

Mexico Weekly Flash

Next week...

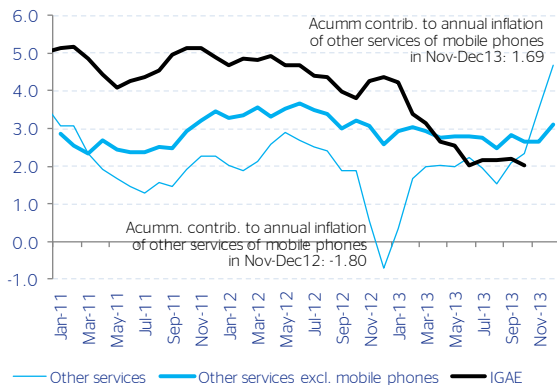
Inflation figures set to show the impact of fiscal changes on prices

Inflation in the first two weeks of January will show the impact of the fiscal reform on prices. We had estimated the impact on monthly headline and core inflation to be 0.44pp and 0.29pp respectively, taking into account a moderate knock-on from the change in the VAT rate on the border - a high one for the new IEPS (special tax on products and services) on sugary drinks and food with a high calorie content and 100% for the tax on fuels containing carbon. Anecdotal evidence points to the knock-on effect from the new IEPS possibly being one hundred percent meaning the impact slant could be slightly upward. In turn, the daily monitoring of farm prices points to a decline in prices for the first two weeks of the month. As a result, taking into account the upward bias for the impact from tax changes possibly being compensated by a slight drop in inflation for farm prices, our monthly outlook for headline inflation remains unchanged at 0.85% and for core inflation at 0.69%. However, the bias could be slightly downward for headline and upward for core. In bi-weekly terms, we expect a 0.55% increase in headline inflation and 0.50% in core inflation, equivalent to 4.5% (vs. 4.0% in December) and 3.1% (vs. 2.8% in December) respectively in yoy terms. The figure for the 'other services' component in core inflation will be important which, excluding cell phone rates, continues to be stable (see chart 1).

Risk appetite falls back on markets due to forward liquidity perception

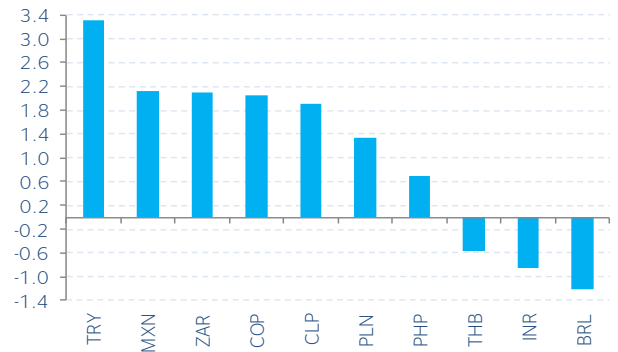
Signs of how strong the US economic cycle is continue to be the main determining factor in terms of risk appetite on markets, mainly due to the liquidity factor. The week was fully loaded with US economic indicators, with most showing upward surprises (retail sales, house building, constructor confidence, regional manufacturing indicators for New York and Philadelphia). Nonetheless, inflation was in line with forecast and core inflation remained very low. The combination of greater economic strength but with a medium-term inflation trend below the target point to the tapering in asset purchases continuing albeit with the start to raising interest rates remaining in the distance. In addition, unlike last year, the upward run in long-term US interest rates can be forecast as being much more contained. Markets responded to the positive economic figures with lower risk appetite seen in weaker emerging currencies while long-term US and Mexican interest rates fell back slightly (4 and 2bp respectively over the week) in light of the policy rate outlook remaining unchanged for a prolonged period.

Chart 1
Headline and core inflation, % change y/y



Source: BBVA Research, INEGI

Chart 2
Strengthening (-) / devaluation (+) of emerging currencies against the dollar, last week, %



Source: BBVA Research and Bloomberg

Calendar: Indicators

Inflation for the first two weeks of January (January 23)

Forecast: headline 0.55%; core 0.50%	Consensus: headline 0.55%; core 0.50%	Previous: headline 0.32%; core 0.08%
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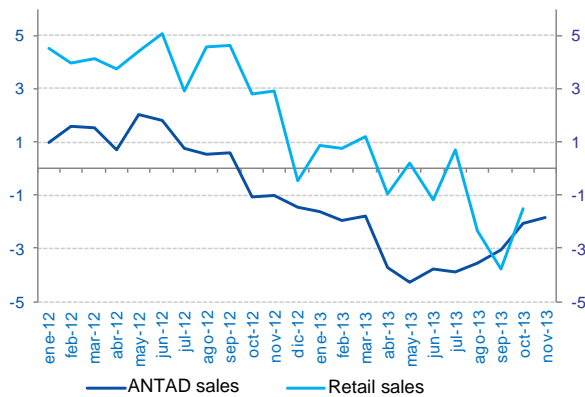
Retail Sales in November (January 24)

Forecast: -1.6% y/y, CSV	Consensus: N/A	Previous: -1.5% y/y, CSV
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Next Friday, January 24, INEGI will release retail sales figures for November 2013. Sales declined (-)1.5% in annual terms (y/y) and increased 0.8% in monthly terms during October, with figures corrected for seasonal variation (CSV). We expect retail sales in November to see a slight 0.9% monthly improvement, although the annual change will remain negative with a decline of -1.6%. This forecast would be in line with the ANTAD sales indicator, which declined (-) 1.1% y/y, CSV in November.

Chart 3

Retail sales and ANTAD sales, % change y/y, CSV

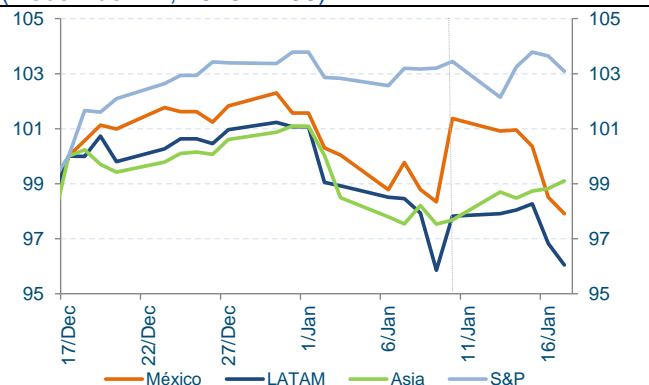


Source: BBVA Research with ANTAD and INEGI figures. CSV=Corrected for Seasonal Variation.

Markets, activity and inflation

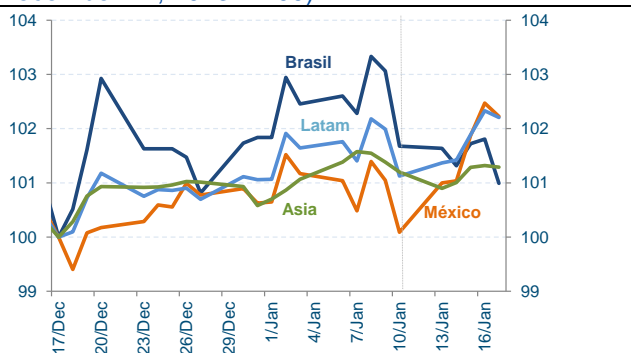
- Better-than-expected industrial output and retail sales in the US underscore the outlook for maintaining the tapering in asset purchases at the FED. This led to falls on stock markets and weaker emerging currencies. The peso saw the highest devaluation over the week amongst LatAm currencies, while the BRL strengthened after the government intervened on the market.

Chart 4
Stock markets: MSCI indices
(December 17, 2013 = 100)



Source: BBVA Research with data from Bloomberg

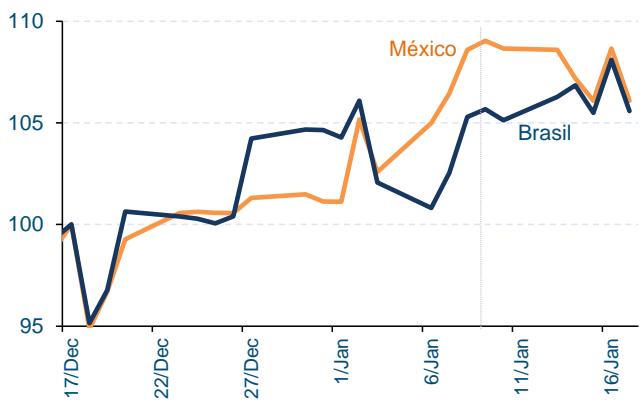
Chart 5
Foreign exchange: dollar exchange rates
(December 17, 2013 = 100)



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.

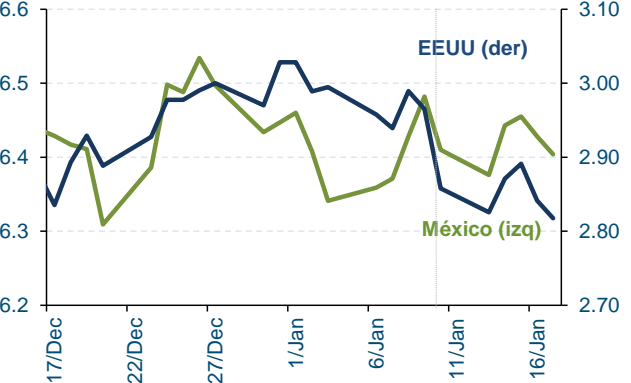
- Marginal weekly changes in Mexican rates that again saw high correlation with US Treasury rates.

Chart 6
Risk: 5-year CDS (Dec 17, 2013 index=100)



Source: BBVA Research with data from Bloomberg

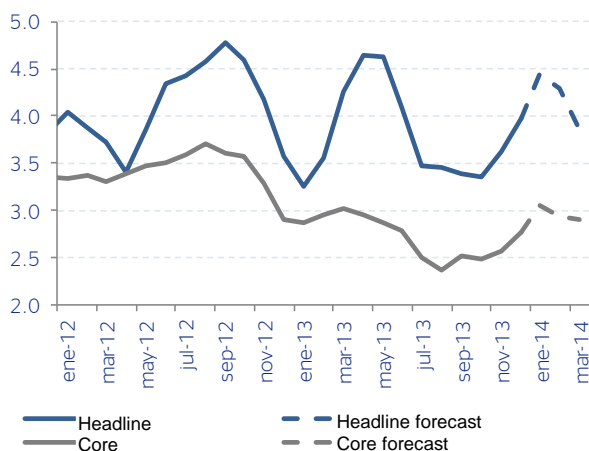
Chart 7
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

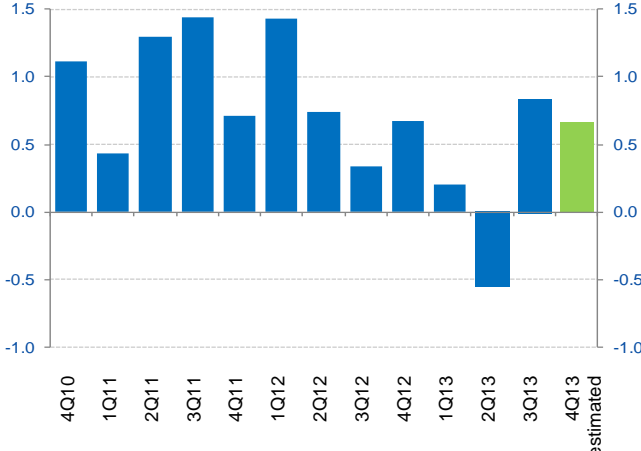
- After inflation ending 2013 at 3.97%, we forecast an increase to around 4.5% in the first two weeks of January due to the fiscal shock

Chart 8
Headline and core inflation (% change y/y)



Source: INEGI, BBVA Research

Chart 9
Observed and estimated GDP 4Q13 (% change q/q)



Source: BBVA Research with INEGI data.

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