Ahead of the Curve

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Market focus this week will be on Banxico's minutes

- **Banxico's minutes.** On Thursday, Banco de Mexico will publish the minutes of its monetary policy meeting held back on March 26, in which the board decided to leave the reference rate unchanged at 3%, as it was widely expected. In our view -and in line with the last statement- the tone of the minutes will be slightly more *dovish*, particularly given that: (1) The board stated that market's perception regarding the next hike in the Feds fund rate could be delayed; and (2) the balance of risks for economic growth has deteriorated

- **February's industrial production report.** On Friday, at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 1.9% yoy expansion in total output during the second month of the year. Taking a look at the breakdown, we believe that construction output could have expanded 4.5% yoy. Additionally, we believe that manufacturing production could post a 3.7% yoy expansion. However, we believe that the increase in industrial output during February will be limited by the poor performance of mining activity, where we expect a 5.4% yoy contraction derived from lower oil production and the reduction in the extraction of other minerals

Mexico weekly calendar

DATE	TIME (EDT)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Tue 7-Apr	10:00am	International reserves	3-Apr	US$ bn	--	--	195.4
Tue 7-Apr	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 3y MBono (Dec'18); 3y Udibonos (Jun'19)					
Tue 7-Apr	3.30pm	Banamex bi-weekly survey of economic expectations					
Wed 8-Apr	9:00am	Consumer confidence	March	index	93.0	92.1	90.3
Thu 9-Apr	9:00am	CPI inflation	March	%m/m	0.39		0.19
				%yoy	3.12		3.00
		Core		%m/m	0.22		0.34
				%yoy	2.41	--	2.40
Thu 9-Apr	10:00am	Banxico's minutes of March 26 meeting	March				
Fri 10-Apr	9:00am	Industrial production	February	%yoy	1.9	1.6	0.3
		(sa)		%m/m	1.0	0.4	-0.4
		Mining		%yoy	-5.4	--	-5.9
		Utilities		%yoy	4.0	--	3.1
		Construction		%yoy	4.5	--	4.2
		Manufactures		%yoy	3.7	3.5	1.2
Fri 10-Apr		Wage negotiations	March	%yoy	4.0	--	4.3

Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Weekly international reserves report. Tomorrow, at 10:00am (EDT), Banco de Mexico will release its weekly balance report. The week before last, net international reserves decreased by US$165mn amounting to US$195.4bn on March 27. According to Banxico's report, this figure comes mainly as a result of: (1) Dollar sales by the Central Bank to the Federal Government for US$40mn; (2) US$260 decrease explained by the introduction of Banxico's USD daily auction; along with a (3) US$135 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, given that on November 2011, the FEC (Federal Exchange Commission) decided to shut down the options scheme that Banxico also used to accumulate reserves. In this context, the central bank has accumulated US$2,136mn of international reserves this year (please refer to the table below).

Banxico's foreign reserve accumulation details
US$, million

	Foreign Reserve		Breakdown			
	Level	Chg	Pemex	Federal govt[1]	Market operations[2]	Other
2006	67,680					
2007	77,991	10,311	12,899	-4,218	-4,240	5,870
2008	85,441	7,450	22,754	-5,413	-18,674	8,783
2009	90,838	5,397	11,529	6,573	-16,246	3,541
2010	113,597	22,759	16,037	2,338	4,466	-83
2011	142,475	28,878	18,692	2,439	4,614	3,134
2012	163,516	21,116	17,867	2,805	-646	1,089
2013	176,522	13,063	18,100	-1,251	0	-3,788
2014	193,239	16,717	14,500	2,570	-200	-154
27-Mar-15	195,375	2,136	3,000	585	-824	-625

Source: Banorte-Ixe, Banco de México; *Year-to-date
1. Includes short-term government's liabilities
2. Includes Banxico's US dollar sales to Mexican financial institutions as well as the Foreign Exchange Commission's USD Put/MXN Call options
*Year-to-date

Weekly government bond auction. Also on Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent-, will offer 3-year fixed-rate Mbonos (Dec'18) as well as 3-year inflation-linked Udibonos (Jun'19), 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, April 7, 2015)

	Maturity	Coupon rate, %	To be auctioned[1]	Previous yield[2]
Cetes				
1m	07-May-15	- -	5,500	3.02
3m	09-Jul-15	- -	9,500	3.16
6m	01-Oct-15	- -	11,000	3.40
Mbono				
3y	13-Dec-18	8.50	9,500	5.26
Udibono				
3y	13-Jun-19	4.00	850	2.40

Source: Banco de México

***Banamex* Survey: Market participants will focus on analysts' monetary policy assessments.** On Tuesday at 4:30pm (EDT) *Banamex* will release its bi-weekly survey of economic expectations. In the last survey published by *Banamex* all of the analysts surveyed expected a rate hike in 2015. Furthermore, analysts will also focus on March's inflation forecast (to be published on Thrusday, April 9), as well as on CPI estimations for 2015. Moreover, we expect moderate downward revisions to the economic growth estimates for.

Consumer confidence will show signs of recovery in March. On Wednesday, at 9:00am (EDT), Banxico and *INEGI* will publish its March's monthly survey on consumer confidence, where we expect a 4.9% yoy expansion, with the index reaching 93 points (vs. 88.8 in March 2014). We highlight that this could be the fifth positive annual growth rate since October 2013. In seasonally adjusted terms, we expect confidence levels to increase 1.2% m/m. We believe that consumer confidence (measured in seasonally adjusted terms) could show visible signs of recovery given the better growth dynamics of the Mexican economy and the downward trend in inflation.

Inflation in March will be explained by pressures on the price of energy along with higher prices of agricultural goods. On Thursday, at 9:00am (EDT), *INEGI* will release its monthly inflation report. We are forecasting a 0.39% m/m increase in March, above market consensus that is forecasting a 0.32% m/m expansion according to Bloomberg's survey. In the core index, we expect an increase of 0.22% m/m, below market consensus (0.25%).

Inflation during the period in question will be explained by pressures on energy prices on the back of higher gasoline prices in cities in the northern border. In addition, our price monitoring suggests higher prices of some important elements in the "*fruits & vegetables*" sub-index, such as tomatoes, whose prices increased particularly in the second half of the month. With these results, annual inflation will remain at levels around 3.1% yoy in March, while core inflation will stand at 2.4% yoy.

Banxico's minutes – Slightly more *dovish* tone. On Thursday, Banco de Mexico will publish the minutes of its monetary policy meeting held back on March 26, in which the board decided to leave the reference rate unchanged at 3%, as it was widely expected. In our view -and in line with the last statement- the tone of the minutes will be slightly more *dovish*, particularly given that: (1) The board stated that market's perception regarding the next hike in the Feds fund rate could be delayed; and (2) the balance of risks for economic growth has deteriorated.

While Banxico mentioned that market's perception of a tighter monetary policy stance by the United States persists, the Board stressed out that given the last monetary policy statement issued by the Fed, the market now considers it more likely that the initial upward movement in the Fed's fund rate could be delayed.

However, we continue to believe that the Fed's monetary policy and FX performance will be Banxico's main focus points, given that the last monetary policy statement stressed out that "*...the Board will remain attentive to the evolution of all the inflation determinants, and market's expectations, but particularly they will be focused in Mexico's relative monetary conditions, particularly with respect to the U.S., as well as the exchange rate performance of."* As we have mentioned throughout our publications, Banxico does not manage the reference rate in absolute terms but, given the global influence of the U.S. monetary policy, it only sets the spread between Mexico's rate and the U.S. federal funds rate. Thus, if the Federal Reserve decides to hike its rate in June, almost independently of Mexico's economic cycle and inflation, Banco de Mexico "*will have to maintain*" the differential between the interest rates in both countries. Particularly given that not doing it could trigger a significant depreciation of the Mexican peso against the dollar.

All in all, we maintain our expectations that Banxico's next move will be a rate hike in mid-2015. Given that economic activity in Mexico will expand at a higher rate this year (vis-à-vis last year), and that the Fed will raise the federal funds rate (probably in June), we consider it highly likely that Banxico will also start a hiking cycle (in July), even though inflation in Mexico will be around its 3% target. In this regard, we believe that the hiking cycle will be supported by: (a) A much more optimistic outlook for the U.S. economy, especially in light of the recent economic data, and growth momentum given the lower gasoline prices (in that country); (b) greater concern for the pass-through effect of the depreciation of the peso against the dollar to inflation; and (c) Banxico's board will probably be more empathic in the next monetary policy announcements about Mexico's relative monetary conditions, in particular to the U.S., given that it is a key factor to decide Mexico's reference rate path. In this context, we acknowledge that given the global deflationary environment, there is a chance that the U.S. Fed might postpone the beginning of its hiking cycle. If this is the case, then we would change our Banxico monetary policy call as well.

We expect a 1.9% yoy expansion in February's industrial output. On Friday, at 9:00am (EDT), *INEGI* will release its monthly industrial production report. We anticipate a 1.9% yoy expansion in total output during the second month of the year. Taking a look at the breakdown, we believe that construction output could have expanded 4.5% yoy. We believe that construction has consolidated its recovery given the better growth dynamics in households' durable goods expenditure. Moreover, formal employment generated within this sector has shown a significant recovery in the past 11 months, which supports our view of a more positive perspective regarding the recovery of this sector. This would imply that construction could reach its ninth positive growth rate after adding 17 consecutive months in contraction.

Additionally, we believe that manufacturing production could post a 3.7% yoy expansion, explained by faster growth in manufacturing exports (3.7% yoy) and vehicle production (14.1% yoy). We believe that in the short run the Mexican manufacturing sector will show better growth prospects, derived from: (1) A stronger external demand, particularly coming from the U.S.; (2) the recent depreciation of the Mexican currency; and (3) the recovery of private consumption in Mexico, which will eventually translate into a higher domestic demand for manufacturing products.

However, we believe that the increase in industrial output during February will be limited by the poor performance of mining activity. In this regard, we expect a 5.4% yoy contraction derived from lower oil production and the reduction in the extraction of other minerals.

March's wage negotiations. On Friday, the Ministry of Labor (STPS) will make its contractual wage negotiations monthly data available. We anticipate workers to have negotiated an annual average wage increase of 4% in March. This would be below the average observed year-to-date (4.3%). In this regard, we believe that March's figure was mainly driven by the increase in wage negotiations in the education sector, specifically wage increases in different labor unions of public universities, coupled with increases in the government sector, and does not imply a rise in inflation expectations.

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