.7% yoy expansion.** On Tuesday, at 10:00am (EST), Banxico will make its family remittances monthly data available. We expect Mexican workers living abroad -mainly in the US-, to have sent US$2,058.4 mn to their families in Mexico during September. This would imply a 4.7% yoy expansion.

We believe that remittances in September will not benefit from the significant depreciation of the Mexican currency. As we have mentioned throughout our publications, the flow of remittances in the short-run is very sensitive to high fluctuations in Mexican peso. In particular, a sharp depreciation may encourage Mexican migrant workers to increase their remittances, given that the purchasing power of the amount remitted is greater in Mexico than in the U.S. However, a strong depreciation doesn't changes the overall growth dynamics of these inflows. Given that the significant growth in remittances during July and August was mostly explained by the peso depreciation, we believe that the FX will not be a preponderating factor in September´s figures.

Therefore, we believe that the better growth dynamics of the Mexican immigrant labor force in the U.S. will explain September's growth. Analyzing data from the Current Population Survey, the unemployment rate for illegal immigrants has fallen in the last four months which implies that we will probably continue to see an upward trend in these inflows.

**Banxico's survey of economic expectations.** Also on Tuesday, at 10:00am (EST), Banco de Mexico will publish its monthly survey of economic expectations. In our view, market participants' focus will be on three issues: (1) 2015 inflation expectations that currently are at 2.75% (Banorte-Ixe: 3%); (2) mid-term inflation expectations—quite important for the central bank's board—that are currently at 3.41% (Banorte-Ixe: 3%); and (3) the analysts' assessments of GDP growth for 2015 given the recent downward revisions made by several economists (currently at 2.31%; Banorte-Ixe: 2.5%).

**Weekly government bond auction**. On Tuesday, 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). As usual, the results will be released at 12:30pm (EST).

**Auction specifics (Tuesday, November 3, 2015)**

| | Maturity | Coupon rate, % | To be auctioned[1] | Previous yield[2] |
|---|---|---|---|---|
| **Cetes** | | | | |
| 1m | 03-Dec-15 | - - | 5,500 | 3.05 |
| 3m | 04-Feb-16 | - - | 9,500 | 3.14 |
| 6m | 28-Apr-16 | - - | 11,000 | 3.30 |
| **Mbono** | | | | |
| 5y | 10-Jun-21 | 6.50 | 8,500 | 5.37 |
| **Udibono** | | | | |
| 10y | 04-Dec-25 | 4.50 | 750 | 2.99 |

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 4.8% yoy expansion in August's GFI.** Next Wednesday at 9:00am (EST), *INEGI* will publish its August's gross fixed investment (GFI) report. We anticipate GFI up by 4.8% yoy. We believe that within the report we will probably see a 11.4% yoy expansion in imported machinery and equipment given that trade balance figures for August showed a similar growth rate. Moreover, we expect a 10.8% growth in domestic machinery and equipment. Finally, we believe that construction spending could increase a scant 0.9% yoy.

**GFI: August (estimates)**

| % yoy | Aug-15 | Aug-14 | Jan-Aug, '15 | Jan-Aug, '14 |
|---|---|---|---|---|
| Total | 4.8 | 4.2 | 5.2 | 0.5 |
| Machinery and equipment | 11.2 | 7.5 | 10.0 | 3.2 |
| Domestic | 10.8 | 9.7 | 11.2 | 1.5 |
| Imported | 11.4 | 6.4 | 9.4 | 4.0 |
| Construction | 0.9 | 2.2 | 2.3 | -1.1 |
| **Annual contribution** | **Aug-15** | **Aug-14** | **Difference** | |
| Total | 4.8 | 4.2 | 0.7 | |
| Machinery and equipment | 4.3 | 2.8 | 1.5 | |
| Domestic | 1.4 | 1.2 | 0.2 | |
| Imported | 2.9 | 1.6 | 1.3 | |
| Construction | 0.6 | 1.4 | -0.8 | |
| **%m/m sa** | **Aug-15** | **Jul-15** | **Difference** | |
| Total | 0.5 | 0.2 | 0.3 | |
| Machinery and equipment | 1.3 | 0.0 | 1.3 | |
| Domestic | 5.9 | 4.2 | 1.7 | |
| Imported | -0.3 | -2.1 | 1.8 | |
| Construction | -0.2 | 0.4 | -0.7 | |

**Source: Banorte-Ixe with data from *INEGI***

**Weekly international reserves report.** On Wednesday, at 10:00am (ET), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US$1,242mn amounting to US $176.9bn on October 23. According to Banxico's report, this figure comes mainly as a result of: (1) A US$1,000mn decrease explained by the introduction of Banxico's USD daily auction without minimum price; along with a (2) US$242mn decrease 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$16,261mn international reserves this year (please refer to the table below).

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

| | 2014 | 23/Oct/2015 | 23/Oct/2015 | Year-to-date |
|---|---|---|---|---|
| | Balance | | Flows | |
| International reserves (B)-(C) | 193,239 | 176,978 | -1,242 | -16,261 |
| (B) Gross international reserve | 195,682 | 178,249 | -1,281 | -17,433 |
| Pemex | -- | -- | -40 | 2,937 |
| Federal govt | -- | -- | 1 | -1,142 |
| Market operations | -- | -- | -1,000 | -19,005 |
| Other | -- | -- | -243 | -223 |
| (C) Short-term government's liabilities | 2,443 | 1,271 | -40 | -1,172 |

Source: Banco de México

**Banxico's QIR.** Banco de México will publish its Quarterly Inflation Report (QIR) for 3Q15 on Wednesday around 1:30pm (EST). The release will be accompanied by a press conference led by Governor Carstens. In our view, market participants will focus on two issues: (1) Any clues regarding Banxico's monetary policy; and (2) Banxico's output gap projection.

In the first case, we believe that the central bank sees no need to move the current monetary policy given that the balance of risks for growth worsened and remained unchanged for inflation vs. previous meeting. However, Banxico highlighted again its concern with the uncertainty surrounding the Fed's normalization of monetary policy, and its effect on the exchange rate given that: *"…any actions from the U.S. Fed could have additional repercussions on the Mexican exchange rate, inflation expectations, and the overall price dynamics…"*. We believe that the central bank remains "tied" to the Fed's monetary policy decision in December; nevertheless, the central bank's more dovish stance relative to the Fed suggests that Banxico will adequate its monetary policy to Mexico's business cycle, and will not necessarily follow the Fed in 2016.

Market participants will also focus on the central bank's assessment regarding output gap projections. The central bank has repeatedly highlighted the lower growth dynamics of the Mexican economy. In this context, market participants will examine the timing in which Banxico's Board believe that the output gap will close. In their last QIR, the central bank clearly showed in their traditional output gap chart, that it will remain open until the end of 2016.

***Banamex* Survey: Market participants will focus on analysts' monetary policy assessments.** On Thursday at 4:30pm (EST) *Banamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts' monetary policy assessments after Banxico's decision. In the last survey published by *Banamex* 18 out of 26 analysts surveyed expected a rate hike in 2015. Furthermore, analysts will also focus on October's inflation forecast (to be published on Monday November 9), as well as on CPI estimations for 2015. Moreover, we expect moderate downward revisions to the economic growth estimates for 2015.

**Consumer confidence will show early signs of recovery.** On Friday, at 9:00am (EST), Banxico and *INEGI* will publish its October's monthly survey on consumer confidence, where we expect a 1.7% yoy contraction, with the index reaching 89 points. However, in seasonally adjusted terms, we expect confidence levels to increase 0.4% m/m. We believe that consumer confidence (measured in seasonally adjusted terms) will benefit from the downward trend in inflation, which will translate in a higher growth for the purchasing power component. Moreover, we believe that the recent recovery in private consumption will be reflected in a higher growth for consumer's expectations regarding the household's present and future economic outlook.

BANORTE IXE

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