

Economic Analysis

Inflation has again reached a historical low and the peso is moving down against the dollar, towards a level of MXN16.10

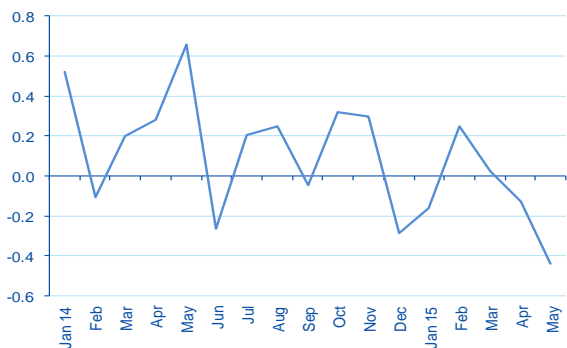
Arnoldo López / Javier Amador / Iván Martínez / Javier Morales / Juan Li / Alfredo Salgado

What happened this week...

Gross fixed investment (GFI) registered annual growth of 2.3% in May 2015 in its initial series. Within this, the construction investment and machinery and equipment investment components grew by 1.5% and 3.6% YoY respectively. Growth in GFI and its components was in line with our forecasts (total GFI of 2.5%, construction investment of 1.5%, and machinery and equipment investment of 4.6%). In terms of its short run performance, May GFI was not encouraging, as the monthly variation in its seasonally adjusted (sa) series was -0.9%. The same was the case for its investment components, with construction showing -1.1% MoM and machinery equipment -0.5% MoM, both sa).

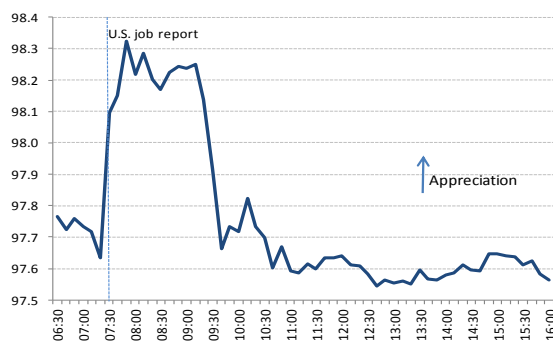
Remittances to Mexico increased by 6.1% YoY in June with inflows of USD2,168.3mn, according to the central bank's figures released on 3 August, which represented an increase of 6.1% YoY. This figure marks the third-best growth reading this year. The positive employment trend for Mexican migrants to the United States appears to have boosted the wiring of remittances. This effect was slightly greater than expected by the market consensus for June, which had aimed for a flow of USD2,130mn and growth of 4.2% YoY. According to figures from the US Bureau of Labor Statistics, the general unemployment rate in the United States was a seasonally adjusted 5.3% in June. According to our own estimates, some 424,400 jobs were created for Mexican migrants in June 2015, which were mostly full-time (356,000 jobs) and in sectors with a demand for skilled labour: trade (+133,000 jobs), educational and health services (+126,000), and professional services (+97,000). If this pace is kept up over the second half of the year, a recovery in the cumulative flow of remittances can be expected by the close of 2015.

Figure 1
Industrial production (MoM % change, sa)



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

Figure 2
Dollar rate against the major currencies. Intra-day performance on 7 August 2015 (DXY index)



Source: BBVA Research with Bloomberg data

As we predicted, annual inflation slumped to a new historical low, reaching 2.74% in July (BBVAe: 2.75%). Headline inflation rose by 0.15% in the month, which was in line with our estimate (BBVAe: 0.16%), and core did so by 0.17% (BBVAe: 0.16%). In annual terms, core inflation dipped to 2.31% compared to 2.33% in June, arriving at a low for the year.

The peso rose by over 1.0% on Friday, despite US employment figures that were in line with estimates.

In a movement that was unusual given the pattern of the last few months, the dollar exchange rate climbed to MXN16.15 (-1.03%) in the last day's trading of the week, even though the employment and wage figures in the United States were virtually in line with forecasts, which increased the chances of a federal funds rate hike in September (see Figure 3). This is the first time since 14 May that the peso has gained more than 1.0% in a single day, which made it the currency which appreciated the most among those of the emerging markets. We should point out that most of these currencies did actually rise, which they did by so much that nine of them (including the Colombian peso and the Brazilian real) gained over 0.3%. What was more, the value of the dollar (against the key world currencies and as measured by the DXY index) rose 0.8% after the employment figures were published and two hours later it dropped back 0.7%, before later ending the day 0.3% down on its closing level of the previous day (see Figure 2). This behaviour could be due to profit-taking in the currency market or to the theory that the market is already discounting a hike in September, although paced thereafter using smaller rises (see Figure 5). In line with this idea, rates on T-bonds rose by between 1.6 and 3.0bp (basis points) among those under two years, while redemption yields for maturities of over five years fell by between 3.8 and 7.1bp. The Mexican curve displayed a movement that was similar in direction, but this involved different magnitudes. The yield for six-month bonds rose by 4bp, while over the rest of the curve it came down by an average of 5bp. Finally, in the stock markets, the IPyC gained 0.24% over the week, distinguishing itself in a positive sense from the performance of the S&P 500, which lost 1.24%, influenced by media company losses.

...What to expect next week

INEGI is set to release the figure for the June industrial production index on 11 August, which we estimate will have risen by 0.2% MoM, sa. Our monthly 0.2% growth estimate for the industrial production index is based on our assumption that the four components within this indicator will have advanced in June thus: mining, 0.3% MoM and -7.4% YoY; water and electricity, 0.4% MoM and 2.0% YoY; construction 0.6% MoM and 1.5% YoY; manufactures, 0.2% MoM and 3.1% YoY. It is worth noting that in May the industrial production index fell by 0.4% MoM, and all of its components showed negative monthly growth rates.

Second quarter inflation report: watching out for clues about the speed of the imminent cycle of rate hikes. Next Wednesday, the central bank will announce its inflation report for 2Q15. With no changes expected in the forecast range for GDP and inflation, the most important aspect will be to learn more details about the current state of domestic activity and expectations with respect to it, above all within the present context of inflation at historically low levels and a potential start for the cycle of hikes in the benchmark interest rate. More specifically, even though the message from the central bank has repeatedly indicated that the start of the monetary normalisation cycle in the United States will serve as the catalyst for the forthcoming rise in the reference rate, expectations regarding the course of economic activity in the coming year will allow us to know to what extent Banxico's cycle of hikes can be less aggressive compared to the process implemented by the Fed. Furthermore, we should remember that this is the last scheduled press conference before the meeting in September.

Minutes from the monetary policy meeting: more details in the release with regard to the peso's exchange rate depreciation? Next Thursday the minutes of the most recent monetary policy meeting will be disclosed. Attention will centre on the comments by the committee members about the currency depreciation and how this ties in with the imminent reference rate hike, even more so given that, one day after the Currency Commission announced that dollar auctions would be stepped up, the governor of the central bank announced that the rate might be raised if volatility continues to have an adverse impact on the peso, regardless of any move by the Federal Reserve. Moreover, it should be remembered that, before that interview, the statement from the central bank had stressed that its biggest concern was over the effects which the opening of the monetary normalisation process in the United States might have on exchange rate pass-through to inflation or building expectations, which, for the moment and in spite of the depreciation for the year of almost 18%, are not showing any significant signs of deterioration.

In the week of 10 to 14 August, the Mexican Social Security Agency (IMSS) will announce the July figure for the total number of workers registered with it. We estimate that for July this figure will rise by a little over 47,000 compared to the previous month. This rise in the total number of IMSS-registered workers will mean that the annual growth rate for formal IMSS-registered employment for July will be 4.5%, which is slightly larger than the annual rate of 4.4% for the previous month.

Calendar of indicators

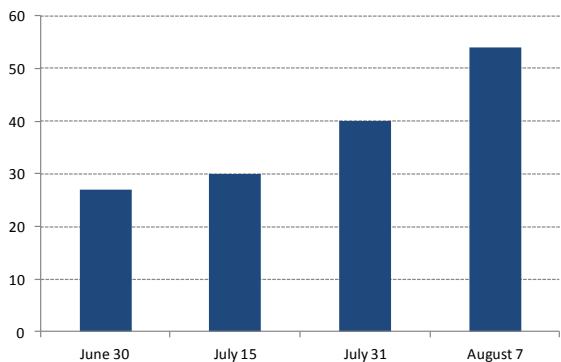
Mexico	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Industrial production (MoM % change, sa)	June	11 August	0.2%	0.4%	-0.4%
IMSS formal employment (thousands of workers)	July	10-14 August	47.2	40.0	78.4

United States	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Adjusted Retail & Food Services Sales (MoM % change, sa)	July	13 August	0.47	0.60	-0.30
Adjusted Retail Sales Less Autos and Gas Stations (MoM % change, sa)	July	13 August	0.28	0.40	-0.40
Industrial Production (MoM % change, sa)	July	14 August	0.30	0.30	0.23
University of Michigan Consumer Sentiment Index	August	14 August	93.76	93.60	93.10

Source: BBVA Research with data from Bloomberg. sa = seasonally adjusted. saar = seasonally adjusted annual rate. YoY = annual % change. QoQ = quarterly % change. MoM = monthly % change. P = preliminary

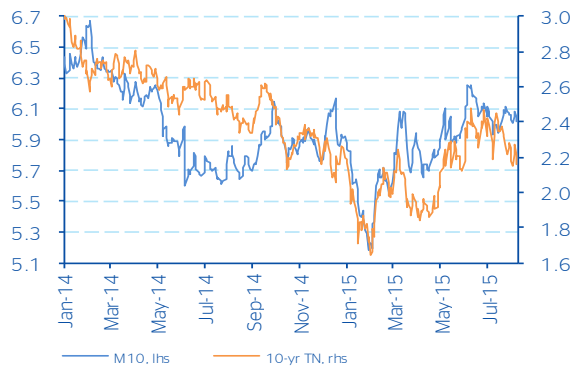
Markets

Figure 3
Implicit Probability of a 25bp rise on the Fed Funds Rate on the September 17 Meeting (%)



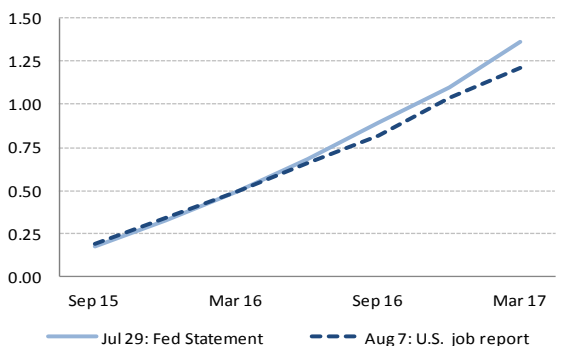
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



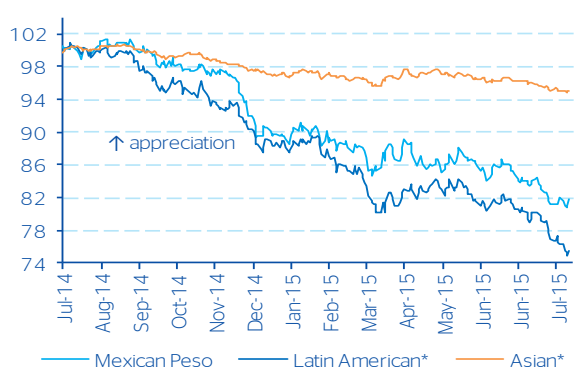
Source: BBVA Research, Bloomberg

Figure 5
1-Month Fed Fund Rate Futures (% USD)



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD (31 Jul 2014 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

	2013	2014	2015
Mexico GDP (YoY % change)	1.4	2.1	2.5
General inflation (% average)	3.8	4.0	2.8
Core inflation (% average)	2.7	3.2	2.4
Monetary Policy Rate (% average)	3.8	3.2	3.2
M10 (% average)	5.7	6.0	5.7
US GDP (YoY % change)	1.9	2.4	2.5

Source: BBVA Research.

Recent publications

Date	Description
4 Aug 2015	➔ Mexico Migration Flash. Remittances to Mexico increased by 6.1% YoY in June, with an inflow of USD2,168.3mn

Disclaimer

This document has been prepared by BBVA Research at the Banco Bilbao Vizcaya Argentaria, S.A. (BBVA) and by BBVA Bancomer. S. A., Institución de Banca Múltiple and the BBVA Bancomer Financial Group, on their own behalf and is for information purposes only. The opinions, estimates, forecasts and recommendations contained in this document refer to the date appearing in the document, and, therefore, they may undergo changes due to market fluctuations. The opinions, estimates, forecasts and recommendations contained in this document are based on information obtained from sources deemed to be reliable, but BBVA does not provide any guarantee, either explicit or implicit, of its exactitude, integrity or correctness. This document does not constitute an offer, invitation or incitement to subscribe to or purchase securities.