Economic Analysis

The January IGAE figure and February exports point to moderate economic performance in the first quarter

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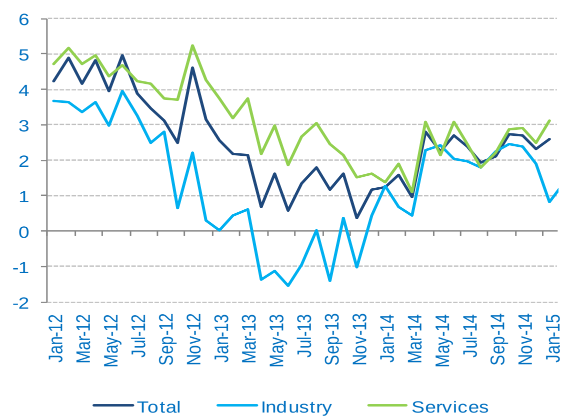
What happened this week …

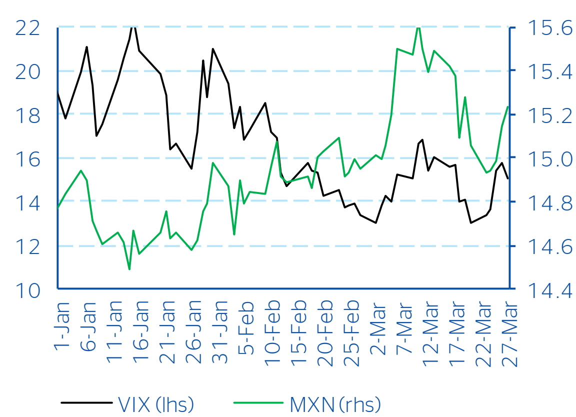
According to the INEGI, Mexico's Global Economic Activity Indicator (IGAE) grew by 2.58% in January compared to the same month a year ago (YoY), with seasonally adjusted figures (sa). This slightly higher-than-expected (BBVAe: 2.44% YoY, sa) growth, was equivalent to a monthly increase (MoM) of just 0.22%, sa, which was the result of an increase in services (0.44% MoM, sa) and agriculture (6.66% MoM, sa); and a fall in industrial production (-0.43% MoM, sa). In original series the IGAE reported annual growth of 2.04%. All in all, economic activity has made a weak start in January, suggesting moderate growth for the first quarter.

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



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

Figure 2
Global risk and exchange rate (VIX index and USDMXN)



Source: BBVA Research with data from Bloomberg.

The rate of unemployment increased to 4.51% in February 2015, with seasonally adjusted figures. This increase was in line with our forecast (BBVAe: 4.46%; consensus: 4.41%); at the same time, the population aged 15 and over which is economically active (the participation rate) slipped marginally, from 59.5% in February 2014, to 59.4% in February 2015. In original series, the unemployment rate came in at 4.33%. In addition, the occupation rate in the informal economy (TOSI1), which covers all those working in non-farming economic units which operate without providing official accounts, using household resources, increased by 0.6pp (percentage points) from 26.6% in January to 27.2% in February 2015. All of the above information suggests that there has been a modest increase in the number of new jobs and that economic activity is making progress, albeit slowly.

We hold to our estimate for an unemployment rate of around 4.58% by the end of the year, more so if there is confirmation in the next few months that the economy will grow more slowly than expected this year.

Core inflation was behind the surprise to the downside in the inflation figures in the first half of March. Inflation was lower than expected, remaining at its lowest level for nearly nine years (2.97%). Core inflation increased by 0.18% FoF (fortnight on fortnight). This surprise to the downside was mainly accounted for by core inflation, which grew less than expected, at 0.15% FoF, while headline inflation was also lower than expected. So far, companies have not passed on the higher costs resulting from the peso's depreciation to their customers (prices of other goods increased much less than in the first half of February). After this positive surprise, we have revised our forecasts for both headline and core inflation to the downside for March by around 0.1pp, while holding to our forecasts for the end of the year, of 2.9% and 2.8% respectively. The monthly inflation figure for March is very likely to confirm low core inflation throughout the first quarter, in a context of currency depreciation, which implies that domestic demand remains weak. These figures support our estimate that the pass-through of the exchange rate to inflation will be low and that annual headline inflation will remain at around 3.0% throughout 2015.

Monetary policy unchanged at 3.0%. All eyes on the Fed (Federal Reserve) against the possible risk posed by consolidating convergence towards the target. The relative monetary stance with the US and the performance of the exchange rate are the most important variables for Banxico, in the light of the risk that the Fed's normalisation cycle may be compromising the likelihood of achieving, and consolidating, convergence with the inflation target. The expansiveness of the economy seems to carry rather less weight in the current situation since, for the first time since July 2013, Banxico is making no reference to "efficient convergence" of inflation, even when it points up the weakness of the economic cycle and a deterioration in the balance of risks in activity. On the contrary, it took a pessimistic stance on economic activity, with references to lower momentum in exports, the weakness of consumption indicators and the continued fall in oil production. In short, the central bank's statement is consistent with an increase in the monetary policy rate in the third quarter of 2015.

The country's trade balance in February was positive by USD558mn. The February 2015 trade balance was in line with our expectations (BBVAe: USD560mn). This figure was the result of an annual fall in both exports (-2.6%) and imports (-1.4%) of goods. Oil exports shrank YoY in February by 46.9%, while non-oil exports grew by 4.0%. Oil exports accounted for 7% of total exports, and non-oil for the remaining 93%. The moderate growth of non-oil exports shows that the depreciation in the exchange rate has not been enough to drive the country's exports; however, it does appear to help in limiting imports. We surmise the latter by noting reductions in both monthly and annual terms in the imports of consumer goods, those for intermediate use and capital goods.

The less positive recent US balance of figures than had been expected have been prompting analysts to revise their forecasts for 1Q15 to the downside. This, on top of tensions in the Middle East, dominated moves in the financial markets this week. Furthermore, a disappointing earnings reports season in the first quarter has kept US stocks down, leading the S&P 500 index to slide 2.2% over the week, practically wiping out the gains made to date this year (see Figure 3). On fixed income markets, yields on the 10-year T-bond widened by 3bp (basis points) over the week, but remained close to the levels reached after the Fed's latest statement on 18 March. In Mexico, yields on the 10-year M-bono widened by 14bp over the week. Meanwhile, unrest in Yemen pushed up oil prices (Brent +4.8% and WTI +9.6%), and drove up demand for safe-haven assets, raising gold prices by 1.5%. On currency markets, although the dollar showed less strength this week (depreciating slightly compared to its main peers: DXY -0.6%), among emerging currencies, some performed well, buoyed up by higher oil prices (the Russian rouble and Chilean peso, for example, appreciated by +2.5% and +1.6%

respectively); others fell, however (the Turkish lira depreciated by 1.4% and the Mexican peso by 1.2%). The central bank's somewhat more relaxed stance, together with the recent positive differentiation of the Mexican peso in the weeks leading up to the announcement by the Exchange Commission of its daily dollar sales, may have influenced the less favourable performance of our currency this week. Next week, the markets will concentrate on the March job creation figure in the US. In the future, the highest risk assets will continue to face a challenging environment: a strong dollar, the approaching Federal Reserve rises, slower growth in China and low commodity prices. In this difficult environment, a significant revaluation of the peso looks unlikely in the near future.

…What is coming up next week

We expect manufacturing and non-manufacturing performance expectations for March, as expressed through the IMEF indicators, to show a moderate improvement. These indicators will signal the expectations for economic activity in the country for the first quarter of 2015. We forecast that the March IMEF manufacturing indicator will post slightly higher than the month before, because of the expectation that manufacturing production in the US economy will be better than in February. We also estimate that the non-manufacturing IMEF indicator will rise marginally compared to last month, thanks to improvements in the services sub-sector.

Remittances to Mexico in February may return to their growth path, with a flow of USD1.892bn (10.1% YoY). Coming on the back of the figure published by the central bank for the remittances received in Mexico in January, which broke a chain of 17 consecutive months of growth, these flows are estimated to return to positive growth rates in February. More remittances were sent in December because of the strong dollar appreciation, which could account for the subsequent fall in the average sum of remittances, resulting in the atypical figure recorded in January. A range of structural conditions, such as economic growth and the drop in the US unemployment rate, continue to be the drivers of remittances to Mexico throughout the year.

We expect the total gross fixed investment index for January to record an annual growth rate of 5.1%. On 1 April, INEGI will report the gross fixed investment figure for January 2015. We estimate that the annual growth rate of this indicator will be 5.1%, on the basis of a YoY expansion in the investment component in construction of 2.1%, and an annual 10.8% increase in the machinery and equipment component. Note that a YoY growth rate of 5.1% for January 2015 contrasts favourably with the negative growth rate of 2.5% posted by this indicator in January 2014.

Calendar of indicators

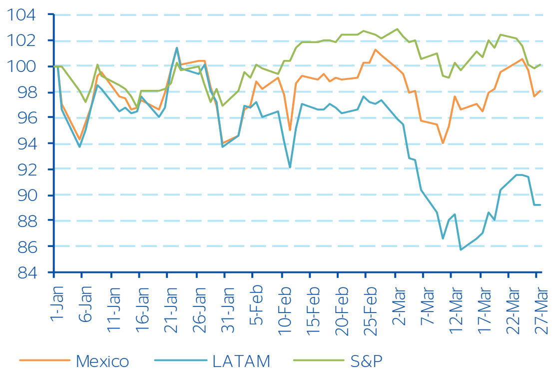
Mexico	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
IMEF manufacturing indicator (index, sa)	March	1 Apr	50.9	51.0	50.7
IMEF non-manufacturing indicator (index, sa)	March	1 Apr	50.0	50.0	49.6
Family remittances (USD million)	February	1 Apr	1,892.0	1,817.0	1,630.7
Gross fixed investment (YoY % change)	January	1 Apr	5.1	6.0	5.5

USA	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Personal Income (MoM % change, sa)	February	30 Mar	0.20	0.30	0.30
ISM Manufacturing PMI (index, sa)	March	1 Apr	53.30	52.50	52.90
Auto Sales Total Annualized (millions, sa)	March	1 Apr	16.30	16.90	16.16
Manufacturers New Orders Total (MoM % change, sa)	February	2 Apr	-0.70	-0.30	-0.20
Unemployment rate (%)	March	3 Apr	5.50	5.50	5.50

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

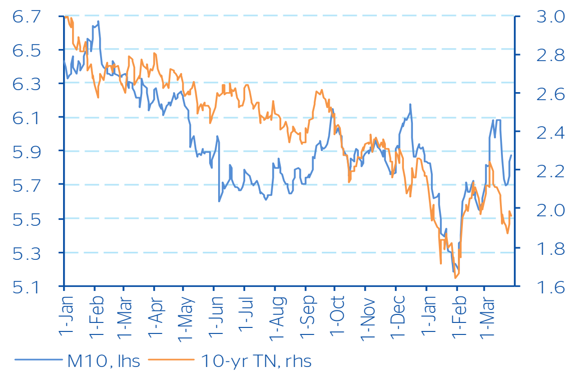
Markets

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



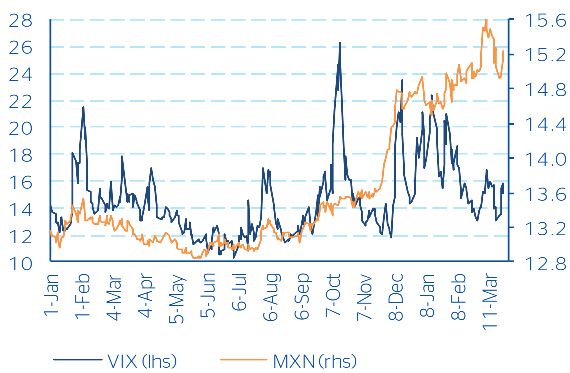
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



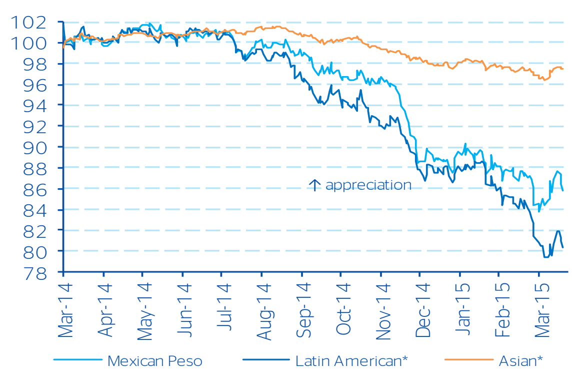
Source: BBVA Research, Bloomberg

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



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD (27 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
23 Mar 2015	➡	Mexico Banking Flash. Banking deposits: outstanding performance in January
24 Mar 2015	➡	Mexico Inflation Flash. Core inflation leads the downside surprise
25 Mar 2015	➡	Mexico Flash. In January the IGAE shows a weak monthly performance (0.2% MoM, sa)
26 Mar 2015	➡	Banxico Flash. Monetary rate unchanged at 3.0%. Attention pinned on the Fed against the possible risk posed by consolidating convergence towards the target