Economic Analysis

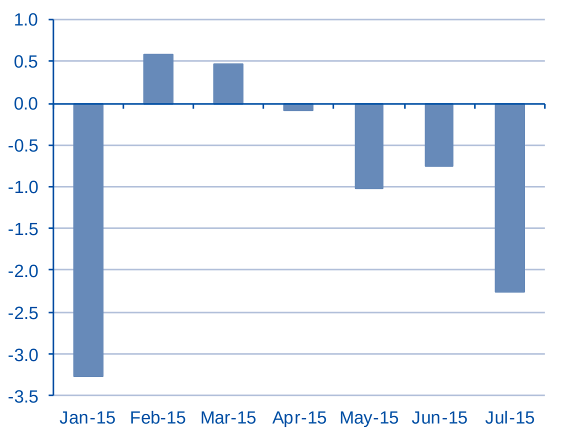
Inflation has once again sunk to an historical low, while the peso exchange rate has reached an absolute high

Arnoldo López / Javier Amador / Iván Martínez / Javier Morales / Alfredo Salgado / Juan Li

What happened this week…

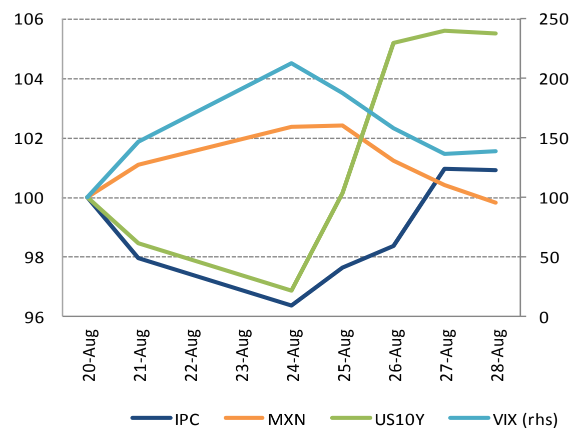
The July balance of trade figure was higher than expected, at -USD2.267bn (BBVAe: -USD1.59bn; consensus: USD1.327bn). This deficit arose from a negative annual growth rate (AGR) for goods exports of 2.6%, owing to a 36.8% contraction for oil exports, and limited growth for non-oil exports of 1.2%. On the other hand, goods imports showed an AGR of 1.1%, which reflected import growth rates of 1.9% for intermediate goods and 1.9% for capital goods, while for consumer goods this decreased (-3.6%).

Figure 1
Goods balance of trade
(USD bn)



Source: BBVA Research with INEGI data

Figure 2
Mexican stock market, peso exchange rate, US 10-year bond yield and risk aversion
(20 August=100)



Source: BBVA Research with Bloomberg data

Annual inflation touched a historical low of 2.64% in the first fortnight of August, when headline inflation provided a mild surprise by rising 0.12% in fortnightly terms (BBVAe: 0.15%; consensus: 0.16%), while core did so by 0.12%, which was practically in line with our forecast and below the consensus estimate (BBVAe: 0.13%; consensus: 0.15%). In annual terms, headline inflation came down to 2.64% (from 2.72% the previous fortnight) and core retreated to 2.29% (from 2.32% in the second fortnight of July). Prices performed seasonally as expected. On the one hand, the increase in university and secondary school fees was partly offset by the drop in tourist service prices with the close of the summer high season. On the other hand, as we were anticipating, non-food goods prices flipped up after the summer discounts. For the whole of August, our preliminary estimate is that prices will rise by 0.22%. If this forecast turns out to be right, annual inflation should reach a new historical low of 2.59%. We continue to predict that exchange rate pass-through to inflation will be minimal, which will have been partly brought about by the situation of considerable slack in the economy. For the year end we forecast that inflation will arrive at 2.5% (compared to 2.9% predicted by the consensus).

A reduction of risk aversion has influenced the peso's appreciation over the week. After hitting its highest outright level since late 2011 on doubts over the slowdown of China's economy, risk aversion as measured by the VIX index came down to its long-term average level and, together with the higher-than-expected revised figure for US second quarter GDP, this led to gains on stock markets and for commodities, as well as for emerging market assets. The peso ended the week at a dollar exchange rate of USD16.75 and was the currency with the fifth highest level of appreciation among the emerging currencies, after strengthening by 1.04%. It should be recalled that on Monday, in response to the sudden upturn in risk aversion, the dollar rate moved as high as 17.20 pesos. In line with the end of week appetite for risk, the US 10-year T-bond's redemption yield rose 14bp (basis points), closing at 2.18%, having momentarily sunk below 2.0% at the beginning of the week. Meanwhile, the 10-year Mbono yield ended unchanged on the previous Friday, having climbed to 6.14%. Among the stock markets, the S&P 500 closed 0.6% better on the week in spite of Monday's plunge of over 5.0%. In Mexico the IPC was up 2.88% over the week, which was a long way ahead of the rise of 0.07% for the MSCI Emerging Markets. Finally, moving to commodities, oil also made a comeback from an initial drop of 2.0%, putting on 12.5% over the week after the better-than-expected GDP figure in the United States.

…What to expect next week

We expect the gross fixed investment index for June to show annual growth of 6.5% when it is published by INEGI on 3 September. The growth should derive from an AGR of 1.8% for its construction investment component and of 16.9% for its machinery and equipment investment component. It is worth pointing out that the average growth rate for this indicator in the first five months of the year was 4.7%, as well as the fact that the AGRs registered by investment in January (8.1%) and in March (6.5%) were particularly high, with the March growth rate equalling our expected figure for June.

Family remittances to Mexico in July could have grown by an annual 4.2%, reaching a level of USD2.083bn. In the first six months of 2015, remittances to Mexico grew by around 4.0% YoY with respect to 1H14, arriving at USD12.089bn. We estimate that remittances will continue their trend of growth in 2015 and could have increased by 4.2% YoY in July to USD2.083bn. The US economy's performance, as well as the employment situation there, appear to be the key drivers behind this, since, for example, US GDP showed quarterly growth YoY of 2.3% in 2Q15, with a 0.6% upward revision for the first quarter, while there was a substantial reduction of around 1pp in the seasonally adjusted unemployment rate in July 2015 with respect to the same month in 2014 in states where Mexican migrants typically reside, such as California (-1.2pp), Texas (-0.8pp), and New York (-0.7pp), among others.

All eyes in markets will be watching out for the activity figures for the US economy, given the proximity of the Federal Reserve's next meeting. Even though China's economy will remain on the agenda, the focus will be on the job creation figure and manufacturing industry activity for August in the United States. The analyst consensus estimate is for 220,000 new jobs, which would mean that average monthly job creation has held at over 200,000 this year, and such a figure would support an imminent hike of the federal funds rate. It should be remembered that these will be the last figures of their kind that are available before the next monetary policy decision by the Federal Reserve, which will take place on Thursday, 17 September.

Calendar of indicators

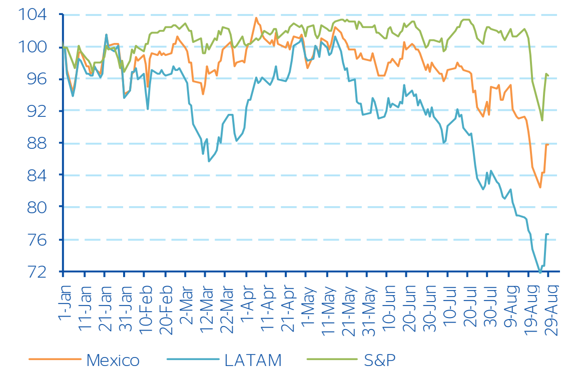
Mexico	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Gross Fixed Investment Index (YoY % change)	June	3 September	6.5%	6.5%	2.3%
Remittances (USD millions)	July	1 September	2,083	2,120	2,168

United States	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
ISM Manufacturing PMI (sa)	August	1 September	52.0	52.5	52.7
Employees on Nonfarm Payrolls Total (MoM Net Change, sa)	August	4 September	207.0	220.0	215.0
Unemployment Rate	August	4 September	5.3	5.2	5.3

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

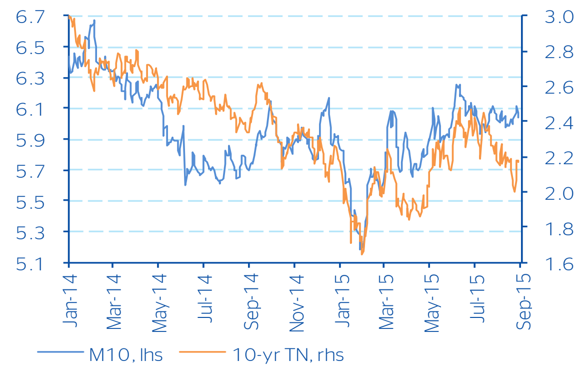
Markets

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



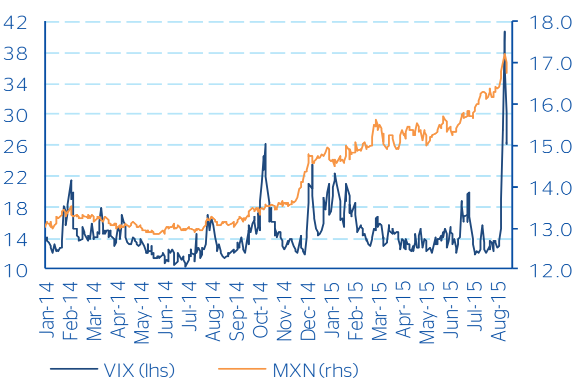
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



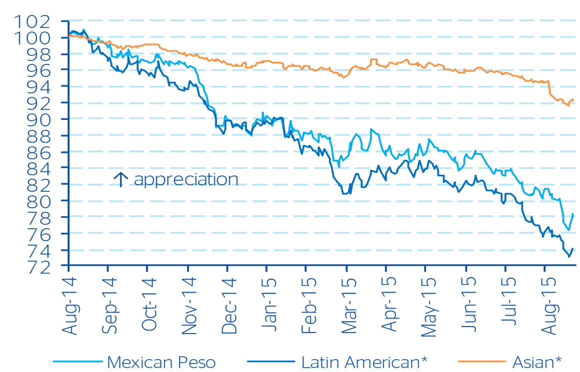
Source: BBVA Research, Bloomberg

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



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD (28 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
26 Aug 2015	Mexico Real Estate Outlook First Half 2015

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