Economic Analysis

Activity increased marginally in May, thanks to the services sector, while inflation sank to a new low and the peso marked its highest absolute dollar rate

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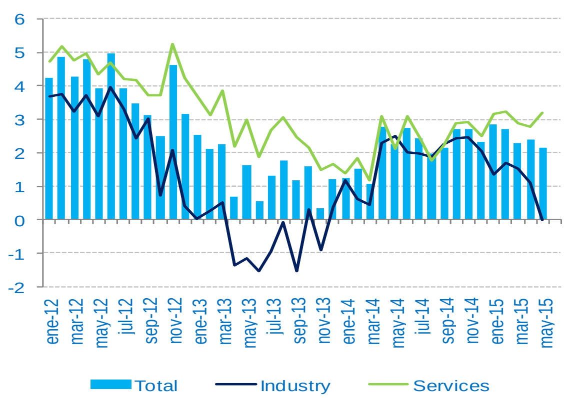
What happened this week…

The monthly rise for the Global Economic Activity Indicator (IGAE) in May was 0.1%, in its seasonally adjusted series (sa), which was slightly below our forecast (BBVAe: 0.20% MoM, sa). This meant that the annual growth rate (AGR) for May was 2.1% sa (BBVAe: 2.3%). As was expected, industry fell back by -0.4% MoM, sa, and the services sector saw MoM growth of 0.4%, while primary sector activity continued to grow, this time at 2.5% MoM.

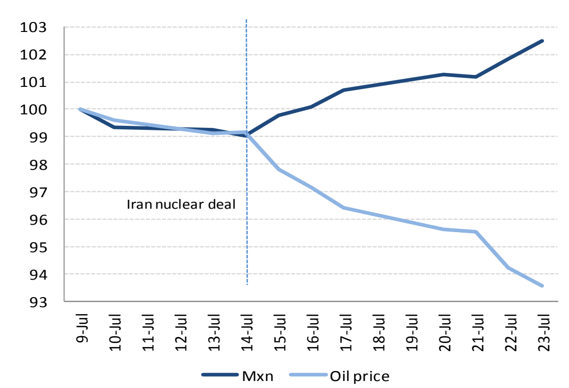
Inflation hit a new historical high of 2.76% in the first fortnight of July, when headline inflation rose 0.09% (BBVAe: 0.22%, consensus: 0.20%), while core prices were up by 0.10% (BBVAe: 0.12%, consensus: 0.16%). In annual terms, headline inflation eased to 2.76%, compared to 2.87% in the second fortnight of June, whereas core showed a rate of 2.30%, compared to 2.35% for the previous half-month. We were forecasting slightly lower core inflation than the consensus, yet the figure was marginally below our estimate, which was due to a more helpful rate of increase in the processed foods component than we had been expecting (of 0.12% QoQ). As we were predicting, the start of the summer holiday season led to a surge in the “other services” sub-index (0.44% QoQ) which was partly offset by the fortnightly fall in the non-food goods sub-index (-0.19%). Such behaviour is seasonal and in line with what we anticipated.

Figure 1
Global Economic Activity Indicator (YoY % change, seasonally adjusted)



Source: BBVA Research with INEGI data.

Figure 2
Exchange rate and the oil price (9 July 2015=100)



Source: BBVA Research with Bloomberg data

It is still worth noting that the exchange rate pass-through to prices remains limited and is being offset by the fine showing from the services component, which is being facilitated by the weakness of the economy. With respect to non-core prices, as we foresaw, fruit and vegetable prices rose substantially (2.04% QoQ) and energy prices made no contribution to the fortnightly increase. A larger-than-expected fall was observed in livestock prices (-0.68% QoQ) with lower prices for eggs and the other items within this sub-index (i.e. beef, pork, chicken and fish). The healthy figure for the first fortnight of the month lends weight to our view that headline inflation will stay below the central bank's 3.0% target rate for the rest of the year and supports the downward bias which we had in our previous forecast at the year-end of 2.6% (the lowest among analysts according to the last Banamex survey of 21 July). We are revising this forecast down to 2.5%, and think that the consensus (2.9%) will tend to adjust down towards our estimate in the coming months.

The peso is at a new historical low. The fall in the oil price adds volatility to the uncertainty over the forthcoming federal funds rate hike. The peso's dollar rate climbed to a new historical high when it hit MXN16.29 on Friday, representing a 1.95% depreciation over the week, which was the eighth largest among the emerging currencies. So far this July, the peso has weakened by 2.9%, which has been exacerbated by a new fall in the oil price, of around 7.0% over the same time. What has happened is that the nuclear agreement between Iran, on the one hand, and the UN and several industrialised nations has given rise to expectations of greater over-supply in the oil market in the short and medium term, which is being reflected in a closer correlation between the currencies of the oil-exporting countries with the oil price. This new source of exchange rate volatility comes on top of uncertainty over the beginning of the monetary normalisation cycle to be decided by the Federal Reserve (the Fed). The Fed is due to issue a statement on monetary policy this coming Wednesday, which will be its last before its eagerly-awaited September meeting, when the market thinks there is a good chance of a rise in the reference rate. In the fixed-income market redemption yields on government bonds rose virtually all along the curve, with the exception of the one-year section. In particular, within the 10-year bracket, the rise was around 15 basis points. Finally, turning to the stock market, the IPyC shed 2.36%, which outstripped the 1.92% fall for the MSCI Emerging Markets index, while the S&P 500 lost 2.06% over the week, hit by lower-than-expected figures on the Chinese economy and regarding new home sales in the United States.

…What to expect next week

INEGI is due to release the June balance of trade figures this 27 July, for which we expect a deficit of USD725mn. Such a shortfall would be as a result of expectations that the improvement in external demand is still only at the fledgling stage and that oil production has still not revived.

Banxico: caught between a historical high for the outright dollar exchange rate and an inflation low. Next Thursday, the central bank will reveal its decision on monetary policy. After the policy committee's decision to reschedule its meetings, it will be vital to pay great heed to the statement from the Federal Open Market Committee (FOMC) at the Fed, which will be released next Wednesday. Although no movement in the federal funds rate is anticipated at the meeting, the market will be alert for any change in the message, above all because this is the FOMC's last scheduled meeting before September. Aside from the Fed, any mention in the Mexican central bank's statement regarding the level and persistence of the currency depreciation and how it relates to inflation from now onwards will be important. This is because, if the pass-through continues to be so limited following an annual depreciation of over 20%, this could raise the possibility that the pace of economic activity is actually slower than expected.

Calendar of indicators

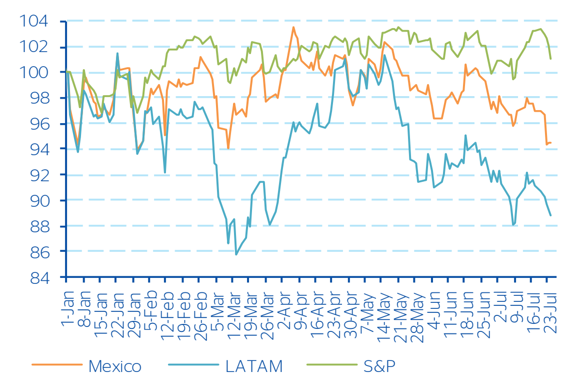
Mexico	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Trade balance (USD millions)	June	27 July	-725	-502	-1,017
Monetary policy rate (%)	July	30 July	3.0%	3.0%	3.0%

United States	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Durable Goods New Orders Industries (MoM % change, sa)	June	27 July	0.9	3.1%	-2.2%
Durable Goods New Orders Total ex Transportation (MoM % change, sa)	June	27 July	0.8	0.5%	0.0%
Federal Funds Target Rate - Upper Bound	--	29 July	0.25%	0.25%	0.25%

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

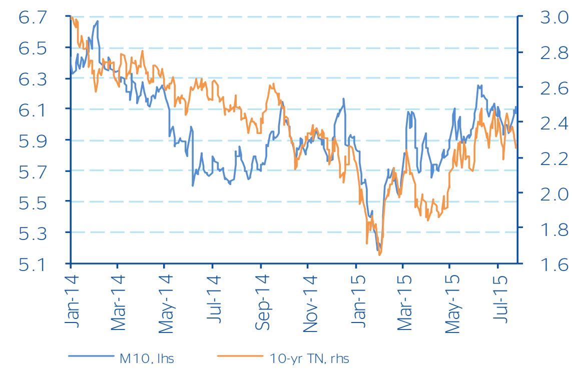
Markets

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



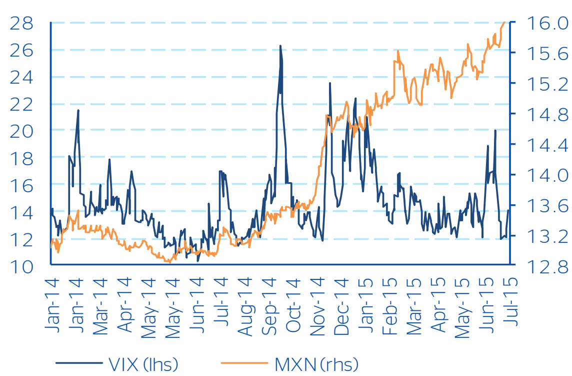
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



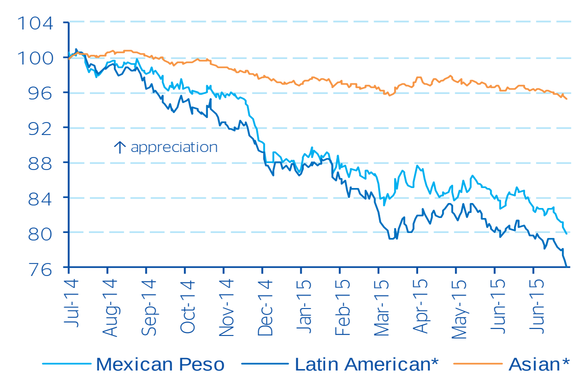
Source: BBVA Research, Bloomberg

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



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD (17 Jul 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	2.5
General inflation (%, average)	3.8	4.0	2.8
Core inflation (%, average)	2.7	3.2	2.4
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
22 Jul 2015	➡	Mexico Real Estate Flash. As of May, mortgage loans have advanced 20%
22 Jul 2015	➡	Mexico Banking Flash. Banking deposits: recovering momentum, led by term deposits