Economic Analysis

The central bank to keep its monetary policy activity on hold as it awaits the Fed's rate-hike decision

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What happened this week…

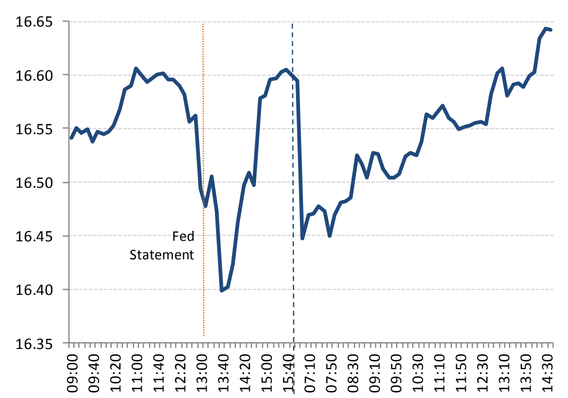
INEGI published the indicators of Global Supply and Demand for Goods and Services for 2Q15, which show that the components under this heading contributed 2.2 percentage points (pp) to annual GDP growth in 2Q15, with the breakdown as follows: Private Consumption (2.0pp), Gross Fixed Capital Formation (1.2pp), which basically came from private-sector investment, Exports (3.0pp), Government Consumption (0.3pp), and Inventory Variation (0.1pp). The components which made negative contributions were the Statistical Discrepancy (-2.6pp) and Imports (-1.8pp). These figures reveal that the main driver of GDP growth was Private Consumption and that the net contribution from the external sector (1.2pp) was high and equalled that of GFCF, as well as the fact that the Discrepancy figure, or statistical adjustment, was also very large.

Figure 1
Contribution of components to annual GDP growth in 2Q15 (Initial series, percentage points)

Total Consumption	**2.3**
Private Consumption	2.0
Public Consumption	0.3
Gross Fixed Capital Formation	**1.2**
Private	1.2
Public	-0.1
Exports	**3.0**
Imports	**-1.8**
Change in Inventories	**0.1**
Statistical Discrepancy	**-2.6**
GDP = Total	**2.2**

Source: BBVA Research with INEGI data.

Figure 2
Intra-day exchange rate, 17 and 18 September (USDMXN)



Source: BBVA Research with Bloomberg data

The Fed (Federal Reserve) is keeping activity on hold and focussing on the risks in connection with the global cycle. The Federal Open Market Committee decided to keep the federal funds rate unchanged within a range of 0 to 0.25%. Despite something of an optimistic tone as regards economic activity, given the modest rise of consumer spending and investment, the recent fall-back in inflation and market expectations of it, served to endorse the policy of waiting for more indicators that reinforce the notion that inflation will converge towards the 2.0% target in the medium term. Furthermore, in what could be considered the most significant change in the statement, explicit mention was made of global events as a risk factor. Nonetheless, the Fed Chair stressed that there have been no significant changes to their economic scenario and, as a result, the Committee is merely waiting for more evidence to substantiate the members' conviction that inflation will converge to their long-term target, and for more elements to study so that they can determine the effects of recent incidents involving volatility on the US economy. In fact, according to the economic projections, 14 of the 17 committee members still expect the normalisation process to commence in 2015. The emphasis which the Fed laid on the impact on US activity and inflation from events in the global economy was influential in the reduced appetite for risk in the final session of the week. Practically all of the major stock markets saw falls. In the United States the S&P 500 shed 1.62%, while in Europe the slides were between 1.0% and 3.0%. The BMV's index, the IPC, closed down 0.52%. In the fixed-income market, the Fed's decision to hold the rate unchanged gave rise to a downward shift in the yield curve. The 10-year Treasury note came down 16bp (basis points) in the final two days of the week, closing at 2.13%. In line with this movement, the 10-year Mbono ended the week with a 19bp fall over two days, finishing at 5.99%. In the currency market, the peso weakened by 0.62% in the two days following the Fed statement, which made it the emerging currency that experienced the third largest depreciation.

…What to expect next week

A delay in the monetary policy rate (MPR) hike in Mexico. On Monday, the central bank is set to disclose its monetary policy decision. We think that it will keep policy moves on hold based on the following reasoning: First, the federal funds rate was held unchanged, which means that the chief risk to consolidating convergence on the target inflation rate (according to the central bank statement) has not materialised this month. Second, there are no signs of pressures on prices and even annual inflation has stayed at a historical low of 2.6%, having risen overall by barely 0.3% in the first eight months of the year. Furthermore, medium-term inflation expectations remain anchored at around 3.5%. Third, economic activity continues to grow at a moderate rate and by less than expected, influenced by weak industrial production growth in the US. The central bank has actually trimmed its forecast range for GDP growth in 2015 from 2.5%-3.5% to 1.7%-2.5% and expects the GDP gap to remain in negative territory until the end of 2016. Finally, thus far peso depreciation has had no significant effect on prices and on top of this it has appreciated by around 3% in the past few days, on lower risk aversion and a stable oil price. On the other hand, not only are we not seeing offloading of foreign-held medium- and long-term bonds, but such holdings have in fact increased. Going forward, we expect the fed funds rate hike to be the key trigger behind an MPR rise in Mexico, for which reason, given expectations of a start to the normalisation process by the Fed towards the end of the year, we think that the pause in monetary policy will come to an end in December with a 25 basis point hike.

INEGI will publish the figure for the Global Economic Activity Indicator (IGAE) for July 2015 on 24 September, for which we expect monthly (MoM) growth to have been a seasonally adjusted 0.3%. This level of expected growth should be driven by the +0.2% MoM in both the secondary, or industrial, sector (observed figure) and the tertiary, or commercial and services, sector. On the other hand, we expect the primary, or agriculture and livestock, sector to have grown at around 3.2% MoM, in a partial recovery from the weakness in this sector the previous month.

On 25 September INEGI will publish the August balance of trade figure, which we predict will show a deficit of USD1.8bn. This arises from a forecast annual contraction in both exports (of -10.5%, with -49.0% for oil exports and -5.7% for non-oil exports) and imports (-8.3%). The drop in oil exports is from the additional fall in the price per barrel of crude that month, while the poor performance by non-oil exports is linked to the setback of industrial and manufacturing production in the US that month.

Calendar of indicators

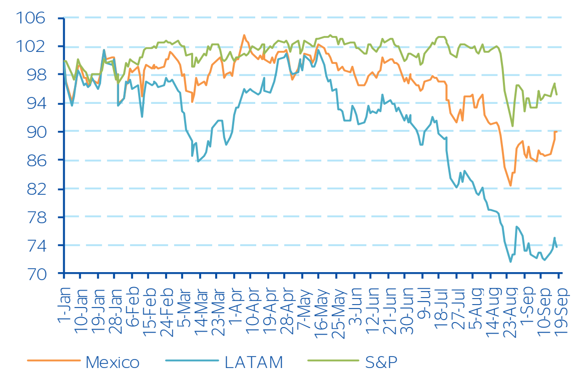
Mexico	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Global Economic Activity Indicator, IGAE (MoM % change, sa)	July	24 Sept	0.29%	0.21%	0.28%
Trade Balance (USD millions)	August	25 Sept	-1,800	-1,927	-2,267

United States	Indicator period	Publication date	BBVA estimate	Consensus	Previous figure
Durable Goods New Orders Total ex Transportation (MoM % change, sa)	August	24 Sept	1.0	0.10	0.40
GDP Chained 2009 Dollars (QoQ % change, saar)	2Q15	25 Sept	3.8	3.7	3.7
University of Michigan Consumer Sentiment Index	September	25 Sept	88.0	86.5	85.7

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

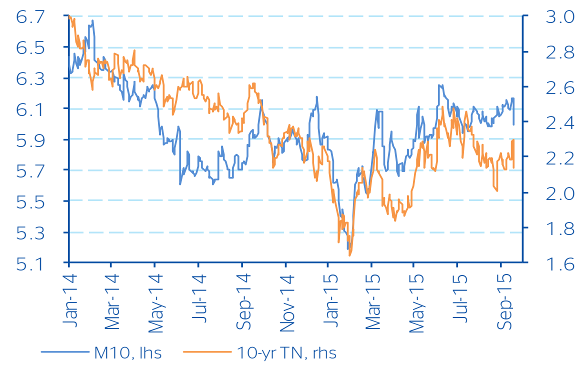
Markets

Figure 3
MSCI stock market indices (Index 1 Jan 2015=100)



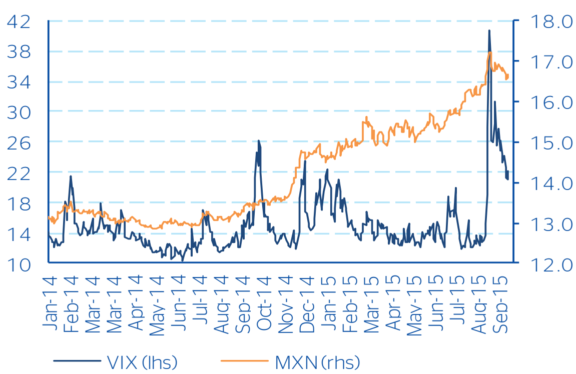
Source: BBVA Research, Bloomberg

Figure 4
10-year government bond yields (%)



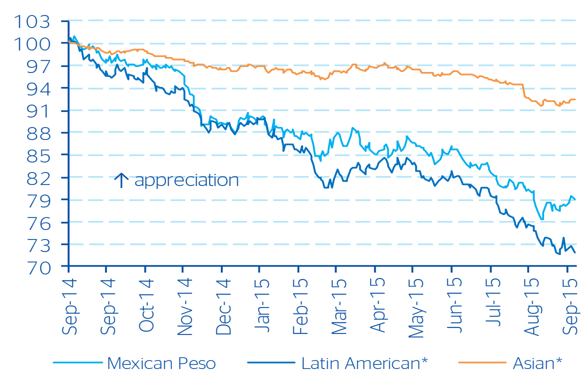
Source: BBVA Research, Bloomberg

Figure 5
Global risk and exchange rate: VIX index and USDMXN



Source: BBVA Research, Bloomberg

Figure 6
Currencies vs. USD (4 Sep 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
3Sep 2015	➡	Mexico Migration Flash. Remittances reached the year's highest level of growth in July, at 11.7%, totaling USD2,231.8mn
3 Sep 2015	➡	Mexico Banking Flash. Private sector credit: this increased by 10.7% in July, with all three of its segments performing better