Economic Analysis

GDP components will show in detail the extent of the positive effect of external demand

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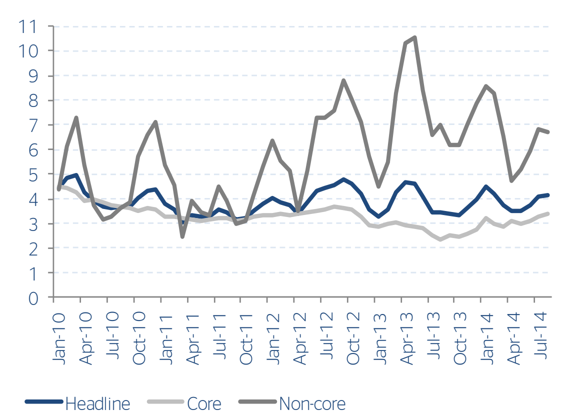
What happened this week …

Industrial production grew in line with our expectations. Industrial production grew by 0.3% in July in monthly terms, implying an annual growth of 2.0% when seasonally adjusted (sa) (BBVAe: 2.2% YoY). An acceleration in the manufacturing sector (1.3% MoM) accounts for most of the improvement, whereas the construction and mining sectors remained weak (-0.1% and -0.3% MoM, respectively).

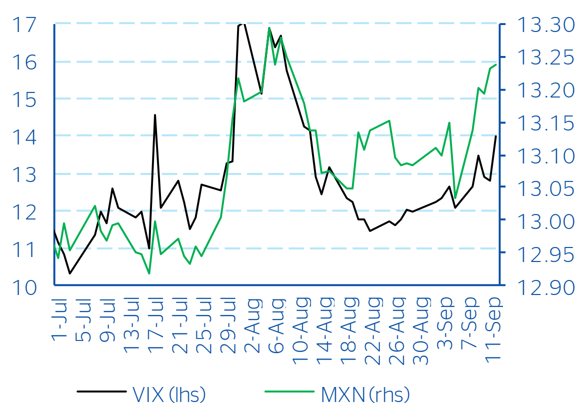
Headline inflation surprised to the upside and core inflation was slightly higher than forecast, too. We are adjusting our inflation prognosis for the end of the year from 3.7% to 3.8%. Headline inflation increased by 0.36% MoM in August. The figure was higher than we expected (BBVAe: 0.31%; consensus: 0.31%). Headline inflation accelerated to 4.15% from 4.07% in July. Core inflation increased 0.21% MoM, slightly above market expectations (BBVAe: 0.18%; consensus: 0.20%). In annual terms, core inflation rose to 3.37% from 3.25% in July. Although core prices, particularly services prices, continue to show an absence of demand-side pressures, processed food prices have risen at a faster rate than last year, even after excluding the effect of new taxes in January. While we continue to expect that core inflation will remain low and relatively stable, we are reviewing our prognosis for the end of the year to 3.4%, from our earlier 3.3%. We expect annual inflation to remain above the inflation target's higher variability limit in the next two months, before falling slightly in the two final months of the year. However, anticipating marginally higher agricultural prices for the rest of the year, and considering our review to the upside of core prices, we have adjusted our prognosis for the end of the year from 3.7% to 3.8%.

Figure 1
Headline inflation and components (YoY % change)



Source: BBVA Research with data from INEGI

Figure 2
Exchange rate and global volatility index (USDMXN; pp)



Source: BBVA Research with data from Bloomberg

The correction to the upside in US Treasury bond yields caused major losses on assets perceived as higher risk. This week the market seems to have started to reverse a part of what it has so far been discounting on monetary policy in the US. After last week, when yields on the 10-year T bond reached their lowest level since June 2013 (2.34%), this week two events related to the perception of monetary policy in the US triggered severe market movements. The first was a document published by the San Francisco Federal Reserve arguing that markets may be underestimating the rate of future monetary policy hardening in the US. The second was the perception that there might be a change in the direction steered by the Federal Reserve (Fed) in its monetary policy statement next week after the monetary policy meeting on 16 and 17 September, in view of recent comments made by the respective Chairs of the Boston and San Luis Feds, Eric Rosengren and James Bullard. In a reaction to these events, the US 10-year bond yield rose 15bp from its level at the close of the week before, and 27bp over the lowest rate seen for over a year (2.34%) recorded at the beginning of the previous week, to come in at 2.61%. These movements and the greater uncertainty caused severe changes in other variables. Stock indicators in emerging markets fell across the board and there was a generalised fall in currencies against the dollar. The biggest losers over the week were the Brazilian real and the Colombian peso. In Mexico the yield on 10-year government bonds increased to 5.94% (+20bp up from the close of last week), while the peso depreciated 1.6%, ending the week at USDMXN 13.24. Next week all eyes will be on the Fed's monetary policy decision announcement on Wednesday.

…What is coming up next week

On 19 September the INEGI will publish the 2Q14 Goods and Services Supply and Demand figures. This gives a detailed breakdown of GDP components in the second quarter on the supply side (GDP and imports) and on the demand side (total consumption, gross capital formation and exports). In 2Q14, the annual growth rate of the original series of GDP was 1.6%, and our estimated annual growth rate for its components is as follows: total consumption, 1.4%; gross fixed capital formation, -0.4%; exports, 5.5%; imports, 3.8%. Based on this information, we believe that total consumption will have accounted for 1.1pp of the 1.6pp growth of GDP in the second quarter. Second, there is the net contribution of the external sector of 0.6pp (1.8pp from exports, less 1.2pp from imports): finally, the contribution of gross investment will be negative, at -0.1pp. Although we estimate that the contribution of investment will have been negative in the second quarter, this already indicates that there has been an improvement compared with the contribution to growth in the first quarter of the year, at -0.2 pp.

Next Friday the minutes of Banxico's monetary policy meeting will be published. It will be helpful to learn about Board members' inflationary perspectives in more detail. The most recent monetary policy announcement adopted a more neutral tone because of the increased short-term inflation risks. In the minutes it will be important to learn about the Board members' views on the outlook for inflation, particularly considering that the announcement of the decision included a revision to the upside of the forecast to the end of 2014 and that convergence to 3.0% was delayed from January to some point in the first half of next year. Furthermore, attention should be paid to comments on economic activity, in the light of a better-than-expected GDP growth figure for the second quarter, which is helping to improve the activity risk balance.

Calendar of indicators

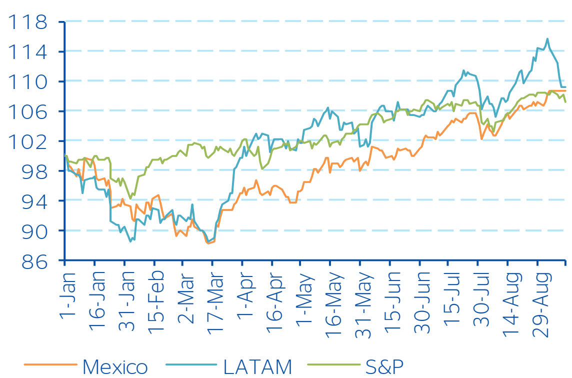
Mexico	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Goods and services supply and demand (YoY % change)	2Q14	19 Sept	2.1	--	2.4

USA	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Empire State general business conditions survey, diffusion index, sa	September	15 Sept	12.75	15.90	14.69
Industrial production indicator (MoM % change, sa)	August	15 Sept	0.50	0.30	0.44
Used capacity (% of total capacity, sa)	August	15 Sept	79.30	79.30	79.20
Philadelphia Fed Business Outlook Survey Diffusion Index General Conditions	September	18 Sept	19.30	23.00	28.00
Conference Board Leading Index MoM	August	19 Sept	0.50	0.40	0.90

Source: BBVA Research with data from Bloomberg. YoY = annual variation rate. sa = seasonally adjusted. MoM = monthly variation rate.

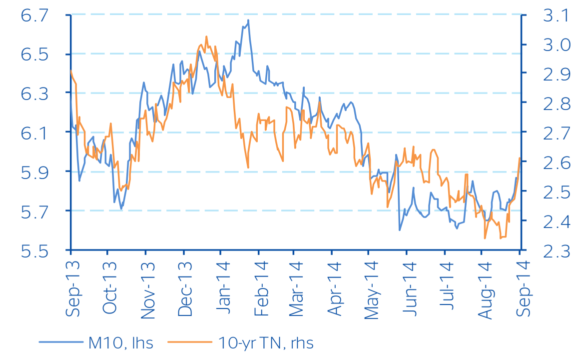
Markets

Figure 3
MSCI stock market indices (Index 1 Jan 2014=100)



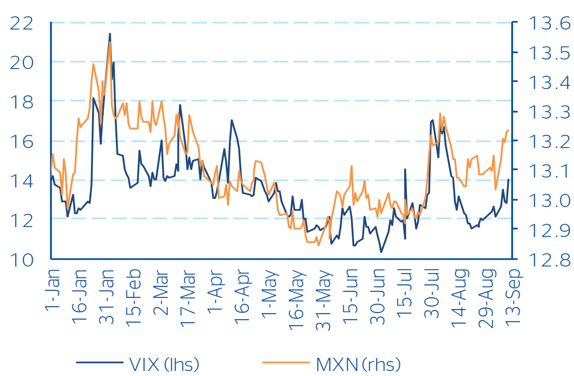
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



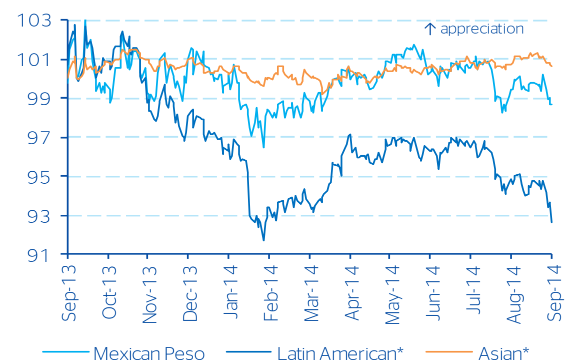
Source: BBVA Research, Bloomberg

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



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD (12 Sept 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
General inflation (%, average)	4.1	3.8	4.0
Core inflation (%, average)	3.4	2.7	3.2
Monetary Policy Rate (%, average)	4.5	3.8	3.2
M10 (%, average)	5.7	5.7	6.1
US GDP (YoY % change)	2.8	1.9	2.0

Source: BBVA Research

Recent publications

Date		Date
9 Sept 2014	➡	Mexico Inflation Flash. We adjust our year-end forecast from 3.7% to 3.8%
10 Sept 2014	➡	Mexico Banking Flash. Banking deposits: performance improves after a brief pause
11 Sept 2014	➡	Mexico Flash. In August formal employment continued to rise in the IMSS and the total number of registered workers was greater than 17 million (Spanish)