Macroeconomic Analysis

In Mexico, annual inflation has surprised to the downside and the financial markets are responding well to the ECB announcement

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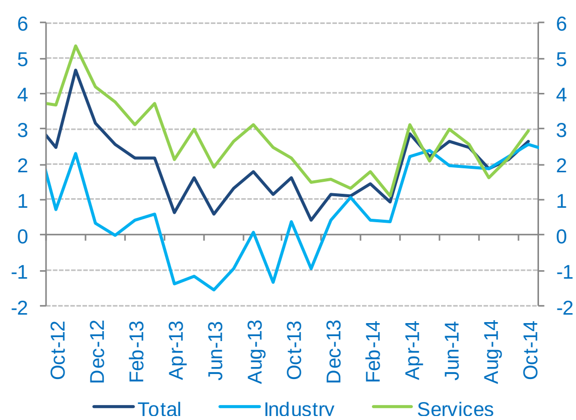
What happened this week …

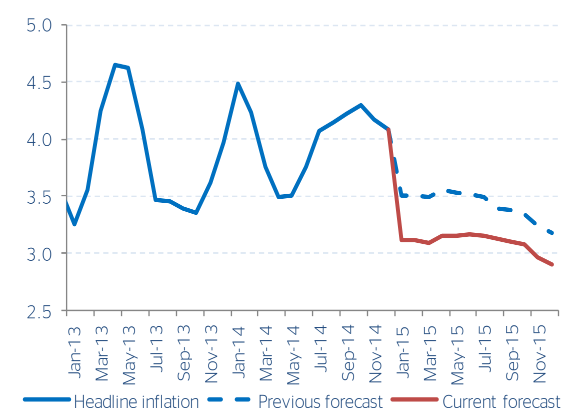
Inflation fell sharply in the first half of January; we have made a downward revision to the forecasts we made for year-end. Headline inflation diminished by 0.19% FoF (fortnight on fortnight) in the first half of January, surprising to the downside (BBVAe: 0.17%, consensus: 0.23%). This surprising result was mainly due to the greater-than-expected falls in telephony prices (at a rate of -0.15pp, rather than -0.10pp), the lower-than-expected rises in petrol (0.9% FoF compared to the expected 1.9% FoF) and in the core component of merchandise (0.40% FoF instead of 0.60% FoF), and stronger falls than expected in the fruit and vegetable component, in particular in tomato prices, which lopped 0.2pp off fortnightly inflation. In annual terms, headline inflation came in at 3.08%, down from 4.08% at the close of 2014. Core inflation, meanwhile, dropped by 0.09% FoF. In annual terms (YoY), core inflation slid to 2.43% from 3.24% at the close of 2014. The unexpected fall in prices in the first half of January has led us to revise our forecast for the year-end to the downside, to 2.9% (from 3.2%), with core inflation at 2.8% (from 3.0%). Furthermore, we now estimate that headline inflation will remain close to the central bank's target (which is 3.0%) for most of the year, before edging down to 2.9% in December.

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



Source: BBVA Research with data from INEGI.

Figure 2
Annual inflation perspectives (%)



Source: BBVA Research with data from INEGI.

The National Association of Self-service and Department Stores (ANTAD) reported that its nominal sales index for December 2014 for all stores had enjoyed YoY growth of 5.4%, slightly above our estimate of 4.2%. In real terms the annual rate of growth of ANTAD stores was only 1.3%, reflecting the feeble momentum in consumption.

The markets welcomed the European Central Bank (ECB)'s quantitative easing. As expected, at its monetary policy meeting on Thursday, the ECB announced the forthcoming purchase of sovereign debt, known as quantitative easing (QE). The programme is more ambitious than expected, with a monthly purchasing rate of EUR60bn. The President of the ECB, Mario Draghi, justified the programme by pointing to the persistence of lower-than-expected inflation which indicated that the degree of current monetary flexibility was insufficient to deal with the risk of an over-long period of low inflation. Draghi explained that the Governing Council (GC) had unanimously agreed that the asset purchasing programme was a real, and compliant, monetary policy tool. In term of inflation perspectives, the GC will continue to monitor closely the medium-term risks, although it stated that it expects the risks to the downside to fall as a result of the measures announced. We expect the ECB programme to be highly effective as a pure monetary policy tool to combat low inflation, keep long-term interest rates low, encourage risk taking and contribute to the depreciation of the euro. The markets responded positively to the asset purchasing programme and yields in bond markets fell across the board. Yields on 10-year government debt in periphery countries saw decreases over the week of -13bp (base points) in Spain, -13bp in Italy, in Portugal -8bp and -95bp in Greece, with Bund yields falling by -9bp. Meanwhile US T-bonds remained practically unchanged (although volatile) and yields on emerging debt fell, encouraged by the behaviour on European bond markets. Yields on the 10-year M-bond closed the week at 5.32% (-9bp). The euro suffered a sharp depreciation against the US dollar, falling below EURUSD1.12 for the first time in over 11 years. Furthermore, European stock markets were boosted over the week (Euro Stoxx +5.6%), with the indexes making significant gains (IBEX +5.4%, DAX +4.7%). US stocks also had an uptick this week (+1.9%) and implicit volatility fell drastically (the VIX index fell by -22.7% to 16.2). Emerging currencies suffered no major changes. Both the ruble and the Brazilian real appreciated against the dollar over the week (by 2% and 1.6% respectively), while the Mexican peso remained stable and the Colombian peso depreciated (-0.9%).

…What is coming up next week

Retail sales in November will be published on 26 January, and we estimate that there will be a YoY increase of 1.9%, seasonally adjusted (sa). This result is affected by the moderate performance of ANTAD sales, given that total stores sales rose in November by 1.0% YoY, sa, and with the continuous generation of formal jobs in November (122,850 jobs). Note that in October retail sales grew YoY by 5.0%, sa.

We forecast that in November the Global Economic Activity Indicator (IGAE) will post YoY growth of 2.3%, seasonally adjusted (sa). The INEGI will publish the IGAE figure for November on 27 January. We expect growth of economic activity to continue slowly because of the sluggish recovery in the services sector. Note that in October the IGAE grew by an annualised 2.7%, sa.

We estimate that in December 2014 the trade balance will have come in positively, at USD1.2bn. On 27 January the INEGI will publish the country's trade balance figure for December 2014. We estimate that the trade balance will be positive, to the tune of USD1.2bn, and this will be the result of an annual growth in exports of goods and services of 5.0%, together with annual growth in imports of 6.6%. Note that in November 2014 the trade balance was negative, at nearly -USD1.1bn, whereas in December 2013 it posted positively, at just over USD1.6bn.

Monetary policy rate unchanged at 3.0%. On Thursday 29 January at 1pm, Banxico will announce its monetary policy decision. In an environment dominated by the divergence of economic cycles between the main regions in the world, the start of the cycle of monetary policy normalisation in the US will have a significant effect on monetary policy decisions in Mexico, as the governor of the central bank commented recently. Nevertheless, it is important to bear in mind the effect on the wider economy of expansive conditions and the reduction in inflation, particularly given the emphasis which the current governmental committee has laid on achieving "efficient" convergence with the inflation target. Thus, based on the current environment and on the outlook for economic growth of above 3.0% this year, we believe that the monetary pause may last until the third quarter of 2015.

Calendar of indicators

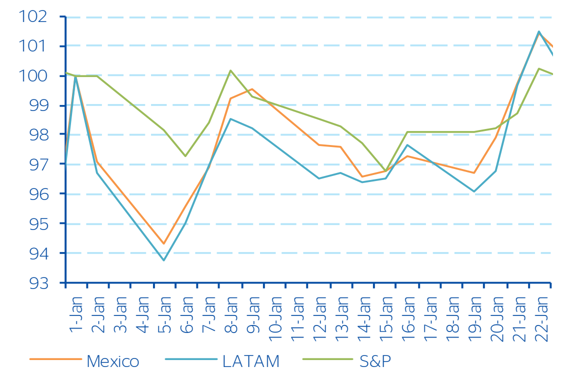
Mexico	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Retail sales (YoY % change, sa)	November	26 Jan	1.92	--	4.96
IGAE (YoY % change, sa)	November	27 Jan	2.3	--	2.7
Trade balance of merchandise (USD mn)	December	27 Jan	1,200	1,011.5	-1,76.4
Monetary policy decision (MPR)	29 January	29 Jan	3.0	3.0	3.0

USA	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Manufacturing activity, Dallas Federal Reserve (MoM % change)	January	26 Jan	2.5	3.2	4.1
Consumer confidence index	January	27 Jan	94.9	95.5	92.6
Annualised GDP (QoQ % change, sa)	4Q14	30 Jan	2.3	3.1	5.0

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

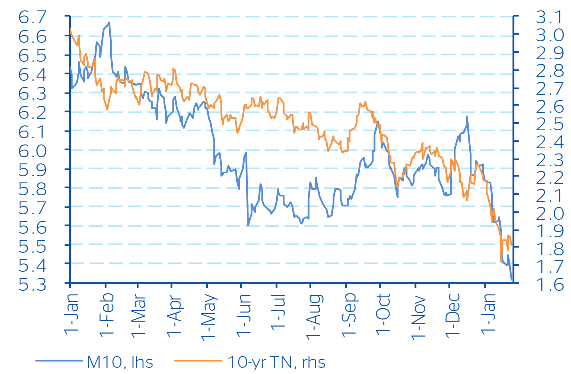
Markets

Figure 3
MSCI stock market indices (Index 1 Jan 2015=100)



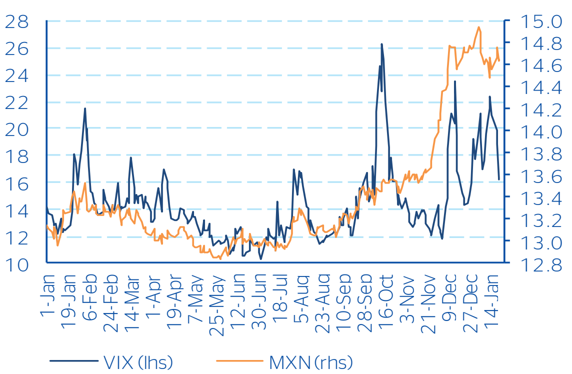
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



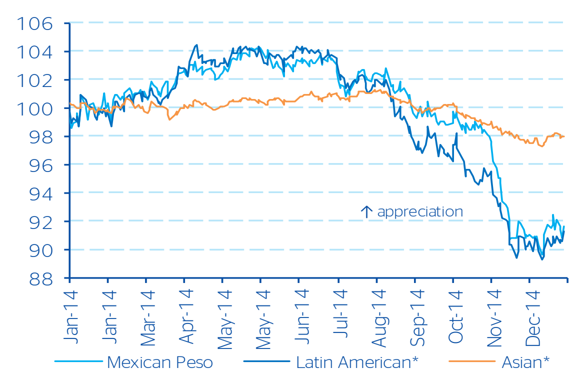
Source: BBVA Research, Bloomberg

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



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD (23 Jan 2014 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

	2013	2014	2015
Mexico GDP (YoY % change)	1.4	2.1	3.5
Headline inflation (%, average)	3.8	4.0	3.1
Core inflation (%, average)	2.7	3.2	2.6
Monetary Policy Rate (%, average)	3.8	3.2	3.2
M10 (%, average)	5.7	6.0	5.7
US GDP (YoY % change)	1.9	2.0	2.5

Source: BBVA Research.

Recent publications

Date	Date	Date
14 Jan 2015	➡	Mexico Banking Outlook, January 2015 (Spanish version)