

Mexico Weekly Flash

Next week...

• Inflation set to start dropping

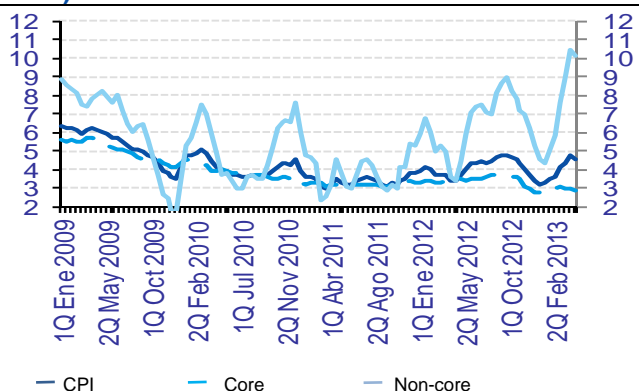
Next Thursday 23 sees the release of inflation data for the first half of May. These are highly important figures since we expect the annual inflation rate to start falling back and come in under the 4% threshold in coming months. We estimate that inflation will fall around -0.51% bi-weekly in the first half of May thanks to seasonal factors such as the summer electricity rates coming into force in some areas and the fading we estimated already being seen in some products where supply was distorted in recent months, such as lemons, green tomatoes, eggs and poultry. Although the decline in prices for these products is not yet enough to talk about the respective markets stabilizing, it should contribute to a drop in inflation in bi-weekly terms. As for core inflation, we estimate an increase of around 0.14% bi-weekly - a moderate climb that should keep the annual rate around 2.9%. Core inflation continues to benefit from the strong peso and lower global grain prices but mainly from the prevailing slack in the economy. This was clear in the GDP figures published today showing that although the economy continues to expand, it is doing so at a lower rate, meaning growth is slowing. In this vein, we restate that inflation will return below 4% in coming months thanks to the gradual fading of supply shocks affecting the non-core component and the stability of core inflation.

• Speculation surrounding a lower asset purchase rate by the FED contributes to a stronger dollar against emerging currencies

The public statements by some Federal Reserve members in the US (FED) in favor of reducing the asset purchase rate contributed to a stronger dollar and higher interest rates. Attention will need to be paid to minutes set for release next week from the Federal Open Market Committee to assess the different options from members regarding the costs and benefits of asset purchases.

Chart 1

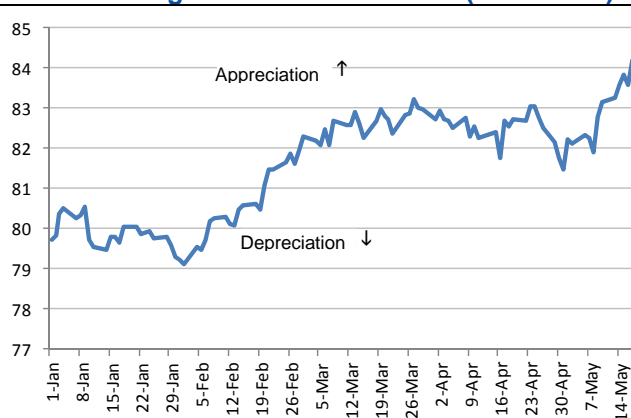
Inflation breakdown. (% change y/y, bi-weekly series)



Source: BBVA Research with INEGI data

Chart 2

Dollar value against main currencies (DXY index)



Source: Bloomberg. The index is a weighted average of the dollar's value against the euro, yen, Swiss franc, Swedish krona, Canadian dollar and pound sterling

Calendar: Indicators

Balance of Payments 1Q13 (May 24)

Forecast: current account -4.503 bn

Consensus: -4.9 bn

Previous: -6.49 bn

Next week sees the release of Balance of Payment figures for 1Q13, important data for an overview of the performance of different exchanges between Mexico and overseas during the period. We estimate a deficit of -4.5 bn (1.5% of GDP) for the current account due to a trade balance deficit of -1.106 bn. This deficit is set to be one of the widest in the last 4 years. In a scenario of continuous economic recovery (albeit at a slower speed currently), a stronger currency and lower oil prices in comparison to 2012, it is normal that the current account deficit widens. Nevertheless, with the prevailing slack in the economy, this widening will not cause funding problems since we believe that the surplus in investment balances will be enough to offset the deficit. In terms of the financial account, it will be interesting to assess if there is a recovery in revenue from FDI given the weakness shown in the previous quarters and to see if the portfolio investment inflow, specifically for public sector shares, continues to be strong.

Retail sales in March (May 22)

Forecast: 0.3% m/m, 1.1% y/y

Consensus: NA

Previous: -0.1% m/m, 0.6% y/y

The retail sales indicator for March to be released this coming Wednesday is set to continue its slowing trend in terms of annual change that has characterized the index since mid-2012. We should take into account that although with lower growth than last quarter, employment in the formal private sector continues to expand at a good rate (4.1% y/y in March) and income in real terms is slightly better than a year ago. Despite this, retail sales will reflect the economy's slowdown cycle as a whole and we expect growth of 0.3% m/m, which in annual terms comes in at 1.1%. Although the ANTAD sales indicator points to a bigger slowdown, it should be stated that the retail sector is merely a single report since the March IGAE service index reported an upturn (1% m/m vs. -0.2% average the previous quarter), a sign that other services could continue to see growth.

Inflation 1st two weeks in May (May 23)

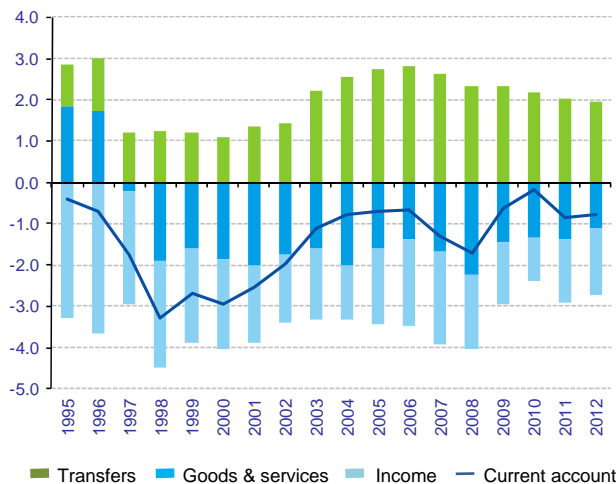
Forecast: -0.51% bi-weekly (4.53% y/y)

Consensus: -0.59% bi-weekly

Previous: 0.07% m/m 4.65% y/y

Chart 3

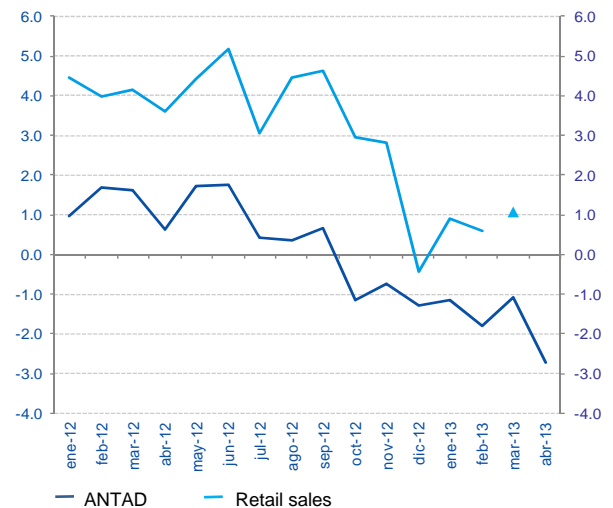
Current Account (% GDP)



Source: BBVA Research with INEGI data

Chart 4

Retail Sales and ANTAD (% change y/y, CSV)

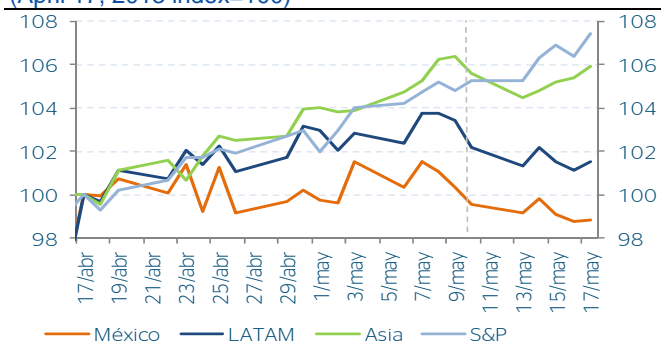


Source: BBVA Research with INEGI data

Markets, activity and inflation

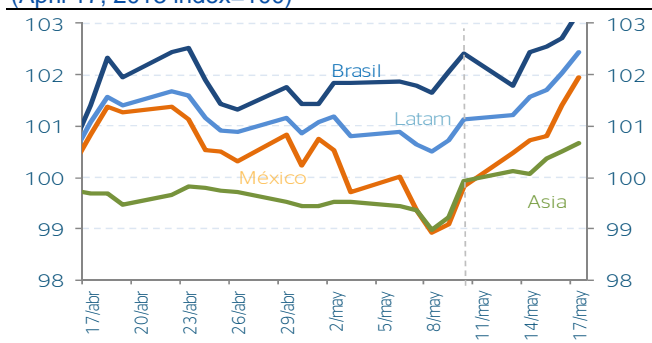
- Consumer confidence and early output indicators in the US heightened speculation on a possible reduction in bond amounts purchased by the Federal Reserve, which in turn led to a stronger dollar against emerging currencies. Stock markets closed up for the week in light of an expected ongoing recovery in the US.

Chart 7
Stock Markets: MSCI indices
(April 17, 2013 index=100)



Source: BBVA Research with data from Bloomberg

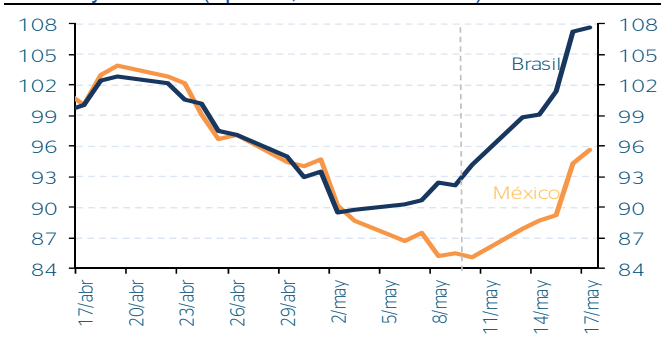
Chart 8
Foreign exchange: dollar exchange rates
(April 17, 2013 index=100)



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.

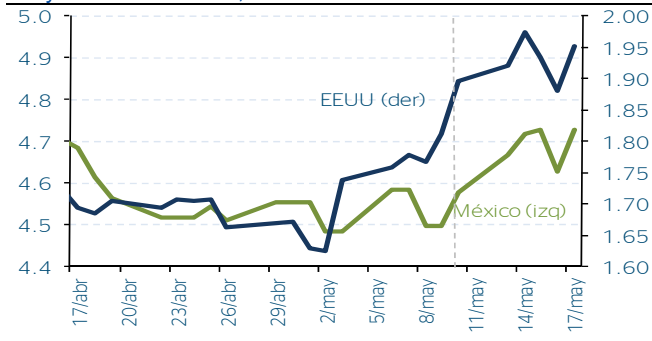
- Higher rates in the US in the face of an expected continual recovery in the US despite mixed data over the week (e.g. house sales, industrial output, consumer confidence). Rates in Mexico maintain their positive correlation with US rates.

Chart 9
Risk: 5-year CDS (April 10, 2013 index=100)



Source: BBVA Research with data from Bloomberg

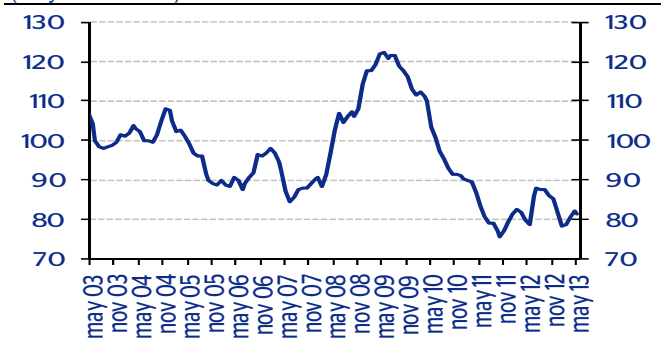
Chart 10
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

- However, constant inflation up to the first two weeks of April has started to fall back. Nonetheless, we believe the bounce will be temporary and have hit a high in April.

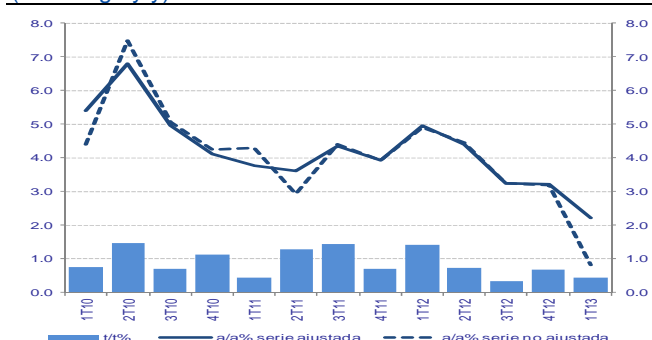
Chart 11
*Inflation Surprise Index
(July 2002=100)



Source: Bloomberg and BBVA Research

*This measures the deviations in inflation in comparison to market-forecast figures, adjusting for inflation volatility. When it trends down, this implies a lower-than-expected inflationary surprise; when it trends up, this indicates a higher-than-expected inflationary surprise.

Chart 12
Observed GDP
(% change y/y)



Source: BBVA Research

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