

Ahead of the Curve

February 24, 2017

Market focus this week will be on Banxico's QIR

- Banxico's QIR (4T16).** Banco de Mexico will publish its Quarterly Inflation Report (QIR) for the fourth quarter of 2016 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 four issues: (1) Headline and core inflation maintained an upward trend as a result of the exchange rate depreciation and the new adjustment in energy prices –particularly gasoline prices–, which implies that the balance of risks for inflation has deteriorated; (2) Banxico's inflationary projections depicted in their traditional fan charts; (3) Banxico's GDP and output gap projections will be particularly interesting to watch after a board member highlighted the uncertainty surrounding its estimation; and (4) any reference to the FEC's FX hedge program announced on February 22.

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Document for distribution among the general public

Mexico's weekly calendar

DATE	HOOR (EST)	EVENT	PERIOD	UNIT	BANORTE-IXE	CONSENSUS	PREVIOUS
Mon 27-Feb	9:00am	Unemployment rate	January	%	<u>3.84</u>	3.90	3.37
		sa		%	<u>3.74</u>	3.74	3.68
Mon 27-Feb	9:00am	Trade balance	January	US\$ mn	<u>-2,303</u>	-2,700.0	28.2
		Total exports		% yoy	<u>6.1</u>	--	6.6
		Oil exports		% yoy	<u>55.0</u>	--	49.9
		Non-oil exports		% yoy	<u>3.8</u>	--	4.9
		Total imports		% yoy	<u>1.8</u>	--	4.1
Tue 28-Feb	10:00am	Comercial banking credit	January	% yoy	<u>9.7</u>	--	11.5
		Consumption		% yoy	<u>8.1</u>	--	8.7
		Housing		% yoy	<u>7.1</u>	--	7.1
		Firms			<u>11.5</u>	--	14.5
Tue 28-Feb	10:00am	International reserves	24-Feb	US\$ bn	--	--	174.9
Tue 28-Feb	12:30pm	Government weekly auction: 1-, 3-, 6-, 12-month CETES; 10y Mbono (Mar'26); 30y Udibonos (Nov'46); 5y Bondes D					
Wed 1-Mar	10:00am	Family remittances	January	US\$ mn	<u>2,023.1</u>	2,060	2,336
Wed 1-Mar	1:00pm	PMI's survey (IMEF)	February				
		Manufacturing		index	<u>48.2</u>	--	49.0
		Non-manufacturing		index	<u>46.7</u>	--	47.1
Wed 1-Mar	1:30pm	Banxico's quarterly inflation report	4Q16				
Thu 2-Mar	10:00am	Banxico's survey of economic expectations	February				
Thu 2-Mar	3:30pm	Budget balance	January	MXN bn	--	--	-503.7
Fri 3-Mar	10:00am	Gross fixed investment	December	% yoy	<u>1.9</u>	-0.1	2.8
		Machinery and equipment		% yoy	<u>3.3</u>	--	1.6
		Domestic		% yoy	<u>10.8</u>	--	1.8
		Imported		% yoy	<u>-0.9</u>	--	-0.2
		Construction		% yoy	<u>1.0</u>	--	1.2

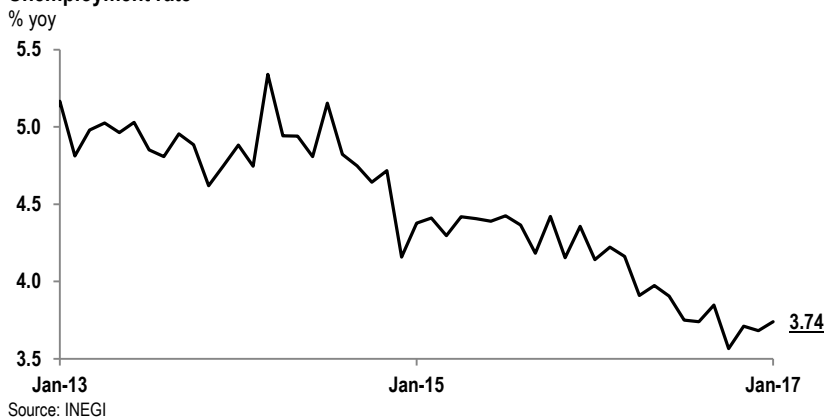
Source: Banorte-IXE; Bloomberg

Proceeding in chronological order...

Unemployment rate in January will stand at 3.84%. On Monday, *INEGI* will publish its employment report for the first month of 2017, in which we estimate an unemployment rate of 3.84% nsa, below the 4.24% observed in January 2016. In seasonally-adjusted terms, we believe that the unemployment rate could stand at 3.74%, which implies a 0.08%-pts increase.

It is likely that January's labor market report will reflect the lower growth dynamics of the Mexican economy. In particular, the downward trend in public spending has translated into a higher number of unemployed workers, and has already affected private investment projects. In addition, we believe that January's report will also reflect the lower growth dynamics of the formal labor market as a result of the uncertainty surrounding Trump's policies on the Mexican economy.

Unemployment rate



Exports will show a significant recovery. Also on Monday at 9:00am (EST), Banxico and *INEGI* will make available its preliminary trade report for January, where we expect to see a US\$2,309 million deficit. On the exports side, we will probably see a 55% 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 3.8% yoy, on the back of a 3.4% hike in manufacturing exports.

On the imports side, we estimate a 1.8% yoy expansion in total imports, as a result of the increase in oil related imports. However, taking a look at the breakdown, we believe that non-oil consumption goods imports decreased 11.8% yoy, while imports of intermediate goods could have increased a scant 2.5% yoy. Finally, we estimate a 3.1% contraction in capital goods imports.

Banking credit will show an 9.7% yoy increase in January. Banco de Mexico will make available its banking credit report on Tuesday at 10:00am (EST). It is our take that banking credit continued flowing in January. In particular, we estimate a 9.7% yoy expansion in banking credit (in real terms), as a result of increases in the area of 8.1%, 7.1%, and 11.5% yoy in consumer, housing and business credit, respectively.

Weekly international reserves report. On Tuesday, at 9:00am (EDT), Banco de Mexico will release its weekly balance report. Last week, net international reserves increased by US\$30 million amounting to US\$174.9 billion. According to Banxico's report, this figure comes mainly as a result of: (1) USD sale to the Federal Government amounting to US\$14 million; and (2) a US\$44million increase due to the change in valuation of the Central Bank's assets. In this context, the Central Bank's international reserves have diminished by US\$1.6billion this year (please refer to the table below).

Banxico's foreign reserve accumulation detail

US\$, million

	2016	Feb 17, 2017	Feb 17, 2017	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	176,542	174,978	30	-1,563
(B) Gross international reserve	178,025	176,067	-520	-1,958
Pemex	--	--	-299	-700
Federal government	--	--	-121	-192
Market operations	--	--	0	-2,000
Other	--	--	-100	933
(C) Short-term government's liabilities	1,483	1,088	-550	-395

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 10-year fixed-rate Mbonos (Mar'26), as well as 30-year inflation-linked Udibonos (Nov'46), 5-year Bondes D, in addition to the “more traditional” 1-, 3-, 6- and 12-month zero-coupon Cetes (please refer to the table below). As usual, the results will be released at 12:30pm (EDT).

Auction specifics (Tuesday, February 28, 2016)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	30-Mar-17	--	7,000	6.24
3m	1-Jun-17	--	11,000	6.42
6m	31-Aug-17	--	11,500	6.68
12m	1-Mar-18	--	11,500	6.92
M Bono				
10y	5-Mar-26	5.75	8,000	7.60
Udibonos				
30y	8-Nov-46	4.00	300	3.87
Bondes D				
5y	13-Jan-22	--	4,500	0.20

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

Family remittances will post a 4.7% yoy expansion in January. On Wednesday, 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\$2,023.1 million to their families in Mexico during January. This would imply a 4.7% yoy expansion.

We believe that the significant expansion in the flow of remittances during January will be determined by the electoral outcome in the US, since Mexican migrants without citizenship are probably discounting a higher probability of being deported. In this context, we consider that the flow of remittances during the next couple of months will be also determined by this factor.

February's PMI surveys. On Wednesday, IMEF (Mexican Institute of Financial Executives) will publish its PMI business confidence indicators for February. We expect manufacturing PMI at 48.2, below the 49 observed in January (seasonally adjusted terms). We believe that the contraction in the manufacturing PMI during February will be explained by the uncertainty regarding the prospects of the Mexican manufacturing industry under Trump's economic policies. We think that this uncertainty will mainly be seen in the new orders and production sub-components.

In addition, we believe that the non-manufacturing PMI will stand at 46.7 points from 47.1 points. In this regard, we believe that the lower growth prospects for the overall economy will also translate into a lower growth outlook for the construction and services industries, which encompass most of the firms measured in IMEF's non-manufacturing survey.

Banxico's QIR. Banco de Mexico will publish its Quarterly Inflation Report (QIR) for the fourth quarter of 2016 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 four issues: (1) Headline and core inflation maintained an upward trend as a result of the exchange rate depreciation and the new adjustment in energy prices –particularly gasoline prices–, which implies that the balance of risks for inflation has deteriorated; (2) Banxico's inflationary projections depicted in their traditional *fan charts*; (3) Banxico's GDP and output gap projections will be particularly interesting to watch after a board member highlighted the uncertainty surrounding its estimation; and (4) any reference to the FEC's FX hedge program announced on February 22.

In the last monetary policy statement, Banxico also referred to the deterioration of inflation expectations in the short, medium and long-term as a result of the negative impact of supply-side shocks, among which the central bank highlighted the increase in gasoline prices, and the recent hike in agricultural goods prices. In addition, the central bank also referred to the second-round effects derived from these shocks to inflation. In this context, we believe that any comment regarding this issue will be relevant in assessing Banxico's monetary stance.

In this context, we consider that the central bank will increase the reference rate by another 100bps in 2017. Given the FEC's announcement, the central bank now has more room to execute monetary policy due to fewer inflationary pressures derived from the reduced volatility of the exchange rate coupled with lower energy prices. In addition, the implementation of the exchange rate hedge program is also likely to lead to lower short-term inflation expectations. As a result, we now believe that Banxico has larger margin not to hike by 50bps as a response to a 25bps Fed hike.

Banxico's survey of economic expectations. Also on Wednesday at 10:00am (EST), Banco de Mexico will publish its monthly survey of economic expectations. The report is particularly relevant considering the new FX hedge program announced by the Foreign Exchange Commission (FEC). In this context, we expect significant revisions to FX forecasts, which we now believe to stand at USD/MXN22.3 by YE17. Moreover, market participants will focus will be on 2017 inflation expectations that currently are at 5.25% (Banorte-Ixe: 5.7%) and the analysts' assessments of GDP growth for 2017 which stands at 1.7% yoy, above our 1.1% yoy forecast.

The MoF's monthly report. On Thursday, the Ministry of Finance (MoF) will make its monthly finance report available for the first month of the year. On the revenue side, we will be looking at non-oil tax collection as it will provide additional information about domestic demand dynamics. However, given the significant depreciation of the Mexican currency in the last 3 months and the upward trend in Mexico's crude oil basket price, the behavior of oil revenues generated by the Federal Government will be specially relevant

In addition, markets will focus on the spending side of the report, in order to assess the execution of the fiscal cut announced by the *MoF* in Mexico's Fiscal Budget for 2017. Finally, it will be important to evaluate the evolution of public sector debt, which currently represents around 48% of Mexico's GDP.

We expect a 1.9% yoy expansion in December's GFI. Finally, on Friday at 9:00am (EST), *INEGI* will publish its December's gross fixed investment (GFI) report. We anticipate GFI up by 1.9% yoy. We believe that within the report we will probably see a 0.9% yoy decrease in imported machinery and equipment, given that trade balance figures showed a similar growth for capital goods imports. Moreover, we expect a 10.8% growth in domestic machinery and equipment. Finally, we believe that construction spending increased a scant 1% yoy derived from the lower public construction spending observed in the latest industrial production figures.

GFI forecasts

% yoy; %-pts

	Dec-16	Dec-15	2016	2015
Total	1.9	1.1	0.5	4.2
Machinery and equipment	3.3	6.5	1.3	8.5
Domestic	10.8	13.0	9.4	9.6
Imported	-0.9	3.1	-2.4	8.1
Construction	1.0	-2.3	0.0	1.6
Annual contribution	Dec-16	Dec-15	Difference	
Total	1.9	1.1	0.9	
Machinery and equipment	1.3	2.5	-1.1	
Domestic	1.6	1.7	-0.1	
Imported	-0.2	0.8	-1.0	
Construction	0.6	-1.4	2.0	

Source: Banorte-Ixe

Disclaimer

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