RESEARCH

Servicio de Estudios Económicos
del Grupo BBVA

Mexico Economic Outlook

First Quarter 2014
Economic Analysis

- Global expansion will continue in 2014-15, now with a greater contribution from the developed economies
- After the slowdown in Mexico last year, the economy has started to bounce back. Reforms must continue to make progress on improving the country's competitiveness
- Mexico's financial assets compare favourably in an environment of volatility and reduction in global liquidity

Index

Closing Date: February 10, 2014

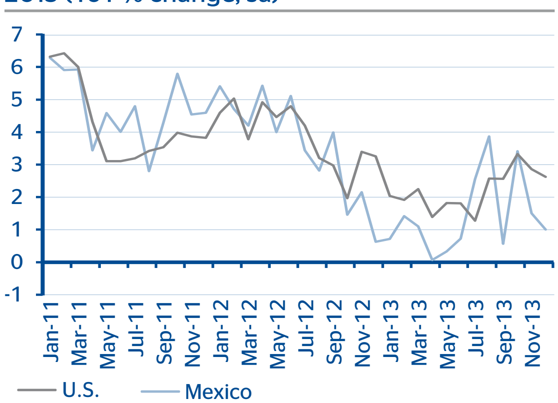
1. Summary

After the slowdown in 2013, when we estimated that GDP had grown around 1.2%, we expect the economy to speed up and grow by 3.4%. This will be as a result of higher foreign demand thanks to the recovery In the US, higher approved public debt and an improvement in internal demand. In addition, this year the reforms should continue to make progress in improving the competitiveness of the Mexican economy, both by harnessing and approving regulations, as well as by presenting further reforms in other sectors.

A favourable factor for the economy is that the variables justifying our acceleration forecast this year seem already to have started to recover in the last few months of 2013. US industrial production posted strong rates of growth once again in November and December, higher than 3.0% YoY. On the other hand, public spending went up in the last months of the year because of the effect of reconstruction processes after natural disasters and the attempt to support economic reactivation. Finally, in terms of the factors affecting internal demand, the signals are mixed: the labour sector has remained weak, but by the last quarter of last year there was a moderate recovery in retail sales. The scenario depends on a continuation of the favourable performance of these variables. We forecast that US growth will strengthen from 1.8% in 2013 to 2.5% in 2014. When it comes to the public sector, the deficit will rise from its 2013 level of around 0.4% of GDP to 1.5% in 2014 (without including investment in Pemex). It is a positive sign that, as noted by the authorities, this deficit helps to increase expenditure on infrastructure and social security, and thus provide a countercyclical stimulus to the economy, and that by 2017 there will be a return to a balanced budget which ensures budgetary stability.

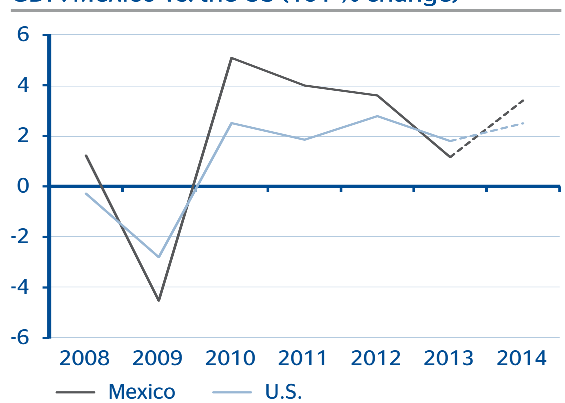
When it comes to foreign accounts, we expect these to remain balanced. In 2014 we estimate a current account deficit on the balance of payments of 1.5% of GDP, similar to our GDP estimate at the end of 2013. A moderate current account deficit such as this indicates the economy's external accounts are not reflecting major imbalances, so they do not represent a significant risk factor for Mexico. What is more, in 2013 foreign direct investment (FDI) behaved favourably, and could reach USD35bn, which contributes to fund said deficit.

Chart 1
Manufacturing output: Mexico vs. the US, 2011-2013 (YoY % change, sa)



sa=seasonally adjusted.
Source: BBVA Research, with information from INEGI

Chart 2
GDP: Mexico vs. the US (YoY % change)



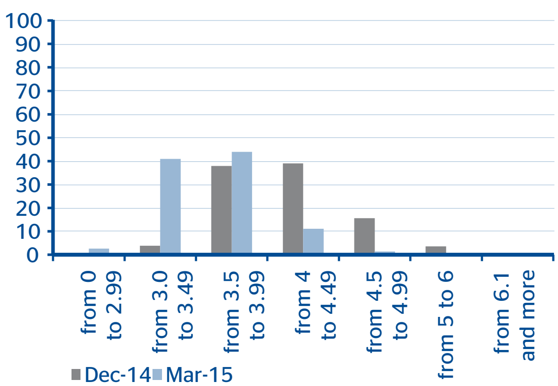
Source: BBVA Research

In the last two decades, Mexico has had annual average annual growth of 2.6%, not enough to generate the formal and good quality jobs that are needed every year to strengthen its domestic market and the welfare of society. This has been influenced to a significant degree by the Mexican economy's lag in competitiveness (ranked In the World Economic Forum's global competitiveness index in 55th place out of 148 countries evaluated worldwide in 2013). However, at the regional level, Mexico is relatively better placed in the various competitiveness indexes than other countries in Latin America. In fact it beats nations in the so-called BRICS (Brazil, Russia, India, China and South Africa). In the last twenty years Mexico has followed a prudent and stable macroeconomic policy, and among its strong points has a very open economy, a large population demanding goods and services, as well as being one of the countries for which foreign direct investment has the greatest appetite, partly as a result of the political and economic stability it has enjoyed for several decades now. In this area Mexico still faces major challenges, and has a competitive and very positive position to start faster and more sustainable growth. The wide-sweeping reforms passed in 2013, once they are underpinned by their respective regulations and come into law, are a key element for containing the economy's weak spots. That is why it is important that in 2014 the country's politicians, private enterprise and the wider Mexican society take this reforming spirit to the next level to ensure the reforms have a deep and lasting impact.

As expected, the supply shock caused by the budget changes caused a significant uptick in inflation in January, which impacted on an acceleration in YoY inflation from 3.97% in December 2013 to 4.48%. Nevertheless, apart from product prices affected by the tax hike, there was no acceleration in other price increases, so that to date no second-round effects have been recorded. This, taken with the fact that the economy is still highly expansive, leads us to forecast that pressures resulting from the fiscal shock will be transitory. Even so, despite the fact that from February onwards headline inflation will again start to slow down and will come in below 4.0% in March, the fiscal shock in January and important base effects in the summer will feed through into higher annual inflation average than in 2013: 4.3% over the course of 2014, compared to the average of 3.8% last year. By the end of the year we expect it to stand at between 3.5% and 4.5% with 64% of probability, and a point estimate of 3.93%. Once the effect of the budget reform has dissipated, by 2015, we forecast that inflation will be lower than 4.0% in March 2015 with 80% of probability, so that by next year there is a high probability that the target will be met.

Chart 3

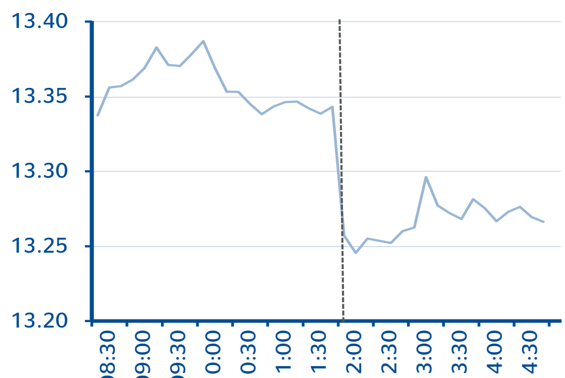
Probability of different ranges for headline inflation in December 2014 and March 2015



Source: BBVA Research

Chart 4

Intraday exchange rate on 5 February 2014 (pesos per dollar)



Source: BBVA Research and Bloomberg

With an inflation rate which is somewhat higher but only for a short period, we expect the monetary policy rate to remain at minimums and the use of central bank communication to become more important, since it is a useful tool for influencing inflation expectations, to anchor them and eliminate price contamination. So we expect the central bank's communication to be more proactive and we maintain our outlook for a prolonged monetary pause, and our inflation perspectives remain stable –although it will be important to be on the lookout for additional inflationary pressures that might materialise.

Meanwhile, in the last few weeks financial markets have suffered increased volatility deriving from a greater perception of risk in emerging markets in a context of less global liquidity. This climate of volatility and flight to quality notwithstanding, and in contrast with other emerging countries, in Mexico there were no abrupt outflows from the government fixed-income market, and there was only a moderate exit of short-term debt since foreign investors' yields were on the part of the curve most exposed to exchange rate volatility.

Over this period, Mexico also differentiated itself positively by benefiting from the upgrade in its sovereign debt rating by Moody's, from Baa1 to A3. This gives Mexico the second highest rating in Latin America, after Chile. The upgrade was based on the passing of a swathe of reforms and the effect of these on potential output and tax revenues. After the news was announced the peso strengthened 14 cents against the dollar, the stock market jumped 1.24% and the long part of the yield curve fell by around 4bp, continuing to do so for the next three days until it had accumulated a 21bp fall. Over the next few months, as global risk aversion dissipates, Mexico's improved rating could differentiate its financial assets from those of other emerging countries. However, it is important to point out that in view of the liquidity tapering in the US, interest and foreign exchange rates are not expected to be as low as those seen in the second part of 2012 and the first half of 2013. Towards the end of the year we expect the exchange rate to reach levels of around USDMXN 12.9, based on reduced levels of global risk aversion and in view of a limited margin for appreciation as a consequence of the withdrawal of quantitative easing in the US. In terms of government debt interest rates, we expect the liquidity premium to continue normalising gradually; this, taken with better expectations for economic growth for next year will generate an increase in medium and long-term rates. For example, yield on 10-year government bonds will close the year around 6.9%.

Based on the arguments above, 2014 is looking as though it will be better than 2013 in the economic arena. Similarly, we expect that this year better foundations will be laid for economic development in the next few years.

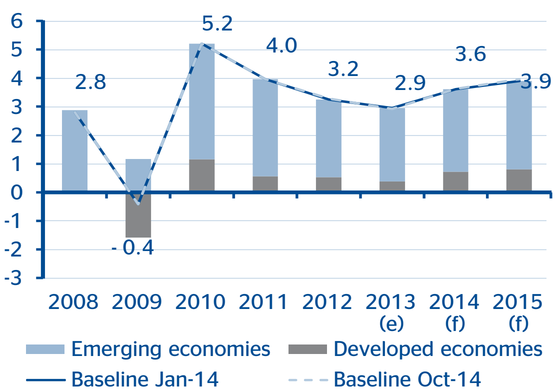
2. More growth in sight and with more balanced risks

The global economic cycle is improving and we now have clarity on some economic policy uncertainties

The global economic cycle strengthened during the latter months of 2013. According to our estimates, during the second half of 2013, global GDP accelerated to c.1% QoQ, leaving behind the moderation with its roots in 2012 and its low at the beginning of 2013, when growth was barely 0.5%. This improvement was driven by the acceleration of the developed economies – particularly the US, but also the eurozone, which started to see moderate growth after the recession ended in mid-2013. In the EMs, the situation is more diverse, but some of them (e.g. China) are posting relatively stable rates of growth.

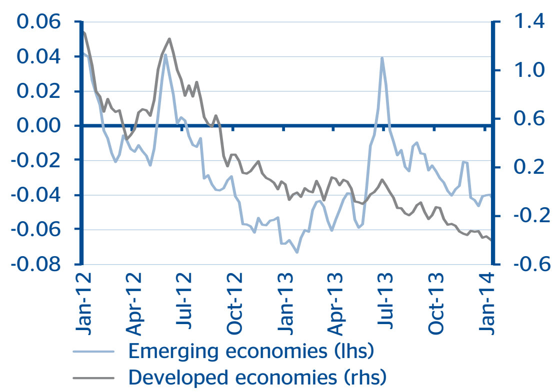
Our improved valuation of the global scenario is also the result of economic policy news flow, inasmuch as this helps to reduce uncertainty. First, the US reached a more far-reaching agreement on fiscal policy than we expected. Meanwhile, the improvement in activity allowed the Fed to start tapering its expansive monetary policy at the beginning of 2014. In Europe, further steps have been taken towards the construction of banking union, which together with the ECB's determination to keep risks under control, should eliminate the hobble represented by financial fragmentation. The global outlook would be clearer if it were not for the effect that the tapering is having on financial markets in the EMs, and which could eventually affect economic growth in some of the countries included in this category.

Chart 5
Global economic growth (%)



Source: BBVA Research with IMF data

Chart 6
BBVA Research Financial Tensions Index



Source: BBVA Research

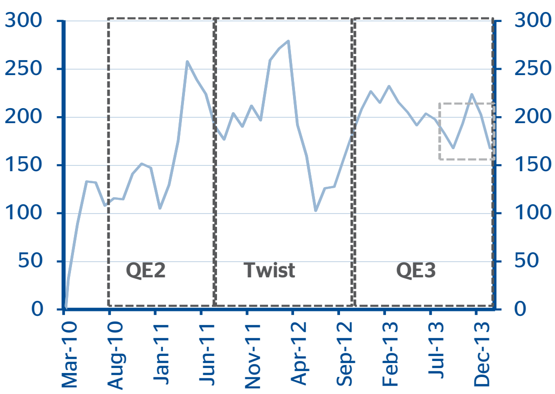
Altogether, our assessment of the global scenario is better than it was three months ago, and this is reflected in the adjustments to our forecasts. Our projections now indicate that global GDP growth, which in 2013 had decelerated to 2.9%, will increase to 3.6% and 3.9% in 2014e and 2015e, respectively (Chart 5), practically the same as our forecasts three months ago, due to the offset between our growth expectations in the different areas: to the upside in the US, to the downside in some emerging economies and with no significant change in our forecasts for the eurozone in 2014. In spite of the expected acceleration in growth, we still see some downside risks to our forecasts. Although these risks are a long way from having the systemic nature that they had in the past, some recent events such as the fall in asset prices and currency depreciation in EMs have made themselves felt.

The US has reached sufficient cruising speed to start unwinding monetary stimulus

US GDP growth has been accelerating through 2013, and by year-end had already reached cruising speed, allowing the Fed to take the first steps towards withdrawing monetary stimulus. In fact, growth in the third quarter accelerated to 1% QoQ, and the preliminary estimation pointed out that growth in the fourth quarter remained robust, although slightly below the third quarter.

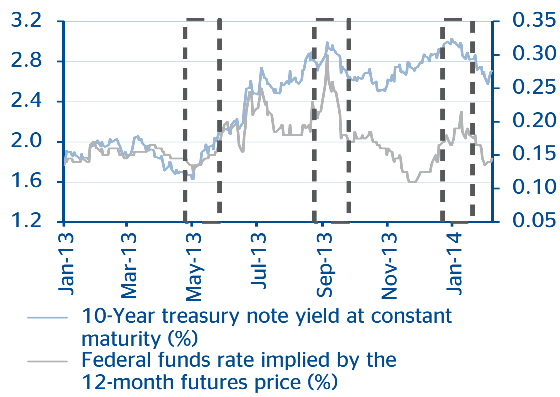
There is now more certainty regarding the tone of fiscal policy, which for 2014 implies less of a drain on economic growth. The lack of agreement between the parties on the fiscal consolidation process in the US led to a partial and temporary interruption of the federal government's activity, which actually had little impact on GDP. Subsequently, in December, an agreement was reached that represents an important step forwards in eliminating the uncertainty regarding the funding of the government's activity in 2014-15, as well as reducing the fiscal adjustment initially forecast for that period. The direct effect of this reduction in the intensity of the fiscal consolidation alone raises our forecast growth for 2014 by a couple of tenths. Then there are also the potential effects, via confidence, that this reduced uncertainty could have on household consumption and corporate decisions regarding investment and hiring. Nonetheless, there are still issues outstanding that affect the long-term sustainability of the public accounts, such as healthcare spending and pensions.

Chart 7
US: Private-sector non-farm payroll (MoM in thousands, 3-month moving average)



Source: BBVA Research with Bureau of Labour Statistics data

Chart 8
US: Fed fund futures vs. long-term interest rates (%)



Source: Bloomberg

The outlook for monetary policy has also clarified recently, in line with our expectations. The Fed had linked the end of its monetary stimulus programme to economic growth. As noted above, activity has tended to accelerate, a rather contained acceleration in the case of the labour market, but nonetheless notable given the lack of additional stimulus (see Chart 7). Meanwhile, the unemployment rate fell to 6.7%, although this was partly a reflection of the contraction in activity. The above were in the context of an outlook for inflation well-anchored within the range determined by the Fed itself.[1] As a consequence, the Fed decided to start to taper its monthly purchases of financial securities, public debt and mortgage-backed securities. All in all, in the fourth quarter of 2014, the central bank will have stopped expanding its balance sheet. Our base scenario also assumes that the first increase in interest rates will take place in the second half of 2015, although the FED will continue to use its forward guidance to anchor interest-rate expectations. In fact, the Fed's efforts to explain its exit strategy have been relatively successful in avoiding episodes of volatility like we saw last summer. Both long-term interest rates and expectations regarding Fed funds remain at levels no higher than the beginning of the summer (Chart 8). This is significant because part of the US recovery was due to interest-rate sensitive sectors such as real estate.

[1] Inflation expectations on a one- to two-year horizon of no more than 0.5pp above the long-term target of 2%.

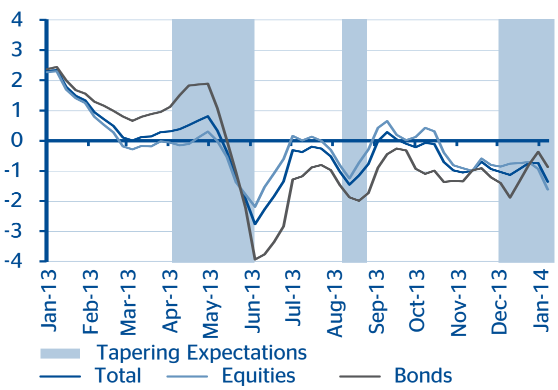
Altogether, we have revised upwards our forecast for US growth in 2014 to 2.5%, the same as our estimate for 2015. This adjustment reflects both the strength of the US economy in the second half of 2013 and the additional momentum contributed by the reduced fiscal drain thanks to the agreement reached at the end of last year. Note that there are also upside risks to our forecast if the improvement in confidence results in additional corporate investment and hiring.

Tapering could cloud the outlook for some emerging economies

The change of direction in US monetary policy has, as usual, had a global impact. The emerging economies are being subjected to capital outflows and currency depreciation, intensified in some cases by domestic events that have increased uncertainty regarding the management of their respective local economic policies. Even so, to date and from an aggregate perspective, the intensity of the non-resident capital outflows is no worse than on previous occasions when expectations have changed regarding the start of Fed tapering (Chart 9). In addition, there continues to be a differentiation between economies depending on their fundamentals: higher external deficits and more dependence on short-term and foreign-currency funding are associated with greater vulnerability to capital outflows and currency depreciation (Chart 10).

Chart 9

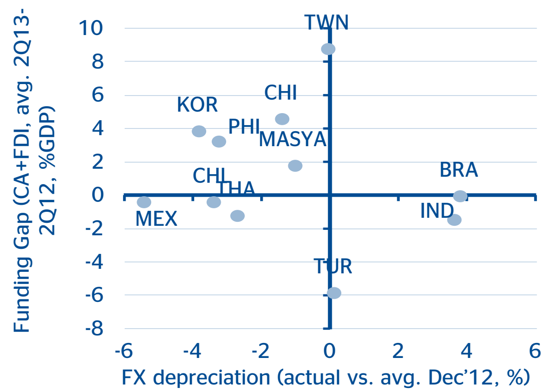
EMs: flows into funds in bonds and equities (4 weeks cumulative, specialist EM funds, flows over total assets)



Source: BBVA Research with EPFR data

Chart 10

Exchange-rate depreciation (%) and external funding gap (CA + FDI, % GDP)



Source: BBVA Research with Haver Analytics data

The recent tensions have not changed our growth forecasts for the EMs as a whole in our most likely scenario, but they do represent a significant downside risk. This risk is higher in the economies that are financially more integrated in global portfolio indexes and that have the above-mentioned vulnerabilities: Turkey, Brazil, Indonesia and India in particular. The monetary tightening being introduced by some of these countries to control currency depreciation and inflation expectations will inevitably have a negative impact on growth. All in all, the diversity within the EM group means that our outlook remains favourable for some parts of South America, such as the Andean economies, emerging Asia and Mexico. In the case of the latter, we have even improved our outlook for growth in 2014 (to 3.4%), driven by the cyclical momentum of the US economy (Chart 11).

Growth in China remains at around 7.5%, but the vulnerabilities are more evident

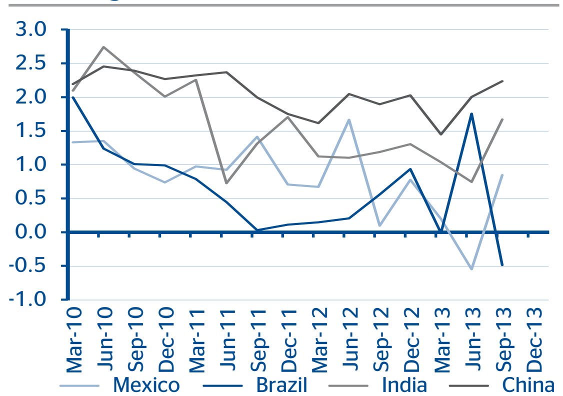
The fourth quarter was a clear example of the duality of China's economy as both a support for the global economy and a potential risk factor. The uncertainty at the beginning of the year regarding the sustainability of its growth and the possibility of a hard landing dissipated in the short term. The economy recovered in the second half of 2013 (Chart 11) and maintains a good tone, although some of the more recent data on confidence and expectations of manufacturing activity are once again below market expectations.

Fundamental changes in economic policy have also been announced. At the Third Plenum of the Chinese Communist Party, the authorities reiterated their commitment to maintaining high rates of growth, while at the same time as proposing measures that will strengthen the role of the market in allocating resources and a rebalancing from a model of investment and exports towards increasing household consumption. These announcements should be valued as steps in the right direction, but their effectiveness will depend on their execution, and they are not without risk.

For example, as regards the financial sector, the authorities are continuing to demonstrate their commitment to tackle the current vulnerabilities, fundamentally linked to the rapid growth of credit. This is being reflected in liquidity tensions in the interbank market which are above all affecting the so-called shadow banking sector.[2] However, the authorities have not managed to moderate the rate of growth in credit (Chart 12), but a continuation of these tensions could have unwelcome effects on the stability of the system.

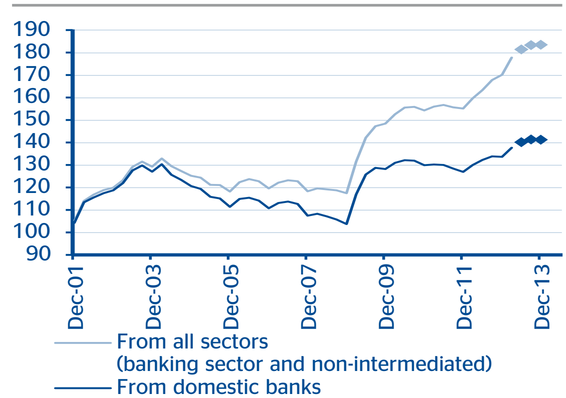
In any case, our 2014 and 2015 forecasts for China's economy remain unchanged, based on our confidence in the authorities' scope and ability to take action. All in all, the risk of a hard landing would be particularly damaging given the size of the economy and its importance for world trade.

Chart 11
EM GDP growth (% QoQ, sa)



Source: BBVA Research

Chart 12
China: credit to the non-financial private sector (% GDP)



Source: BBVA Research with BIS and Haver Analytics data

[2] The group of financial institutions and vehicles that fall outside the regulation of the banking system, but that carry out the same intermediary functions between the economic agents with surplus liquidity and those with insufficient savings to take consumption or investment decisions.

The gradual recovery in the eurozone continues, with the support of the ECB and with banking union in its sights

After starting the year in recession, the eurozone managed to sustain moderate expansion throughout the second half of the year, in line with our forecast. Thus if our expectations are confirmed, the fourth quarter data will indicate YoY growth of 0.4%, which although only slight, is its best since the end of 2011. The driver of this slight improvement was the prospect of an increasing role played by domestic demand, although the engine of European growth in 2013 and 2014 was, and will continue to be, the export sector.

The factors supporting the moderate recovery in the eurozone are: i) the recovery of external demand; ii) the sustained improvement in financial conditions, favoured by the ECB's determination of, and commitment to, an expansive monetary policy; and finally and linked to that, iii) the steps taken towards banking union, which should reduce the financial fragmentation that is hampering the role of monetary policy in the region as a whole. In any case, we cannot rule out periods of instability as we approach events that could alter the panorama of progress in banking union and of strengthening the monetary union in Europe in general. The events to watch in this context include the European Parliamentary elections, and news flow on the conditions and results of the stress test and asset quality review of the banking sector.

All in all, we reiterate our forecast for eurozone GDP growth at 1.1% for 2014. For 2015 we estimate 1.9%. However, given our projection of continued cyclical weakness, we are also maintaining as a risk event to our forecast horizon a scenario of significant deflation, although we assign a low probability to this risk (see Chapter 3).

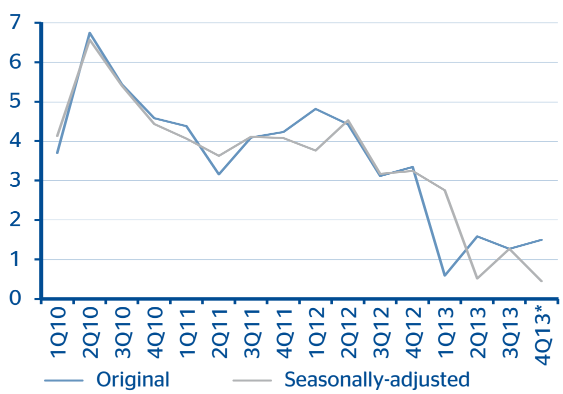
3 The economy has begun to pick up after the slowdown

3.1 Growth will speed up this year and reforms should continue to help improve Mexico's productivity

The Mexican economy slowed sharply in the first half of 2013, due to weak external demand and the stagnation and even contraction of key sectors, including manufacturing, mining and construction. Growth returned in the second half of the year, but the recovery was both weaker and slower than expected. The recovery in the latter part of the year was driven mainly by rising external demand, in particular by the strong performance of US industry, which imported more Mexican products, and by high public spending connected with reconstruction following natural disasters, as well as efforts to revive the economy.

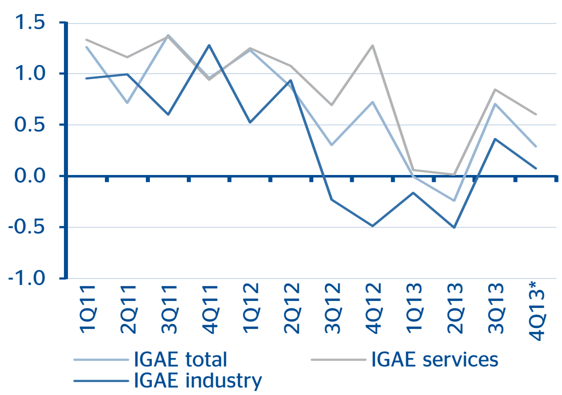
The economy grew by 2.8% QoQ in the first quarter of 2013, 0.5% QoQ in the second quarter, and 1.3% QoQin the third (see Chart 1), all seasonally adjusted. We expect expansion to continue, albeit slowly, in the fourth quarter, so that the economy should close the year with annual GDP growth of 1.2% (see Chart 14). We expect the economy to continue to expand in 2014, growing at an annual rate of 3.4%. This growth forecast does not factor in the effects of the reforms approved in 2013, which we expect to be implemented and to begin to bear fruit only in the medium term.

Chart 13
Mexican GDP, 2010-2013 (Seasonally adjusted and original series, YoY, % change)



* 4Q13 is an estimate.
Source: BBVA Research with INEGI data

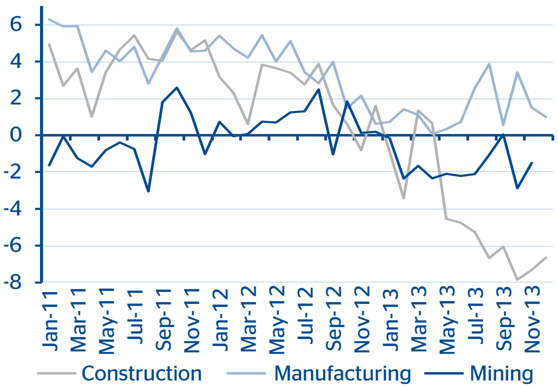
Chart 14
Mexican Economic Activity Index (IGAE) (QoQ % change, sa)



*The December figure is an estimate. sa = seasonally adjusted
Source: BBVA Research with INEGI data

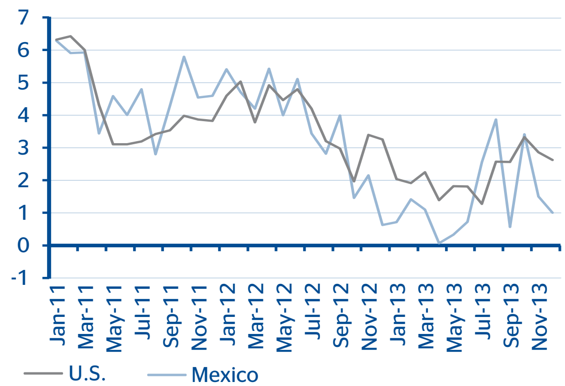
As we expected, the economy made a very moderate recovery towards the end of 2013, due to the slight upturn in industrial output and a gentle improvement in domestic demand related with a weak, segmented labour market. According to the seasonally-adjusted figures contained in the IGAE, farm output shrank by -4.0% YoY in November and industry contracted by -1.3%, while services grew by 1.1%. As a result, the monthly index grew by just 0.1% YoY. In the industrial sector, manufacturing and electricity, gas and water grew by 1.5% and 0.4% YoY, respectively. Construction fell by -6.6% and mining shrank by 2.9% compared to November 2012. The recovery in Mexican manufacturing was largely driven by rising export demand, as industrial output finally began to grow again at faster rates (3.2% YoY in November and 3.7% YoY in December). Specifically, manufacturing output grew by 2.9% YoY in November and by 2.6% YoY in December, although it remains below the levels reported in 2012 (3.4% and 3.3% YoY, respectively) (see Charts 15 and 16).

Chart 15
Industrial output in Mexico: components, 2011-2013 (YoY % change, sa)



sa=seasonally adjusted
Source: BBVA Research with INEGI data

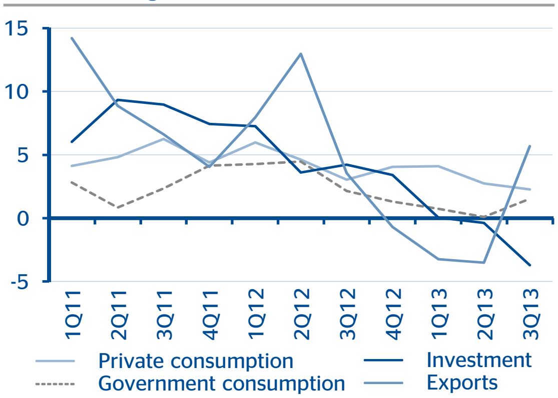
Chart 16
Mexican and US manufacturing output, 2011-2013 (YoY % change, sa)



sa=seasonally adjusted
Source: BBVA Research with INEGI data

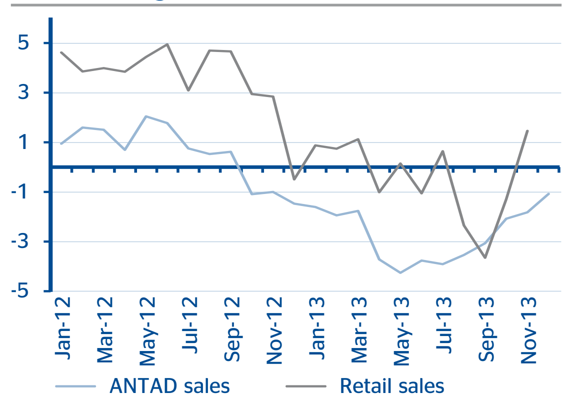
The performance of almost all the factors related with domestic demand was very moderate, and in some cases even negative (see Chart 17). Slower job creation, the scant change in real wages and a smaller inflow of foreign currency in the form of remittances resulted in weak consumer demand. Private consumer spending grew by 2.3% YoY in the third quarter of 2013 (3.0% in the third quarter of 2012) and public sector spending expanded by just 1.5% YoY (2.1% in 3Q212). These figures crystallised in lower retail and ANTAD sales in the first three quarters of the year, although a moderate recovery appeared in the last quarter, which we expect to continue in 2014 (see Chart 18).

Chart 17
Aggregate demand: components, 2011-2013 (YoY % change, sa)



sa=seasonally adjusted
Source: BBVA Research with INEGI data

Chart 18
Retail and ANTAD sales, 2012-2013 (YoY % change, sa)

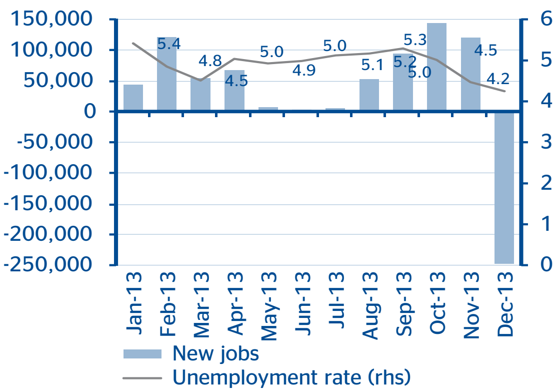


sa=seasonally adjusted
Source: BBVA Research with INEGI data

Measured in terms of the total number of workers affiliated to the Mexican Social Security Institute, the formal economy created a total of 463,018 jobs in the year to December 2013, an increase of 2.9% compared to 2012. As a consequence, the open unemployment rate fell to 4.25% compared to 4.47% in December 2012 (see Chart 19). However, this represents a decline compared with the 711,708 new jobs created between 2011 and 2012.

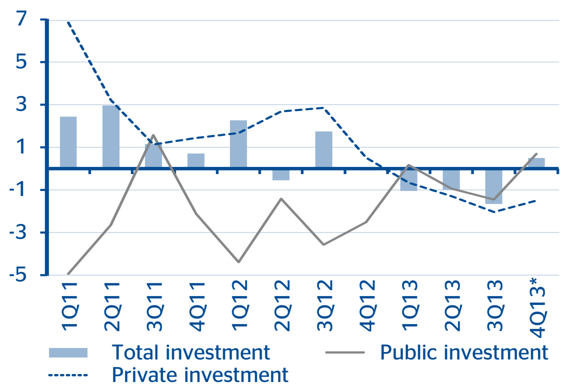
Investment performed poorly in 2013. The quarter-on-quarter change in total investment reflects three consecutive quarters of contraction, in contrast to other cycles, accompanied by falls in both public and private investment. This is a sign of weakness in the domestic market and the absence of supply chains capable of reinforcing the country's growth. We estimate that the fourth quarter of 2013 will reflect growth in public investment, in line with the larger budget approved by Congress. This growth is expected to continue throughout 2014 (see Chart 20).

Chart 19
Job creation and unemployment rate, 2013 (number of jobs and YoY % change)



Source: BBVA Research with INEGI and Labor Ministry (STPS) data.

Chart 20
Investment: components, 2011-2013 (QoQ % change, sa)

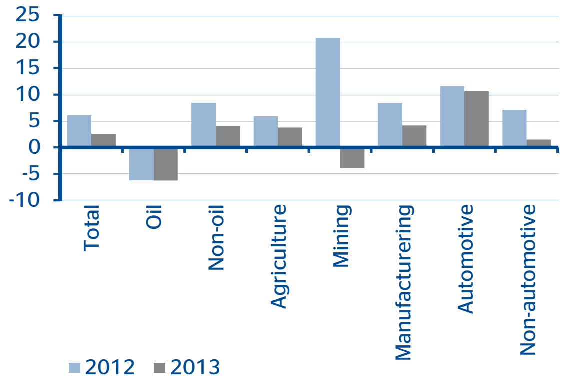


sa=seasonally adjusted. * 4Q13 is an estimate
Source: BBVA Research with INEGI data

Mexico's total exports rose by 2.6% YoY in 2013, a poor performance compared to growth of 6.1% in 2012. Non-oil exports grew by 4% YoY (8.5% in 2012), but oil exports fell by -6.2% (as in the prior year). The non-oil export figure breaks down into 4.2% growth in manufactured goods (8.4% in 2012); 3.8% growth in farm and fisheries products (5.9% in 2012); and a -3.9% contraction in mining exports (20.7% in 2012). In contrast to the majority of manufacturers, the automotive industry succeeded in maintaining growth in its exports, which increased by 10.6% in 2013, a rate close to 2012. However, non-automotive manufacturing exports lagged behind, growing at just 1.5% in 2013 compared to 7.1% in the previous year (see Chart 21).

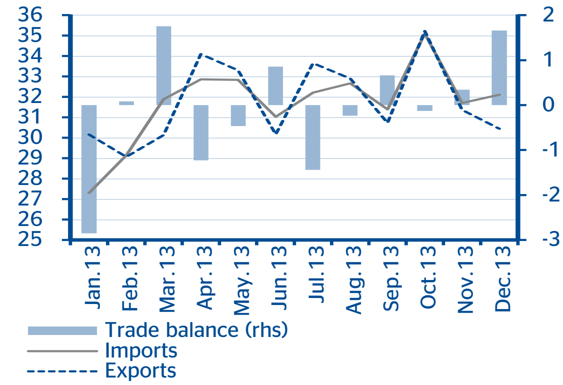
Meanwhile, imports grew by 2.8% YoY (5.7% in 2012), mainly due to the increase in imports of consumer goods (5.6% in 2013 vs. 4.8% in 2012), followed by intermediate/producer goods (2.5% in 2013 vs. 5.3% in 2013) and capital goods (1.3% in 2013 vs. 10.1% in 2012). As a consequence, the trade balance reflected a deficit of USD1.0bn in 2013, compared to a deficit of just USD46mn in 2012 (see Chart 22). It is expected that the current account deficit in the country's balance of payments will be around 1.3% of GDP at the close of 2013, compared to a slightly lower figure of 1% of GDP in 2012. This moderate current account deficit demonstrates that the economy's trade accounts are free of major imbalances, and this factor is unlikely to hinder Mexico's economic growth. This is a relevant point, as we expect a current account deficit of some 1.5% of GDP in 2014, a figure which would likewise be manageable for the economy.

Chart 21
Total exports and exports by sector, 2012-2013 (YoY % change)



Source: BBVA Research with INEGI data

Chart 22
Trade balance, 2013 (USD billions)

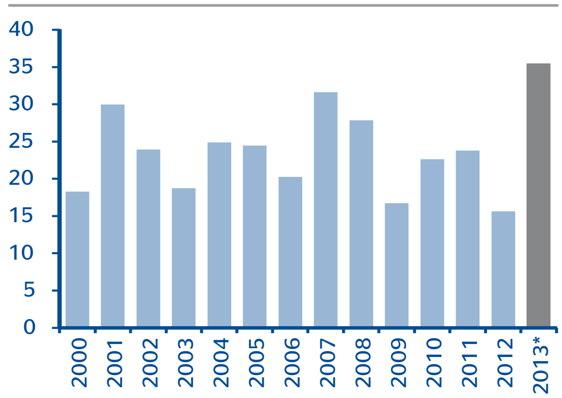


Source: BBVA Research with INEGI data

Foreign direct investment (FDI) received in the third quarter of 2013 totalled USD28.2bn, compared to USD14.3bn over the whole of 2012. This increase was due in part to extraordinary income from the sale of the Modelo group, and as a result FDI could be as much as USD35.4bn in 2013 (see Chart 23). This represents significant growth, which will foster development and confidence in the economy.

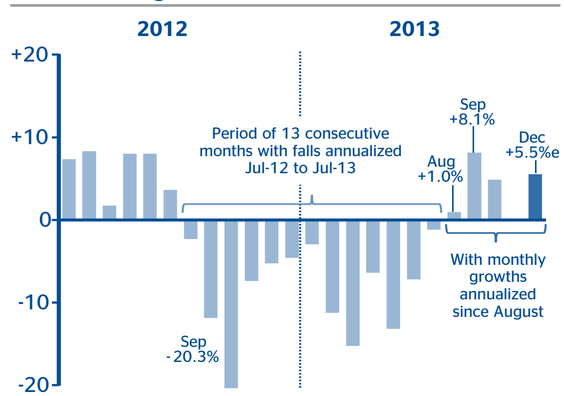
Meanwhile, family remittances to Mexico recovered towards the end of the year, driven by improving employment conditions in the USA. The US Bureau of Labor Statistics reported a national unemployment rate of 6.7% last December, the lowest observed since 2008. Furthermore, US Department of Labor figures show that existing and new unemployment insurance claims fell by 9.8%, based on a comparison of the figures for the last week of December 2013 and 2012. These improvements in US labour market indicators helped to improve employment conditions for Mexican migrants, with positive effects on remittances to Mexico in the period. Remittances received in the month of December 2013, totalled USD1.8bn, an increase of 5.5% YoY (see Chart 24).

Chart 23
Foreign direct investment , 2000-2013 (USD billions)



*BBVA estimates
Source: BBVA Research with Ministry of Economy. data

Chart 24
Family remittances to Mexico, 2012-2013 (YoY % change in USD)



e: BBVA estimate
Source: BBVA Research with Banxico data.

Turning to public finances, SHCP data for 2013 show that the government's budgeted income increased in real terms by 4.3% compared to the same period of 2012. Non-oil tax receipts increased by a significant 4.4%, which was due, among other matters, to the extraordinary income generated by the sale of the Modelo group. Total net public sector budget spending grew by 2.8% compared to 2012. In terms of components, current spending decreased by 0.3% in real terms, but investment expenditures grew by 3.8%, also in real terms. As a consequence, the public finances reflected a deficit of MXN375bn, representing 2.3% of GDP for 2013. This deficit was the result of budgeted public sector spending equal to 25.6% of GDP, while the corresponding revenue items totalled only 23.3% of GDP. Excluding PEMEX investment, the deficit totalled MXN46.7bn, equal 0.3% GDP, less than the deficit anticipated in the Economic Package for 2014 (0.4% of GDP).

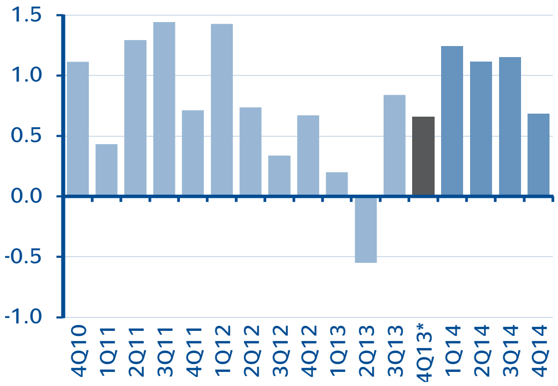
At the close of 2013, the federal government's net debt was 35.0% of GDP, 1.7% higher than in December 2012. Meanwhile, the historic balance of the public sector borrowing requirement was equal to 38.3% of GDP, 1.7% above the figure at the close of 2012. These levels of debt compare favourably with equally or more developed countries internationally. The deficit of MXN620bn approved for 2014 will represent some 3.5% of GDP for the year (1.5% excluding investment in PEMEX), resulting from public sector spending equal to 25.3% of GDP and revenues for the year of 21.8%. It is expected that the deficit will be reduced gradually in order to ensure fiscal stability.

According to the general economic policy criteria established by the SHCP, the deficit will help increase spending on infrastructure and social security commitments, at the same time as providing a countercyclical stimulus for the economy. Meanwhile, the SHCP expects that Mexico will return to a balanced budget by 2017. This will occur to the extent that the economy picks up and further satisfactory progress is made in implementing the raft of recently approved structural reforms. In terms of the soundness of Mexico's public finances and development, this will require the fulfilment of two conditions. In the first place, structural reforms will need to be adequately instrumented to ensure that they are reflected in a faster rate of economic growth. Second, public spending will need to be governed by efficient criteria to ensure that the beneficiary sectors help to support and foster the country's current and future economic growth.

The Mexican economy was ranked 55th most competitive out of 148 countries worldwide in the World Economic Forum's global competitiveness index. At the regional level, Mexico is relatively better positioned in the different competitiveness indices than other Latin American countries. Indeed, it also ranks above the BRICS nations (Brazil, Russia, India, China and South Africa). In February 2014, the credit rating agency Moody's Investors Service raised its rating of Mexico's sovereign debt from Baa1 to A3 with a stable outlook, based on the approval of structural reforms, stronger public finances and increased government saving, and harmonisation with other countries with a similar credit profile. In this regard, Mexico's reforms and general economic stability differentiate the country favourably from other emerging markets. However, Mexico still faces major challenges to improve its competitiveness internationally and to raise the level of development and economic growth (see Box 1).

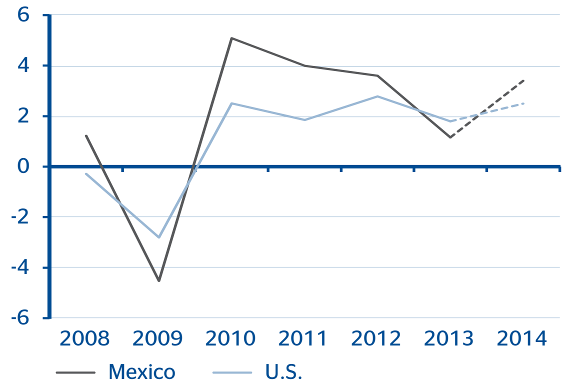
Based on our estimates, the Mexican economy enjoyed a moderate economic recovery in the second half of 2013 and it should achieve growth of 1.2% for the year as a whole. Meanwhile, we expect faster growth of 3.45% in 2014, due to increased public spending and investment linked in part to reconstruction work following a series of natural disasters, and also to a recovery in job creation in the formal economy, which should encourage private consumer spending. Also, the improved performance of the US economy should increase demand for goods and services produced in Mexico. These factors will result in a higher growth rate than that of Mexico's main trading partner (see Charts 25 and26).

Chart 25
Quarterly GDP growth for Mexico (QoQ % change, sa)



sa=seasonally adjusted. *BBVA estimates as of 4Q13
Source: BBVA Research with INEGI data

Chart 26
Mexican and US GDP, 2008-2014 (YoY % change, sa)



sa=seasonally adjusted
Source: BBVA Research with INEGI and BEA data

Over the last twenty years, Mexico has followed prudent, stable macroeconomic policies, but major challenges remain. Among its strengths, the country is very open to trade, having entered into numerous free trade agreements worldwide. According to the Secretary of the Economy, Mexico has formed a network of 10 Free Trade Agreements (FTAs) with 45 countries, 30 Bilateral Agreements on Reciprocal Promotion and Protection of Investments (ARPPIs) and 9 limited scope agreements (Economic and Trade Agreements and Partial Trade Agreements) within the framework of the Latin American Integration Association (ALADI).

Mexico also has a large population (118.4 million in 2013) who are eager for goods and services, and it is one of the most attractive countries in the world for foreign direct investment because of the political and economic stability it has shown over a period of decades (Mexico was ranked 12th worldwide, according to the United Nations Conference on Trade and Development (UNCTAD) in 2013, coming seventh out of the emerging economies and third in Latin America).

In the current macroeconomic climate, however, certain weaknesses have appeared in the Mexican economy. Mexico achieved average annual growth of only 2.6% over the last two decades, insufficient to generate the quality jobs in the formal economy needed each year to strengthen its domestic market and foster the well-being of society. The need remains to improve the tax system in order to enhance the efficiency of tax collection and expand the taxpayer base, thereby providing government with the instruments it needs to strengthen the provision of public goods and services and to extend the cover provided by the social security system. The country also makes insufficient use of its energy potential, which could become a source of competitiveness for Mexican business. Furthermore, the education system remains highly segmented, which prevents the elimination of inequality and the creation of more secure conditions in the country, among other challenges.

Structural reforms were approved in a number of areas in 2013, and once the necessary secondary legislation has been approved and the reforms begin to take hold they should lessen the weaknesses in the economy, as explained above. In this regard, it will be important for the country to consolidate the reforms approved in 2014 and for government, private initiative and Mexican society in general to strive to ensure faster growth, in order to offer all segments of society the chance of a brighter future.

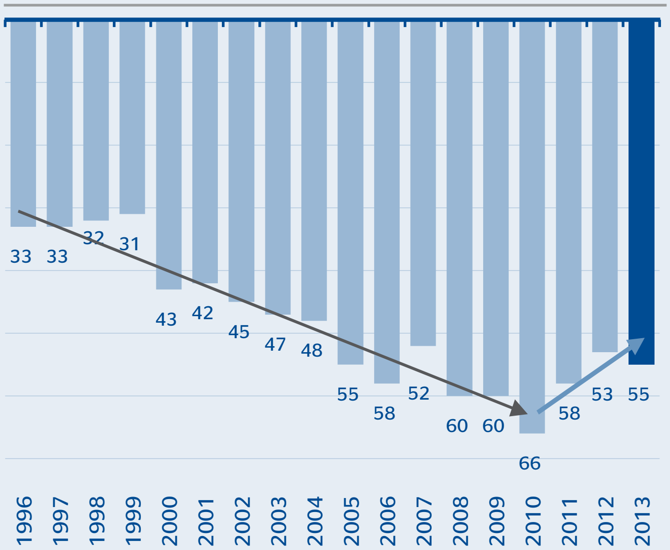
Box 1. Situation of the Mexican economy and challenges affecting competitiveness

It is no secret that a nation's development and growth are closely linked to its competitiveness, understood as the whole array of institutions, policies and factors determining the country's level of productivity, and its capacity to attract and retain investment and talent. However, increasing competitiveness is a challenge which has become increasingly difficult for many countries in the world, including Mexico. According to the World Economic Forum's global competitiveness index (2013-14), Mexico was ranked 55th out of 148 countries assessed, a similar level to 2005. Moreover, it slipped two places in 2012, but what is more worrying is that Mexico has lost ground in the index since 1996 (even allowing for the increase in the number of countries evaluated), mainly because of bad results in areas like corruption, crime and theft, bureaucracy and government inefficiency, inefficient tax regulations, restrictive labour legislation, poor infrastructure, insufficient innovation, an ill-educated workforce and others. The country has climbed up the rankings since 2010, but only by a little (see Chart 27).

Mexico lagged far behind the top ten nations in the various industrial comparison indices, generally in the bottom third of the table. Nevertheless, its relative position was similar to, or even better than, the majority of BRICS nations. For example, only China (29th) and South Africa (53rd) out of the BRICS nations ranked higher than Mexico (55th) in the 2013 global competitiveness index. Next came Brazil (56th), India (60th) and Russia (64th) (see table 1). In the international competitiveness index prepared by the Mexican Institute for Competitiveness IMCO for 2013, Mexico ranked 32nd out of the 46 countries assessed. Brazil came 31st, South Africa 33rd, China 36th, Russia 40th and India 42nd. Meanwhile, Mexico ranked 53rd out of 189 in the World Bank's 2014 Doing Business index. South Africa came in 41st, with countries like Russia (92nd), China (96th), Brazil (116th) and India (134th) lagging far behind. This shows that Mexico has the potential to achieve both greater competitiveness and a high rate of economic growth. In spite of the areas where it scores poorly, Mexico has an attractive economy for domestic and foreign investment. Seen in this light, the country's starting position is strong, and it should be able to climb the rankings to join better-placed nations.

Chart 27

Mexico: ranking in the global competitiveness index, 1996-2013*



*Note: The world's most competitive countries are ranked around the 1st place.
Source: BBVA Research with World Economic Forum and World Bank data

Table 1

International comparison indices, selected countries, 2013-14

Global competitiveness 2013-2014 (World Economic Forum), 148 countries ranking		International competitiveness 2013 (IMCO), 46 countries ranking		Doing Business Report 2014 (World Bank), 189 countries ranking	
Switzerland	1	Switzerland	1	Singapore	1
Singapore	2	Denmark	2	Hong Kong	2
Finland	3	Sweden	3	New Zealand	3
Germany	4	Netherlands	4	United States	4
United States	5	Ireland	5	Denmark	5
Sweden	6	United Kingdom	6	Malaysia	6
Hong Kong	7	Begium	7	Korea, Rep.	7
Netherlands	8	Japan	8	Georgia	8
Japan	9	Australia	9	Norway	9
United Kingdom	10	Norway	10	United Kingdom	10
China	29	Brazil	31	South Africa	41
South Africa	53	**Mexico**	**32**	**Mexico**	**53**
Mexico	**55**	South Africa	33	Russia	92
Brazil	56	China	36	China	96
India	60	Russia	40	Brazil	116
Russia	64	India	42	India	134
Yemen	145	Bolivia	43	South Sudan	186
Burundi	146	Guatemala	44	Libya	187
Guinea	147	Nicaragua	45	Central African Rep.	188
Chad	148	Venezuela	46	Chad	189

Source: BBVA Research with World Economic Forum, World Bank and IMCO data

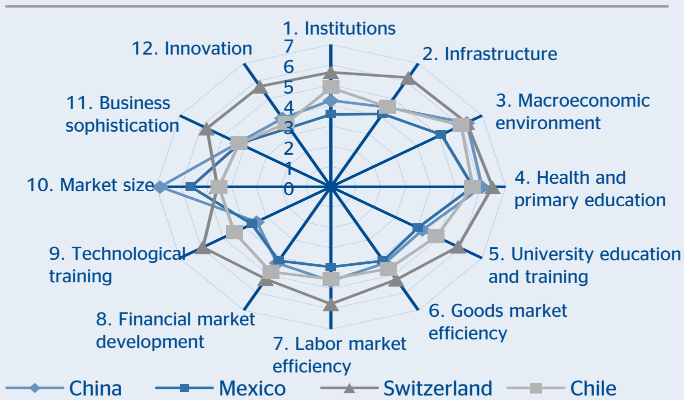
Chart 28 shows a comparison of Mexico's score in each of the global competitiveness sub-indexes compared to the top-ranked country (Switzerland), the top-ranked BRICS country (China), and the top-ranked Latin America country (Chile). Mexico ranks lower than its competitors in the majority of the sub-indexes, including the macroeconomic climate, even though this aspect has been one of the most stable, remaining favourable to Mexico for several decades. Mexico comes out above Switzerland, the top-ranked country in the world, only in the size of its market. If we contrast Mexico with each of the BRICS countries, however, it appears to be much better positioned, and on this comparison it ranks above India, Brazil and South Africa in terms of macroeconomic climate, health and primary education. Moreover, Mexico did not rank below the worst-ranked BRICS country in any sub-index (see Chart 29).

At the national level, the IMCO competitiveness index placed the Federal District of Mexico City in first place in 2012. This was because investment per employee averaged 10,459 pesos per year, the percentage of people aged over 25 years with a higher education was 40% of the total (retention of talent), and per capita GDP was 169,798 pesos per annum. The next four positions in the ranking were occupied by the States of Nuevo León, Baja California, Coahuila and Querértaro. The three states at the bottom of the ranking were Guerrero, Chiapas and Oaxaca in that order, with investment per employee of less than 2,000 pesos, per capita GDP of around 40,000 pesos per annum, and talent retention below 18%. The 2012 state competitiveness index published by the Instituto Tecnológico y de Estudio Superiores de Monterrey (ITESM) reported very similar results. For example, Mexico City, Nuevo León and Querértaro were ranked among the most competitive states, while those that had made most progress in the rankings were Tabasco, Campeche and Morelos. This index assesses four competitiveness factors: economic performance, government efficiency, business efficiency and infrastructure. The top-ranking states in terms of economic performance were Nuevo León, Coahuila and Sonora. In terms of government efficiency, the leaders were Campeche, Colima and Querétaro. Meanwhile, Mexico City, Nuevo León and Baja California Sur came first in business efficiency, and Mexico City, Nuevo León and Morelos in infrastructure.

To sum up, these results demonstrate the need to boost competitiveness, raise productivity, push back the informal economy, reduce insecurity, improve the labour market, foster educational quality, encourage scientific and technological innovation and development and preserve the environment. The structural reforms that have been approved pursue these goals. It is only in this way that Mexico will succeed in becoming more competitive, enhance its development and achieve sustained and sustainable economic growth.

Chart 28

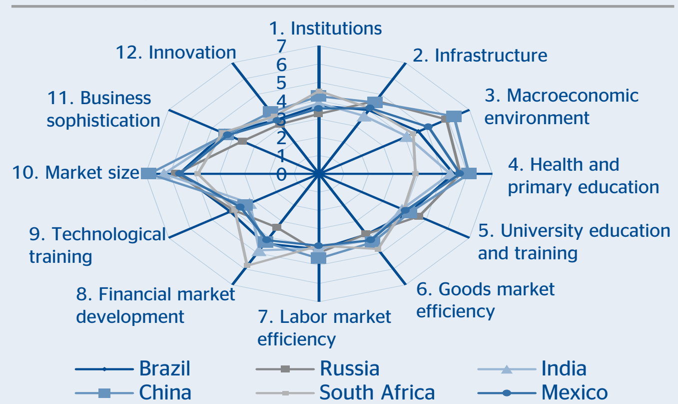
Global competitiveness sub-index scores for the top ranked country (Switzerland), the top ranked BRICS (China), the top ranked Latin American nation and Mexico, 2013-14*



*Note: The closer a country is to the centre, the worse its ranking and vice versa.
Source: BBVA Research with World Economic Forum and World Bank data

Chart 29

Global competitiveness sub-index scores for the BRICS and Mexico, 2013-14*



*Note: The closer a country is to the centre, the worse its ranking and vice versa.
Source: BBVA Research with World Economic Forum and World Bank data

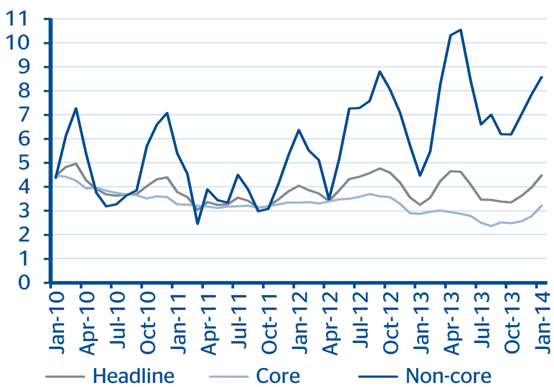
3.2 As expected, inflation rose at the beginning of the year due to fiscal reform, but pressures will be temporary

We expect headline inflation in December 2014 to show a similar level to the close of 2013, again below 4.0% and probably around 3.93%. As expected, the supply-side shock caused by tax changes caused a significant bounce in inflation in the first month of the year, accelerating in annual terms from 3.97% in December 2013 to 4.48% in January 2014, a level outside the range established around the Banxico target rate of 3.0% (Chart 30). This acceleration reflected the impact of fiscal reform measures, consisting mainly of new taxes on fuel, sugary drinks and high-calorie foods. The increase in prices observed in January in fact strengthened our standpoint that there would be no second-round effects from the reform, as there was no apparent rise in prices unrelated to the goods affected by the new taxes in the new year. In view of the still significant slack in the economy, we continue to believe that the pressures caused by the fiscal shock will be temporary.

While we expect headline inflation to return to a downward trend in February and to drop below 4.0% in March (3.87%), the fiscal shock in January and significant base effects in the summer will put headline inflation above 4.5% on two occasions in 2014, resulting in higher annual average levels of inflation than last year (4.3% in 2014 compared to the average of 3.8% in 2013. The tax changes also had a significant impact on core inflation. In annual terms, it rose to 3.2% in January of this year from a level of 2.8% at the close of 2013. We expect core inflation to end 2014 on a rate of around 3.46%, and to average 3.3% over the year (0.57pp more than in 2013).

Chart 30

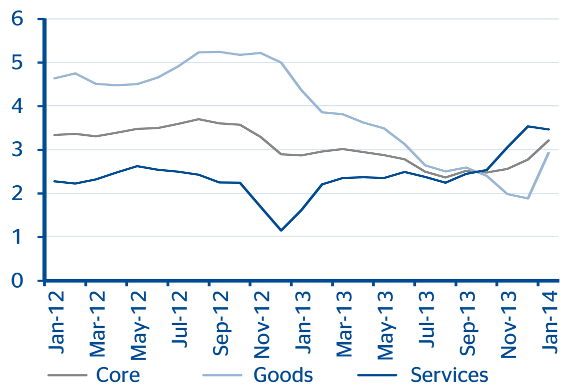
Inflation and components YoY % change)



Source: BBVA Research with INEGI data

Chart 31

Core inflation and components YoY % change)



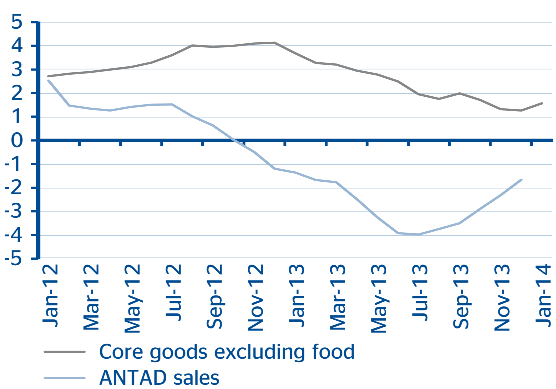
Source: BBVA Research with INEGI data

Meanwhile, the recent performance of core inflation, which provides a better indicator of the medium-term behaviour of inflation, has been highly favourable. The trend in the first three quarters of 2013 was downward, helped by the weakness of the economic cycle and the consequent slack, which translated into a lack of any demand-side pressure on prices. In all four quarters of last year, core inflation averaged less than 3.0% (2.95% in 1Q13, 2.87% in 2Q13, 2.46% in 3Q13 and 2.61% in 4Q13), falling to historic lows both in terms of the closing rate for the year (2.78%) and the average annual rate (2.72%), and in the all-time low of 2.37% in August 2013. This excellent performance was made possible by the progress of inflation in goods prices, which saw a continual moderation between November 2012 and December 2013 before the uptick observed in January 2014 as a result of the fiscal shock (chart 31). The slower rate of increase in these prices is explained by the downward trend in annual inflation in the food and other goods sub-indices. The moderation of inflation in the food sub-index was driven by the significant fall in international grain prices in 2013, and to a lesser extent by the appreciation of the peso in the early months of the year. Meanwhile, the favourable trend in the other goods sub-index was due in part to the strength of the peso, though it is also a response to the weakness of the economy (chart 32), which may have persuaded firms not to increase their prices.

The slack in the economy also favoured the service component of core inflation (Chart 33). Annual inflation in this sub-index remained low and stable between January and October 2013 (averaging 2.30%), before picking up in the last two months of the year to reach a level of 3.5% due to sharp increases in the prices of mobile telephone services, where it remained in January 2014 due to greater than anticipated increases in cafeteria and restaurant prices. This is, in fact, one of the sub-indices to be watched in the coming months, to detect any risk that the core inflation rate might be about to rise. Mobile telephony prices displayed significant volatility over the last year, causing the year-on-year inflation rate in the other services component to rise from -0.72% YoY in December 2012 to 4.69% YoY in December 2013.

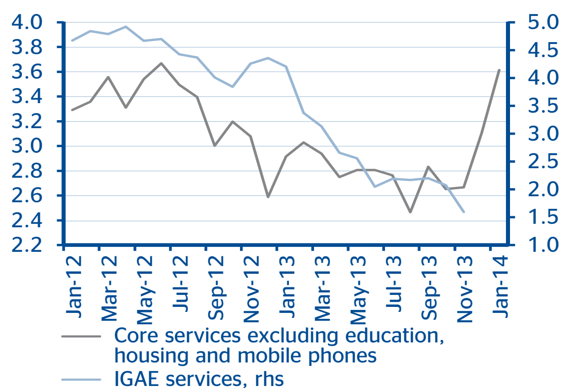
In order to isolate prices from this source of volatility and to understand the trend in services more clearly, we have constructed the sub-index without including mobile telephony prices. Housing and education prices were also eliminated from the sub-index, because their behaviour is more seasonal and less closely related to the economic cycle. The acceleration in annual inflation in this sub-index occurred mainly in January of this year as a result of the steep increase in cafeteria and restaurant prices, which together represent 45% of the other services component, excluding mobile telephony prices (Chart 33). The sharp rise in food-related services was the main upward surprise in inflation figures for that month. Cafeteria prices increased by 1.85% on a monthly basis and restaurant prices by 1.52%. This increase may have been caused in part by price hikes in restaurants for products affected by the new taxes (e.g. sugary drinks), but it may also be because restaurateurs have passed on rising input prices in the latter months of 2013, resulting from steep increases in the prices of unprocessed foods.

Chart 32
Core inflation in goods prices without food and ANTAD sales, sa YoY % change and YoY % change, 3mma



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

Chart 33
Core inflation in services without education, housing and mobile telephony* and IGAE services, sa, YoY % change and YoY % change, 3mma



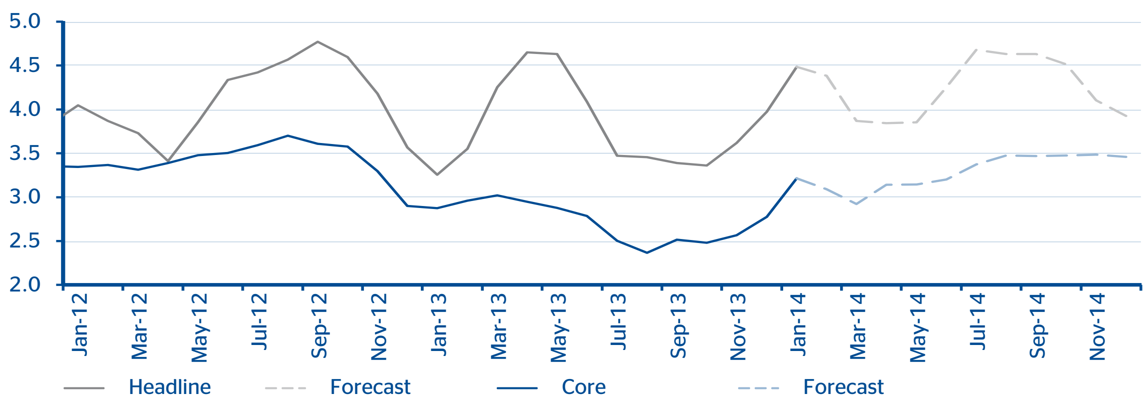
sa: seasonally-adjusted
* Based on the index constructed by BBVA Research
Source: BBVA Research with INEGI data

From the standpoint of a gradual recovery in the economy, then, we do not expect to see demand-side pressure on prices, or financial tensions which could result in substantial depreciation of the prices or a sufficiently strong global recovery to cause any significant increase in commodity and raw materials prices. However, the determinants of inflation imply a somewhat less favourable context for core prices than was observed in 2013. Despite our prediction of continuing moderation in core inflation, we therefore anticipate a slight increase over the course of the year to an average of 3.1% in 1H14, 3.5% in 2H14 and 3.3% in 2014 as a whole. Much of this increase will be due to base effects, because the historically low monthly changes observed between April and August 2013 (monthly average of 0.11%) are not expected to recur. Following the impact of the fiscal shock, we expect monthly increments of 0.23% for core inflation this year, equal to the average for 2013 as a whole and close to the increase of 0.24% observed in the last four months of last year.

Meanwhile, non-core inflation was exposed to various supply-side shocks in the last five months of last year. On average, the prices of fresh fruit and vegetables increased at a monthly rate of 3.62% in the period August-December 2013, in part because of the lagged effects of flooding in several of the States, felt in the latter months of the year. The adverse behaviour of these prices in the second half of the year was behind the increase in the headline rate. No further supply-side shocks are anticipated at present. Given current inflation rates, however, the occurrence of any significant impact, particularly in the summer months, could put upward pressure on inflation, entailing a risk that it could rise to levels close to 5.0%.

To sum up, the effect of the fiscal reform will be temporary, but the sharp increase in both headline and core prices resulting from the new taxes, combined with adverse base effects, will cause average levels of headline inflation to rise in 2014. Meanwhile, in a general context of recovery and falling global liquidity, we do not expect the favourable conditions for core inflation seen last year to recur in 2014, and in this light we expect a moderate rise in the rate over the course of the year (see Chart 34). According to our base scenario, then, the inflation dynamic predicted for both headline and core inflation is the most likely outcome (see Box 2).

Chart 34
Inflation outlook YoY % change)



Source: BBVA Research with INEGI data

Box 2. Following the fiscal shock, what are the likely levels of inflation for the end of 2014 and beginning of 2015? We use an ordered probit model to estimate the probability ranges

The fiscal shock caused by new taxes on fuel, sugary drinks and high calorie foods resulted in a spike in YoY inflation to 4.48% in January, after 2013 had closed on a rate of 3.97%. While the January figure did not reflect the second-round effects arising from the fiscal shock, and our position is that these will not appear in the future, the impact was sufficiently large to generate a degree of uncertainty about the inflationary outlook. In order to quantify the uncertainty surrounding price changes, we have estimated the likelihood of different inflation ranges, seeking to limit uncertainty in relation to the behaviour of the factors determining prices.

An ordered probit model to limit uncertainty

We define and calculate an ordered probit model,[1] consisting of a model of qualitative options which assigns a probability to a given value range for the dependent variable (i.e. inflation). These ranges are from 0.00% to 3.00%, from 3.01% to 3.50%, from 3.51% to 4.00%, from 4.01% to 4.50%, from 4.51 to 5.00%, from 5.01% to 6.00%, and above 6.01%.

We calculate an ordered probit model to determine the probability of these ranges. The sample period comprises monthly data from January 2000 to January 2014. Meanwhile, the equation calculated is as follows:

$$INPC^*_t = \beta 1\Delta\log(Wages_t) + \beta 2\Delta\log(Distribution\ prices_t) + \beta 3\Delta\log(Exchange\ rate_t) + \beta 4\Delta\log(Corn\ price_t) + \beta 5\Delta\log(Inflation\ expectations\ index_t) + \beta 6\Delta\log INPC_{t-2} + u_t.$$

Where t represents the period and $INPC^*_t$ is a qualitative variable denoting the range in which inflation fell in the period, defined as follows:

$$INPC^* = \begin{cases} 1 \text{ if } 3.00 \geq \text{inflation} \geq 0.00 \\ 2 \text{ if } 3.50 \geq \text{inflation} \geq 3.01 \\ 3 \text{ if } 4.00 \geq \text{inflation} \geq 3.51 \\ 4 \text{ if } 4.50 \geq \text{inflation} \geq 4.01 \\ 5 \text{ if } 5.00 \geq \text{inflation} \geq 4.51 \\ 6 \text{ if } 6.00 \geq \text{inflation} \geq 5.01 \\ 7 \text{ if inflation} \geq 6.01\text{, for all t} \end{cases}$$

The determining factors applied are those identified by the Economic Watch "Inflation, influenced by slack in production factors" as the most relevant explanatory variables for Mexican inflation. The calculation was performed for differences of 12 months because the series follow a unit root process, and this transformation enables estimating a process which is subject to seasonality. The same specification is applied to core inflation. The results obtained from calculation of the model are presented in the table at the end of this box.

The estimates show that wages, transport costs and the exchange rate are significant for both for headline and core inflation, and they take the appropriate sign (positive). The price of maize is significant to headline inflation, and inflationary expectations at 12-months are significant to core inflation. The high coefficient of lagged general inflation shows that prices are persistent.

The estimate of probabilities is based on the BBVA Research economic scenario.[2] The probabilities reflect uncertainty surrounding the target for the close of 2014. Indeed, as our year-end forecast (3.93%) suggests, the most likely scenario is that headline inflation will be around 4.0% in December 2014. The results indicate a 64% probability of inflation between 3.5% and 4.5%, without any clear bias that it will finally be either slightly below or slightly above 4.0% (the probability of the ranges 3.5%-4.0% and 4.0%-4.5% is 32% in both cases; see Chart 35). The model also points to two other matters: i) the inflationary pressures caused by the fiscal shock will be temporary. For example, the model assigns a probability of almost 70% to inflation in one of the ranges below 4.0% in the period May-June; and ii) there is a high and increasing probability that the inflation target for next year will be met, and the probability that inflation will be lower than 4.0% in March 2015 is 80%, rising to 82% at the close of the year.

The key conclusions from the results of our calculation of the probability ranges for core inflation are as follows: i) it is highly likely that core inflation will end 2014 on a higher level than at the close of 2013 (2.78%), and ii) the model appears to confirm that possible second round effects from the fiscal shock are fairly unlikely. These two conclusions

[1] Based on the ordered probit model described in the Economic Watch entitled: "There is a 60% probability that inflation will be between 3.5 and 4.0% at the close of 2012."
[2] Raw materials prices are expected to rise slightly. The price of maize is particularly relevant in Mexico's case, in view of its weight in the basket of consumer goods, and we have assumed that it will rise gradually this year following the sharp fall in international prices in 2013 (-39.6%), ending the year with a cumulative increase of around 5.0% y/y. The rest of the economic scenario is as follows: GDP growth of 3.4% in 2014 and 3.0% in 2015, translating into wage rises (we expect actual growth of 0.12pp and 0.5pp in 2014 and 2015 respectively). We assume that the increase in transport prices will be similar to 2013, which is itself close to the average observed over the period 2007-2013. The exchange rate is expected to appreciate gently to levels of 12.9ppd and 12.8ppd in December 2014 and 2015 respectively. Finally, 12-month inflationary expectations are taken from our base scenario.

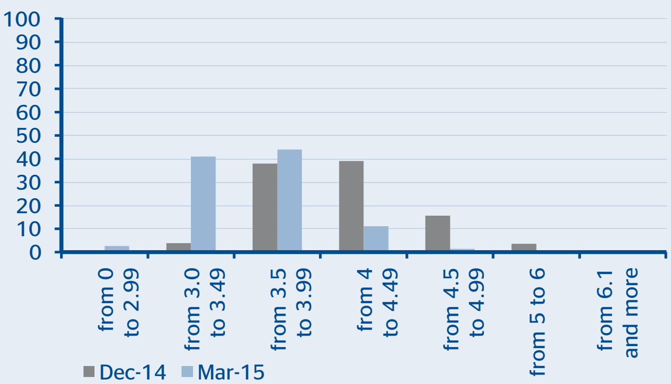
are consistent with our base scenario, which anticipates core inflation of 3.46% at the end of 2014. The range with the highest probability both in December 2014 and March 2015 is 3.0%-3.35% (see Chart 36), though the bias suggested by the probabilities for the different ranges is that it could be slightly higher (the second most likely range is 3.5%-4.0%). For the time being, the probability that core inflation will be below 3.0% at the close of 2014 is low, but so is the probability of persistent pressure on prices that could push up core inflation above 4.0%.

Table 2
Explanatory variables for headline and core inflation ranges

	INPC	Core
Δ12log(wage)	7.31**	42.63*
	(5.59)	(5.92)
Δ12log(exchange rate)	2.93*	4.84*
	(1.16)	(1.33)
Δ12log(transport prices)	18.61*	28.75*
	(6.41)	(6.56)
Δ12log(12-month inflation expectation index)		82.84*
		(11.84)
Δ12log(corn prices)	0.91*	
	(0.34)	
L. Δ12log(INPC)	144.9*	
	(15.18)	
Observations	168	168
R-square	0.38	0.41

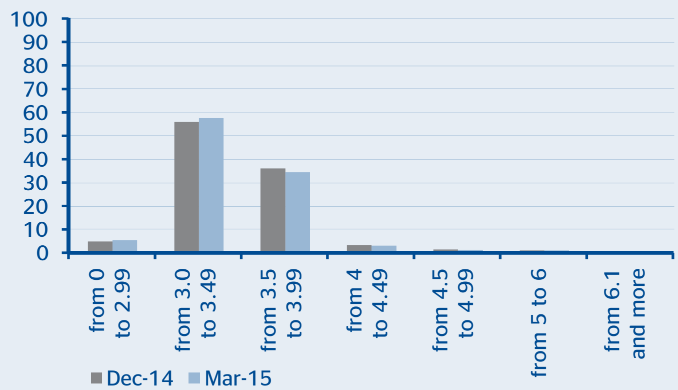
Notes: L indicates a lag; Standar errors in parenthesis; ** p<0.15; * p<0.05;
Sample 2000:1-2014:1
Source: BBVA Research The variable ΔlogINPC,t-2 is lagged by two periods so that it acts as an instrumental variable in order to avoid problems of multicollinearity with wages.

Chart 35
Probability of different ranges for headline inflation in December 2014 and March 2015



Source: BBVA Research

Chart 36
Probability of different ranges for core inflation in December 2014 and March 2015



Source: BBVA Research

References

López Marmolejo, Arnoldo y Uriz Borrás, Pedro (2011), “La inflación, al ritmo de la holgura de factores productivos”, Observatorio Económico de BBVA Research.

López Marmolejo, Arnoldo y Uriz Borrás, Pedro (2012), “La inflación se encontrará al final de 2012 entre 3.5 y 4.0% con el 60% de probabilidad”, Observatorio Económico de BBVA Research

3.3 Despite temporarily higher inflation, the monetary policy rate remains low, and announcements by the central bank have become more important

In a scenario of rising inflation caused by supply-side shocks, changing the monetary policy rate is inefficient as a way of controlling inflation. Among other reasons, this is because the increase in prices is not linked to the performance of the economy and, therefore, it is beyond the influence of the monetary policy rate, and also because of the lag with which the rate acts on the economy and the negative impact that any increase would have on the parts of the economy that are not affected by price rises. In this situation, central bank announcements are important as a tool to anchor inflationary expectations and prevent price contamination.

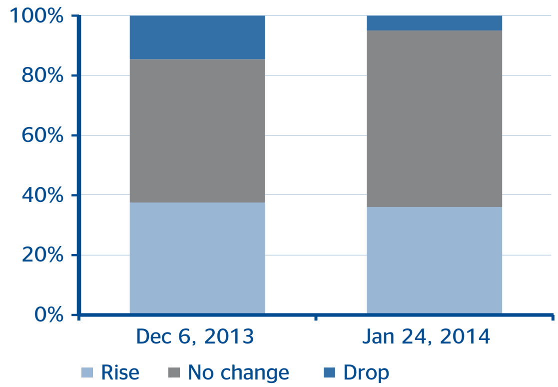
As explained above, Mexican inflation has risen recently because of supply-side shocks like lower output of certain farm products and the entry into force of new tax measures. In addition, a rise in global risk aversion has caused moderate currency depreciation, which could to some extent raise the cost of imports. In this scenario, the central bank's announcements shifted towards a somewhat more restrictive tone. In its most recent monetary policy announcement, it noted that the recent rise in prices would be temporary and would not affect the price formation process. Despite the moderate increase predicted for inflation in the coming years, meanwhile, the balance of inflationary risks has decreased and the balance of risks for output has improved, a matter which has not been mentioned in a monetary policy announcement since 2012.

In this context, careful attention is needed to assess the risk that the recent adjustments in relative prices may be due to rising inflationary expectations, which may in turn translate into second-round effects, a factor that could indeed require adjustment of the monetary policy rate. However, this risk would appear to be low, given the slack observed in the economy of late. Furthermore, the uptick in inflation caused by the tax reform was less than had been expected by many analysts, and most now believe that the monetary policy rate will remain unchanged in 2014.

Meanwhile, the central banks of a number of emerging nations raised their reference rates sharply during the recent rise in global risk aversion. Combined with the slower rate of asset purchases by the Federal Reserve, this could be interpreted as a relatively more lax monetary posture on the part of Mexico, and therefore as an argument in favour of adjusting the reference rate to prevailing conditions. A number of other factors would qualify this point, however. To begin with, the Federal Reserve has cut the rate of asset purchases, but its announcements make clear that this does not mean that it has adopted a more restrictive stance. Rather, its policy continues to be one of monetary relaxation, as it has explained that the Federal funds rate will remain at its present exceptionally low levels, even after the joblessness rate has fallen to levels considered consistent with full employment. Second, the increase in reference rates in emerging countries was, in the first place, an effort to reduce any sharp depreciation in their currencies, and it affected only a few economies. Furthermore, this occurred at a moment when macroeconomic imbalances (e.g. current account deficits and high inflation) and the scant autonomy of some emerging economy central banks aggravated global risk aversion, resulting in massive sales of financial assets. These conditions were not present in Mexico, and it is expected that it will become possible to differentiate positively between emerging markets when risk aversion is finally dispelled.

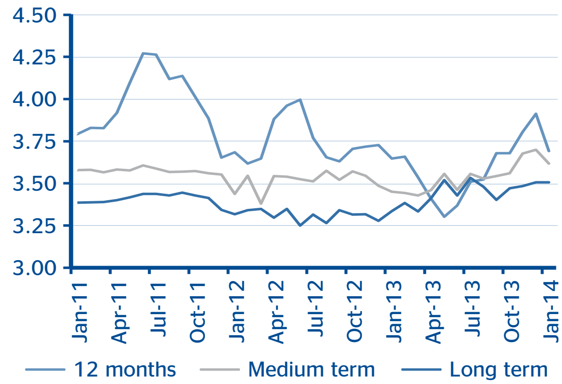
For the future, we maintain our prediction of a prolonged monetary pause, in view of the following factors. First, we do not expect any second-round effects on prices from recent price rises given the amount of slack in the economy, and as a consequence headline inflation will stay within the central bank's target range at the end of the year. Second, we expect in view of our 3.4% growth outlook for 2014 that the economy will retain some slack and, ultimately, that there will be no demand-side pressure on prices. However, an alert stance will still be needed given the possibility of additional inflationary pressures caused by faster than expected growth, further depreciation of the exchange rate due to a fresh outbreak of global volatility, or an increase in inflation expectations, among other factors.

Chart 37
Distribution of analysts' responses to possible changes in the monetary policy rate in 2014 (average responses of analysts surveyed)



Source: BBVA Research with Thompson Reuters data

Chart 38
Inflation expectations (%)

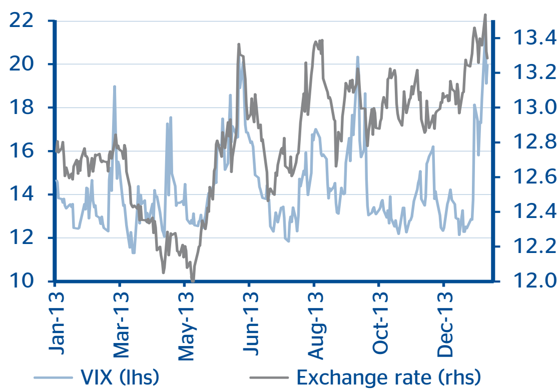


Source: Banxico

3.4 Upgrade in Mexico's sovereign debt rating in a climate of global risk aversion

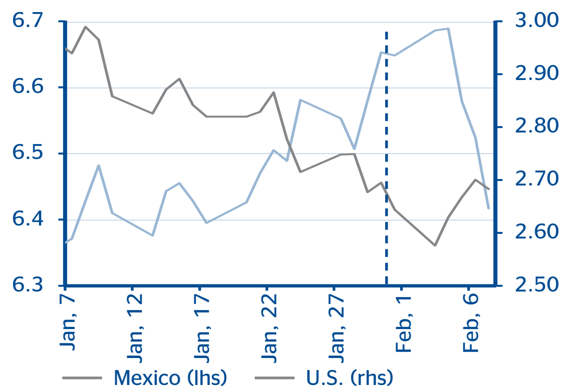
In recent weeks the financial markets have grown increasingly volatile, due to rising perceptions of risk in emerging economies in a context of falling global liquidity, and this has in turn sparked generalised sales of assets held in emerging nations. Specifically, the reduction in asset purchases announced by the Federal Reserve (Fed)[1] and lower than expected manufacturing output in China, raising concerns about a possible slowdown in the Asian giant's growth, resulted in a global increase in risk aversion. This risk aversion may be perceived in volatility indicators like the VIX index, measuring the volatility of S&P 500 options, which rose in January to its highest level since December 2012. Sales of the riskiest assets are related to the events mentioned above, insofar as the combination of tapering by the Fed, rising interest rates in developed markets and the outlook for slower growth in China have increased the risks of deepening macroeconomic imbalances in some emerging nations, including current account deficits and high rates of inflation.

Chart 39
Exchange rate and risk aversion (pesos per dollar, VIX index (%))



Source: BBVA Research with Bloomberg data

Chart 40
Long-term interest rates, 10-year bond (%)



Source: BBVA Research with Bloomberg data

Exchange rates were the variable that was hardest hit by this increase in risk aversion. On 4 February, the Turkish lira had slipped by 4.02% compared to the closing rate for 2013, and the South African rand and Indian rupee were down by 5.35% and 1.01% respectively. Meanwhile, the Mexican peso has lost 2.12% in a clear correlation with rising risk aversion, resulting in an exchange rate of 13.53 pesos to the dollar, the highest level since July 2012, although there were no problems with market liquidity. The depreciation of the Mexican peso was close to the average for Latin American currencies, behind the Argentine peso, the Colombian peso and the Chilean peso.

Given the scale of depreciation, the central banks of India, Turkey and South Africa raised their reference rates, temporarily halting the slide in their currencies. The behaviour of other financial variables was in line with an episode of 'flight to quality', into secure assets. The yield on US 10-year Treasury bonds fell by 25bp (basis points) between the end of 2013 and 4 February 2014, while the yield on Mexican bonds with similar maturity increased by 23bp. Prices in the Mexican stock market slipped 6.18% in this

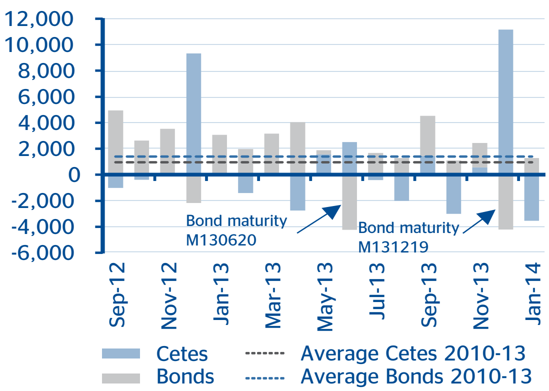
[1] In December 2013 the Federal Reserve (Fed) announced that it would reduce its monthly asset purchases by USD10bn beginning in January 2014. On 29 January 2014 the Fed announced an additional cut of USD10bn, so that asset purchases will total USD 65 billion as of February, comprising USD35bn in Treasury bonds and USD30bn in mortgage-backed bonds. If tapering continues at this rate, asset purchases will end this year.

period, a decline which compares favourably with the steeper falls observed in emerging countries' stock markets (8.47%)[2] and in the Brazilian stock market, which lost 8.82%. Finally, the credit risk inherent in Mexican debt (measured in terms of credit default swaps (CDS) increased by 13bp, a level comparable to the 14bp rise in Turkish debt, though somewhat higher than the increases of around 6bp reported in Brazil and India.

In spite of this climate of volatility and flight to quality, and of the large volumes of public debt held by foreign investors, no abrupt outflows were observed in the market for Mexican government debt. Figures for the month of January show that foreign holdings of medium- and long-term government debt (the "M bonos") actually increased by around USD1.3bn, although this level is below the average inflow for 2013. However, a moderate reduction of around USD3.5bn was reported in holdings of short-term debt (the "Cetes"). This behaviour on the part of investors is consistent with the rising volatility of exchange rates, as investment strategies seeking to exploit any gap between interest rates in different countries, which depend on favourable movements in exchange rates, tend to be concentrated in the short-term part of the yield curve.

Chart 41

Change in foreign investors' debt holdings (USD millions)



Source: BBVA Research with Banxico data

Chart 42

Stock markets (USD indexes)

Source: BBVA Research and Bloomberg

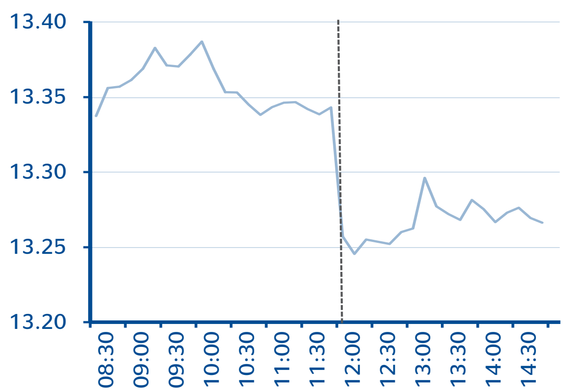
In this period, Mexico also benefited from an upgrade in its sovereign debt rating from Baa1 to A3 with a stable outlook, issued by Moody's on 5 February. This positions the Mexican economy as the second best in Latin America after Chile. The upgrade was based fundamentally on the rating agency's approval of the reform agenda and its effects on output potential and tax receipts. Standard & Poor's also upgraded its rating for Mexico to BBB+ in December, in view of the country's improved economic outlook following the approval of reforms. Following this news, the peso rose by 14 cents against the dollar, the stock market climbed 1.24% and the long end of the yield curve fell by around 4bp. The exchange rate duly fell again as the news was absorbed, appreciating by a cumulative 0.3% in the three days after the announcement. However, the 10-year interest rate yield continued to fall by a cumulative 21bp in the same period. Meanwhile, Mexico's improved rating could differentiate its financial assets from those of other emerging nations in the coming months, as global risk aversion is gradually dispelled. In view of the tapering process in the USA, however, the very low levels of interest and exchange rates seen in the second half of 2012 and first half of 2013 are not expected to recur.

[2] Measured by the MSCI Emerging Markets index.

The recent uncertainty surrounding the emerging nations has stirred memories of the crisis which broke out in Asia in 1997, when Thailand suspended payments when its high level of foreign debt became unsustainable after it allowed its currency to float, because it lacked sufficient international reserves to defend an exchange rate pegged to the US dollar. A key difference on this occasion is that the fundamentals of the emerging economies are less vulnerable than at that time. These fundamentals include 1) the existence of flexible exchange rates; 2) the larger volumes of international reserves held; 3) lower current deficits, and 4) lower levels of public debt, both in general and denominated in foreign currency. These fundamentals are, then, less vulnerable to the possibility of an event of the magnitude observed at the end of the 1990s, although there is of course no certainty with regard to future movements in the markets.

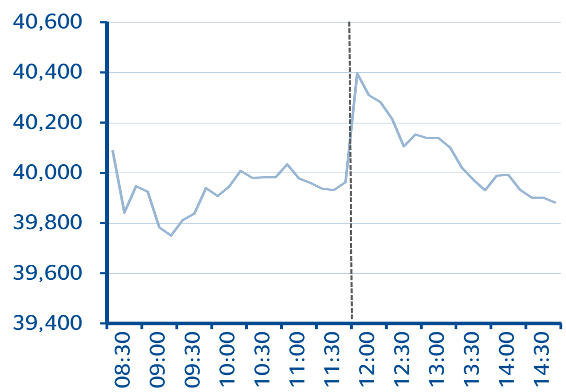
We expect to see an exchange rate of around 12.9 pesos to the dollar at the end of the year, based on a reduction in the level of global risk aversion and in view of the limited room for appreciation resulting from the USA's tapering. Meanwhile, interest rates on government debt are expected to continue with gradual normalisation of the liquidity premium, which will combine with rising expectations of economic growth next year to push up medium- and long-term rates. In particular, we believe the yield on 10-year government bonds will close the year at around 6.9%.

Chart 43
Intraday exchange rate, 5 February 2014 (pesos per dollar)



Source: Bloomberg and BBVA Research

Chart 44
Mexican intraday stock market, 5 February 2014 (points index)



Source: Bloomberg and BBVA Research

4. Indicators and forecasts

Table 3

Macroeconomic forecasts: Gross Domestic Product

(YoY growth rate)	2011	2012	2013	2014	2015
United States	1.8	2.8	**1.9**	**2.5**	**2.5**
EMU	1.6	-0.6	**-0.4**	**1.1**	**1.9**
Germany	3.4	0.9	**0.5**	**1.8**	**2.0**
France	2.0	0.0	**0.2**	**1.1**	**1.6**
Italy	0.6	-2.6	**-1.8**	**0.8**	**1.5**
Spain	0.1	-1.6	**-1.2**	**0.9**	**1.9**
UK	1.1	0.3	**1.9**	**2.6**	**2.4**
Latin America *	4.0	2.6	**2.2**	**2.5**	**2.6**
Mexico	4.0	3.7	**1.2**	**3.4**	**3.0**
Brazil	2.7	1.0	**2.2**	**2.5**	**1.9**
EAGLES **	6.7	5.0	**4.8**	**5.2**	**5.4**
Turkey	8.5	2.4	**3.9**	**1.5**	**5.2**
Asia-Pacific	6.0	5.3	**5.2**	**5.3**	**5.4**
Japón	-0.4	1.4	**1.7**	**1.5**	**1.3**
China	9.3	7.7	**7.7**	**7.6**	**7.5**
Asia (exc. China)	3.7	3.5	**3.4**	**3.7**	**4.0**
World	4.0	3.2	**2.9**	**3.6**	**3.9**

* Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela
** Brazil, Corea, China, India, Indonesia, Mexico, Russia, Taiwan, Turkey
Closing date: February 7, 2014
Source: BBVA Research

Table 4

Macroeconomic Forecasts: inflation (Average)

(YoY growth rate)	2011	2012	2013	2014	2015
United States	3.2	2.1	**1.5**	**2.3**	**2.4**
EMU	2.7	2.5	**1.4**	**1.0**	**1.4**
Germany	2.5	2.1	**1.6**	**1.5**	**1.7**
France	2.3	2.2	**1.0**	**1.0**	**1.2**
Italy	2.9	3.3	**1.3**	**0.8**	**1.2**
Spain	3.2	2.4	**1.4**	**0.5**	**1.0**
UK	4.5	2.8	**2.6**	**1.9**	**2.0**
Latin America *	8.0	7.5	**8.9**	**11.6**	**10.7**
Mexico	3.4	4.1	**3.8**	**4.3**	**3.4**
Brazil	6.6	5.4	**6.2**	**6.1**	**5.6**
EAGLES **	6.0	4.2	**4.2**	**4.4**	**4.2**
Turkey	6.2	8.7	**7.6**	**8.2**	**5.3**
Asia-Pacific	4.9	3.1	**2.9**	**3.5**	**3.5**
Japón	-0.3	0.0	**0.3**	**2.1**	**1.5**
China	5.4	2.6	**2.6**	**3.3**	**3.5**
Asia (exc. China)	4.5	3.4	**3.1**	**3.7**	**3.6**
World	5.1	4.1	**3.8**	**4.1**	**4.0**

* Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela
** Brazil, Corea, China, India, Indonesia, Mexico, Russia, Taiwan, Turkey
Closing date: February 7, 2014
Source: BBVA Research

Table 5

United States indicators and forecasts

	2012	2013	2014	2015	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14
Macroeconomic Indicators												
GDP (real % change)	2.8	1.9	**2.5**	**2.5**	1.1	2.5	4.1	3.2	1.6	2.2	2.2	**2.5**
Personal consumption (real % change)	2.2	2.0	**1.8**	**1.7**	2.3	1.8	2.0	3.3	1.4	1.2	1.2	**1.6**
Gov. consumption (real % change)	-1.0	-2.2	**-0.9**	**0.0**	-4.2	-0.4	0.4	-4.9	0.0	0.0	0.0	**0.0**
Gross fixed investment (real % change)	8.3	4.3	**4.9**	**7.3**	-1.5	6.5	5.9	0.9	4.8	6.7	6.1	**6.9**
Construction	3.4	3.1	**4.3**	**5.5**	3.8	-1.5	5.7	3.2	4.1	6.1	4.1	**6.1**
Industrial prod. (real annual % change)	3.6	2.6	**3.6**	**3.1**	2.4	2.0	2.5	3.6	3.5	3.9	4.0	**3.0**
Current account balance (% of GDP)	-2.7	**-2.6**	**-2.5**	**-2.1**	-2.5	-2.3	-2.3	-2.7	-2.3	-2.5	-2.6	**-2.7**
Final annual inflation	1.7	1.5	**2.4**	**2.5**	1.5	1.8	1.2	1.5	2.0	2.3	2.7	**2.4**
Average annual inflation	2.1	1.5	**2.3**	**2.4**	1.7	1.4	1.6	1.2	1.9	2.2	2.6	**2.6**
Primary fiscal balance (% of GDP)	-6.8	**-4.2**	**-3.4**	**-2.2**				-4.2				**-3.4**

Note: **Bold** figures are forecast
Source: BBVA Research

Table 6
Mexico Indicators and Forecasts

	2011	2012	2013	2014	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14
Economic Activity												
GDP (seasonally-adjusted series)												
Real annual % change	4.0	3.7	1.2	**3.4**	2.8	0.5	1.3	0.5	**1.9**	**3.8**	**2.8**	**5.3**
Per inhabitant (US dollars)	9.948	10,135	10,742	**11,153**	10,802	10,766	10,697	10,703	**10,631**	**11,171**	**11,244**	**11,567**
US$ billions	1,150.8	1,186.3	1,271.8	**1,335.2**	1,278.9	1,274.6	1,266.5	1,267.2	**1,277.6**	**1,337.3**	**1,346.0**	**1,384.8**
Inflation (average, %)												
Headline	3.4	4.1	3.8	**4.3**	3.7	4.5	3.4	3.7	**4.3**	**4.0**	**4.7**	**4.2**
Core	3.2	3.4	2.7	**3.3**	3.0	2.9	2.5	2.6	**3.1**	**3.2**	**3.4**	**3.5**
Financial Markets (eop, %)												
Interest rates												
Bank funding	4.5	**4.5**	**3.5**	**3.5**	4.0	4.0	3.8	3.5	**3.5**	**3.5**	**3.5**	**3.5**
28-day Cetes	4.4	3.9	3.2	**3.5**	4.2	3.9	3.5	3.2	**3.1**	**3.5**	**3.5**	**3.5**
28-day TIIE	4.8	4.8	3.8	**3.9**	4.4	4.3	4.0	3.8	**3.9**	**3.9**	**3.9**	**3.9**
10-year Bond (%, average)	6.5	5.4	5.7	**6.6**	5.0	5.8	6.1	6.4	**6.4**	**6.5**	**6.8**	**6.9**
Exchange rate (average)												
Pesos per dollar	13.9	12.9	13.0	**13.0**	12.3	12.9	13.1	13.0	**13.2**	**13.0**	**12.9**	**12.9**
Public Finances												
*FRPS (% of GDP)	-2.6	-3.1	-2.9	**-4.1**				-2.9				**-4.1**
External Sector[3]												
Trade balance (US$ billions)	-1.5	0.0	-1.0	**-3.8**	-1.0	-0.8	-1.0	1.9	**-1.4**	**0.7**	**-3.1**	**-0.1**
Current account (US$ billions)	-11.8	-14.2	-20.3	**-25.2**	-5.2	-5.0	-5.5	-4.5	**-8.0**	**-4.5**	**-7.6**	**-5.2**
Current account (% of GDP)	-0.9	**-1.0**	-1.3	**-1.5**	-1.4	-1.3	-1.4	-1.2	**-2.0**	**-1.1**	**-1.8**	**-1.2**
Oil (Mexican mix, dpb, eop)	101.1	102.0	98.6	**101.2**	103.0	98.6	100.5	92.1	**103.5**	**100.1**	**101.0**	**100.2**
Employment												
Formal Private (annual % change)	4.3	4.6	3.5	**3.5**	4.1	3.8	3.1	2.9	**3.2**	**3.5**	**4.1**	**3.2**
Open Unemployment Rate (% active pop.)	5.2	5.0	4.9	**4.6**	5.0	5.1	4.9	4.7	**4.7**	**4.6**	**4.5**	**4.4**

Continues on next page

Mexico Indicators and Forecasts

	2011	2012	2013	2014	1Q13	2Q13	3Q13	4Q13	1Q14	2Q14	3Q14	4Q14
Aggregate Demand [4] (annual % change, seasonally-adjusted)												
Total	4.9	3.8	1.4	**4.9**	2.9	1.3	1.1	0.2	**4.2**	**4.3**	**5.1**	**5.9**
Domestic Demand	4.7	3.9	1.5	**4.7**	3.2	1.2	1.5	0.3	**3.1**	**5.0**	**4.9**	**5.7**
Consumption	4.6	4.2	2.1	**3.7**	3.6	2.4	2.2	0.3	**2.0**	**3.1**	**4.4**	**5.4**
Private	4.9	4.4	2.3	**3.5**	4.1	2.7	2.3	0.1	**1.6**	**2.9**	**4.2**	**5.3**
Public	2.5	3.0	1.0	**5.3**	0.7	0.1	1.5	1.5	**4.5**	**4.7**	**5.5**	**6.3**
Investment	7.9	4.6	-1.2	**7.3**	0.1	-0.4	-3.7	-0.6	**5.8**	**7.5**	**9.7**	**6.4**
Private	12.2	7.9	-0.5	**3.6**	5.5	1.4	-3.4	-5.1	**0.1**	**3.4**	**4.8**	**6.4**
Public	-3.8	-9.0	-0.4	**20.6**	-7.2	-6.7	-4.7	18.1	**26.4**	**23.0**	**29.7**	**6.3**
External Demand	8.3	5.9	0.7	**3.9**	-3.2	-3.5	5.7	4.2	**7.6**	**0.9**	**1.2**	**6.3**
Imports	8.1	4.3	1.7	**9.4**	3.5	3.7	0.5	-0.8	**11.6**	**6.0**	**12.6**	**7.6**
GDP by sectors (annual % change, seasonally-adjusted)												
Primary	-1.9	6.7	0.7	**3.5**	-2.3	3.1	0.9	1.1	**3.4**	**3.9**	**0.9**	**5.8**
Secondary	3.4	2.6	-0.8	**1.8**	-0.2	-1.8	-0.6	-0.5	**0.4**	**2.6**	**1.9**	**2.2**
Mining	-0.6	1.2	-2.0	**0.5**	-1.5	-2.3	-2.6	-1.3	**-0.2**	**1.6**	**-0.6**	**1.3**
Electricity	6.7	1.6	0.4	**2.2**	1.4	0.3	-0.2	0.2	**1.6**	**2.1**	**1.3**	**3.8**
Construction	4.0	2.1	-4.6	**n.d.**	-0.7	-5.7	-6.9	n.d.	**n.d.**	**n.d.**	**n.d.**	**n.d.**
Manufacturing	4.6	3.3	1.5	**3.5**	1.8	0.5	2.8	1.0	**2.5**	**3.7**	**2.8**	**4.9**
Tertiary	4.6	4.3	2.2	**4.3**	3.7	1.8	2.4	1.0	**2.6**	**4.4**	**3.3**	**7.0**
Retail	9.5	3.9	2.7	**5.4**	4.4	1.7	4.4	0.4	**1.9**	**6.4**	**4.2**	**9.0**
Transportation, mail and warehouse	4.1	4.2	1.5	**4.3**	2.5	1.0	2.0	0.7	**3.1**	**4.3**	**1.8**	**8.1**
Massive media information	4.2	16.3	6.4	**7.1**	10.8	7.0	5.0	3.3	**4.7**	**5.6**	**7.4**	**10.5**
Financial and insurance	7.1	8.6	3.9	**9.3**	4.1	6.7	1.9	3.0	**6.2**	**8.3**	**9.8**	**13.0**
Real-estate and rent	2.8	2.1	1.6	**2.3**	3.0	1.7	1.4	0.4	**1.3**	**3.0**	**0.9**	**3.9**
Prof., scientific and technical servs.	4.9	1.0	-0.8	**2.4**	2.4	-1.4	-4.3	0.1	**2.1**	**2.3**	**1.5**	**3.5**
Company and corporate management	3.3	6.7	-1.7	**1.4**	1.2	-3.9	-2.3	-1.6	**-0.6**	**0.0**	**1.1**	**4.8**
Business support services	5.8	4.3	4.0	**5.2**	6.3	3.8	3.1	2.6	**3.6**	**4.1**	**5.2**	**8.0**
Education	1.4	2.1	1.0	**1.2**	1.2	1.3	1.2	0.2	**0.8**	**0.8**	**0.6**	**2.6**
Health and social security	2.1	2.1	2.0	**2.1**	3.4	2.7	0.9	1.0	**1.5**	**2.3**	**1.0**	**3.6**
Cultural and sport	-0.7	2.8	0.4	**2.2**	3.1	-1.4	-0.6	0.7	**0.5**	**2.4**	**1.6**	**4.1**
Temporary stay	1.5	5.5	1.9	**3.7**	3.7	1.3	1.5	1.1	**3.1**	**3.9**	**2.7**	**5.0**
Other services, except government activities	1.8	2.8	2.0	**3.7**	2.6	2.0	1.6	1.9	**3.9**	**4.3**	**2.5**	**4.0**
Government activities	-1.4	3.8	0.3	**4.3**	-0.2	-1.4	2.3	0.7	**4.3**	**3.0**	**3.0**	**7.1**

1: Residential investment
2: Fiscal balance (% GDP)
3: Accumulated, last 12 months
4: Base 1993=100; GDP by sector base 2003=100. The observed data of the primary sector, secondary and tertiary seasonally-adjusted by INEGI, the rest own seasonally-adjusted
bd: billions of dollars
dpb: dollars per barrel
*FRPS: Financial Requirements of the Public Sector
na: not available
Note: **Bold** figures are forecast
Source: BBVA Research with Federal Reserve, Bureau of Labor Statistics, Banco de Mexico, INEGI and SHCP data

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