

Economic Analysis

IGAE's performance in May was more sluggish than expected

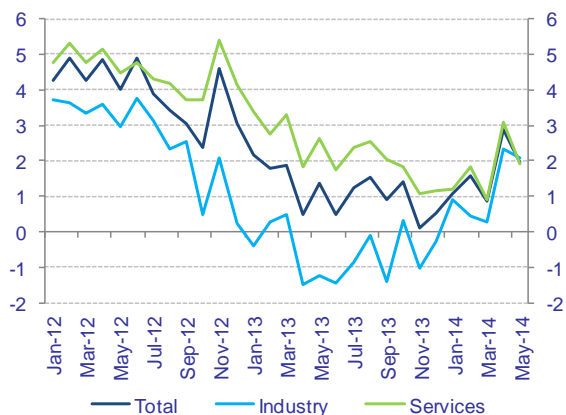
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What happened this week ...

In line with our estimates, retail sales in May grew by 1.2% YoY, with seasonally adjusted figures (sa) (BBVA Research: 1.1% YoY, sa). In monthly terms they fell by 0.1%, sa. This is due to the slow rate of employment creation and the scarcely increased real wages in February and March.

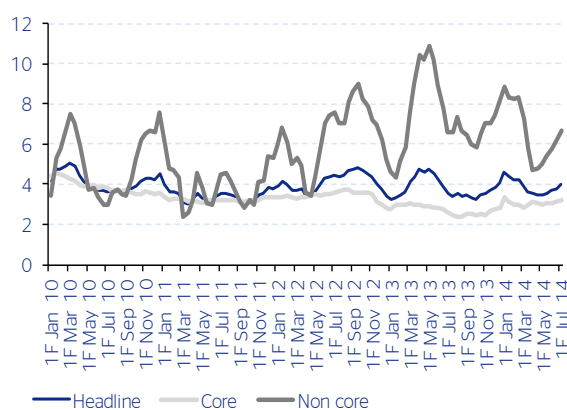
Mexico's Global Economic Activity Indicator (IGAE) grew 1.9% in May compared to the same month last year, after seasonal adjustments. However, in monthly terms, the IGAE fell by 0.1%, sa, in May, which was below our expectations (BBVA Research: 0.3%, sa). This result was principally due to the fall in services (-0.2% MoM, sa) and to the fact that growth in both industry (0.1% MoM, sa) and agriculture (1.0% MoM, sa) was moderate. This shows that the second quarter is performing rather more slowly than expected (see Figure 1).

Figure 1
Global Economic Activity Indicator and its components, 2012-14 (YoY % change, sa)



Source: BBVA Research with data from INEGI.
sa = seasonally adjusted.

Figure 2
Headline inflation and its components (YoY % change)



Source: BBVA Research with data from INEGI

As we forecast, inflation in the first half of July was driven by the summer holiday season. Both headline and core inflation increased virtually in line with our forecasts, surprising the market to the upside. Headline inflation went up by 0.20% QoQ in the first half of July (BBVAe: 0.22%; consensus: 0.16%). The YoY rate

accelerated to 4.0% (BBVAe: 4.02%; consensus: 3.96%). Core inflation was 0.14% QoQ, almost exactly the increase we had forecast (BBVAe: 0.15%, consensus: 0.10%). This figure surprised the market and was driven, as we anticipated, by the summer holiday season, inasmuch as there was a steep jump in tourism services and air transport fares. In annual terms, core inflation accelerated to 3.20% (BBVAe: 3.21%, consensus: 3.16%) from 3.09% in the previous fortnight. Annual inflation will hover around 4.0% between July and September, due to base effects, before falling to 3.7% by the end of the year.

June's trade balance was in surplus by USD424mn. INEGI's information on the balance of trade for June indicates a positive performance, and the surplus achieved this month was the result of a 7.7% annual increase in total exports and expansion of 9.6% in imports. This surplus was below our estimate (BBVA Research: USD 756mn) and was the result of greater-than-expected expansion in both exports and imports, although with greater emphasis on imports. As long as this improvement in exports continues, it should have a favourable impact on economic activity.

Weak internal demand continues, in the view of most members of Banxico's steering committee.

According to the minutes of the most recent monetary policy meeting, the greater dynamism in the economy in the second quarter was due to external demand. In terms of the different components of internal demand, most members stated that there were signs of recovery or a degree of improvement, for which reason some members considered that the balance of activity risks showed an improvement, somewhat similar to that seen in the minutes from last April. As far as the balance of inflation risks goes, there is disagreement, since while the majority believe that it continues to be favourable, some argue that it maintains an upward bias. The lack of consensus between the members of the Committee is also apparent in the degree of differentiation between investors in the scenario of Mexico facing an episode of volatility, such as might occur in the event of a faster-than-expected increase in the US monetary policy rate. Finally, the divided voting over the latest cut was reflected in the opinions over the markets' reaction: while most of them stated that the reaction had been positive, some members considered it a risk to have acted in an unexpected manner, and were concerned by the fact that some agents did not fully understand the cut.

Optimism in markets about China's economic reacceleration. The geopolitical risks resulting from tensions with Russia have had very little impact on emerging economies' financial assets. Global economic performance has been the predominant factor in recent market behaviour. Over the last few weeks, the improved macroeconomic data from China have exceeded expectations. In particular, this week China's PMI (from HSBC) rose to 52 points, a much stronger reading than expected, and its highest for 18 months, which suggests that the government's recent measures are underpinning growth in the second quarter. Taken in conjunction with the surprise to the upside in China, the manufacturing PMI in the eurozone was also higher than expected this week. This continued to drive the risk-on mood in the markets, reflected by the stock exchange indexes (see Figure 3). Furthermore, in the last few weeks of low financial volatility, the negative correlation between bond yields and shares seems to have returned. Thus, the long-term rates of interest in the US fell. Emerging economy currencies remained strong, although they were relatively unchanged over the week.

...What is coming up next week

On Friday 1 August the IMEF will publish its indicators about expectations for manufacturing and non-manufacturing performance in July. These indicators will provide clues about the country's manufacturing and non-manufacturing activity at the outset of the third quarter. We estimate that the performance of IMEF indicators will be moderate, but positive, in view of the slight improvements in the economic activity data from the US. A monthly increase in the industrial sector of 0.2% and of 0.1% for US manufacturing in June.

Inward remittances may reach USD1.978bn in June, equivalent to a 1.4% increase YoY. As we anticipated in previous months, despite the impetus enjoyed by remittances in the first quarter this year, in the second quarter remittances may have had more moderate growth rates. Downward adjustments to economic growth forecasts in the US are also reflected in variables relating to the performance of Mexican migrants there, and the latter are linked to the flow of remittances to Mexico. On the other hand, however, the US unemployment rate in June improved, coming in at 6.1%, its lowest rate since 2008.

Next week, market attention will return to the US with the publication of the first flash on 2Q GDP, the ISM industrial activity index and the employment figure for July. As well as the above, the Federal Reserve will meet to take its monetary policy decision.

Indicator Calendar

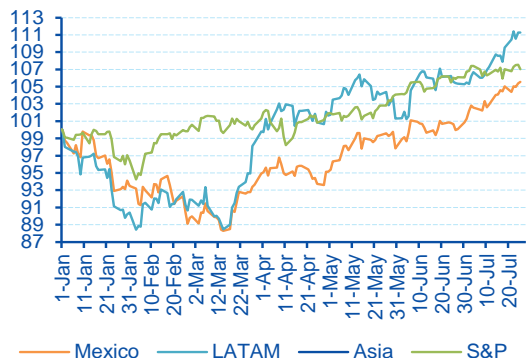
Mexico	Indicator Period	Date of Publication	BBVA Estimate	Consensus	Previous figure
IMEF manufacturing index (index, sa)	July	1 Aug	50.6	50.8	50.3
IMEF non-manufacturing index (index, sa)	July	1 Aug	50.4	50.5	50.3
Household remittances (USD mn)	June	1 Aug	1,978.0	2,042.0	2,144.5

United States	Indicator Period	Date of Publication	BBVA Estimate	Consensus	Previous figure
Consumer confidence indicator (index)	July	29 July	85.50	85.45	85.18
Annualised GDP (QoQ % change, sa)	2Q14	30 July	3.50	3.10	-2.90
Fed funds target rate (%)	July 30	30 July	0.25	0.25	0.25
Unemployment rate (%)	July	01 Aug	6.10	6.10	6.10
Manufacturing ISM, PMI (index, sa)	July	01 Aug	55.90	56.00	55.30

Source: BBVA Research with data from Bloomberg. sa = seasonally adjusted. QoQ= quarterly variation rate. 2Q14=Second quarter of 2014.

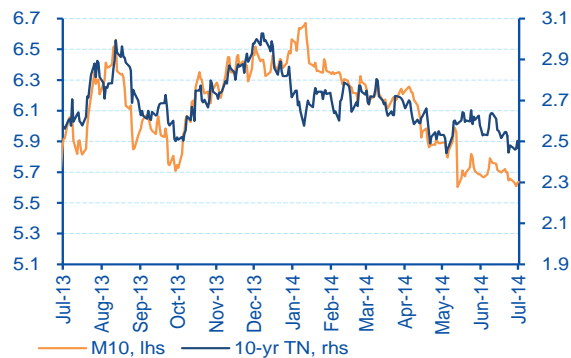
Markets

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



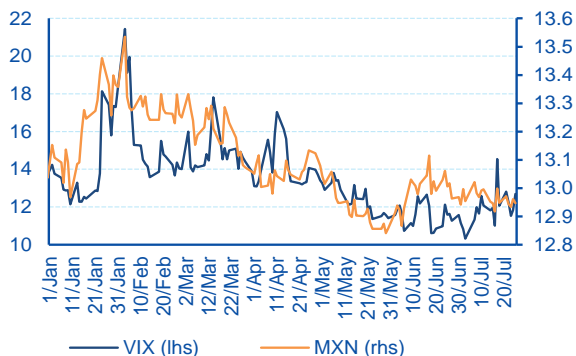
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



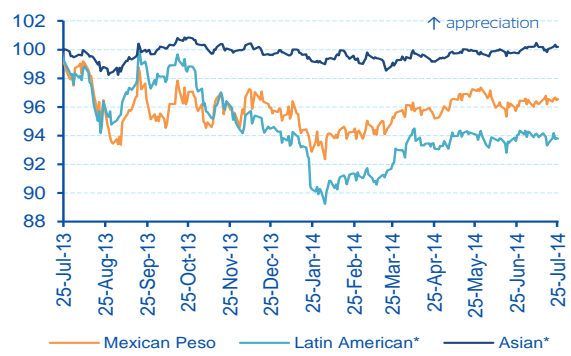
Source: BBVA Research, Bloomberg

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



Source: BBVA Research, Bloomberg

Figure 6
Currencies to USD (25 July 2013 index=100)



* JP Morgan indices of Latin American and Asian currencies vs. USD; 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	3.9
Core inflation (% , avg.)	3.4	2.7	3.2
Monetary Policy Rate (% , avg.)	4.5	3.8	3.2
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
22 July 2014	➔ Mexico Financial Inclusion Watch. Do remittances foster financial inclusion in Mexico?
22 July 2014	➔ Mexico Banking Outlook First Half 2014 (Spanish version)
24 July 2014	➔ Mexico Inflation Flash. Strong inflation driven by the summer vacation season
24 July 2014	➔ Mexico Flash. In May IGAE shows a unexpected negative monthly performance (-0.1% MoM, sa)

Disclaimer

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