Mexico Weekly Flash

Next week…

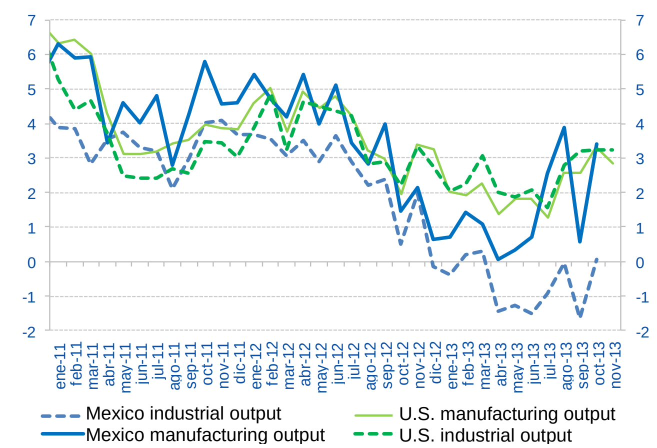
The GDP breakdown will be important to see how investment and consumption performed in the third quarter - key variables for future growth

Next week the consumer and producer confidence indices, the global IGAE (economic activity) indicator and the figures for industrial output and its breakdown will be released. Attention should focus on the recovery level for the Mexican economy toward the last quarter of the year and its possible effects on employment and consumption. Given the recovery in industrial output, especially in manufacturing in the US, we expect to see an upturn in this sector in Mexico with the remaining components such as construction continuing to be restrained. In the same way, a recovery in the IGAE and consumer and producer confidence are also expected (see details on page 2). In addition, December inflation figures will also be released. We forecast headline inflation to increase by 0.47% and core by 0.30% meaning they should end the year at 3.87% and 2.75% respectively, before rising in January due to the fiscal shock to 4.3% and 3.0%. The service component to core inflation will be important which has been rising above expectations.

Disappointing start to the year for emerging markets

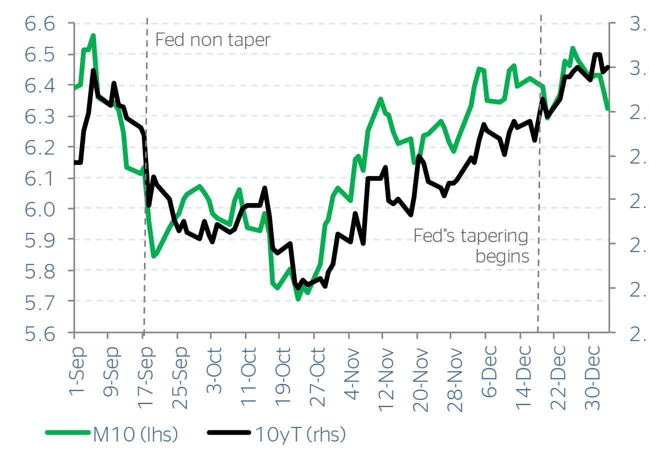
Emerging markets did not see a good start in the first week of the year. Two factors seemed to have contributed to this. On the one hand, positive data from the US (strong manufacturing confidence [ISM] continued at high levels in December [57.0] and improved consumer confidence) contributed to the increase in 10-year treasury bond interest rates which hit 3.03% over the week (their highest level since June 2011) before ending the week at 3.0%. On the other, the decline in manufacturing confidence in China in December was not good for higher risk assets on emerging markets. With this backdrop, currencies weakened and stock markets saw losses. Although the global economic cycle and actions from the Fed continue to be determining factors, there seems to be a certain differentiation which could favor Mexican variables over coming months. Mexico will be one of the better-off economies thanks to a stronger US in addition to the higher sovereign debt rating awarded on December 19. In this sense, for the first time in months this week saw long-term Mexican bond yields decouple from the movements of its US counterparts (see chart 2).

Chart 1
Industrial output and manufacturing: Mexico and US, % change y/y, CSV



Source: BBVA Research with INEGI and Bloomberg data. CSV=Corrected for Seasonal Variation.

Chart 2
10-year interest rates, %



Source: BBVA Research and Bloomberg

Calendar: Indicators

Consumer and producer confidence in December (January 8)

Forecast:		
Consumer: (92.1 pts.), 0.4% m/m, CSV	Consensus: N/A	Previous: (91.7 pts.), -1.5% m/m, CSV
Producer: (51 pts.), 0.4% m/m, CSV	Consensus: N/A	Previous: (50.8 pts.), -1.6% m/m, CSV

INEGI will release the consumer and producer confidence indices for December 2013 this coming week. These indices showed a monthly decline of (-)1.5% and (-)1.6% in November. Taking into account the upturn in job creation and slight decline in unemployment in November (4.93% vs. 5.01% in October), we expect the consumer confidence index to rise and hit 92.1 points, equivalent to a monthly rise of 0.4%, CSV. In turn, due to the slight improvement in US manufacturing in November (0.9% m/m, CSV) and its knock-on effect for Mexico, we expect the producer confidence index for December will hit 51 points, i.e. a monthly rise of 0.4%, CSV.

October IGAE (January 9)

Forecast: 1.2% y/y, CSV	Consensus: N/A	Previous: 0.6% y/y, CSV

INEGI will release the Global Economic Activity Index (IGAE) for October this coming week. This indicator provide information on GDP growth for the last quarter of 2013. In September, the IGAE saw growth in annual terms (0.6%, CSV) linked to the upturn in agriculture (7.8% y/y, CSV) and services (1.7% y/y, CSV). Meanwhile, the manufacturing sector fell (-)1.7% y/y, CSV. Due to the improvement in the Mexican industrial activity indicator (0.79% m/m, CSV) and a slight upturn in formal employment in the services sector (0.1% m/m, CSV), both for October, the IGAE is expected to show annual growth of 1.2% (figures corrected for seasonal variation).

Inflation (January 9)

Forecast: headline 0.47%; core 0.30%	Consensus: 0.45%; 0.33%	Previous: 0.93%; 0.14%

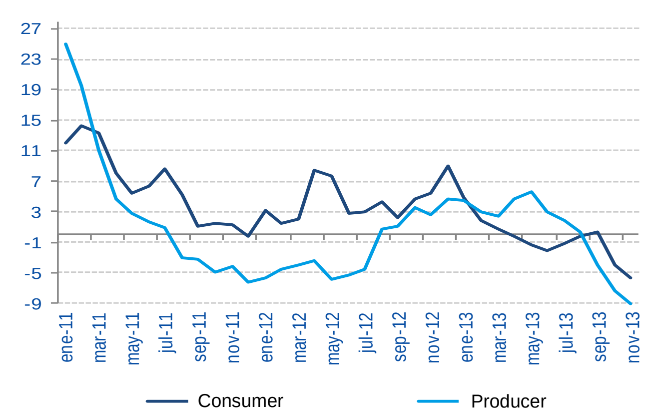
Industrial Output in November (January 10)

Forecast: 1.2% y/y, 2.6% m/m, CSV	Consensus: N/A	Previous: 0.1% y/y, 0.8% m/m, CSV

Next Friday, January 10, INEGI will release industrial output performance for November 2013. In October, industrial output in Mexico broke its negative run and rose 0.1% in annual terms (y/y), corrected for seasonal variation (CSV). The indicator increased 0.8% in monthly terms (m/m). The upturn in industrial output was due to higher manufacturing (3.4% y/y, CSV) and electricity, gas and water (0.6% y/y, CSV). Meanwhile, construction declined (-)7.3% y/y, CSV and mining was at a standstill, 0% y/y, CSV. In turn, the IMEF manufacturing indicator increase 1.9% m/m in November. In line with this performance and thanks to the major monthly growth for US industrial output in November (1.3% m/m), we expect the industrial output indicator for Mexico to show monthly growth of 2.6%. This would represent annual growth of 1.2%, CSV.

Chart 3

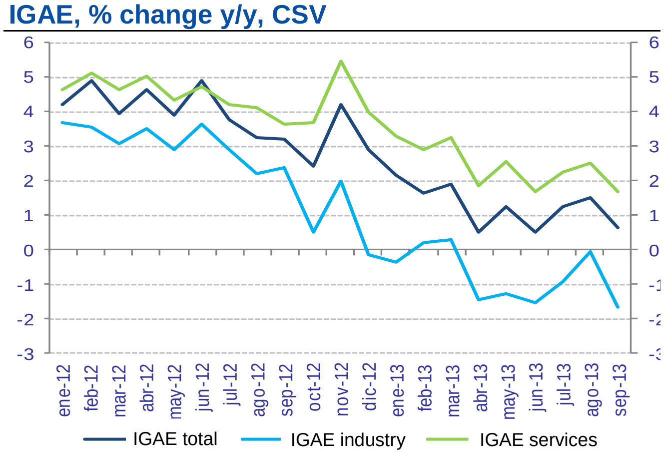
Consumer and producer confidence, % change y/y, CSV



Source: BBVA Research with INEGI data. CSV=Corrected for Seasonal Variation.

Chart 4

IGAE, % change y/y, CSV

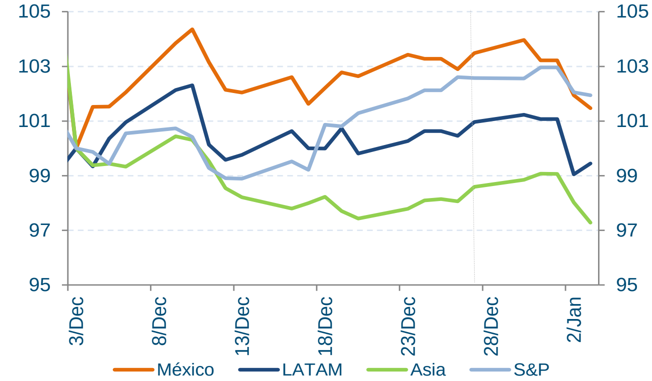


Source: BBVA Research with INEGI data. CSV=Corrected for Seasonal Variation.

Markets, activity and inflation

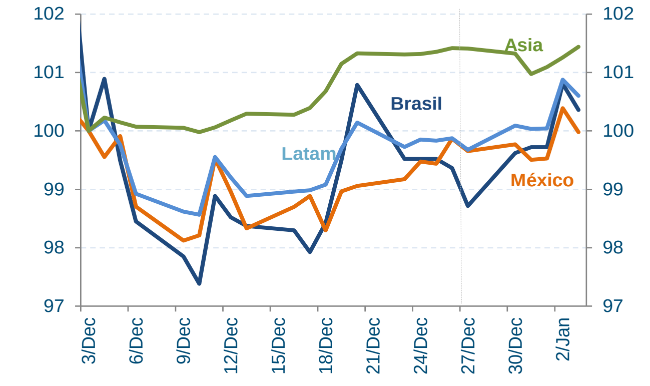
- Stock markets fell on the first trading day of the year due to investors cashing in after the gains seen in the last weeks of 2013. The dollar strengthened against emerging currencies thanks to better-than-expected manufacturing output in December.

Chart 5
Stock markets: MSCI indices
(December 3, 2013 = 100)



Source: BBVA Research with data from Bloomberg

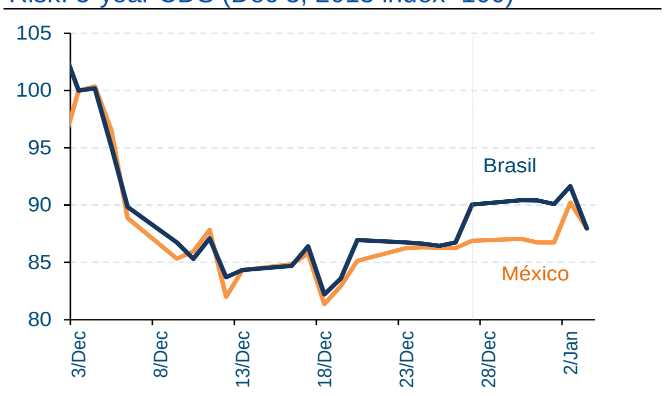
Chart 6
Foreign exchange: dollar exchange rates
(December 3, 2013 = 100)



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.

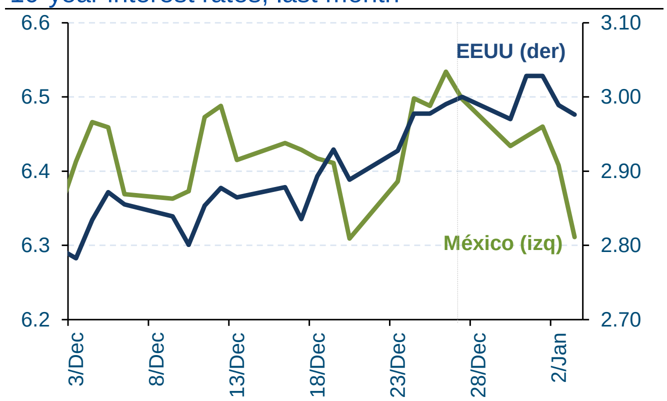
- Long-term interest rates in Mexico decoupled from Treasury bond yields thanks to the higher sovereign debt rating awarded on December 19 and the increase in short- and medium-term debt issuances to fund the higher deficit.

Chart 7
Risk: 5-year CDS (Dec 3, 2013 index=100)



Source: BBVA Research with data from Bloomberg

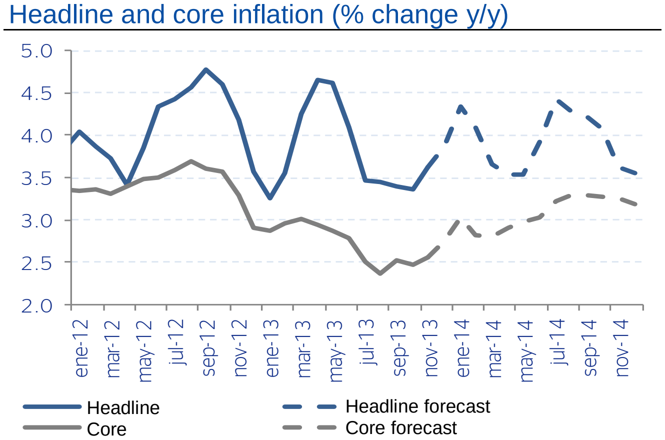
Chart 8
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

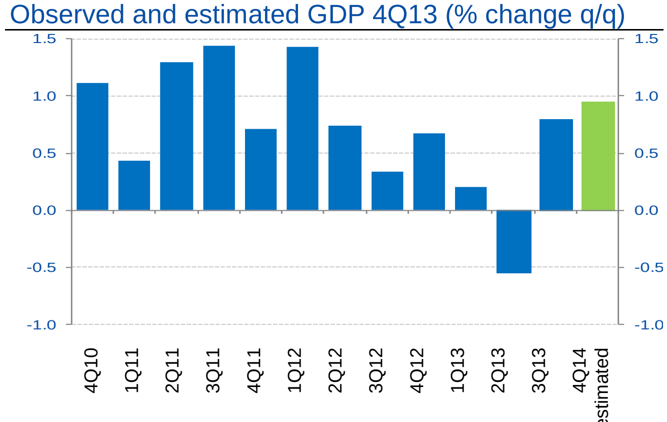
- We forecast inflation ending the year at 3.9% and rising to 4.3% in January due to the fiscal shock. Core inflation should end the year at 2.75% and rise to 3.0% in January.

Chart 9
Headline and core inflation (% change y/y)



Source: INEGI, BBVA Research

Chart 10
Observed and estimated GDP 4Q13 (% change q/q)



Source: BBVA Research with INEGI data.

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