

Economic Analysis

We estimate that second quarter 2014 GDP will show quarterly growth of 0.85% sa

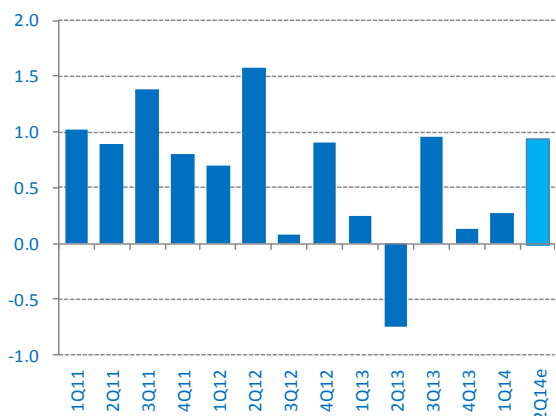
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What happened this week...

June industrial production showed a monthly fall (-0.2%) sa, although because of comparison base effects this was equivalent to an annual (YoY) increase of 1.8%, sa. This slight monthly drop was associated with a significant decrease in manufacturing (-0.7% MoM, sa) and in mining (-0.6% MoM, sa). Meanwhile the construction subsector grew (1.2% MoM, sa), while electricity, gas and water were unchanged (0.0% MoM, sa). This supports our expectation of slow economic growth for the second quarter of this year. The industrial sector's performance in June, especially manufacturing, as noted elsewhere, is strongly linked to weak internal demand, despite the improvement in industrial production in the US and its links with Mexican production.

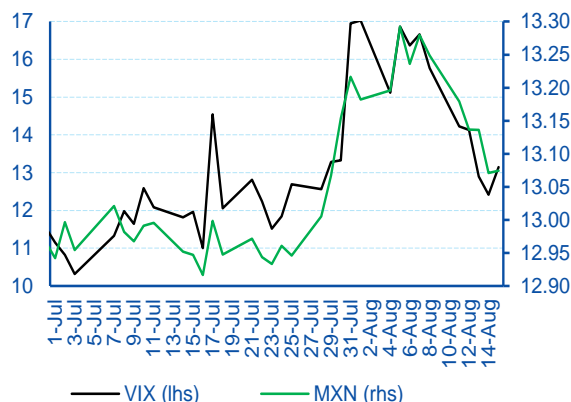
Banxico cut its growth estimate to a range between 2.0 and 2.8%. During the presentation of its April-June 2014 inflation report, Banxico reiterated that monetary policy was focused on achieving an efficient convergence, that is, at the least cost in terms of economic activity. It reduced its growth estimates for 2014 to between 2.0% and 2.8%, down from between 2.3% and 3.3%, taking into account the lower than expected growth data for the first quarter. For 2014 the growth prognosis remains unchanged, within a range of 3.2% and 4.2%. The primary feature was an absence of demand side pressures on prices in a context of a widening output gap, which is not expected to close until the latter part of next year.

Figure 1
Real and estimated GDP for 2Q14 (QoQ % change, sa)



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

Figure 2
Exchange rate and global risk (USDMXN and pp)



Source: BBVA Research with data from Bloomberg.

Workers newly affiliated to the Mexican Social Security Institute increased by 37,457 in July. The total number of jobs registered with Social Security during the month expanded by 3.7% YoY to a total of 16,965,972. In the preceding month of June there were 43,295 new jobs registered, so July's result did not achieve the hoped-for increase in this indicator.

Even though there was no clear positive trigger, financial assets performed favourably, partially reversing their losses over the last two weeks. This week the data from key economies were generally disappointing. Growth and inflation in the eurozone deteriorated. The eurozone recorded quarterly annualised, seasonally adjusted (qasa) growth of just 0.2%. The surprises to the downside were led by the contraction in the key economies (Germany -0.6% qasa, France -0.1% qasa and Italy -0.8% qasa). Inflation in the eurozone slipped to 0.4% YoY in July and expectations point to the annual rate falling more over the next few months. In the US, retail sales surprised to the downside in July and figures from preceding months were revised downwards. It is possible that financial assets reacted positively to the bad economic news for a combination of two reasons. First, the combination of weak GDP growth and the fall in eurozone inflation puts more pressure on the ECB to make monetary policy even more flexible so as to prevent deflation risks from materialising. Second, sales figures in the US allayed concerns that the Fed may be forced to act on rates earlier than planned. Furthermore, although geopolitical tensions persist, they eased slightly over the course of the week. In this context, risk premia on emerging markets' financial assets were sufficiently attractive for investors to generate demand for these assets. The peso was one of the strongest currencies last week.

...What is coming up next week

Second quarter (2Q14) GDP will be published. We expect quarterly (QoQ) growth to be 0.85%, with seasonally adjusted series. On Thursday 21 August the INEGI will announce GDP growth for the second quarter. Following on from 0.28% quarterly growth in the first quarter, the economy is expected to have accelerated, with 0.85% QoQ GDP growth (see Figure 1). The key components sustaining this estimate are, on the one hand, the increase in industrial production in April and May, although it fell in June (+0.5%, +0.3% and -0.2% MoM, sa, respectively) and on the other, acceleration in exports, particularly manufacturing. We expect this quarterly growth to be confirmed and accelerate in the next few quarters, to reach the estimated rate of 2.5% annual economic growth by the end of 2014.

We estimate that the Global Economic Activity Index (IGAE) for June will show YoY growth of 1.85%, sa. Nevertheless, in monthly terms we forecast a slight fall, related to small decreases in both the industrial and services sectors. We should recall that the IGAE fell in May, MoM, by 0.12%, sa, due for the most part to the slackening in the services sector (-0.22% MoM, sa). In the original series, the IGAE will register annual growth equivalent to 2.54% in June.

We forecast that the unemployment rate will reach 4.86% in July. On Friday, 22 August the INEGI will publish the occupation and job index for July. Given the economy's sluggish performance, we expect the rate of unemployment to increase slightly and to come in at 4.86% in July, up from 4.80% in June 2014.

We expect annual inflation to remain slightly above 4.0% from August to October. For the first half of August we anticipate a fortnightly increase of 0.16% in the general price index and of 0.11% in the core index. If our forecasts are correct, in annual terms headline inflation will come in at 4.04% (compared to 4.07% in July) while core inflation will be around 3.30% (compared to 3.25% in July). As far as core prices go, the end of the summer holiday season will account for a fortnightly fall in prices in the other services sub-index. This fall will be more than offset by the onset of seasonal rises in school fees (although the rises are higher in September, they

are also noticeable in August because of the start of term in higher education). Our price monitoring suggests an increase in the four main components in the agriculture and fisheries sub-index and significant upticks in the prices of chicken and other meat, particularly pork. These increases more than offset the monthly fall in the price of LP gas. As far as our outlook for the year is concerned, and as we have forecast already, inflation came in above the upper variability limit of Banxico's target in July, and we forecast that it will remain slightly over this threshold from August to October, before slipping to 3.8% in November and to 3.7% by the end of the year. We forecast that core inflation, on the other hand, will remain relatively stable at 3.3% for the rest of the year.

Economic symposium at Kansas City Federal Reserve Bank. Central bankers, academics, finance ministers and financial market players will meet between 21 and 23 August to discuss major economic issues, and the implications of monetary policy decisions. This year the symposium is titled "*Re-Evaluating Labor Market Dynamics*". The markets will be on the look-out for what the Chair of the Fed has to say, in order to gain clues about upcoming monetary policy decisions in the US.

Indicator calendar

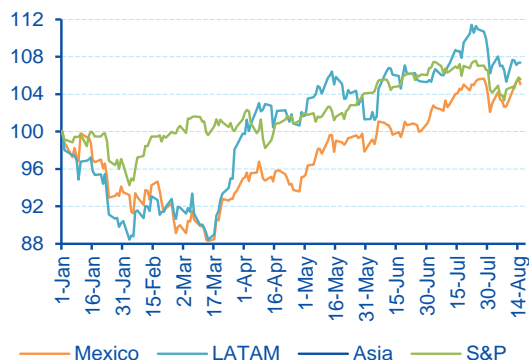
Mexico	Indicator Period	Date of Publication	BBVA Estimate	Consensus	Previous figure
Gross Domestic Product (QoQ % change, sa)	2Q14	21 Aug	0.85	0.80	0.28
IGAE (YoY % change, sa)	June	21 Aug	1.85	--	1.94
Unemployment rate (YoY % change)	July	22 Aug	4.86	5.00	4.80
Headline inflation (FoF % change)	1F Aug	22 Aug	0.16%	0.12%	0.12%
Core inflation (FoF % change)	1F Aug	22 Aug	0.11%	0.10%	0.05%

United States	Indicator Period	Date of Publication	BBVA Estimate	Consensus	Previous figure
Unemployment benefit claims ('000s, sa)	16 Aug	21 Aug	300.0	300.0	311.0
Existing home sales (% change, annualised, sa)	July	21 Aug	5.10	5.00	5.04
Existing home sales (MoM % change, sa)	July	21 Aug	1.10	-0.80	2.65
Leading indicator, Conference Board (MoM % change)	July	21 Aug	0.30	0.60	0.30

Source: BBVA Research with data from Bloomberg. sa = seasonally adjusted. YoY = annual variation rate. QoQ = quarterly variation rate. FoF = fortnightly variation rate. MoM = monthly variation rate. 2H14 = second half of 2014. 1FAug = first fortnight of August.

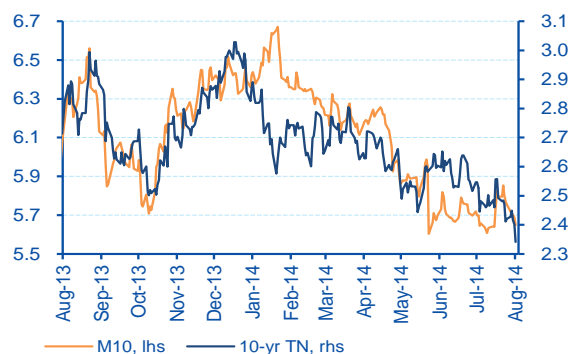
Markets

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



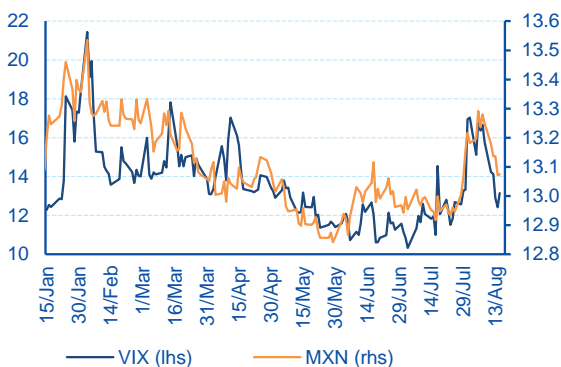
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



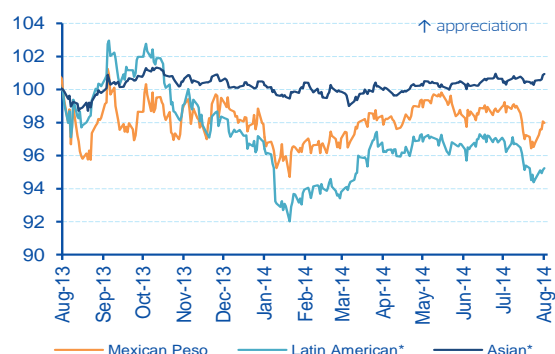
Source: BBVA Research, Bloomberg

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



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD
(15 Aug 2013 index=100)



* JP Morgan Latin American and Asian currency indexes 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
US GDP (YoY % change)	2.8	1.9	2.0

Source: BBVA Research

Recent publications

Date	Description
11 Aug 2014	➡ Mexico Flash. Industrial Production shows a small monthly decrease in June (-0.2%, sa)
13 Aug 2014	➡ Banxico Flash. Banxico reduces its 2014 growth estimate to between 2.0 and 2.8% (Spanish)

Disclaimer

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