Economic Analysis

Economic activity in August surprised to the downside, due to the weak services sector

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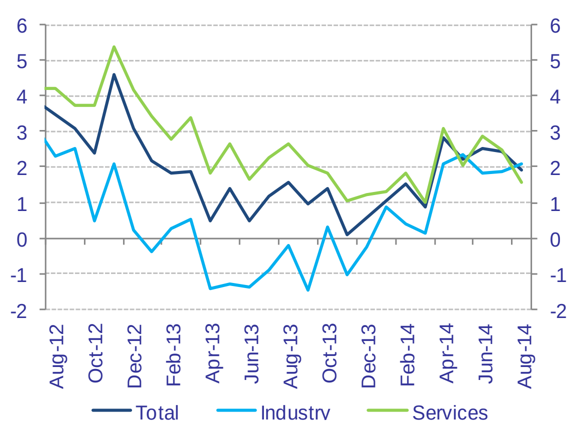
What happened this week …

The Global Economic Activity Index (IGAE) slowed in August, with a monthly (MoM) fall of 0.2%, mainly as a result of a weaker-than-expected services sector, with seasonally adjusted figures (sa). The monthly fall of the IGAE was a result of decreases in agriculture, (-0.4% MoM, sa) and in services (-0.2% MoM, sa), although industry increased by 0.48% MoM, sa. In annual terms, the IGAE grew by 1.9% sa (BBVAe: 2.7% YoY, sa), while in terms of its components, agriculture grew by 7.2% YoY, sa; industry by 2.1% YoY, sa; and services by 1.6% YoY, sa. These results suggest a slow pace in economic growth, although we should wait and see whether services do better in September, thanks to strong performance by industry and their high correlation with the latter sector.

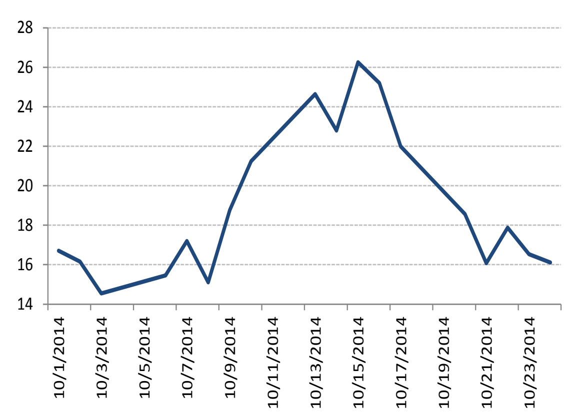
Annual inflation has reached its peak. We expect it to stand at 3.8% by the end of the year. Headline inflation rose 0.50% QoQ in the first half of October, driven upwards principally as a result of the seasonal correction in electricity prices. This figure surprised a little to the upside (BBVAe: 0.46%; consensus: 0.46%). Headline inflation increased to 4.32% from 4.22% the previous fortnight. Core inflation was 0.12% QoQ, lower than expected (BBVAe: 0.16%; consensus: 0.14%). In annual terms it stood at 3.32%, slightly less than the previous fortnight (3.34%). Although inflation was a little higher than expected, the breakdown of the fortnightly increase is consistent with our forecast for the end of the year (BBVAe: 3.8%; consensus: 4.0%), given that it is clear that there are no demand-side pressures and that pressure on farming and fishery prices seems to be easing.

Figure 1
IGAE by components, 2012-14 (YoY % change, sa)



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

Figure 2
Global risk aversion (VIX index, %)



Source: BBVA Research with data from Bloomberg.

Retail sales surprised to the upside, rising by 5.0% in August YoY, after seasonal adjustments (sa). This higher-than-expected increase (BBVAe: 2.7% YoY, sa), represents the biggest annual increase since December 2013 (5.3% YoY, sa). In monthly terms (MoM), the acceleration in retail sales was 0.6%, sa. The faster pace of formal job generation (57,689 jobs) and the recovery of industrial production (0.37% MoM) in August appear to account for this rise. This indicator merits close attention, since it uses a new statistical method, which causes major changes in the results from the earlier calculation method. For example, under the former system of measurement, July retail sales enjoyed annual growth of 1.6%, sa, whereas the new methodology puts this increase at only 1.0%.

Week of lower risk aversion influenced by favourable data from the eurozone. Concerns about a slowdown in the rate of activity at a global level fell over the week, after the figures on the outlook for the manufacturing industry (PMI) in Europe and China were more positive than expected. In addition, the figures in the third quarter corporate results in the US do anything but suggest a forthcoming slowdown. Indeed, of the 64 companies on the S&P 500 index which have published their results so far, 60% have beaten analysts' expectations. As well as this round of higher-than-expected corporate results, there is the US August inflation figure (0.2%MoM, 1.7% YoY) which keeps price increases below the Fed's target and, as such, generates expectations that the cycle of monetary tightening will not be brought forward. In this context of lower risk aversion, the S&P 500 stock index showed gains of 4.13% over the week, while the IPC grew by 0.9%. On the government bond market, yields on the 10-year T-bond rose by 7 basis points over the week, closing at 2.26%. In Mexico the equivalent M-bond closed unchanged from the previous week at 5.86%. Finally, on FX markets the MXN depreciated over the week by 0.26%, the third biggest depreciation among LatAm currencies.

…What is coming up next week

We expect the balance of trade as of September 2014 to register a smaller positive balance. On 27 October the INEGI will publish the balance of trade figures for September. We estimate that the external balance will be positive in August, at close to USD100mn (consensus: - USD318mn). We have reached our forecast by taking the estimated annual growth rate to September 2014 for goods exports of 3.6% and an annual growth rate of imports of 5.5%. In terms of the comparison between the balance of trade and other figures, in September 2013 the former showed a surplus of USD650mn, while by August 2014 the external balance was negative, at –USD1.1bn. Insofar as the consensus and this bank both estimate that the balance of trade, whether surplus or deficit, will be small, both estimates consider that the amounts of goods exports and imports in September will be similar.

The monetary policy rate will stay at 3.0% in an inflationary context which is still above the inflation target range of variability. The monetary policy decision will be published next Friday. We do not expect changes in the rate, for the following reasons: i) inflation remains over 4.0%. In the first half of October inflation crept up to 4.32% YoY, which we expect will be its peak of the year. Although we forecast that inflation will fall from this point onwards, down to around 3.8% YoY by December, we cannot yet rule out the short-term risks represented by fish product prices; ii) mixed figures in terms of economic activity. Although the August figure from the IGAE surprised to the downside (-0.2% MoM), growth in the industrial sector (0.4% MoM), influenced to a large degree by an increase in external demand which is expected to hold, leads us to believe that the drop in the services sector in August (-0.2% MoM) could reverse. In fact, over the last five years there have only been four occasions on which there has been a monthly fall in the services sector after the industrial sector had grown 0.4% MoM or more during the previous month. Furthermore, higher-than-expected job creation figures (156,432) and for retail sales (0.6% MoM) in September are signs that the quarter will close in positive territory, and iii) the central bank's communication. Banxico adopted a neutral tone in its latest monetary policy statement and has reiterated that it holds to its conviction that additional reductions in the foreseeable future are not to be recommended.

All the attention of the markets will be on the Fed's monetary policy meeting and the US GDP figure. On 29 October, the Federal Reserve will publish its monetary policy decision, in which it is expected to conclude its bond-purchasing programme (QE3). The markets will be looking out for any changes in the language of the statement which might provide more information about any delay in the cycle of monetary tightening. Furthermore, on 30 October the US Trade Department will issue the initial estimate of 3Q growth in the US economy.

Calendar of indicators

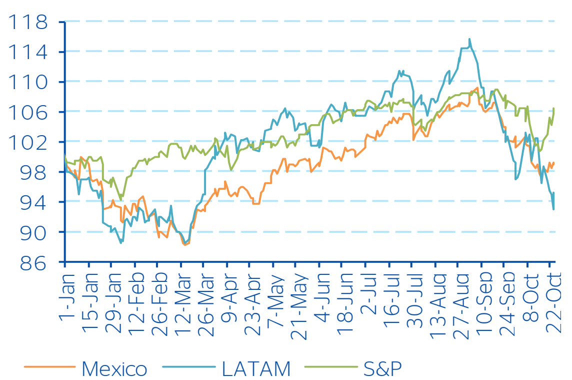
Mexico	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Balance of trade (USD mn)	September	27 Oct	97.0	-317.8	1,123.1
Monetary policy decision	October	31 Oct	3.0	3.0	3.0

United States	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Durable Goods New Orders Industries (MoM, sa)	September	27 Oct	3.00	0.50	0.40
Conference Board Consumer Confidence (sa, 1985=100)	October	28 Oct	87.30	87.00	86.00
GDP Chained 2009 Dollars (QoQ, saar)	3Q	30 Oct	2.50	3.05	4.60
University of Michigan Survey of Consumer Confidence Sentiment	October	31 Oct	86.00	86.40	86.40

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

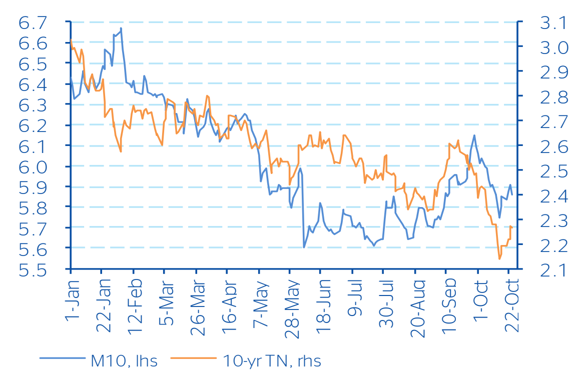
Markets

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



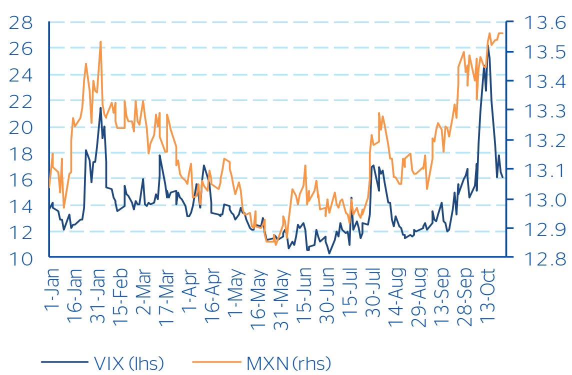
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



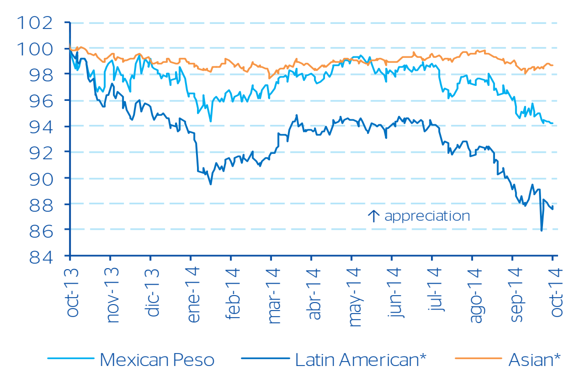
Source: BBVA Research, Bloomberg

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



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD (17 Oct 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	6.0
US GDP (YoY % change)	2.8	1.9	2.0

Source: BBVA Research

Recent publications

Date		Description
20 Oct 2014	➡	Mexico Banking Flash. Banking deposits: growth slows, but stays in double figures
23 Oct 2014	➡	Mexico Inflation Flash. Annual inflation has peaked. We expect it to reach 3.8% by year-end