

Ahead of the Curve

December 21, 2018

Watch for Banxico minutes and activity data, including trade balance, unemployment, remittances and PMI surveys

- Trade balance (November).** We expect a US\$604.5 million deficit in November, more modest than the US\$ 2,936.0 million shortfall of the previous month, which was the second highest so far this year. In our view, the figure will be benefitted by the steep fall in oil prices that began in October, along lower imports of non-oil consumption, intermediate, and capital goods as a result of weakness in the Mexican peso
- Banxico minutes (December 20th).** In our view, market participants will be very attentive to the discussions of the Board about overall risks to the inflation outlook. We believe that relevant discussions will also include the recent minimum wage increase, which was higher than in the two previous years with an added adjustment of 100% in the Northern Border. We will watch carefully if the Board details any possible impact or risk stemming from this measure. On the other hand, we will also search comments about the budget proposal for fiscal year 2019, as they said that it was very important to achieve the fiscal goals outlined in spite of the favorable local market reaction and prudent macroeconomic framework.

We expect the minutes to reflect the still hawkish tone observed in the communiqué, focused primarily on inflation expectations and de-anchoring risks, apart from comments about possible structural changes in the Mexican economy due to policies implemented by the new administration and how could these impact not only potential GDP but also the price formation process

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Document for distribution among the general public

Mexico weekly calendar

DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 24-Dec	9:00am	Unemployment rate	November	%	<u>3.12</u>	3.22	3.24
		sa		%	<u>3.18</u>	3.20	3.19
Mon 24-Dec	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 5y Mbono (Dec'23); 10y Udibonos (Nov'28)					
Wed 26-Dec	10:00am	International reserves	Dec-21	US\$ bn	--	--	174.1
Fri 28-Dec	9:00am	Trade balance	November	US\$ mn	<u>-604.5</u>	200.5	-2,936.0
		Total exports		% yoy	<u>6.8</u>	--	12.6
		Oil exports		% yoy	<u>-4.9</u>	--	17.8
		Non-oil exports		% yoy	<u>7.6</u>	--	12.3
		Total imports		% yoy	<u>9.6</u>	--	13.7
Fri 28-Dec		Budget balance	November	MXN bn	--	--	-275.6
Mon 31-Dec	10:00am	Commercial banking credit	November	% yoy	<u>6.6</u>	--	6.5
		Consumption		% yoy	<u>1.7</u>	--	1.6
		Mortgage		% yoy	<u>4.4</u>	--	4.3
		Firms		% yoy	<u>9.6</u>	--	9.8
Mon 31-Dec	1:30pm	Government weekly auction					
Wed 2-Jan	11:00am	Family remittances	November	US\$ mn	<u>2,698.4</u>	--	2,940.1
Wed 2-Jan	11:00am	International reserves	Dec-28	US\$ bn	--	--	--
Wed 2-Jan	2:00pm	PMI's survey (IMEF)	December				
		Manufacturing		index	<u>49.5</u>	--	49.7
		Non-manufacturing		index	<u>49.7</u>	--	49.2
Thu 3-Jan	10:00am	Banxico's minutes	December				

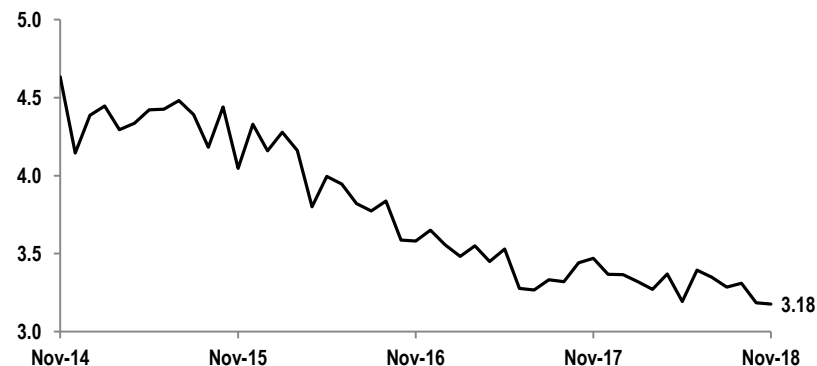
Source: Banorte; Bloomberg

Proceeding in chronological order...

Unemployment in November could keep declining at the margin. We estimate an unemployment rate of 3.12% nsa, below the 3.24% print observed in the previous month. When using seasonally adjusted figures, we expect a decrease to 3.18% from 3.19%, which would result in a new historical low for this indicator since it started to be published, back in 2005. In this respect, the labor market seems to remain strong according to most indicators, even with local uncertainty picking up meaningfully. In that sense, we only see a marginal reduction of the unemployment rate during the month. Employment growth has been decelerating in recent months, increasing 3.55% yoy in November since July 2016. Despite the slowdown, this rate would still be enough to compensate for the natural growth of the labor force. Nevertheless, if the moderation continues further, it could not be enough to result in additional declines on the unemployment rate. Going forward, we believe that unemployment could rebound higher in December due to the entry of the new Federal Government and the implementation austerity measures that have included job cuts in the public sector. In this respect, we will be very attentive to the possibility that the unemployment rate may have reached its cyclical in November, considering also the expectation of more moderate global and local economic growth in 2019.

Unemployment rate

%, sa



Source: INEGI, Banorte

Weekly government bond auction. The Ministry of Finance (MoF) –via Banco de Mexico as its financial agent–, will offer 5-year fixed-rate Mbonos (Dic’23), 10-year inflation-linked Udibonos (Nov’46), in addition to the “more traditional” 1-, 3-, and 6-month zero-coupon Cetes (please refer to the following table). As usual, results will be released at 12:30pm (ET).

Auction specifics (Monday, December 24th, 2018)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	24-ene-19	--	6,000	8.00
3m	28-mar-19	--	10,000	8.27
6m	20-jun-19	--	10,000	8.57
M Bono				
5y	07-dic-23	8.00	7,000	9.02
Udibonos				
10y	30-nov-28	4.00	UDIS 300	4.39

Source: Banorte 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. Last week, net international reserves decreased by US\$37 million, closing at US\$174.1 billion. According to Banxico's report, this figure comes mainly from a negative valuation effect in central bank assets. In this context, the central bank's international reserves have increased US\$1.3 billion during 2018 (please refer to the following table).

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

	2017	Dec 14, 2018	Dec 14, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	174,081	-37	1,279
(B) Gross international reserve	175,450	177,878	1,165	2,428
Pemex	--	--	-111	-344
Federal government	--	--	1,609	1,939
Market operations	--	--	0	0
Other	--	--	-332	833
(C) Short-term government's liabilities	2,648	3,797	1,202	1,149

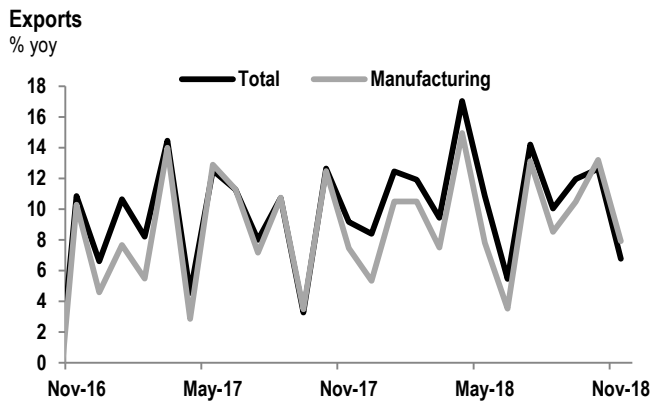
Source: Banco de México

Trade balance deficit could moderate on lower oil prices and non-oil imports. We expect a US\$604.5 million deficit in November, more modest than the US\$ 2,936.0 million shortfall of the previous month, which was the second highest so far this year. In our view, the figure will be benefitted by the steep fall in oil prices that began in October and the fact that Mexico is a net importer of oil-related products. In this respect, WTI and the Mexican oil mix plunged 19.6% and 14.4% during the month, respectively. We forecast the oil deficit to shrink modestly, from -US\$ 2,532.1 to -2,104.4 million on a monthly basis, while the non-oil balance would jump back to positive territory, from a US\$ 403.9 million deficit to a US\$ 1,499 million surplus. The latter will likely be aided by MXN weakness, particularly in terms of lower intermediate- and capital- goods imports, coupled with more modest purchases of consumption goods in absolute terms as inventories were already replenished ahead of the holiday season that started this month.

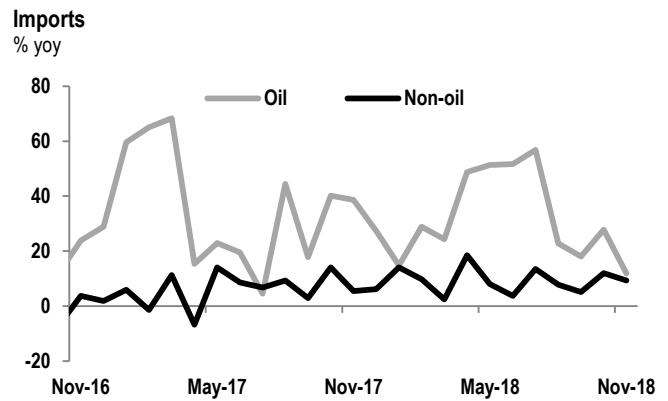
Inside the report, we estimate a 6.8% yoy increase in total exports, slowing down from the 12.6% increase of the previous month. This would be mostly driven by oil exports, forecasted to fall 4.8%. In particular, the average price of Mexican crude-oil stood at US\$/bbl 63.45, still higher than the year-ago level; nevertheless, we expect decreasing export volume to more than compensate for this. On the other hand, we forecast 7.6% growth in non-oil exports, with manufacturing at +7.9% from +13.2% in October, driven by a more modest performance in autos, with exports actually contracting for the first time since July and broadly consistent in terms of direction with data in the US, apart from the decrease in the new orders component of the latest *IMEF* PMI.

Going to imports, we estimate a 9.6% yoy increase, also more modest when compared to the previous print at +13.6%. Consumption of oil goods -mainly gasoline- are expected to moderate significantly, from +37.3% in October to +2.5%, driving total imports in this sector to 11.9% from 27.8%.

On the other hand, non-oil would stand at 9.3% yoy, with lower purchases in consumption goods on an absolute level despite still with a healthy advance relative to the previous year, while expecting a moderation in intermediate- and capital- goods imports, at 9.7% and 10%, respectively.



Source: INEGI, Banorte



Source: INEGI, Banorte

MoF’s public finance report (November). In it, we will focus on income and spending dynamics of the Federal Government. On the revenue side, we will be looking at non-oil tax collection, as it will provide additional information about domestic demand. Moreover, data regarding collection of fuel-excise tax (IEPS) will be relevant given the significant moderation in the policy to smooth gasoline price variations in recent months. In addition, markets will focus on the spending side of the report, in particular vs. 2017, both on the discretionary side as well as debt servicing costs, particularly in the former, observing specific changes in the spending of administrative branches.

In this context, we expect the Public Sector Borrowing Requirements to widen the deficit from the MXN\$289.4 bn figure seen in the previous month. Finally, we will evaluate the evolution of public sector debt (as measured by the Historical Balance of Public Sector Borrowing Requirements), which currently represents close to 43.8% of Mexico’s GDP.

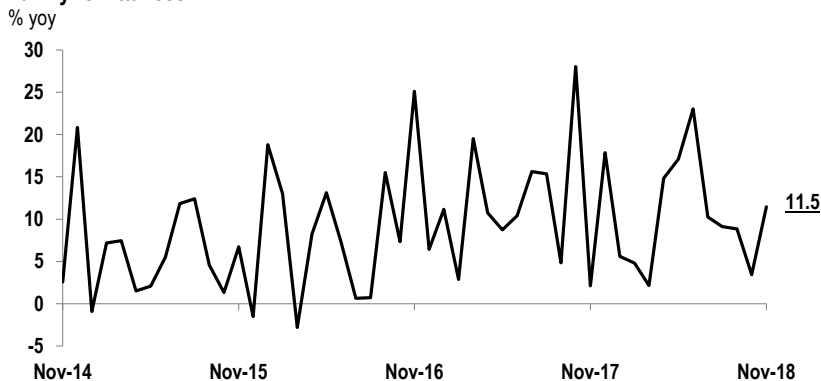
Banking credit will show a 6.6% yoy increase in November. It is our take that credit to the non-financial sector continued flowing in the eleventh month of the year. In particular, we estimate a 6.6% yoy expansion in banking credit to the private sector (in real terms), as a result of a 1.7% increase in consumer credit, coupled with a 4.4% and 9.6% expansion in mortgage and credit to firms, in the same order.

Weekly government bond auction. Given that the Ministry of Finance (MoF) hasn’t released its auction calendar for 1Q19, we expect that in the December 31st auction –and using Banco de Mexico as its financial agent–, will offer 10-year fixed-rate Mbonos, 30-year inflation-linked Udibonos, 5-year Bondes D, in addition to the “more traditional” 1-, 3-, 6-, and 12-month zero-coupon Cetes.

Remittances in November: Seasonally weaker, but still healthy. We expect remittances in November at US\$ 2,698.4 million and +11.5% yoy, highest since June and marginally above the 10% increase year-to-date. With this figure, YTD remittances would reach US\$ 30,315 million, already surpassing the yearly flow of US\$ 30,291 million observed in 2017. It is worth noting that November is a relatively weak print due to seasonality, which we believe could be driven by migrants' higher expenses on Thanksgiving and Black Friday. Nevertheless and in seasonally adjusted terms, we expect remittances to remain quite strong, as most indicators suggest more favorable conditions.

In this respect, the Mexican peso depreciated 5.6% on average during the month, reaching up to 20.63 per dollar at its weakest level, not seen since mid-June before the presidential election. On the other hand, employment of Mexican migrants in the US (both naturalized and those without citizenship) kept improving, as evidenced by a net job creation of 235,883 people during November. This figure is quite high and marks the fourth consecutive month in which net job creation among this group is in positive territory. Last but not least, we believe that anti-immigration rhetoric by the US administration has been incentivizing a higher flow of remittances. In particular, events relating to the migrant caravan were still making headlines (such as the US closing the border in the San Ysidro border cross that connects Tijuana and San Diego), while President Trump upped his pressure to Congress for the funding of the Border Wall, which has been increasingly difficult after the mid-term election. In our view, this latest driver could have been more relevant since around April, helping explain relatively higher annual growth rates in remittances from then on (except for last month, which was impacted by an unfavorable base effect).

Family remittances



Source: Banxico

We believe PMI indices to stay in contraction territory. Broadly speaking, the first half month was characterized by still high levels of uncertainty in the local economy, a situation that has moderated during the second half, as suggested by the performance of the Mexican peso. In particular, business confidence kept declining in November, with heightened concerns over the outlook for investment and future country conditions. On the other hand, we believe that some impact could be observed given the above-average increase in minimum wages starting in 2019, which could limit the employment component.

This anticipate increase could weigh relatively more in January, although some adjustment could be observed synched this print considering that estimates for economic growth have been cut in recent months.

Considering the latter, we estimate the manufacturing PMI to weaken 0.2pts to 49.5pts, below the 49.7pts of November and in contraction territory for second month in a row. For this sub index, we also note that December PMI's in the US fell across the board, with forward indicators in regional surveys (Empire and Philly) also relatively weak. Moreover, we noted higher uncertainty in the auto parts sector after GM announced an operations restructuring in their US plants starting in 2019- According to industry sources, this could have a strong impact in local value chains, as 90% of local production is exported to that country.

Going to the non-manufacturing index, we estimate a 0.5pts rebound, from 49.2pts in November to 49.7pts in December. In this respect, recent indicators of domestic activity have provided mixed signals. On the negative front, business confidence in construction was the weakest among all subsectors tracked, particularly regarding present and future conditions of the country. In contrast, present conditions in the commerce subsector actually strengthened in spite of the deceleration in October retail sales. Employment remains strong although we have seen some deceleration in job creation growth in recent months, which we believe could exacerbate in December due to expected layoffs in the public sector.

Banxico minutes focused on the deterioration of inflation expectations. In our view, investors will be very attentive to the discussions of the Board regarding this issue. In particular, we noted that the statement included, for the first time, an explicit reference to the possibility of an impact in mid- and long-term inflation expectations, while stressing the *permanent* nature of Banxico's target at 3.0%, in contrast with the long-term average of inflation expectations according to the market, which is closer to 3.5%.

We also noted that the balance of risks to inflation is still tilted to the upside and deteriorated further, according to the Board. In this context, the two most recent inflation prints (corresponding to the 2nd half of November and the 1st half of December) have actually surpassed consensus expectations to the upside by a wide margin (23bps and 22bps, respectively). In this front, we believe discussions will also include the recent minimum wage increase, which was higher than in the two previous years, with an added adjustment of 100% in the Northern Border. We will watch carefully if the Board details any possible impact or risk stemming from this measure. On the other hand, we will also search for any comments about the budget proposal for fiscal year 2019, as the communiqué stated that it was very important to achieve the fiscal goals outlined in spite of the favorable local market reaction and prudent macroeconomic framework.

Regarding growth, we will focus on: (1) The expected deceleration of economic activity in 4Q18; (2) slack conditions; (3) updated views on the global outlook both in this respect but also about its potential impact on the monetary policy normalization strategy of the Fed; and (4) opinions on global inflation as a result of the recent drop in oil prices.

In conclusion, we expect the minutes to reflect the still hawkish tone observed in the communique, focused primarily on inflation expectations and de-anchoring risks, apart from comments about possible structural changes in the Mexican economy due to policies implemented by the new administration, especially as how these could impact not only potential GDP but also the price formation process.

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HOLD	<i>When the share expected performance is similar to the MEXBOL estimated performance.</i>
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