Economic Analysis

Industrial production down 0.4% MoM (sa) in January. Growth expectations for 1Q15 under downward pressure

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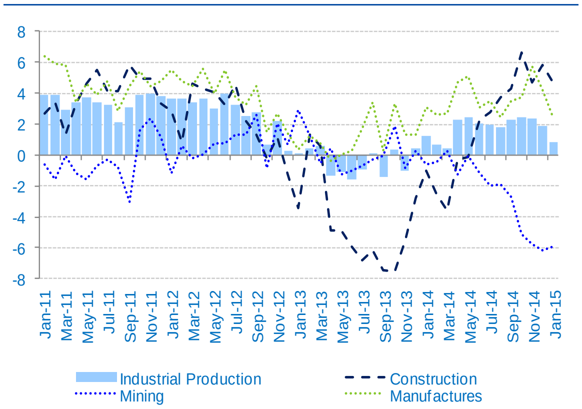
What happened this week…

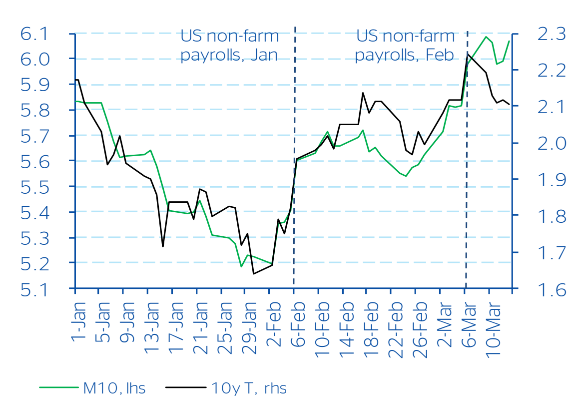
According to the INEGI, industrial production in Mexico fell by 0.4% in January from the previous month, with seasonally adjusted figures (sa). In annual terms it grew by just 0.8% (YoY), sa, while in original series industrial production grew marginally by 0.3% YoY. Industrial production's negative monthly performance in January was due mainly to the fall in construction (-1.5% MoM, sa); in mining (-0.5% MoM, sa), and in manufacturing (-0.1% MoM, sa), its second successive month of contraction. Electricity, gas and water increased marginally (0.4% MoM, sa). January's industrial production figure is very bad news for the country's first quarter economic growth, and puts downward pressure on expectations for economic performance for the year as a whole. This negative result comes on top of high volatility in the financial markets and the expectation of interest rates hikes and fiscal contraction, because of low public revenues, linked to the fall in production and in international prices for Mexican mixed crude oil. Today's figure is also affected by the close link between Mexican industry and the external sector, particularly with US manufacturing performance; the latter slid in January by 0.4% MoM, sa. Once again, the domestic market is notable by its absence as a driver for the country's growth, which would be a potential outlet for managing the volatility of external demand. We expect moderate economic activity in the country over the next few months, closely linked to weak internal demand, which is setting a strong bias to the downside on our economic growth expectations for 2015, currently standing at 3.5%.

Figure 1
Mexico's industrial production and its components (YoY % change, sa)



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

Figure 2
10-year sovereign bond yields (%)



Source: BBVA Research with data from Bloomberg.

The Mexican Social Security Institute (IMSS) reported that in February the monthly increase in the total number of workers registered with this Institute was 133,691. In BBVA Research we had anticipated that the rise in the total number of registered workers registered on the IMSS in February would be 117,600. Meanwhile, the accumulated total increase in workers from January to February 2015 was 193,475, whereas over the same two months in 2014 it was lower, at 147,538. Although the figures for employment growth in the first two months in 2015 compare favourably with 2014, we should not forget that most of this increase (perhaps around 50%) could have been due to the effect of the programme, which the labour authorities started to roll out in the second half of 2013, of bringing jobs into the formal sector. This would imply that the remaining increase in formal employment (the other 50%) that has been showing up in the monthly figures is linked to a higher level of economic activity. The final result for 2015 will be a significant rise in the number of workers signed up through the IMSS, together with a slower rate of GDP growth, as was the case in 2013 and 2014.

Emerging market (EM) assets were squeezed again this week by concerns about the likelihood of a rise in the Fed's federal funds rate around mid-year. The pressure may intensify next week if the Fed decides to suppress the reference to being "patient" in their statement. The US dollar appreciated across the board against emerging currencies; the Chinese renminbi and Mexican peso were the sole exceptions, closing the week virtually unchanged from the previous Friday. For example, the Chilean and Colombian pesos and the Brazilian real depreciated by 1.8%, 3.2% and 5.7% respectively against the dollar this week. The decision by Mexico's Exchange Commission to auction USD52mn every day from 11 March until at least 8 June, in order to inject liquidity into the exchange market, prevented the continuing depreciation of the peso this week. The depreciations suffered by other currencies suggest that, had this measure not been announced, the exchange rate would have gone up to around USDMXN15.80, or even higher. Against core currencies, the dollar rose 2.6% and has racked up an aggregate appreciation of 10.9% so far this year. The dollar is at its highest level against the euro for the last twelve years. The strong dollar has caused US stock markets to fall, and this, together with risk aversion, has translated into losses on stock markets around the globe. Nevertheless, Mexico enjoyed a positive differentiation in this market, too.

The European Central Bank (ECB) started its much-vaunted bond purchases, and some central banks in the region announced interest rate reductions, perhaps anticipating the Fed's forthcoming hikes. In a context of widespread cuts to European interest rates, yields on US T-bills narrowed, interrupting their recent trend to the upside after the positive surprises in the employment figures for January and February, published on 6 February and 6 March respectively. Thus, yields on the 10-year T-bill fell by 13 basis points (bp) over the week, closing at 2.11%. By contrast, the yield on the M10 bond widened by 11bp, ending the week at 6.09%, its highest level since mid-December 2014. Two main factors account for this lack of synchronisation in last week's movements: i) the global risk aversion which has contaminated all EM asset valuations, and ii) the concern that the central bank might raise its benchmark rate before the Fed does. The former factor may remain with us for the next few weeks, particularly next week after the Federal Reserve meeting; the latter ought to start weighing less from now onwards, particularly since we continue to believe that the central bank's monetary policy movements will be coordinated with those of the Fed. Even so, it is important to indicate that the risks of a pass-through of the exchange rate to inflation have risen as a result of this rate being so high, and because of the likelihood that the MXN may remain weak in the next few months because of the challenging global environment.

Next week, the statement from the Federal Reserve's March meeting will take another step towards the long-expected increase in the federal funds rate. Although we do not expect the first rise in rates to occur until the middle of 2015, the meeting will provide another opportunity for the Fed to ready itself for the change in monetary policy, whenever it occurs. In particular, we could see a change in its monetary policy forward guidance, given that both the minutes from the January meeting and the testimony of the Chair of the Federal

Reserve, Janet Yellen, to Congress implied that the Fed would eliminate, sooner rather than later, the reference to being "patient" from the text of its statements. The forecasts published after the meeting could help to clarify when it estimates that inflation will return to its target once again.

…What to expect next week

We estimate that January retail sales will grow by 2.9% YoY, seasonally adjusted (sa). This information will be published on 20 March by the INEGI. The result will be related to the performance of ANTAD sales, which by total stores rose in by January 5.6% YoY, sa, and to the increase in formal employment in January (59,784 jobs registered through the IMSS). We should recall that in December retail sales grew by an annual 1.9%, sa.

Calendar of indicators

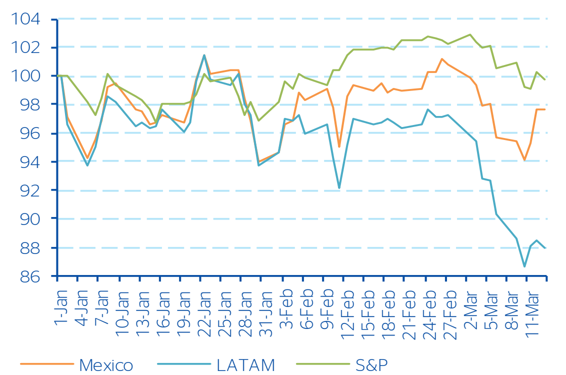
Mexico	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Retail sales (YoY % change, sa)	January	20 Mar	2.9	--	1.9

USA	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Industrial production (MoM % change, sa)	February	16 Mar	0.10	0.20	0.15
Manufacturing production (MoM % change, sa)	February	16 Mar	-0.20	0.00	0.20
Private Housing Units Started by Structure (MoM % change, sa)	February	17 Mar	0.56	-1.60	-2.00
Federal Funds Target Rate - Upper Bound	18 March	18 Mar	0.25	0.25	0.25
Conference Board Leading Index (MoM % change, sa)	February	19 Mar	0.20	0.20	0.20

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

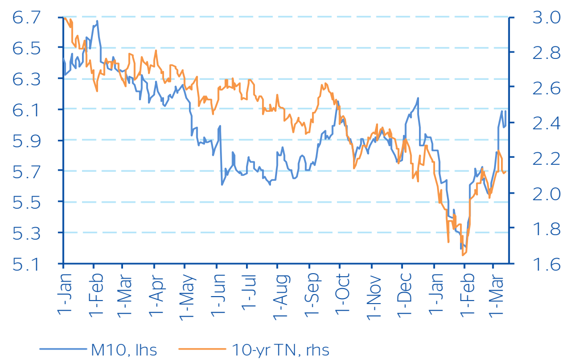
Markets

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



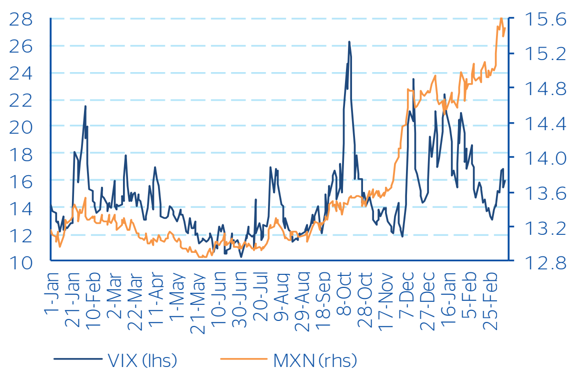
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



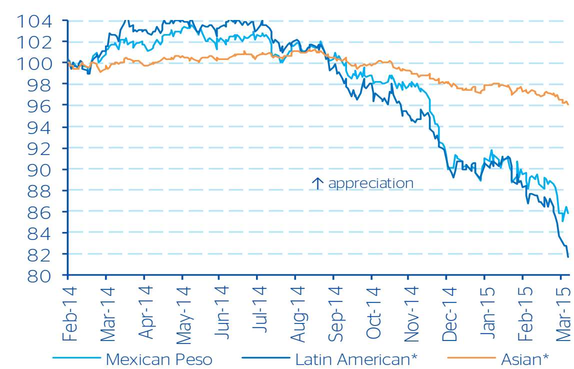
Source: BBVA Research, Bloomberg

Figure 5
Global risk and exchange rate: VIX index and USDMXN



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD (13 Mar 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
General 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	2.9

Source: BBVA Research.

Recent publications

Date		Description
9 Mar 2015	➡	Mexico Inflation Flash. Still little evidence to suggest that higher import costs (due to a weaker Peso) have been passed on to consumer prices
11 Mar 2015	➡	Mexico Economic Watch. Understanding savings affordability of Mexican consumers through socio-demographic variables
13 Mar 2015	➡	Mexico Flash. Industrial production fell in January 0.4% MoM, sa