Economic Analysis

Precautionary spending cut, to mitigate fiscal risks in 2016

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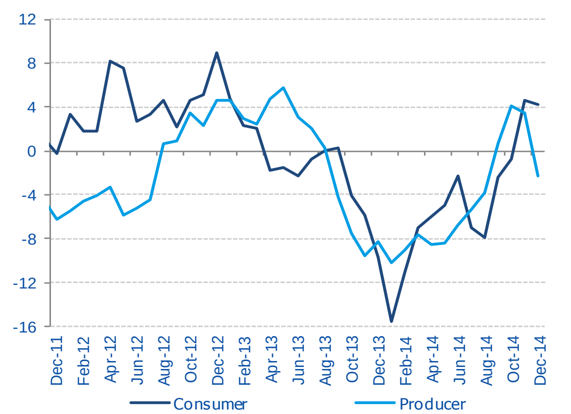
What happened this week …

Retail sales rose by 1.9% at an annual rate (YoY) in November, with seasonally adjusted (sa) figures. This increase, which we were expecting (BBVAe: 1.9% YoY, sa), equates to a monthly rate of 0.8%. In original series, the YoY rise was 1.2%, vs. 5.6% the preceding month. This figure indicates a slow growth rate in consumption at the end of last year, in line with our expectations of moderate economic growth in 2014.

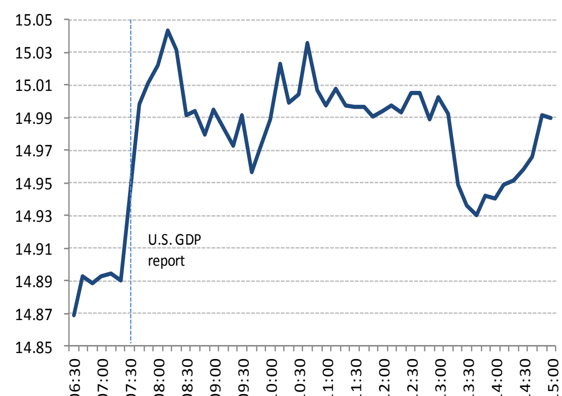
The Finance Ministry (SHCP) announced a public spending cut equivalent to 0.7% of GDP, to preserve the fiscal stability of the country in the light of low oil prices on international markets. On Friday the Ministry announced a spending cut worth MXN124.3bn, prompted by the lower revenues expected from the state sector as a result of the expectation of a prolonged low oil price on international markets, and in order to adopt a precautionary position for public finances in 2016. Pemex and CFE have cut their spending by MXN72bn, representing 58% of the correction, while MXN52bn, the remaining 42%, will come from adjustments in Federal Government departments. Of the latter, 65% of the reduction will come from current spending, with the remaining 35% to be found from investment projects, among other items, by cancelling the plans for a Transpeninsular passenger train and the suspension of the México-Querétaro train project (see Mexico Flash, in Spanish, "Se anuncia recorte al gasto del sector público de 0.7% del PIB").

Figure 1
Producer and consumer confidence indicators (Annual % change, sa)



Source: BBVA Research with data from INEGI.

Figure 2
Interday exchange rate 30/Jan/2015 (USDMXN)



Source: BBVA Research with data from INEGI.

According to the INEGI, Mexico's global Economic Activity Indicator (IGAE) rose by 2.8% in November over the same month the year before (YoY), with seasonally adjusted figures (sa). In original series the IGAE reported annual growth of 2.0%. The IGAE's better-than-expected performance (BBVAe: 2.3% YoY, sa), was a result of an annual increase in the following sectors: Services (3.0% in November vs 3.0% in October) and Agriculture (1.2% in November vs -1.9% in October), while Industry grew by 2.4% (vs 2.6% in October), all with seasonally adjusted figures. In monthly terms, the IGAE enjoyed growth in November of 0.49%, sa. This result was due to major rises in services (0.33% MoM, sa) and in industry (0.23% MoM, sa). Meanwhile, agriculture dropped by 2.02% MoM, sa. This represents a major boost in economic performance in the fourth quarter of last year, although still within the moderate growth parameters for 2014 (2.1%).

The monetary policy rate was held at 3.0%. Monetary stance relative to the US and the exchange rate remain the focus of attention for the central bank. Banxico reiterated the importance of strengthening the macroeconomic framework in the monetary and fiscal areas in view of the risks of greater exchange rate volatility, particularly in a scenario in which the Federal Reserve raises interest rates. There are no major changes in the balance of risks for economic activity and inflation, even after the reduction in annual inflation to 3.08% in the first half of January. Nevertheless, the central bank was cautious about the upside risks on prices which a prolonged exchange rate depreciation would bring. We consider that the tone of the statement, taken with our economic scenario for 2015, supports our forecast of a hike in the monetary rate around the third quarter of the year.

…What is coming up next week

We forecast that the IMEF indicators on the manufacturing and non-manufacturing performance expectations for January will remain stable. These indicators will give hints about expectations for the country's economic activity at the outset of 2015. We forecast that the IMEF manufacturing index will not show any significant changes from the month before, because of the accumulation of stocks and the effect of the post-holiday budget crunch, and that the IMEF non-manufacturing indicator will increase marginally over the previous month because of a slow performance in services.

In December, remittances may have reached USD1.897bn, equivalent to growth of 2.6% YoY. Over the course of 2014, the trend of employment recovery in the United States was confirmed, with a reduction in the unemployment rate from 6.7% to 5.6% between December 2013 and December 2014. Monthly estimates based on the Current Population Survey (CPS) do not provide enough evidence to conclude that the volume of Mexican migrants in the US is already curving upwards; even so, in 2014 there was an increases in remittances, mainly explained by two factors: 1) the increase in the number of jobs for Mexican migrants in the US (nearly 400,000 jobs in 2014); and 2) part-time jobs being substituted by full-time ones. Thus, the total flow of remittances entering Mexico in 2014 is forecast to be close to USD23.3bn, which would be a YoY increase of 6.4%.

We expect the producer confidence index to remain negative in January and the index of consumer confidence to change very little. On 5 and 6 February, the INEGI will publish the producer confidence (PCI) and consumer confidence (CCI) indexes for January. We estimate that the PCI will come in at 49.6 points (pt), seasonally adjusted (sa), down from 50.4pt the previous month, due to the moderation in production because of the post-holiday budget crunch. Furthermore, in view of the job destruction in the formal economy in December

(-235,490 jobs), we expect the CCI to reach 93.3pt, compared to 93.0pt last month (see figure 1). This is equivalent to 92.8pt with original series.

The dollar has risen to over 15 pesos because of lower-than-expected US growth. The exchange rate on the intraday market was higher than USDMXN15.00 for the first time since 2009, on the news that the US economy grew by 2.6% YoY, below the 3.0% expected by analysts. By the end of trading it was USDMXN14.97. The peso depreciated 2.15% over the week, making it the currency with the fourth biggest depreciation among emerging currencies, below the Turkish lira, the Brazilian real and the Russian rouble. During the week, the central bank's statement reduced the pressure on the peso to some extent, after the markets discounted its expansionary stance and some analysts were even expecting a reduction in the rate. On the variable income markets, poorer-than-expected company results in the US, uncertainty about the situation in Greece and further reductions in the price of oil all influenced the weekly losses of 2.76% on the S&P 500 and of 3.98% of the IPC. On the bond market, the correlation between US T-bonds and the reduction in inflation took precedence over the episodes of volatility and kept interest rates in Mexico down. So it was that yields on the 10-year M-bono fell by 8 basis points, closing at 5.23%, their lowest since 2013.

Indicator calendar

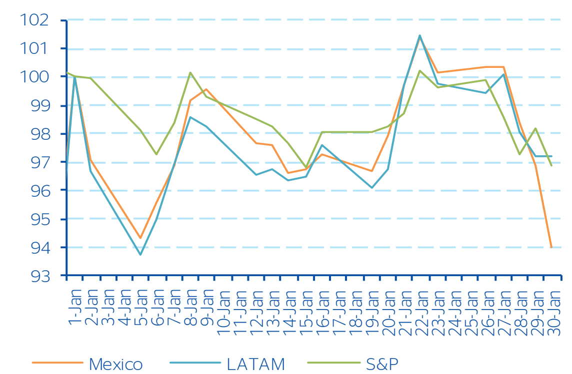
Mexico	Indicator Period	Date of Publication	BBVA Estimate	Consensus	Previous figure
IMEF manufacturing indicator (index, sa)	January	2 Feb	49.7	50.4	49.7
IMEF non-manufacturing indicator (index, sa)	January	2 Feb	50.1	50.3	49.9
Household remittances (USD mn)	December	3 Feb	1,897.0	1,922.4	1,772.0
Producer confidence (Index, sa)	January	5 Feb	49.6	--	50.4
Consumer confidence (Index)	January	6 Feb	92.8	93.6	93.6

United States	Indicator Period	Date of Publication	BBVA Estimate	Consensus	Previous figure
Personal income (MoM % change, sa)	December	2 Feb	0.10	0.20	0.40
ISM Manufacturing PMI (Index, sa)	January	2 Feb	55.10	54.50	55.10
Auto sales (million units, annualized, sa)	January	3 Feb	17.10	16.60	16.80
Manufacturers new orders (MoM % change, sa)	December	3 Feb	-1.00	-2.20	-0.70
ISM non-manufacturing NMI (Index)	January	4 Feb	55.70	56.50	56.50

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

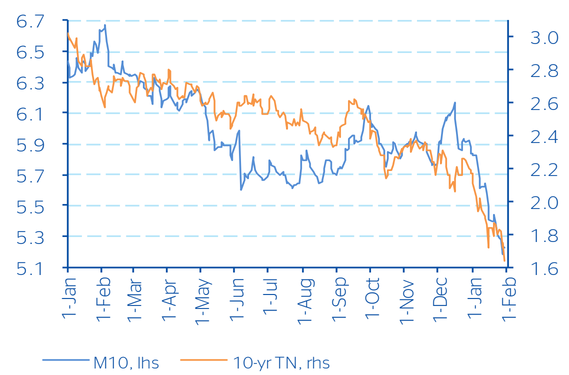
Markets

Figure 3
MSCI stock market indexes (1 Jan 2015 index=100)



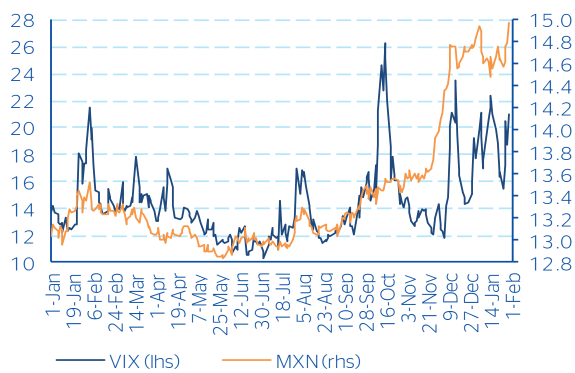
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



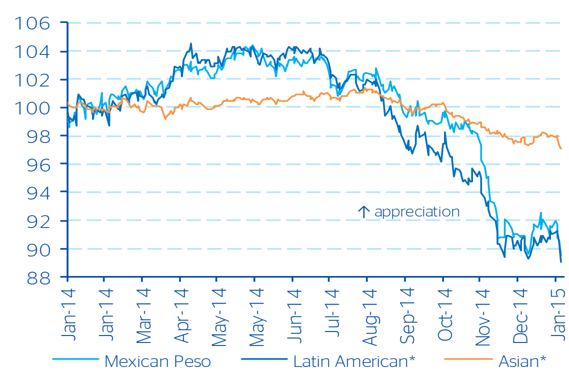
Source: BBVA Research, Bloomberg

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



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD (23 Jan 2014 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

	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	2.4	2.5

Source: BBVA Research.

Recent publications

Date		Description
27 Jan 2015	➡	Mexico Flash. In November the IGAE shows a positive annual performance (2.8% YoY, sa)
29 Jan 2015	➡	Banxico Flash. Fondeo rate unchanged at 3.0%
30 Jan 2015	➡	Mexico Flash. The Mexican Ministry of Finance announces that 2015 budget is cut in 0.7% of GDP (in Spanish)