Economic Analysis

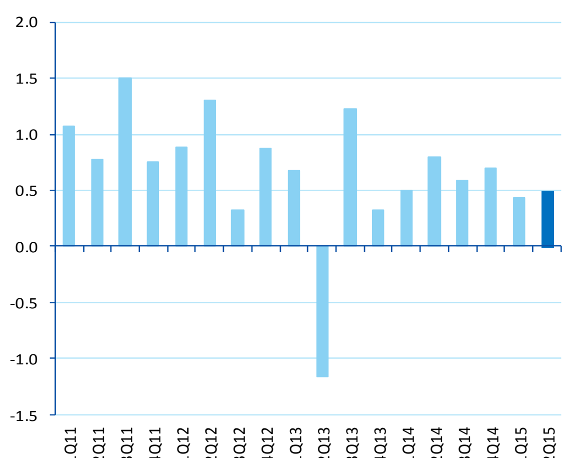
The peso's exchange rate level is at an absolute historical high, given the fall in the oil price and the uncertainty in the global cycle

Arnoldo López / Javier Amador / Iván Martínez / Javier Morales

What happened this week…

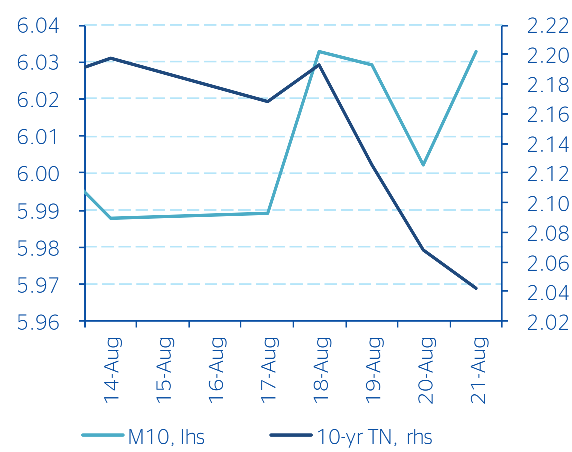
QoQ GDP growth for the second quarter was slightly above expectations (observed: 0.5% QoQ; BBVAe and consensus: 0.4% QoQ, seasonally adjusted), which left the annual (YoY) growth rate for the quarter at 2.2%. The encouraging quarterly growth was enabled by a strong boost from the services sector (0.9% QoQ, sa). Meanwhile, industrial sector growth was non-existent (0.0% QoQ, sa) and growth in agricultural and livestock activities was a negative 1.6%, QoQ, sa. The most recent figures suggest that the industrial sector has begun to grow (0.2% MoM in June, sa) as US industrial production picks up again.

Figure 1
Gross Domestic Product (QoQ % change, sa)



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

Figure 2
10-year government bond yields (%)



Source: BBVA Research with Bloomberg data

The plunging oil price and concerns over China's economy are battering global markets and have taken the exchange rate against the dollar to a new outright high. The minutes from the Fed's last meeting failed to dispel doubts over the potential date for the start of the cycle for the federal funds rate hikes. Although the tone was taken to be a little milder (i.e. less restrictive) than might have been expected, bearing in mind the change in the way the language was couched in the monetary decision statement, uncertainty persists over whether the initial hike will take place in September or afterwards. Whatever the case, the minutes did nothing to help sentiment among the emerging markets (EMs), even though the toned-down nature could have provided a little respite for the assets in these economies. Despite the importance of the minutes and the impression that they would be the main event of the week, the falls in commodity prices and unease over growth in China were the dominant drivers behind market movements. Worries over the strength of the world economy - and the renewed risk of deflationary pressures, given plummeting commodity prices (mainly oil) - subjected risk assets to fierce pressure over the last week. This pressure was whipped up on Friday, after the surprisingly low manufacturing activity PMI figure for China, which dropped to 47.1 (against an expected 48.2) and is both in contractionary territory and at its lowest ebb since March 2009. Investors reacted to the deeply foreboding prospect of a deteriorating outlook for China. This, combined with the somewhat more relaxed than anticipated tone of the minutes from the FOMC meeting, contributed to a retreat for US bond yields. For example, the rate on the 10-year Treasury Note shrank back after the minutes were published and carried on downwards over the rest of the week, finally closing at 2.04% (-16 basis points compared to the close a week earlier). Likewise, equity markets were rocked by heavy falls on concern over China. The European indices (Euro Stoxx: -5.1%, DAX: - 6.2%, CAC: -4.7%, IBEX: -3.7%) and their Asian counterparts (Shanghai Composite: -11.5%, Hong Kong Hang Seng: -6.70%) received the biggest buffeting, although falls were widespread and substantial (e.g. S&P 500: -5.8%). Meanwhile, oil prices took a tumble again, reaching their lowest level this year (Brent: -6.3%, also as a result of a rise in crude inventories in the United States). In the currency markets, the dollar went better against EM currencies, especially against those most closely linked to oil (RUB: -5.3%, MXN: -3.7%). The USD/MXN exchange rate climbed to a new outright high, almost touching USD17.00, having depreciated by 5.4% overall so far in August, 7.9% since the June close and 15.1% for the YtD. The present situation of anxiety over world growth, uncertainty produced by the imminent start on monetary policy normalisation in the United States, the low oil price and the prospect of it staying depressed for a considerable time, are all factors which will do nothing to help turn around the peso’s sharp depreciation in the near future.

…What to expect next week

We predict that annual inflation will have continued on its downward course over the first fortnight of August (2.67% estimated, compared to 2.72% in the second half of July). Our forecast for this first half of August is a fortnightly rise of 0.15% for headline inflation and one of 0.13% for core. Should our estimates prove right, in annual terms core inflation would have eased slightly, to 2.30% (compared to 2.32% for the previous fortnight). Over this particular fortnight we will see two significant seasonal effects at work in core prices. First, the close of the high season in the summer holiday period should prompt a drop in prices within the “other services” sub-index. Second, the end of summer discounts will bring about a rise in the non-food goods sub-index. We still anticipate that exchange rate pass-through to inflation will remain limited, to a large extent because of the weakness of domestic demand, and that the increase in inflation among non-food goods will continue to be offset by a decent performance from the services component. With respect to the non-core component, our price-monitoring suggests that falls in the tomato price could partly make up for the higher prices of other fruit and vegetables, whereas, within the livestock prices component, we foresee a rise in the price of eggs in the wake of the plunge observed in July, and also for beef and chicken prices, which could be partly offset by a drop in pork prices.

We forecast a deficit of USD1.59bn for Mexico's balance of trade in July, which is due to be published by INEGI on 27 August 2015. This expected figure for the balance of the external trade account, of a deficit of USD1.59bn, would arise from an annual contraction of total goods exports of 6.6% (-51% for oil exports and -3.2% for non-oil), as well as an annual reduction of total goods imports of 4.7%.

Calendar of indicators

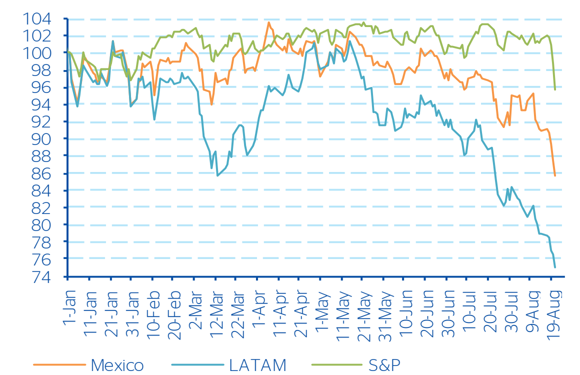
Mexico	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Headline inflation (FoF % change)	1F August	24 August	0.15%	0.16%	0.08%
Headline inflation (YoY % change)	1F August	24 August	2.67%	2.69%	2.72 %
Core inflation (FoF % change)	1F August	24 August	0.13%	0.14%	0.06%
Core inflation (YoY % change)	1F August	24 August	2.30%	2.31%	2.32%
Trade Balance (USD millions)	July	27 August	-1,590	-1,327	749

United States	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Conference Board Consumer Confidence (sa, 1985=100)	August	25 August	94.70	93.30	90.91
GDP US Chained 2009 Dollars (QoQ, saar)	2Q15	27 August	2.4	3.2	2.3
Personal Income (MoM % change, sa)	July	28 August	0.3	0.4	0.4
University of Michigan Consumer Sentiment Index	August	28 August	93.00	93.10	92.90

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

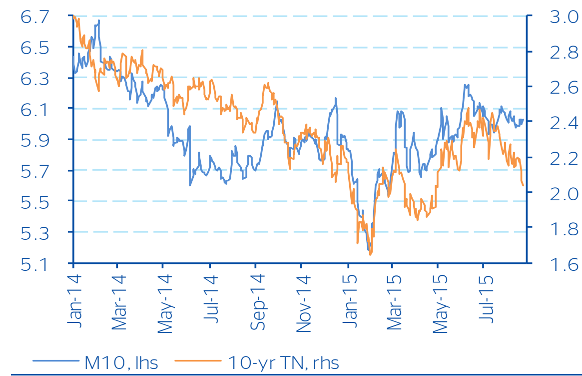
Markets

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



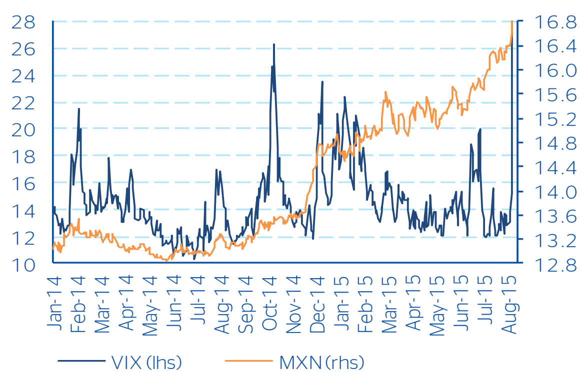
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



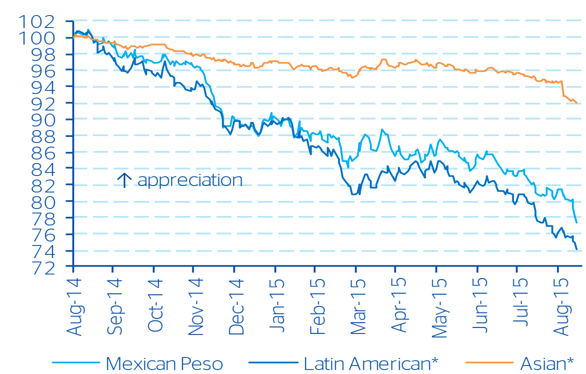
Source: BBVA Research, Bloomberg

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



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD
(24 Aug 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
4 Aug 2015	Mexico Migration Flash. Remittances to Mexico increased by 6.1% YoY in June, with an inflow of USD2,168.3mn