Economic Analysis

All eyes on the January IGAE, which we expect to grow by a seasonally adjusted annual 2.4%

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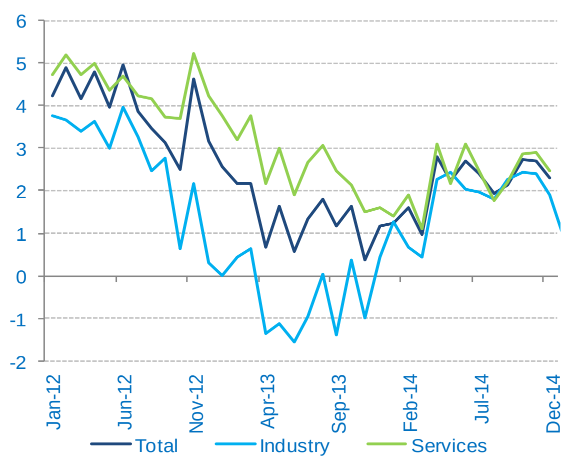
What happened this week …

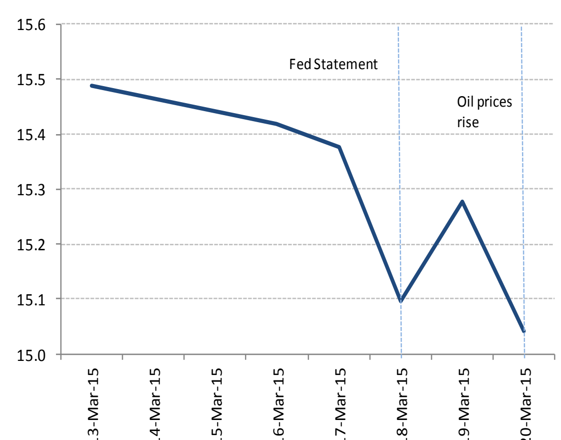
The oil price hike sustained the Mexican peso after it was unable to maintain the appreciation it experienced as a result of the changes in the Federal Reserve communication. The Federal Open Market Committee (FOMC) exchanged the reference to its "patient" stance for a paragraph linking the first rise in the rate to further improvements in the US labour market and a comment that the FOMC feels "reasonably confident" that inflation will return to its 2.0% target in the medium term, thus increasing its scope for manoeuvre when setting the date for the first increase in the monetary rate. The Chair of the Federal Reserve (Fed) specifically mentioned that, although this change does not necessarily mean that rates will rise in June, this date cannot be ruled out. In addition, the forecasts by the FOMC members about the speed of growth in the federal fund rate showed a significant reduction, a sign that the round of hikes will be very gradual. The MXN reacted well to these changes in the forecasts, appreciating 1.86% over its close the day before, bringing the exchange rate on 18 March to USDMXN15.09, a gain of MXN0.26. The dollar went as low as USDMXN14.99 on the intraday market. Nevertheless, this appreciation was practically wiped out the next day, with renewed appetite for US currency globally. By the end of the week the increase of over 4.5% in the oil price had led to the exchange rate returning to around USDMXN15.00, with the result that the appreciation over the course of the week came in at about 3.0%. On the sovereign bond market, the curve fell by 22bp (basis points) on average over the week because of the Fed's changes in communication, matching the direction of travel on the part of T-bills. On the stock markets, there were gains over the week too, with the IPC rising by 0.48%, while the S&P 500 moved up by about 2.7%.

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



Source: BBVA Research with data from INEGI.

Figure 2
Exchange rate (USDMXN)



Source: BBVA Research with data from Bloomberg.

Retail sales rose by 4.9% at an annual rate (YoY), with seasonally adjusted series (sa). The increase was higher than the market had expected (BBVAe: 2.9% YoY; consensus: 3.1% YoY). In monthly terms (MoM) the increase was 2.1%, seasonally adjusted (sa). This figure indicates a slight improvement in consumption at the start of 2015. Before seasonal adjustment, the YoY growth rate was 4.7%.

…What is coming up next week

We expect the Global Economic Activity Indicator, the IGAE, to show YoY growth in January of 2.4%, seasonally adjusted (sa). The INEGI will publish January's IGAE figure on 25 March. We would expect to see a degree of lethargy in economic growth in January, because of the fall in industrial growth over the same month (-0.4 MoM, sa) and only moderate performance in services, in view of the latter's 2.1% MoM, sa increase in retail sales in January. Note that in December the IGAE moved up by 2.3% YoY, sa, which in monthly terms translated into a 0.3% fall.

We expect the monetary policy rate to remain unchanged at 3.0% because of uncertainty about the beginning of the Fed's normalisation cycle. The decision on monetary policy will be announced on Thursday. In its latest statement, Banxico has repeated that the impact on inflation of the Fed's monetary normalisation process will be an important factor when it makes its own decision. What is more, the most recent meeting minutes reflect some committee members' opinions that Mexico should even act before the Fed's first interest rate hike. Based on the central bank's statement, we expect the benchmark to remain unchanged until September, for the following reasons: i) the depreciation of the peso, affected by uncertainty around the Fed's decisions, would have a low pass-through on consumer prices in the next few months, with the implication that convergence towards the 3.0% target will not be put at risk this year, and ii) at the moment there is no clarity about the date when the Fed will start its cycle of monetary rate hikes, but recent data showing weaker economic activity in the US and the downwards revision to the FOMC federal funds outlook indicate that this may take place towards the third quarter of this year.

We forecast that the unemployment rate will edge up to 4.55% in February. On 27 March, the INEGI will publish February's unemployment rate. Given the figure for employment creation in the formal sector in February (133,691 jobs through the IMSS), offset by weak industrial production in January (-0.4% MoM, sa), we expect the unemployment rate to stand at 4.55% in February, up from 4.51% in January. In seasonally adjusted terms, we estimate that February unemployment will be 4.46%, a little higher than the previous month's 4.43%.

We forecast that annual inflation will edge up to 3.12% in the first half of March. We anticipate fortnightly rises of 0.32% and 0.25% respectively for headline and core inflation in the first half of March. If our forecasts are correct, in annual terms headline inflation will be 3.12% (as against 3.00% in February) while core inflation will come in at 2.53% (compared to 2.40% in February). On the side of core inflation, while there has been little evidence to date to suggest that the higher import costs resulting from a weaker peso have passed through to consumer prices, a similar increase in the sub-index for other merchandise to that of the month before would suggest some kind of pass-through of the exchange rate to inflation. In any event, we forecast that this will be minor, favoured by the expansiveness of the economy and weak internal demand. On the side of non-core inflation, after substantial falls in the first two months of the year, our fruit and vegetable price tracker suggests a significant rise in prices in the first half of March. Turning to agricultural and livestock products, further increases in the price of beef and eggs could be partially offset by falls in chicken and pork prices. We continue to expect headline inflation to remain at around 3.0% for the entire year and to close 2015 at 2.9%. Similarly, we expect core inflation to hold at below 3.0% throughout 2015, although with a tendency to increase gradually, more clearly so from the second half of the year, supported by an improvement in activity, to close 2015 at 2.8%.

We believe that the balance of trade will be positive in February, by USD560mn. On 27 March, the INEGI will publish the country's balance of trade figures for last month, which are forecast at USD560mn. This figure can be broken down into annual growth in exports of 3.6%, and one of 4.9% in the case of imports. Note that in February 2014 the balance of trade was positive, at USD918mn; in fact the balance of trade in February has been positive since 2010.

Calendar of indicators

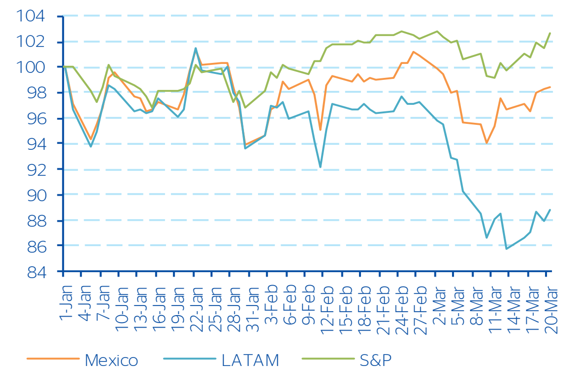
Mexico	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Headline inflation (FoF % change)	1H Mar	24 Mar	0.32%	0.25%	0.08
Headline inflation (YoY % change)	1H Mar	24 Mar	3.12%	3.05%	2.97%
Core inflation (FoF % change)	1H Mar	24 Mar	0.25%	0.20%	0.05
Core inflation (YoY % change)	1H Mar	24 Mar	2.53%	2.48%	2.38%
IGAE (YoY % change, sa)	January	25 Mar	2.4	--	2.3
Monetary policy rate (%)	March 26	26 mar	3.0	3.0	3.0
Unemployment rate (YoY % change)	February	27 Mar	4.55		4.51
Unemployment rate (YoY % change, sa)	February	27 Mar	4.46	4.41	4.43
Trade balance (million USD)	February	27 Mar	560.0	310.0	3,247.5

USA	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
New One Family Houses Sold Annual Total (MoM % change, sa)	February	24 Mar	-1.25	-2.90	-0.20
Durable Goods New Orders Industries (MoM % change, sa)	February	25 Mar	-0.90	0.20	2.80
University of Michigan Consumer Sentiment (Index)	March	27 Mar	91.70	92.00	91.20
GDP Chained 2009 Dollars (QoQ % change, sa)	4Q14 t	27 Mar	2.30	2.40	2.20

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

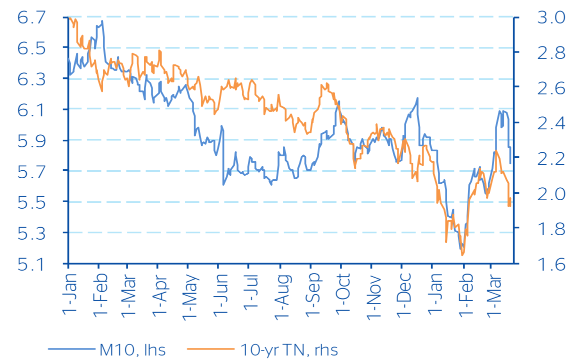
Markets

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



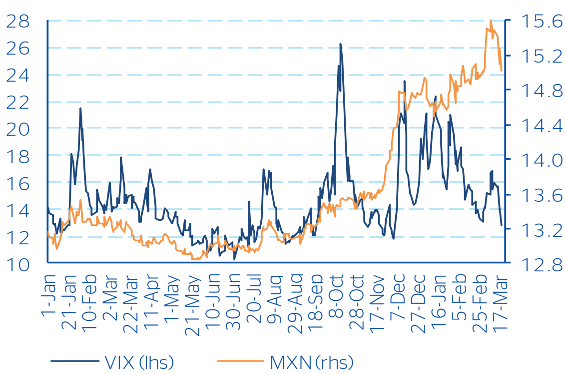
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



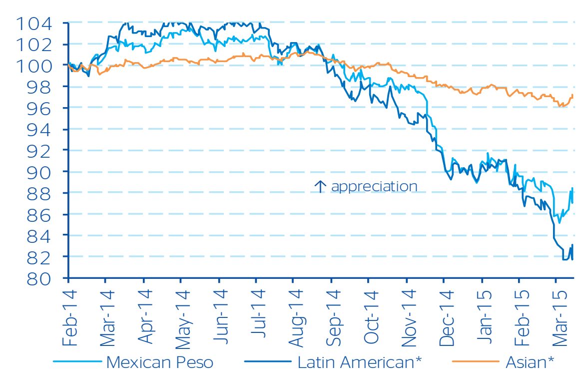
Source: BBVA Research, Bloomberg

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



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD (20 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
18 Mar 2015	➡	Mexico Economic Outlook First Quarter 2015