Economic Analysis

The central bank is holding the monetary policy rate at 3.0%. The next move will depend on rates in the United States and activity in Mexico

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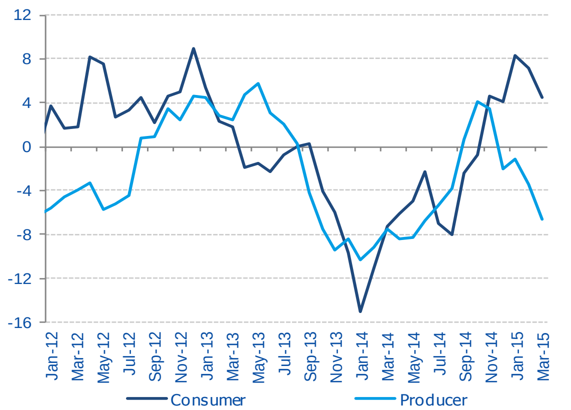
What happened this week …

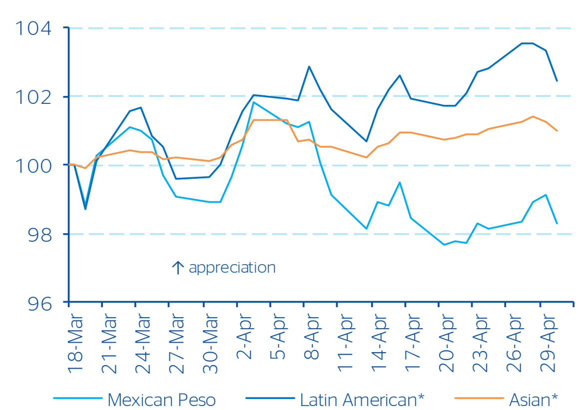
Long-term rate rises in the United States, after the Federal Reserve did not rule out a possible commencement of the cycle of hikes in June. Despite this, the revised reading being made of economic activity levels points to rates going up after June. As expected, the policy committee stuck to its customary script regarding its strategy of any rate rises depending on the figures. Added to this, they do not state that the initial rate hike is closer at hand than it was during their meeting last month. There was no specific mention that an upward move for interest rates remains “unlikely” in June, but the take on recent economic activity had negative overtones to it that seem hard to reconcile with any rise in the federal funds rate at the next meeting of the FOMC. We are standing by our forecasts of the first upward shift in rates happening in September. The US activity data was mixed but overshadowed by the surprise on the low side for 1Q15 growth (0.2% QoQ YoY). In these circumstances, 10-year T-Note rates rose 13bp over the week to close at 2.04%. In harmony with this, the M10 bond yield saw a rise for the week of 11bp. In the FX market the peso was slightly firmer (rising 0.2%), with its performance on the week at around the average for EM currencies, although it is still showing a negative relative level since the dollar stopped appreciating against such currencies in mid-March (see Figure 2), despite the fact that over the same period the currencies of the oil-exporting countries have generally appreciated, moving relatively stronger. **The analyst consensus forecasts a USD/MXN exchange rate at the close of 2015 of 14.8 pesos to the dollar.**

Figure 1
Producer and consumer confidence indexes (YoY % change, sa)



Source: BBVA Research INEGI data.

Figure 2
Currencies against the USD (Index 18 Mar 2015=100)



Source: Bloomberg, BBVA Research

The central bank is waiting for the Federal Reserve to make a move. The funding rate is still at 3.0%, after the central bank decided that in its opinion the risks on balance as regards domestic activity and inflation have not seen any change at all. As in the previous statement, there is recognition of the weakness of the economy in an environment of inflation converging on the target level and with expectations anchored, though the importance was reiterated of the cycle of monetary normalisation in the USA as the primary factor in taking any decisions on monetary policy. Among the few changes on the previous statement are: i) the allusion to the additional delay in expectations for the first rise in the federal funds rate, given the slowdown in economic activity in the United States; ii) the mention that the transmission of the exchange rate through to inflation has mainly been manifested in durable goods, although this has not prompted any second-round effects, and iii) the qualification that the exchange rate trend will be another of the factors to monitor closely. Taking into account the information in this statement, we are standing by our forecast of a rise in the federal funds rate next September, with a bias towards a later start and a slower tightening cycle, given the weakness of economic activity.

The unemployment rate hit 4.2% in March 2015, in seasonally adjusted figures (sa). This figure is under the market forecast (BBVAe: 4.41%; consensus: 4.43%) and was accompanied by a marginal dip in the economically active population aged 15 and over (participation rate) from 60.2% in March 2014 to 59.3% in March 2015. In terms of initial data series, the unemployment rate was 3.86%. The informal sector employment rate (known as TOSI1), which includes all those working for non-livestock and agricultural economic units that do not keep accounts and operate using family resources, rose 0.1pp (from 27.6% in February to 27.7% in March 2015). All of this suggests that there has been a modest increase in new jobs and that the economic activity in the country is still slowly getting off the ground.

In March the trade balance showed a surplus of USD480mn. This was below the estimate (BBVAe: USD810mn), mainly due to larger-than-expected growth in imports. Specifically, total exports grew by 2.7%, with a rise of 8.7% for non-oil exports (93.9% of the overall figure) and a reduction of 44.3% for oil exports (the remaining 6.1%). On the other hand, total goods imports were up by 4.3% and the most dynamic portion of these was intermediate goods imports. The trade balance will find itself in a sounder position to the extent that the value of oil exports stops contracting.

…What to expect next week

We predict that expectations about the performance of manufacturing and non-manufacturing activity for April, as expressed in the IMEF indicators, will show a slight improvement. These indices will provide clues about the country's economic activity expectations for the start of 2Q15. We forecast that the performance of the IMEF manufacturing indicator for April will reveal a level fractionally higher than it read the previous month, on expectations of improved manufacturing output for the US economy with respect to March. We also estimate that the non-manufacturing IMEF indicator will nudge upwards slightly from the previous month on improvements in the services sub-sector.

Remittance income into Mexico could reach USD2,251mn (7.3% YoY). The fine performance by economic and employment variables in the United States has still not fed through into a substantial rise in remittance flows into Mexico during the first two months of 2015. This situation is expected to be turned around, and growth on a bigger scale is forecast in March and over 2Q15 in the flow of incoming family remittances. If this is not the case, remittances will probably not top the growth level of 8.0% YoY observed in 2014. With the current figures, growth in the US economy in 2015 is not expected to have a significant impact on employment for Mexican migrants there. No fluctuations either are forecast of any great magnitude in the USD/MXN exchange rate, so therefore remittances could return to the path of growth in 2015.

We consider that the YoY growth rate of the gross fixed investment index in February will be 1.2%, which implies a slowdown on the 7.3% rate of the previous month. INEGI is due to publish the figure on 4 May for Mexico's gross fixed investment index for February 2015. In January 2015 the AGR for this was 7.3%, and its construction component grew 7.3%, while the machinery and equipment investment item did so by 13.7%. For February we expect investment growth to dampen and that this will be 1.2%, given the negative annual growth of 0.3% expected in construction investment and the more sedate growth rate of 2.8% for investment expected in machinery and equipment for that month. The reason for the slower growth rate in construction investment in February is the AGR for the global indicator for construction activity in February of 1.1%, compared to 6.1% in January. As regards machinery and equipment investment, the slowdown comes from a slip in the AGR for capital goods imports from 8.1% in January to -3.1% in February.

We estimate that annual inflation will be around 3.11% in April. We forecast a MoM fall of 0.22% for headline inflation and a rise of 0.14% for its core counterpart. If our predictions come true, in YoY terms headline inflation should hold at 3.1%, whereas core inflation should come down to 2.29% (against 2.45% in March). With respect to core prices, a kinder seasonal performance by the services sub-index following the Easter holiday period will be partly offset by a rise in the goods sub-index. Turning to non-core inflation, falls in the fruit and vegetables component will come on top of the start of the downward adjustment in electricity rates as the warm season comes around in making a contribution to MoM deflation.

We expect the producer confidence indicator to continue its negative trend and consumer confidence to improve in April. On 6 and 8 May respectively INEGI is set to release the figures for the producer (PCI) and consumer (CCI) confidence indices for April. We expect the PCI to be around 48.5 points (sa), from 48.2 points the previous month, because of expectations of a gradual recovery in industrial sector activity in Mexico and the United States. On the other hand, taking into account the job creation in the formal market in March (105,136 jobs registered with the IMSS), we see the CCI climbing to a level of 93.7 points (sa), compared to 92.7 points the previous month. This will also be the equivalent of a level of 93.7 points based on the non-seasonally adjusted series.

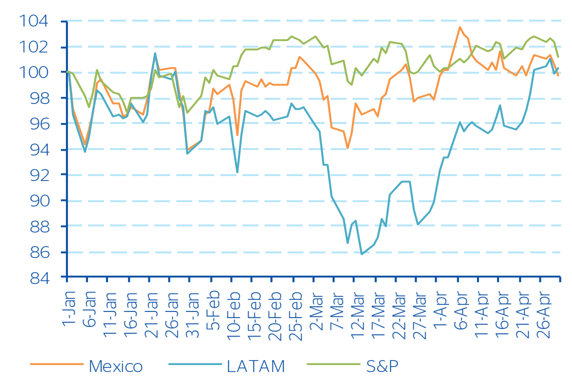
Calendar of indicators

Mexico	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
IMEF manufacturing indicator (index, sa)	April	4 May	51.6	51.6	51.4
IMEF non-manufacturing indicator (index, sa)	April	4 May	49.7	50.1	49.3
Family remittances (US million)	March	4 May	2,251.0	2,2100	1,839.2
Gross fixed investment (YoY % change)	February	4 May	1.2	1.6	7.3
Producer confidence (index, sa)	April	6 May	48.5	--	48.2
Headline inflation (MoM % change)	April	8 May	-0.22%	-0.26%	0.41%
Headline inflation (YoY % change)	April	8 May	3.11%	3.06%	3.14%
Core inflation (MoM % change)	April	8 May	0.14%	0.14%	0.26%
Core inflation (YoY % change)	April	8 May	2.29%	2.29%	2.45%
Consumer confidence (index)	April	8 May	93.7	93.7	93.1

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

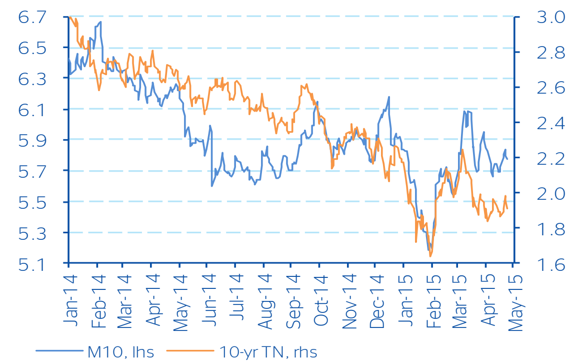
Markets

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



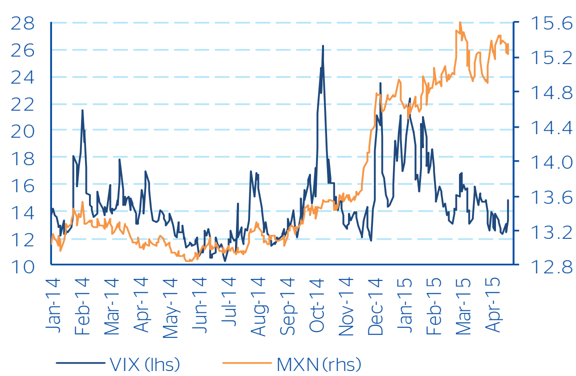
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



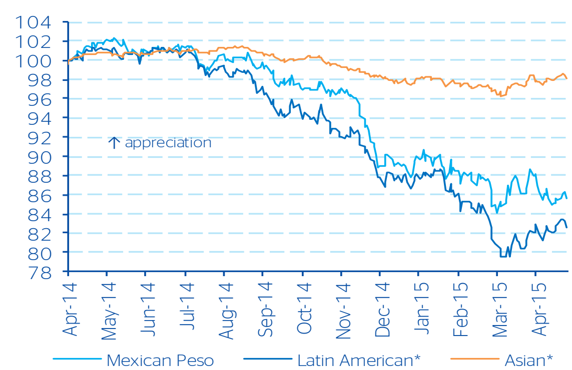
Source: BBVA Research, Bloomberg

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



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD (27 Apr 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	3.0
Core inflation (%, average)	2.7	3.2	2.5
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 Apr 2015	➡	Mexico Flash. In February the IGAE shows a negative monthly performance (-0.03% MoM, sa)