

Ahead of the Curve

December 16, 2016

Market focus the following weeks will be on Banxico's minutes

- The monetary policy minutes will shed light on Banxico's 50bps hike.** On Thursday (December 29), Banxico will publish the minutes of their last monetary policy meeting, in which the central bank decided to increase the reference rate by 50bps to 5.75%. We believe that the discussions of the Board members focused around the deterioration of short and medium-term inflation expectations, coupled with the uncertainty surrounding Mexico's economic environment.

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Mexico's weekly calendar

DATE	HOUR (EST)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Tue 20-Dec	9:00am	Retail sales	October	% yoy	<u>6.9</u>	--	8.1
Tue 20-Dec	10:00am	International reserves	16-Dec	US\$ mn	--	--	176.7
Tue 20-Dec	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 20y Mbono (Nov'34); 5y Bondes D					
Tue 20-Dec	4:30pm	Banamex bi-weekly survey of economic expectations					
Wed 21-Dec	9:00am	Aggregate Demand	3Q16	% yoy	<u>1.5</u>	--	2.1
		Private consumption		% yoy	<u>3.4</u>	--	2.6
		Government consumption		% yoy	<u>1.7</u>	--	1.7
		Gross-fixed investment		% yoy	<u>-0.7</u>	--	-0.9
Thu 22-Dec	9:00am	Global economic indicator (sa)	October	% yoy	<u>1.2</u>	1.2	1.6
				% m/m	<u>-0.2</u>	--	0.5
		Primary activities		% yoy	<u>6.8</u>	--	4.6
		Industrial production		% yoy	<u>-1.4</u>	--	-1.3
		Services		% yoy	<u>2.5</u>	--	3.2
Thu 22-Dec	9:00am	CPI inflation	1Q Dec	% 2w/2w	<u>0.31</u>	0.40	-0.04
				% yoy	<u>3.37</u>	3.52	3.30
		Core		% 2w/2w	<u>0.34</u>	0.34	-0.1
				% yoy	<u>3.32</u>	--	3.29
Fri 23-Dec	9:00am	Trade balance	November	US\$ mn	<u>-321</u>	-568	-899.5
		Total exports		% yoy	<u>3.1</u>	--	-4.4
		Oil exports		% yoy	<u>5.4</u>	--	4.4
		Non-oil exports		% yoy	<u>3.0</u>	--	-4.9
		Total imports		% yoy	<u>-0.9</u>	--	-5.9
Fri 23-Dec	9:00am	Unemployment rate	November	%	<u>3.52</u>	3.46	3.67
Tue 27-Dec	10:00am	International reserves	23-Dec	US\$ bn	--	--	--
Tue 27-Dec	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Jun'21); 10y Udibonos (Dec'25)					
Thu 29-Dec	10:00am	Banxico's minutes of December 17 meeting					
Fri 30-Dec	10:00am	Comercial banking credit	November	% yoy	<u>11.9</u>	--	12.1
		Consumption		% yoy	<u>8.8</u>	--	9.6
		Housing		% yoy	<u>7.1</u>	--	7.3
		Firms		% yoy	<u>15.3</u>	--	14.7
Fri 30-Dec	3:30pm	Budget balance (year to date)	November	MXN bn	--	--	-222.4

Source: Banorte-IXE

Proceeding in chronological order...

Retail sales will post a 6.9% yoy expansion in October. On Tuesday (December 20) at 9:00am (EDT), *INEGI* will publish its retail sales report for October, where we anticipate a 6.9% yoy expansion. Retail sales' growth will be explained by the favorable performance of durable goods sales. In particular, vehicles sales increased by 8.9% yoy according to *AMIA*'s report. In addition, *ANTAD* total store sales posted a 8.1% yoy growth in real terms during the period in question. However, retail sales growth will be bounded by the 7.5% yoy contraction in consumption goods imports –which have a strong correlation with retail sales.

Weekly international reserves report. Moreover, on Tuesday, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US\$2,592 million amounting to US\$176.7 billion on the 9th of December. According to Banxico's report, this figure comes mainly as a result of: (1) US dollar sales from the Federal Government to the central bank amounting to US\$ 2,647 million; and (2) US dollar sales from Pemex to Banxico totaling US\$1,416 million. In this context, the Central Bank's international reserves have diminished by US\$79 million this year (please refer to the table below).

Banxico's foreign reserve accumulation details

US\$, million

	2015	9/Dic/2016	9/Dic/2016	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,735	176,656	2,592	-79
(B) Gross international reserve	177,597	178,967	3,939	1,369
Pemex	--	--	1,416	3,404
Federal government	--	--	2,647	2,053
Market operations	--	--	0	-5,562
Other	--	--	-124	1,539
(C) Short-term government's liabilities	861	2,310	1,347	1,448

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 20-year fixed-rate Mbonos (Nov'34), 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). As usual, the results will be released at 12:30pm (EDT).

Auction specifics (Tuesday, December 20, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	19-Jan-17	--	7,000	5.51
3m	23-Mar-17	--	11,000	5.70
6m	22-Jun-17	--	12,000	5.97
Bondes D				
5y	18-Nov-21	--	4,000	0.24
Mbono				
20y	23-Nov-34	7.75	1,500	6.68

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

Banamex Survey: Market participants will focus on inflation and monetary policy forecasts. In addition, on Tuesday at 4:30pm (EST) *Banamex* will release its bi-weekly survey of economic expectations, where market participants will focus on analysts' monetary policy assessments given the 50bps hike in Banxico's reference rate, and the hawkish tone depicted in the *communiqué*.

Furthermore, analysts will also focus on the inflation forecasts for the first half of December (to be published on Thursday, December 22), as well as on CPI estimations for 2017. In addition, *Banamex* 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 moderate upward revisions to the FX estimates for 2017.

We estimate a 1.5% yoy expansion in aggregate demand during 3Q16. On Wednesday (December 21), *INEGI* will publish its aggregate supply and demand report for the third quarter of the year, where we believe aggregate demand increased 1.5% yoy in 3Q16, vs. the 2.1% yoy expansion observed in 2Q16.

Taking a look at the breakdown, we expect a 3.4% yoy increase in private consumption, while we estimate a 0.9% yoy contraction for gross fixed investment. Moreover, we believe that government spending will likely show a moderate 1.7% yoy increase, given the fiscal cuts implemented by the federal government.

We expect a 1.2% yoy expansion in October's IGAE. On Thursday (December 22), at 9:00am (EST), *INEGI* will release its monthly global economic indicator for October (GDP monthly proxy), where we expect a 1.2% yoy expansion. We believe that Mexico's economic growth will be explained by a 1.4% contraction in industrial production, coupled with a 2.5% yoy increase in services output.

As we had mentioned in our last report, IP's contraction in October was partially explained by the 0.6% fall in manufacturing output. In addition, mining activity fell 9% as a result of the significant contraction in Mexico's oil production, and the lower investment in Mexico's drilling projects. However, construction output posted a 2.5%, despite of the 13.6% reduction of public civil engineering construction projects given the fiscal cuts implemented by the Federal Government.

Moreover, we believe that the 2.5% yoy estimated expansion in services will be explained by the deceleration in private consumption. In addition, we believe that all the services that hold a strong correlation with manufacturing activity, such as trade and transportation, will also decelerate.

Inflation in the first half of December will be explained by pressures on the price of services along with higher prices of goods. Also on Thursday, at 9:00am, *INEGI* will release its bi-weekly inflation report. We are forecasting a 0.31% 2w/2w increase in the first half of December. In the core index, we expect an increase of 0.34% 2w/2w. Inflation during the period in question will be explained by pressures on services prices along with higher goods prices.

Nevertheless, we expect this figure to be 5.2bps higher than the observed in same period last year, derived from: (1) 6.5bps stemming from a higher contribution of energy (1.5bps vs. -5 in 2015); (2) 4.5bps stemming from a higher contribution of goods prices (10bps vs. 5.5 in 2015). By contrast, (3) we expect -5.6bps from a lower contribution agriculture prices (4bps vs. 9.6 in 2015), as shown in the table below

With these results, annual inflation is at 3.37% yoy in the first half of December from previous 3.32% while core inflation is at 3.32% from 3.29% yoy.

1H-December inflation by components

% bi-weekly incidence

	Banorte-Ixe	2015	Difference
Total	0.31	0.26	0.05
Core	0.25	0.20	0.05
Goods	0.10	0.06	0.04
Processed foods	0.05	0.04	0.01
Other goods	0.05	0.02	0.03
Services	0.15	0.15	0.00
Housing	0.02	0.02	0.00
Education	0.00	0.00	0.00
Other services	0.13	0.13	0.00
Non-core	0.06	0.05	0.00
Agriculture	0.04	0.10	-0.06
Fruits & vegetables	0.03	0.09	-0.06
Meat & eggs	0.01	0.01	0.00
Energy & government tariffs	0.02	-0.05	0.06
Energy	0.02	-0.05	0.07
Government tariffs	0.00	0.00	0.00

Source: Banorte-Ixe with data from INEGI and Banco de México.

Note: Contributions might not add due to the number of decimals allowed in the table.

Previous to year 2011, contributions might not add because of the change in CPI-calculation methodology

Exports will show a marginal recovery. On Friday (December 23) at 10:00am (EST), *INEGI* will make available its trade report for November, where we expect to see a US\$321.2 million deficit. On the exports side, we will probably see a 5.4% yoy expansion of oil exports as a result of the higher prices for the Mexican crude oil basket. In addition, non-oil exports could have increased 3% yoy, on the back of a 2.3% hike in manufacturing exports.

On the imports side, we estimate a 0.9% yoy contraction in total imports. Taking a look at the breakdown, we believe that consumption goods imports decreased 9.3% yoy, while imports of intermediate goods could have increased 0.7% yoy. Finally, we estimate a null growth in capital goods imports.

Unemployment rate in November will stand at 3.52%. Also on Friday, *INEGI* will publish its employment report for the eleventh month of 2016, in which we estimate an unemployment rate of 3.52% nsa, below the 3.96% observed in November 2015. In seasonally-adjusted terms, we believe that the unemployment rate could stand at 3.64%, which implies a 0.08%-pts increase.

It is likely that November's labor market report will reflect the lower growth dynamics of the Mexican economy. In particular, the downward trend in public spending has translated in a higher number of unemployed workers, and has already affected private investment projects. We believe that these collateral effects will also have a negative impact in the Mexican labor market.

Weekly government bond auction. On Tuesday (December 27), 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. As usual, the results will be released at 12:30pm (EDT).

The monetary policy minutes will shed light on Banxico's 50bps hike. On Thursday (December 29), Banxico will publish the minutes of their last monetary policy meeting, in which the central bank decided to increase the reference rate by 50bps to 5.75%. We believe that the discussions of the Board members focused around the deterioration of short and medium-term inflation expectations, coupled with the uncertainty surrounding Mexico's economic environment.

Within Banxico's *communiqué*, the central bank did acknowledge that the balance of risk for inflation deteriorated as a result of: (1) The pass-through effect of FX depreciation to prices; (2) the impact of the 9.9% increase in Mexico's minimum wage to prices which will be implemented on January 2017; and (3) the effect of the gradual liberalization of gasoline prices in Mexico. Banxico also mentioned that the preventive increases throughout the year will be reflected in the economy and inflation will eventually converge to the central bank's 3% target in 2018

As we mentioned in our previous reports, we believe that after the 50bps hike in both February's extraordinary meeting and June's ordinary meeting (just a week after Brexit), Banxico preconditioned market participants to expect minimum 50bps hikes in order to achieve any market reaction. In this context, we believe that Banxico will increase the reference rate by at least 100bps throughout 2017, although we can't rule out additional hikes if the FX volatility increases. The minutes of today's meeting will be published on the 29th of December, while Banxico's next meeting will take place on February 9

Banking credit will show an 11.9% yoy increase in November. Banco de Mexico will make available its banking credit report on the last Friday of the year at 10:00am (EST). It is our take that banking credit continued flowing in November. In particular, we estimate an 11.9% yoy expansion in banking credit (in real terms), as a result of increases in the area of 8.8%, 7.1%, and 15.3% yoy in consumer, housing and business credit, respectively.

The MoF's monthly report. Also on Friday, the Ministry of Finance (MoF) will make its monthly finance report available for November. On the revenue side, we will be looking at non-oil tax collection as it provides additional information about domestic demand dynamics. Moreover, markets will focus on the spending side of the report, in order to assess the execution of the fiscal cuts announced by the *MoF*. Finally, it will be important to evaluate the evolution of public sector debt, which currently represents around 48% of Mexico's GDP.

Disclaimer

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