Economic Analysis

We forecast no changes to the monetary policy rate

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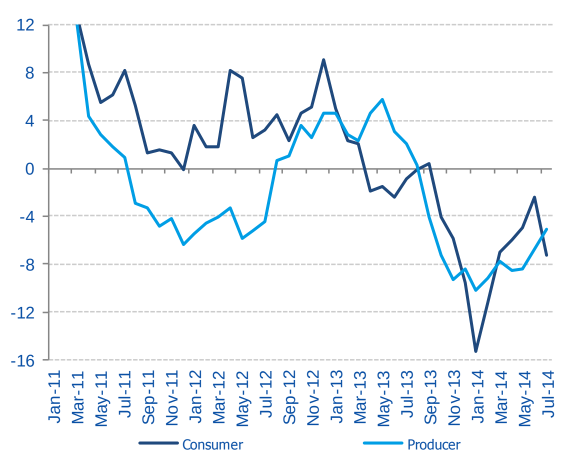
What happened this week …

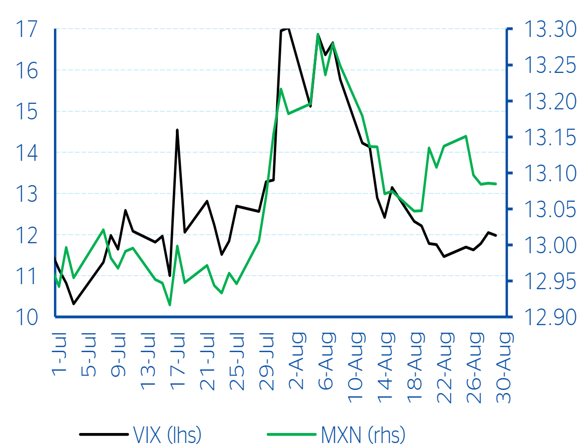
Retail sales are still weak. Retail sales inched up just 0.2% on a monthly rate (MoM) in June, with seasonally adjusted figures (sa), driven mainly by strong sales in textiles and footwear (7.1% MoM, sa). Nevertheless, these figures are not clear indicators of an acceleration in internal demand, since five of the eight components slipped, among them sales in household goods, computers and decorative items; vehicles and spare parts; and self-service and department store articles (-0.9%, -0.7% and -0.1% MoM, sa, respectively). Retail sales actually rose 1.4%, however, on an annual comparison. By the beginning of the third quarter, July's reduction in sales at ANTAD stores taken as a whole (-0.3% MoM sa), accompanied by a fall in consumer confidence, suggest that weak internal demand prevails. This is partly influenced by the moderate rate of job creation and the low growth in real wages in recent months.

Figure 1
Producer and consumer confidence indicators, 2011-14 (YoY % change, sa)



Source: BBVA Research with data from Inegi.
sa = seasonally adjusted.

Figure 2
VIX volatility index and exchange rate (points and ppd)



Source: BBVA Research with data from Bloomberg

External demand remains relatively strong. In July 2014, the annual growth rate of total exports and imports was 4.5% and 3.1%, respectively, causing the trade balance deficit to come in at USD980mn. We estimated that this deficit at the equivalent of USD560mn, because of our higher forecasts for the annual growth rate in exports (BBVAe: 7.3%) and in imports (BBVAe: 4.5%) than those in fact achieved. We should point out, however, that Mexico is achieving better results in 2014 compared to 2013; even so, the growth rate in exports is still not high enough to give the Mexican economy a good boost.

Expectations that the ECB (European Central Bank) will take more action drove market optimism, although positive sentiment was dampened by the escalation of the conflict between Russia and Ukraine. Mario Draghi's speech in Jackson Hole helped to generate market optimism that global monetary conditions will remain slack for a prolonged period of time. Furthermore, the expectation is that the ECB might take further measures in order to drive demand in the eurozone (i.e. quantitative easing). Nevertheless, increased tensions between Russia and Ukraine, because of Ukraine's accusations that Russia is involved in the escalation of violence in its territory, neutralised the positive effect of Jackson Hole. All in all, the stock indices posted gains over the week, perceived risk stayed low, emerging market currencies remained fairly stable, and interest rates tended slightly downwards. Next week, the markets' attention will be on the ECB meeting and US economic activity data.

…What is coming up next week

On Monday 1 September, the IMEF will publish its August performance expectations indicators for manufacturing and non-manufacturing activity. These indicators will be a guide to expectations for economic activity performance in the country in the third quarter of 2014. We forecast that the IMEF indicators will perform moderately positively in the light of the improved economic activity data over the last few months in the US, particularly in the industrial sector, with monthly growth of 0.4% in July.

Income from remittances to Mexico could reach USD1.982bn in July (an annualised rise of 7.7%). Recent figures show no significant increase in the volume of Mexican migrants in the US. However, the relatively low rate of unemployment in the US has also favoured employment among Mexican migrants, whose reported unemployment rates in the last few months have been below the national average, if we consider that Mexican migrants' participation has remained fairly constant. In addition, the proportion of part-time jobs (as a result of employer constraints) has gradually diminished. Thus, we estimate that the July increase in remittances could be better than those seen over the last three months.

Monetary pause, consistent with improved economic activity in the second quarter. On Friday 5 September Banxico will announce its monetary policy decision. We believe that it will maintain the monetary pause for two main reasons. First, GDP growth in the second quarter of the year was slightly higher than expected (1.0% vs. 0.8% QoQ) and this improvement is expected to extend over coming quarters, thanks to the uptick in the US economy and the increase in public sector investment. This figure enables us to stick to our annual growth forecast for 2014 of 2.5%, which is also within Banxico's forecast threshold and is consistent with a reduction in the output gap by 2015. Second, although annual inflation is above 4.0%, its growth recently is principally the result of the effects of the annual comparison which are intrinsically transitory, and will disappear in the final months of the year, with the result that YoY inflation will close the year at around 3.7%. Furthermore, note that annual inflation will fall to levels of around 3.0% at the beginning of 2015, once the base effect of the tax reform has worn off. In view of an outlook in which inflation is tending towards target and economic activity is maintaining the rate of growth, we are sticking to our expectation of a monetary pause for the rest of the year.

We expect the producer confidence indicator to report a significant improvement in August (0.7% MoM, sa) and consumer confidence to rise slowly (0.3% MoM, sa). On 5 September INEGI will publish the producer (PCI) and consumer (CPI) confidence indexes for August. We expect the PCI to come in at 52.1 points, sa, from its previous 51.8 points, sa, the month before, due to strong performance in the manufacturing sector, particularly in the automotive segment. Furthermore, in view of moderate job creation in the formal economy in July (37,457 jobs) and the low level of consumption, we anticipate that the CPI will reach a level of 88.4 points, sa, compared to 88.1 points last month. This will be equivalent to a level of 90.8 points, with original series (see Figure 1).

Calendar of indicators

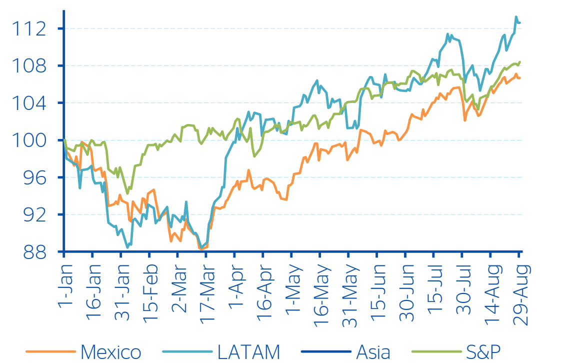
Mexico	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
IMEF manufacturing (index, sa)	August	1 Sept	49.8	50.8	49.1
IMEF non-manufacturing (index, sa)	August	1 Sept	50.5	51.5	50.1
Household remittances (USDmn)	July	1 Sept	1,982.0	1,958.8	2,037.8
Monetary policy rate announcement (%)	August	5 Sept	3.0	3.0	3.0
Producer confidence (index, sa)	August	5 Sept	52.1	--	51.8
Consumer confidence (index)	August	5 Sept	90.8	91.0	90.5

USA	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
ISM Manufacturing PMI (index, sa)	August	2 Sept	57.5	57.0	57.1
Manufacturers new orders (MoM % change, sa)	July	3 Sept	18.5	10.9	1.1
Trade balance (USDbn)	July	4 Sept	-42.0	-42.4	-41.5
ISM non-manufacturing NMI (index)	August	4 Sept	59.3	57.5	58.7
Unemployment rate (%)	August	5 Sept	6.2	6.1	6.2

Source: BBVA Research with data from Bloomberg. sa = seasonally adjusted. MoM = monthly variation rate.

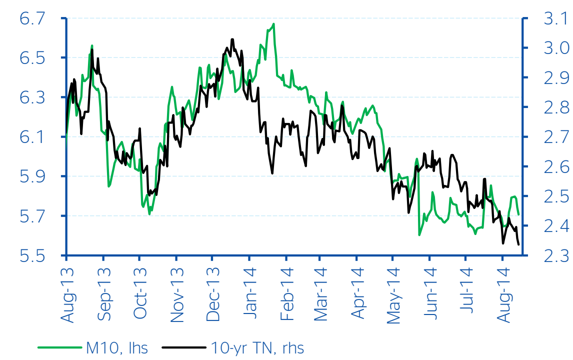
Markets

Figure 3
MSCI stock market indices (Index 1 Jan 2014=100)



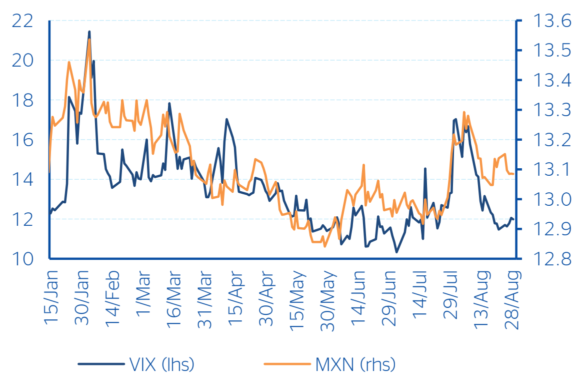
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



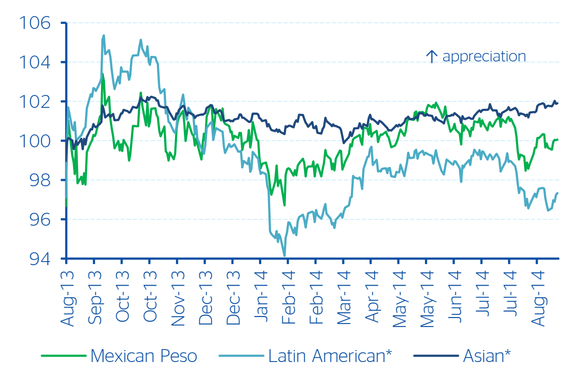
Source: BBVA Research, Bloomberg

Figure 5
Global risk and exchange rate (VIX index and USDMXN)



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD (29 Aug 2013 index=100)



* JP Morgan indices of Latin American and Asian currencies vs. USD; weighted averages by trade & liquidity.
Source: BBVA Research, Bloomberg

Annual information and forecasts

	2012	2013	2014
Mexico GDP (YoY % change)	4.0	1.1	2.5
General inflation (%, average)	4.1	3.8	3.9
Core inflation (%, average)	3.4	2.7	3.2
Monetary Policy Rate (%, average)	4.5	3.8	3.2
M10 (%, average)	5.7	5.7	6.1
US GDP (YoY % change)	2.8	1.9	2.0

Source: BBVA Research

Recent publications

Date	Description
28 Aug 2014	Mexico Flash. Trade Balance from January to July 2014 the accumulated deficit was of almost 1.3 US billion dollars. This figure was 64% less that the deficit reported in the same months of 2013