Mexico Weekly Flash

Next week…

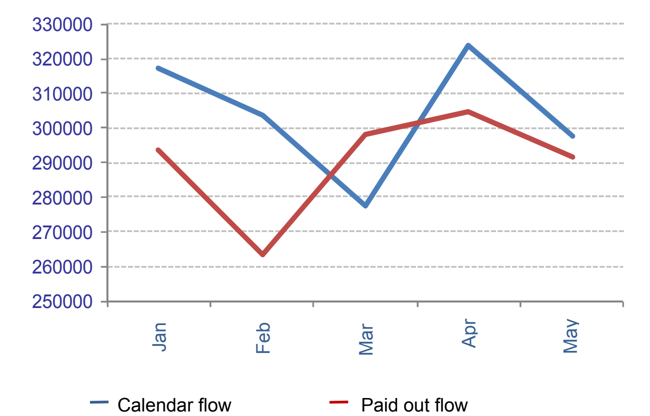
- **The 2Q12 quarterly public finance report may give a signal on an upturn in spending**

Next Tuesday sees the release of the public finance report for June. The report will provide clues on three important areas: 1) whether the planned fiscal consolidation continues to happen as seen in the first quarter; 2) whether the fuel subsidy continues to fall as happened for the first time this year in May; and 3) the size of the underspend at the end of the first six months of the year. In terms of point 1, the aggregate deficit for four quarters is expected to come in very close to 2% of GDP, as was approved for the end of the year. As for the fuel subsidy, there are doubts on what effect the weaker peso seen in June may have had. Finally, in terms of underspending, the SCHP provided signs that it may have almost completely reversed in June. Nonetheless, since the aggregate underspend to May was 4.6%, a reversal would mean that spending had to have expanded to major extent. In addition, it will be important to look at the performance of oil revenue which has suffered due to lower production and the lower exchange rate and prices in comparison to 2012.

- **Market moves again dominated by economic data**

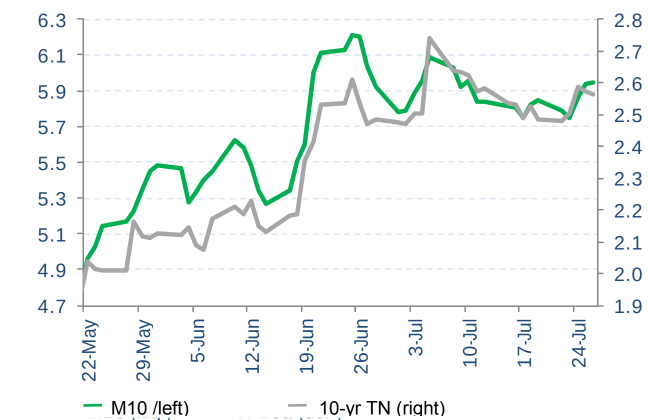
After the revaluing of risk assets last week where Bernanke finally found a more balanced tone to explain the Fed's exit strategy, moves on financial markets this week were again dominated by economic data. Although figures were mixed for the US, the ISM data were better than expected and dominated market sentiment. After this positive surprise, the 10-year T-bill rate bounced 9bp (to 2.59%). The 10-year Mexican bond yield continued to move in line with the US rate, although it also increased on Thursday and Friday for Mexico (in contrast to the stability seen in the US rate). This may be due to discounting the improved industrial output for the US suggested by the ISM upturn, which would drive the recovery in Mexico in the second half of the year and possibly mean an additional cut from Banxico at coming meeting is unlikely. This outlook was backed-up by the tone in the minutes where there was a clear bias for a cut despite the pessimistic tone in terms of economic output and optimistic for inflation. The peso fell 1.0% over the week. All eyes on the markets will be on the GDP figures for the US next week.

Chart 1
Federal spending: budgeted and paid out (millions of current pesos)



Source: BBVA Research with SHCP and DOF data

Chart 2
10-year interest rates (%)



Source: BBVA Research and Bloomberg

Calendar: Indicators

IMEF July (August 1)

Forecast: 50 pts	Consensus: 49.6 pts	Previous: 47.5 pts

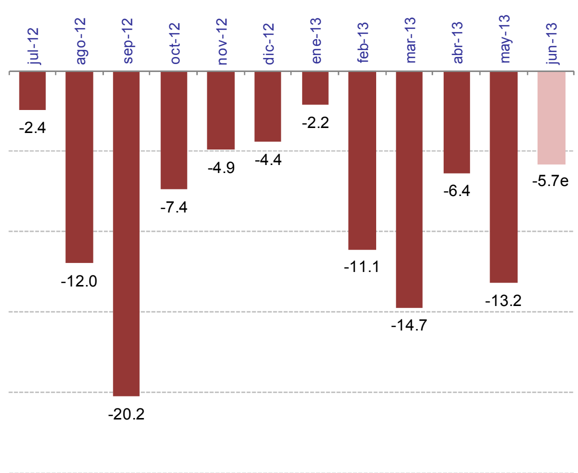
It will important to assess the IMEF indicator this week (released on Thursday) concerning the Mexican business environment (IEEM) which aims to measure business sentiment regarding the economic environment. It should be stated that this indicator emulates the US ISM, taking 50 points as threshold between pessimism and optimism. The IMEF manufacturing producers indicator came in at 47.5 points in June, below the threshold for the second month in a row. We expect to see some recovery in July based on the better US industrial output figures, although we remain cautious regarding manufacturing performance since automotive production fell back slightly in June.

Family remittances in June (August 1)

Forecast: 1.976 bd	Consensus: 2.082 bd	Previous: 2.034 bd

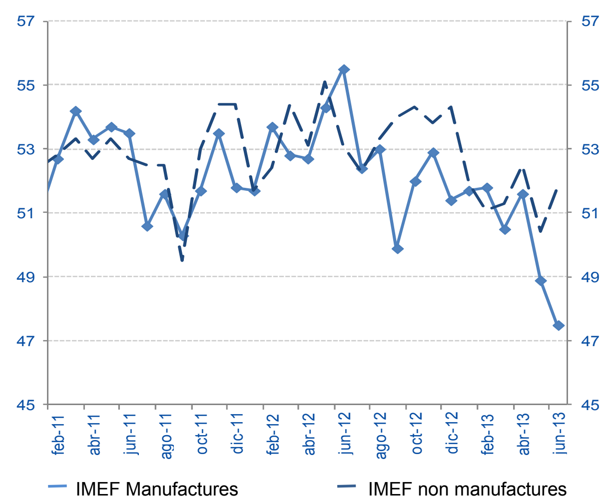
On Thursday August 1, Banxico will release figures on remittances received in Mexico in June. In general, there are two key factors for remittances to Mexico: employment of Mexican migrants in the US as a key long-term factor and changes in the peso/dollar exchange rate in the short-term. The important +5.6% variation in the average pesos per dollar exchange rate between May and June could lead to remittance revenue strengthening. In terms of employment, there has been a slight recovery in jobs for Mexican migrants in the US between and April and June this year, although lower than what could be expected given the total job figures for the country. In this sense, estimates for June point to Mexico having received around 1.976 billion dollars in remittances, equating to an annual flux of -5.7%. This means that if another decline is seen this month, we would have a run of 12 months in a row of annual declines in remittances to the country

Chart 3
Family Remittances to Mexico
% change y/y in dollars



Source: INEGI, Banxico, BBVA Research

Chart 4
IEEM IMEF Indicator

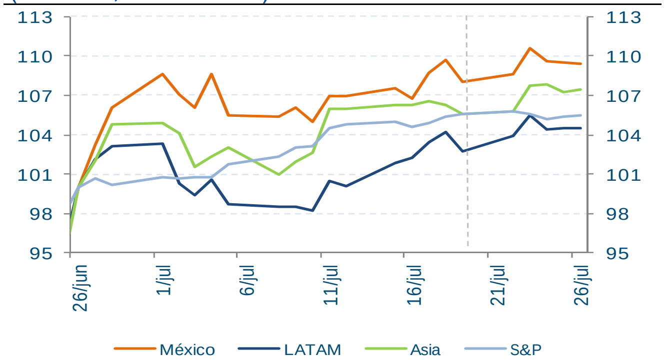


Source: BBVA Research and Bloomberg

Markets, activity and inflation

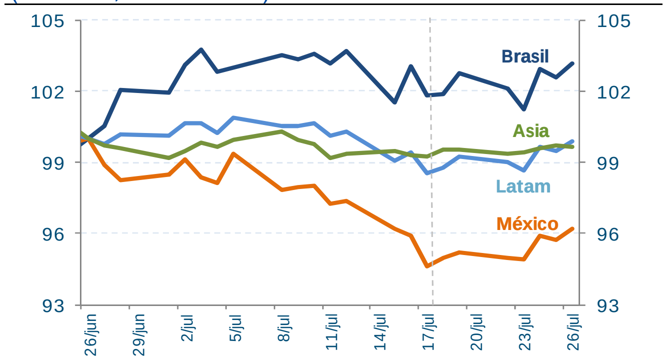
- Gains on stock markets over the week thanks to higher-than-expected figures on consumer confidence, the housing sector and US corporate reports. The exchange rate fell over the week after higher-than-expected data revived concerns that the FED would start to reduce its monetary stimulus program in September.

Chart 5
Stock markets: MSCI indices
(June 26, 2013 = 100)



Source: BBVA Research with data from Bloomberg

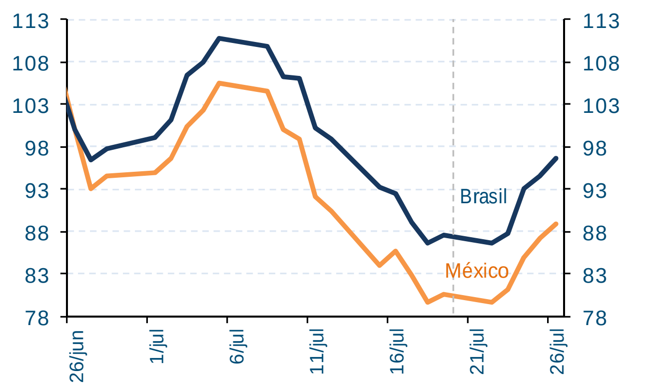
Chart 6
Foreign exchange: dollar exchange rates
(June 26, 2013 = 100)



Source: BBVA Research with Bloomberg data NB: LATAM includes Argentina, Brazil, Chile, Colombia and Peru. Asia includes the Philippines, South Korea, Taiwan, Singapore, Indonesia and Thailand.

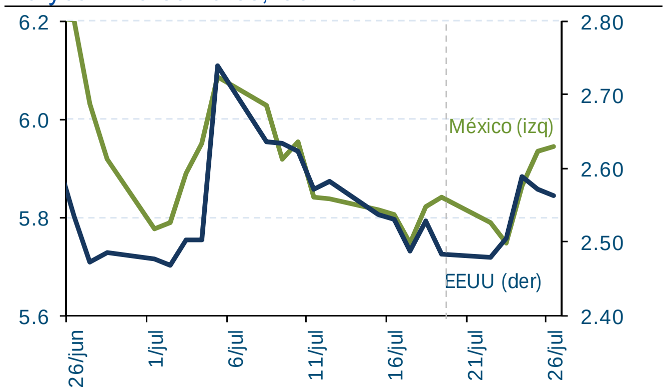
- Higher rates in the US and Mexico mainly due to possible lower monetary stimulus and before the next FED Open Market Committee meeting set to be held Wednesday.

Chart 7
Risk: 5-year CDS (June 26, 2013 = 100)



Source: BBVA Research with data from Bloomberg

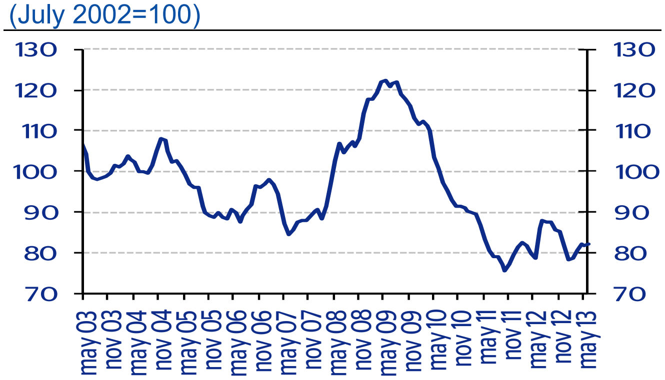
Chart 8
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

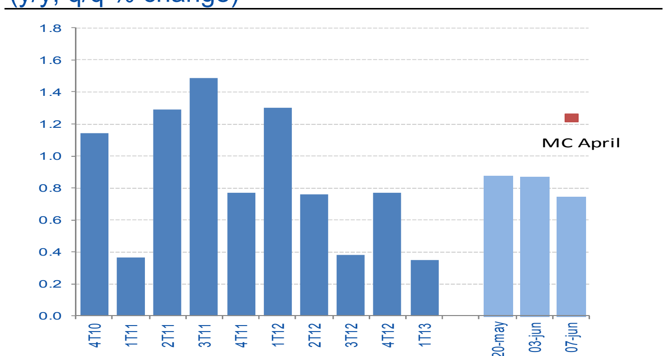
- Inflation started to drop back decisively in June and we expect a rebound in activity in the coming quarters following the rapid decline in 1Q13.

Chart 9
*Inflation Surprise Index
(July 2002=100)



Source: Bloomberg and BBVA Research
*This measures the deviations in inflation in comparison to market-forecast figures, adjusting for inflation volatility. When it trends down, this implies a lower-than-expected inflationary surprise; when it trends up, this indicates a higher-than-expected inflationary surprise.

Chart 10
Observed GDP
(y/y, q/q % change)



Source: BBVA Research

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