

Ahead of the Curve

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Market focus this week will be on Banxico's *Quarterly Report* and July's trade balance

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- **Banxico's Quarterly Report (2Q18).** Banco de Mexico will publish its *Quarterly Report* (QR) for the second quarter of 2018 on Wednesday around 1:30pm (ET). The release will be accompanied by a press conference led by Governor Diaz de Leon. In our view, market participants will focus on three topics: (1) Possible changes in inflation forecasts; (2) Banco de Mexico's perspective on economic growth; and (3) the traditional "grey boxes" that will probably elaborate on some themes currently affecting the Mexican economy
- **Trade balance (July).** On Monday at 9:00am (ET), Banxico and INEGI will make available their preliminary trade report for July, where we expect to see a US\$1,919.4 million surplus. On the exports side, we will probably see a 43.3% yoy expansion of oil exports as a result of the higher prices for the Mexican crude oil basket (52.2% yoy). In addition, non-oil exports could have increased 7.4% yoy, on the back of a similar growth in manufacturing exports. On the imports side, we estimate a 10.3% yoy expansion in total imports, as a result of the increase in oil related imports

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Mexico weekly calendar

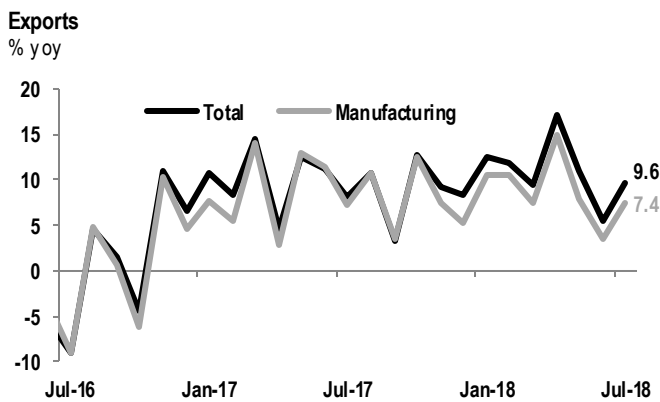
DATE	HOUR (ET)	EVENT	PERIOD	UNIT	BANORTE	CONSENSUS	PREVIOUS
Mon 27-Aug	9:00am	Trade balance	July	US\$ mn	<u>-1,919.4</u>	-1,400.0	-896.9
		Total exports		% yoy	<u>9.6</u>	--	5.4
		Oil ex ports		% yoy	<u>43.3</u>	--	41.0
		Non-oil ex ports		% yoy	<u>7.4</u>	--	3.6
		Total imports		% yoy	<u>10.3</u>	--	8.0
Tue 28-Aug	9:00am	Unemployment rate	July	%	<u>3.55</u>	<u>3.50</u>	3.39
		sa		%	<u>3.41</u>	<u>3.43</u>	3.39
Tue 28-Aug	10:00am	International reserves	Aug-27	US\$ bn	--	--	173.3
Tue 28-Aug	12:30pm	Government weekly auction: 1-, 3-, 6-month CETES; 10y Mbono (Jun'27); 5y Bondes D					
Wed 29-Aug	12:30pm	Banxico's Quarterly Report					
Thu 30-Aug		Budget balance	2Q18				
Fri 31-Aug	10:00am	Commercial banking credit	July	MXN bn	--	--	-206.7
		Consumption		% yoy	<u>7.5</u>	--	7.8
		Housing		% yoy	<u>2.8</u>	--	2.4
		Non-banking private firms		% yoy	<u>4.0</u>	--	3.9
					<u>10.5</u>	--	12.5

Source: Banorte; Bloomberg

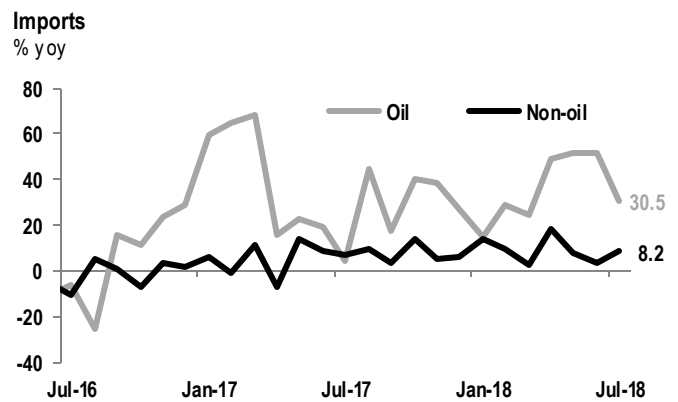
Proceeding in chronological order...

Strong performance of manufacturing exports will continue to support trade figures. On Monday at 9:00am (ET), *Banxico* and *INEGI* will make available their preliminary trade report for July, where we expect to see a US\$1,919.4 million surplus. On the exports side, we will probably see a 43.3% yoy expansion of oil exports as a result of the higher prices for the Mexican crude oil basket (52.2% yoy). In addition, non-oil exports could have increased 7.4% yoy, on the back of a similar growth in manufacturing exports.

On the imports side, we estimate a 10.3% yoy expansion in total imports, as a result of the increase in oil related imports. Moreover, taking a look at the breakdown, we believe that non-oil consumption goods imports edged-up 1.5% yoy, while imports of intermediate goods could have advanced 8.6% yoy. Finally, we estimate a 12.5% yoy growth in capital goods imports.

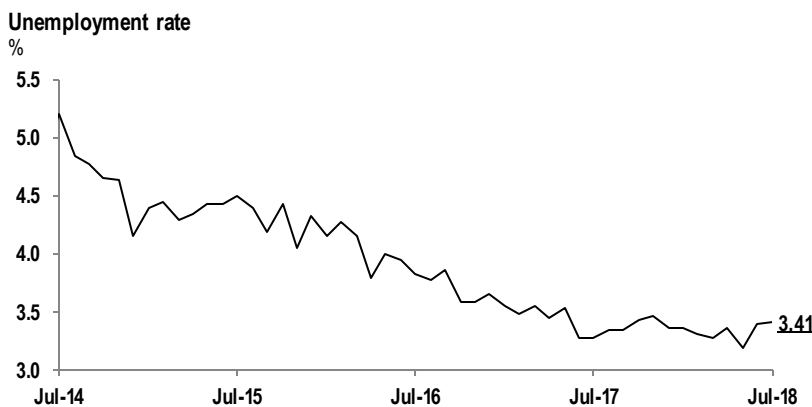


Source: INEGI, Banorte



Source: INEGI, Banorte

The unemployment rate in July will stand at 3.55%. On Wednesday, *INEGI* will publish its unemployment report for the seventh month of 2018, in which we estimate an unemployment rate of 3.55% nsa, above the 3.39% observed in June. In addition, in seasonally adjusted terms, we believe that the unemployment rate could stand at 3.41% which implies a 0.02% -pts increase from last month's figures. We believe that the marginal increase in the unemployment rate (seasonally adjusted) will be explained by the slowdown in the rate of formal job creation. However, it is worth noting that the unemployment rate continues to stand at low levels.



Source: INEGI, Banorte

Weekly international reserves report. On Tuesday, at 10:00am (ET), Banco de Mexico will release its weekly balance report. Last week, net international reserves decreased by US\$22 million amounting to US\$173.3 billion. According to Banxico’s report, this figure comes mainly as a result of a negative valuation effect in central bank assets. In this context, the central bank’s international reserves have increased by US\$527 million during 2018 (please refer to the following table).

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

	2017	Aug 17, 2018	Aug 17, 2018	Year-to-date
	Balance		Flows	
International reserves (B)-(C)	172,802	173,329	-22	527
(B) Gross international reserve	175,450	176,295	-392	845
Pemex	--	--	-73	-549
Federal government	--	--	-187	407
Market operations	--	--	0	0
Other	--	--	-132	987
(C) Short-term government's liabilities	2,648	2,966	-370	318

Source: Banco de México

Weekly government bond auction. In addition, on Tuesday, the Ministry of Finance (MoF) –via Banco de Mexico as its financial agent–, will offer 10-year fixed-rate Mbonos (Jun’27), 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 (ET).

Auction specifics (Tuesday, August 28th, 2018)

	Maturity	Coupon rate, %	To be auctioned ¹	Previous yield ²
Cetes				
1m	27-Sep-18	--	7,000	7.71
3m	29-Nov-18	--	11,000	7.90
6m	28-Feb-19	--	11,500	8.07
Bondes D				
5y	06-Jul-23	--	5,000	0.15
M Bono				
10y	03-Jun-27	7.50	9,000	7.75

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

Banxico’s Quarterly Report. Banco de Mexico will publish its *Quarterly Report (QR)* for the second quarter of 2018 on Wednesday around 1:30pm (ET). The release will be accompanied by a press conference led by Governor Diaz de Leon. In our view, market participants will focus on three topics: (1) Possible changes in inflation forecasts; (2) Banco de Mexico's perspective on economic growth; and (3) the traditional “grey boxes” that will probably elaborate on some themes currently affecting the Mexican economy.

Regarding inflation, we believe recent comments of the monetary authority on the subject could lead to an upward revision to the point estimates for the next quarters. This would probably imply that headline inflation would not fall within Banxico's target range until 2019, instead of 4Q18 as expected in the previous report (refer to the following table). It should be noted that in the last minutes, the Board made a greater emphasis than usual in the behavior of core inflation, commenting that “...it is the component that responds the most to monetary policy”. In this sense, we do not expect large revisions to its trajectory, thus leading us to think that further rate hikes are not likely in coming months.

Banxico inflation forecasts

% yoy, quarterly average

	Headline			Core		
	Forecast	Actual	Difference	Forecast	Actual	Difference
1Q18	5.5	5.3	0.2	4.4	4.3	0.1
2Q18	4.6	4.6	0.0	4.0	3.7	0.3
3Q18	4.3	4.8	-0.5	3.8	3.7	0.1
4Q18	3.8	4.5	-0.7	3.6	3.8	-0.2
1Q19	3.3	4.3	-1.0	3.3	3.7	-0.4
2Q19	3.1	3.9	-0.8	3.2	3.6	-0.4

Source: Banxico, INEGI, Banorte. *Note: Starting with 3Q18, Banorte's forecasts are used in the "Actual" column

In terms of economic growth, GDP shows a slight deceleration of the Mexican economy, mentioned both in the last *communiqué* as well as the minutes. In particular, 2Q18 GDP stood at 1.6% yoy (sa), below the 2.3% yoy (sa) of the previous quarter. We believe this was one of the highlights in both documents, in particular the mention that the growth estimates for 2018 “...is anticipated to fall to the lower part of the estimated range (2 to 3%)...”. As a result, we believe Banxico will revise its growth forecast to a range between 1.8% and 2.8%. The latter could result in less demand-side pressure on prices. Lastly, we will also focus on the updated for the output gap including 2Q18 data, which can give us more information about the cyclical position of the economy and its possible impact on the price formation process.

Although recent inflationary dynamics could put pressure on the central bank to increase the reference rate, we consider that this effect is transitory because of two factors: (1) The increase in international energy prices that is due in part to seasonal conditions; and (2) recent reversion to the mean in the prices of agricultural products after the steep fall seen in 1H18. In this context, once these factors dissipate, we expect headline inflation to converge towards our estimate year-end estimate of 4.3%. In terms of the FX, we anticipate that the currency will remain within a reasonable range despite recent bouts of volatility, with our forecast still at USD/MXN18.60 for the end of the year. Regarding the relative monetary policy stance vs. the US, it is worth noting that Banco de Mexico's next monetary policy decision is due one week after the FOMC holds its September meeting, at which we and the market expect a 25pb rate hike. Given that since December 2015 the Fed has increased its reference rate by 175bps while Banxico has hiked its rate by 475bps, it is our take that Mexico's monetary authority has some leeway to decouple from the Fed, at least in the short term. Taking into account these factors, we reiterate our view that Banxico will remain on hold for the next 18 months.

MoF's monthly public finance report. Next Thursday, the Ministry of Finance (MoF) will release its monthly finance report for July. In it, we will focus on the 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 behavior.

In addition, markets will focus on the spending side of the report, in particular comparing it vs. 2017, both on the discretionary side as well as with the debt servicing costs. Finally, it will be important to evaluate the evolution of public sector debt, which currently represents close to 45.2% of Mexico's GDP.

Banking credit will show a 7.5% yoy increase in July. Banco de Mexico will make available its banking credit report on Friday at 10:00am (ET). It is our take that banking credit continued flowing in July. In particular, we estimate a 7.5% yoy expansion in banking credit (in real terms), as a result of a 2.8% increase in consumer credit, coupled with a 4% and 10.5% expansion in mortgage and credit to firms, respectively.

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