

Macroeconomic Analysis

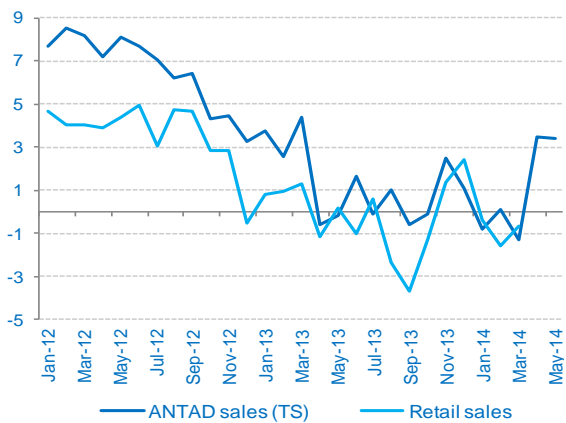
The minutes from Banxico's meeting will help to explain the surprising monetary cut

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What happened this week ...

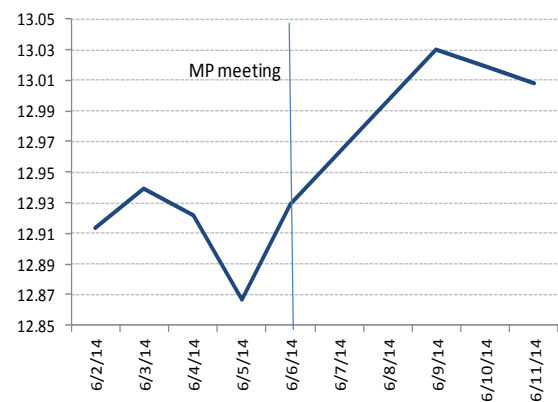
Mexico's industrial production grew by 2.5% in April compared to the same month in 2013, with seasonally adjusted figures (sa). This acceleration was mainly the result of a large annual (YoY) increase in the manufacturing sector (4.4%). The Electricity, Gas and Water item grew by 3.7% YoY, Construction by 0.3% YoY and Mining did so by 0.1% YoY, all with seasonally adjusted figures. The substantial improvement in Manufacturing indicates that external demand is picking up, but the weakness of the remaining sectors appears to suggest that more time is needed before this improvement can be seen in internal demand. In monthly terms, industrial production grew 0.6%, which was slightly above our forecast and below the consensus (BBVA Research: 0.4%; consensus: 0.9%). This positive result was mainly due to a significant increase in Manufacturing (1.1% MoM). Meanwhile, Electricity, Gas and Water grew by 1.3% MoM, Construction by 0.6% MoM, but Mining dropped 0.4% MoM, after seasonal adjustments. As long as industrial production in the United States, and particularly manufacturing production, continues its recent improvement, we can expect constant, although moderate, growth in Mexico's industrial sector. However, there is still a gap between industrial production growth in Mexico and the US, our main trading partner. This seems to be linked to the weakness in certain sectors more concentrated in domestic demand, where we expect to see a more visible recovery in the second half of 2014.

Figure 1
Retail sales and ANTAD sales, 2012-14
(annual % var. sa)



Source: INEGI

Figure 2
Exchange rate (USDMXN)



Source: Bloomberg and BBVA Research

Headline inflation fell by 0.32% MoM in May. This figures was virtually in line with our forecast and a little above market expectations (BBVAe: -0.30%; consensus: -0.36%). In annual terms, headline inflation went up to 3.51% from 3.50% in April. Core inflation increased by 0.09% MoM in May, above market expectations (BBVAe and consensus: 0.06%). The surprise came in the form of basic goods prices, which climbed 0.28% MoM in May (BBVAe: 0.18%). In annual terms, core inflation shrank to 3.0% from 3.11% in April, confirming the absence of demand pressures. Due to base effects, we anticipate that annual headline inflation will start to rise gradually in June (to 3.9%) and to levels slightly higher than 4.0% from July to October, before falling to 3.7% at the end of the year. Core inflation should stay under control for the rest of the year, but it is likely to accelerate slightly in the second half, if the economy strengthens as expected.

The gross fixed investment index for March 2014 registered an annual growth rate of 1.7% in its original series, whereas its monthly, seasonally adjusted, growth rate was negative, at -0.8%. We expected the investment index to grow in March by 0.4% YoY, since we forecast the machinery and equipment investment component would grow by 7.0%, and the observed figure was 8.4%. In terms of the investment component in construction, this was in line with the forecast (expected: -2.4%, observed: -2.2%). Thus, the investment components continue to behave differently. Investment in machinery and equipment shows signs of improvement with positive growth rates, since its average annual growth rate in the first quarter of 2014 was 3.5%, whereas the growth rate for this investment period in construction was negative, at -3.3%.

Adjustments after the monetary surprise in domestic markets. All eyes are on the Fed's monetary policy meeting next week. In a week without important data for the international markets, Mexican markets continued adjusting after the surprising 50bp cut in the monetary policy rate. At the beginning of the week the peso fell again, taking it to levels slightly above USDMXN13.0. Thus, two trading days after this cut, the peso depreciated 1.3%, the biggest depreciation of the emerging market currencies. In the days following, the exchange rate has moved in a narrow band between USDMXN12.97 and USDMXN13.02. In the government debt market, the rates adjusted upward after the average 37bp fall last Friday. Thus, the 10-year Mbono fell over the week by +6bp, closing at 5.67%, movements which are very much in line with the behaviour of US T bonds. For next week the markets will be focusing on the Federal Reserve's monetary policy statement. On this occasion, as well as the statement, they will publish the FOMC members' economic forecast and the Fed Chair will give a press conference.

The Mexican Social Security Institute (IMSS) reported that between April and May the total number of workers registered with this institute increased by 47,853 jobs. This means that the total number of jobs recorded with the institute in May will show an annual growth rate of 3.2%. Similarly, the total number of workers at the end of May has come in at 16,885,220. The increase in the number of workers who are permanently registered with the IMSS (workers with permanent labour contracts) was 67,042, whereas the number of workers with non-permanent jobs went down by 19,189.

...What is coming up next week

GFP components will be published. It is expected that these will show the weakness of both consumption and private investment in the first quarter. On 19 June the INEGI will publish the global supply and demand statistics for goods and services for the first quarter of 2014. This information refers to GDP components on the demand side, that is, consumption, investment, exports and imports. Our estimate of their quarterly growth rates in seasonally adjusted terms for these areas is as follows; private sector consumption, 0.2%; public sector consumption, 3.5%; gross fixed investment in the private sector, -1.7%; gross fixed investment in the public sector, 5.0%; exports, 1.5%, and imports, 2.5%.

Retail sales in April will show a 1.2% YoY increase, seasonally adjusted (sa). The figures will show a monthly increase of 0.8%, sa, driven by a slight recovery in employment and stable inflation. In March retail sales shrank by 0.63% YoY, sa.

Minutes from the Bank of Mexico's monetary policy meeting. Next Friday the minutes on the most recent monetary decision will be published. Given the surprising 50bp cut, the market will be looking closely at the opinions of the government's committee members, particularly those concerning activity performance. We should recall that the cut was made after lower-than-expected growth in 1Q and after the members announced, in their April monetary decision statement, a marginal improvement in some components of internal demand. The opinion debate about the short-term real rate should be carefully studied, particularly after last October's minutes indicated that a negative real rate was not necessary for prevailing economic conditions.

Indicator Calendar

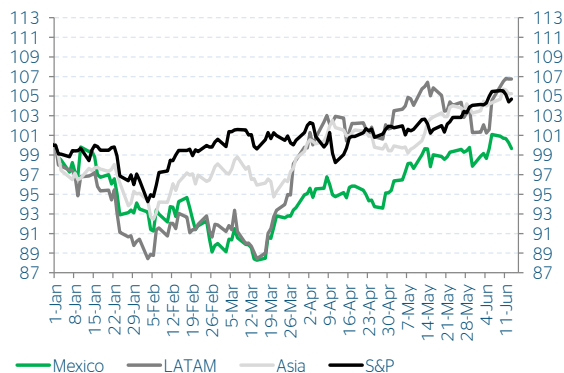
Mexico	Indicator Period	Date of Publication	BBVA Estimate	Consensus	Previous figure
Global supply and demand, private consumption (QoQ % change)	1Q14	19 Jun	0.2%	-	0.1%
Global supply and demand, private investment (QoQ % change)	1Q14	19 Jun	-1.7%	-	-0.2%
Retail sales (YoY % change, sa)	April	20 Jun	1.2%	--	-0.63%

United States	Indicator Period	Date of Publication	BBVA Estimate	Consensus	Previous figure
Industrial production (MoM % change, sa)	May	16 June	0.8%	0.5%	-0.6%
Capacity utilization (%)	May	16 June	78.9	78.9	78.6
Headline inflation (MoM % change)	May	17 June	0.2	0.2	0.3
Housing starts ('000s)	May	17 June	1,010	1,030	1,072
Leadind index (mOm % change, sa)	May	19 June	0.3	0.6%	0.4%

Source: BBVA Research with data from Bloomberg. sa = seasonally adjusted. 1Q14= First quarter 2014.

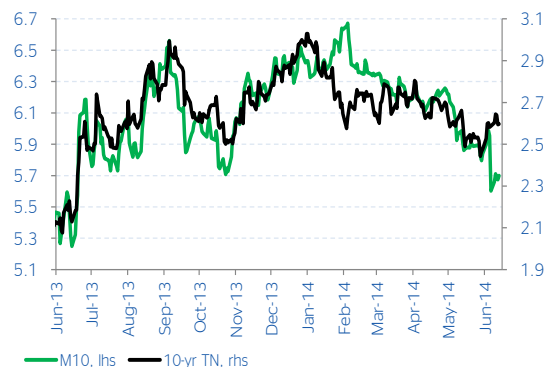
Markets

Figure 3
MSCI stock market indexes (1 Jan 2014 index=100)



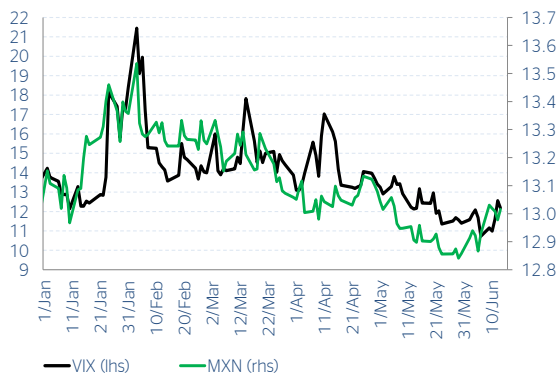
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



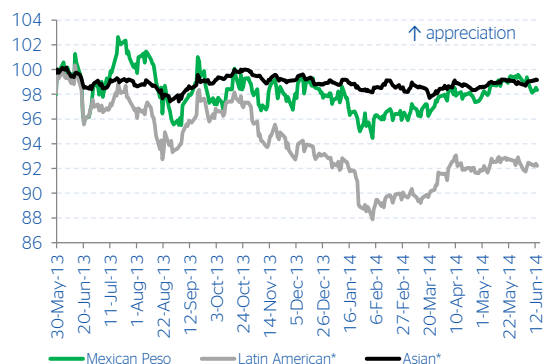
Source: BBVA Research, Bloomberg

Figure 5
Global risk and exchange rate (VIX index & USDMXN)



Source: BBVA Research, Bloomberg

Figure 6
Currencies to USD (30 May 2013 index=100)



* Latin American and Asian currencies against the JP Morgan dollar; weighted averages by trade & liquidity. Source: BBVA Research, Bloomberg

Annual information and forecasts

	2012	2013	2014
Mexico GDP (YoY % change)	4.0	1.1	2.5
Headline inflation (avg. %)	4.1	3.8	4.0
Core inflation (avg. %)	3.4	2.7	3.1
Monetary Policy Rate (avg. %)	4.5	3.8	3.5
M10 (avg. %)	5.7	5.7	6.1
GDP USA (YoY % change)	2.8	1.9	2.5

Source: BBVA Research

Recent publications

Date	Description
9 Jun 2014	➔ Mexico Inflation Flash. The inflation outlook remains benign
10 Jun 2014	➔ Mexico Flash. Data of IMSS of May indicate that formal employment in Mexico continued to increase
11 Jun 2014	➔ Mexico Flash. Industrial production shows a robust increase in April, mainly driven by manufactured goods
11 Jun 2014	➔ Mexico Real Estate Watch. The 2014-18 National Infrastructure Programme is the most ambitious yet: if executed, it will impact positively on the economy

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