

Mexico Weekly Flash

Next week...

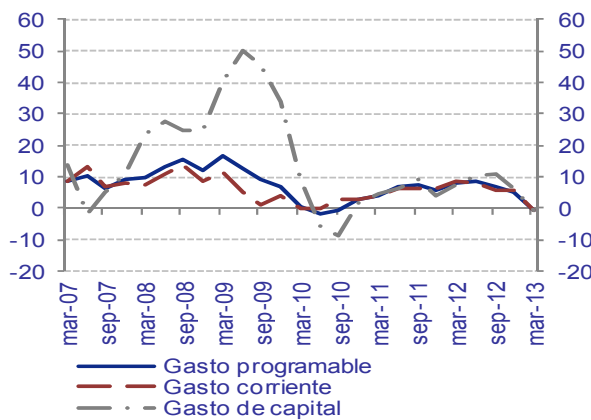
- **The April public finance report may give a signal on improved spending**

Public finances have become more relevant due to the strong decline in federal spending in 1Q13, having fallen by 10% y/y due to drops of -10.5% y/y in projected expenditure and -8.5% y/y in non-projected expenditure. In projected expenditure, the -10.6% y/y decline in current spending is worth mentioning, with the greatest contraction being registered in spending for aid, subsidies and transfers, which is down -18.2% y/y. Although the contraction of spending in early 2013 has been significant, it is not easy to make a comparison, since the first quarter of 2012 registered the highest spending level since 2009. This was probably due to the positive economic cycle during the period and to the fact that investment projects are in their final phase toward the end of a six-year presidential term, while in the early stages of a new administration it is natural for many projects to be in a planning phase. Moreover, before the election, this year's budget was approved in December and envisages lower deficit. We thus expect the current contraction to be reversed in the second half of the year, although given the consolidation approved in the budget, spending will grow moderately.

- **Markets bounced strongly in response to the possibility that the Fed may slow the pace of asset purchases in the coming months**

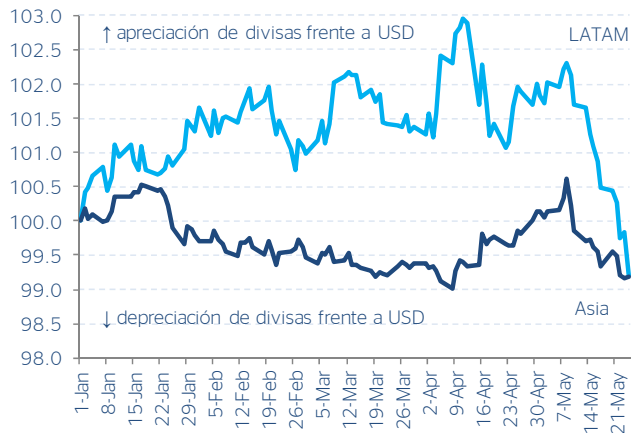
What changed this week? Not the fundamentals of the global economy. US data have been mixed, manufacturing output remains weak in the euro zone, and in Asia the most significant data was the weak Chinese PMI (49.6 in May, suggesting a contraction). What changed then? The Fed sent signals that seem to have confused investors. The Fed members Dudley and Bullard seemed relaxed this week, as did Bernanke during this appearance before Congress. However, during the Q&A session he seemed to open the door to a slowdown in the purchases of assets in the coming months. In addition, the FOMC minutes show that some participants thought that slowing the pace in June was one possibility and the discussion highlighted the lack of agreement within the FOMC about what constitutes sufficient improvement of the economy. The markets bounced strongly. Looking ahead, market volatility could remain high and the movements of financial variables could become increasingly dependent on US economic data, in particular employment data, and this could result in a reassessment of the Fed's pace of asset purchases.

Chart 1
Projected expenditure and main headings (y/y % change), four-quarter rolling average.



Source: BBVA Research with Banxico data

Chart 2
Emerging economy currencies against the dollar (LACI and ADXY indices, January 1 2013=100)



Source: BBVA Research and Bloomberg

Calendar: Indicators

Trade balance in April (May 27)

Forecast: -341 md

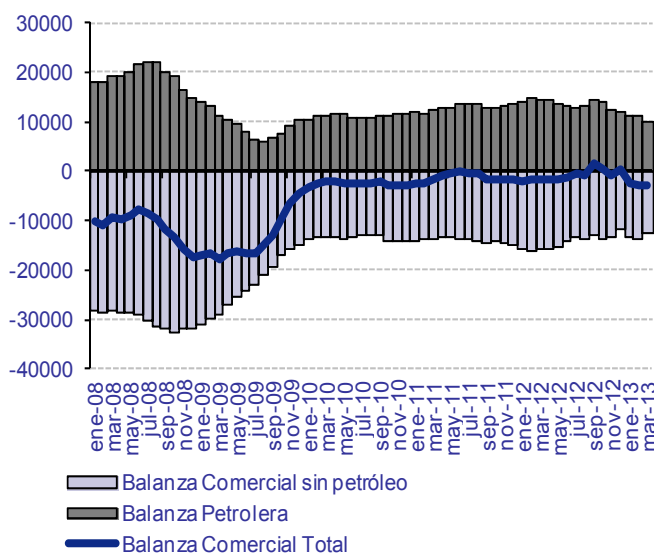
Consensus: 338 md

Previous: 1714 md

The April trade balance data will be released next week, and we believe that they will show a small deficit of -341 md (millions of dollars). Although the trade balance showed a 1,714 md surplus the previous month, we believe that because of the weakness shown by industrial output in the US in April, lower oil prices and lower auto sales in the US, exports will stand at around 30,500 md (-1.5% y/y), while imports will remain stable at around 31,000 md (1.7% y/y). Because the outlook for growth in the US has not changed significantly, Mexican companies, which import intermediate goods for their exports to the US market, will not reduce their purchases sharply. Lastly, we believe that at year-end the trade balance deficit will be wider than last year's (163 md) thanks to the ongoing recovery of domestic demand and the appreciation of the peso.

Chart 3

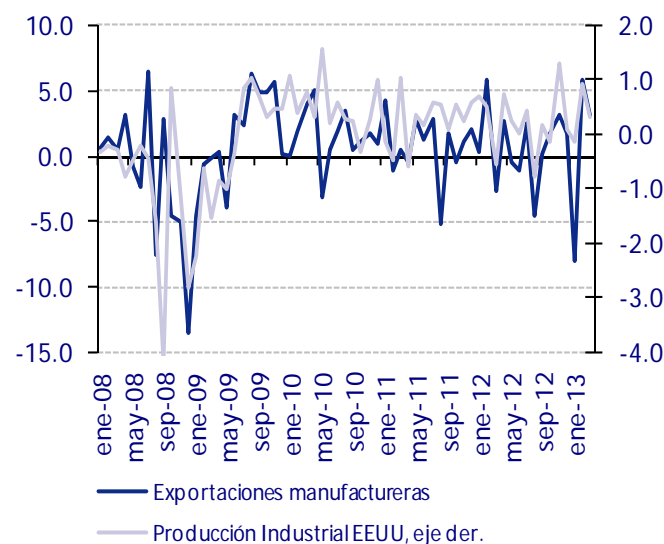
Trade balance (md, 12-month rolling figure)



Source: BBVA Research with INEGI data

Chart 4

Manufacturing exports and US industrial output (m/m % change)

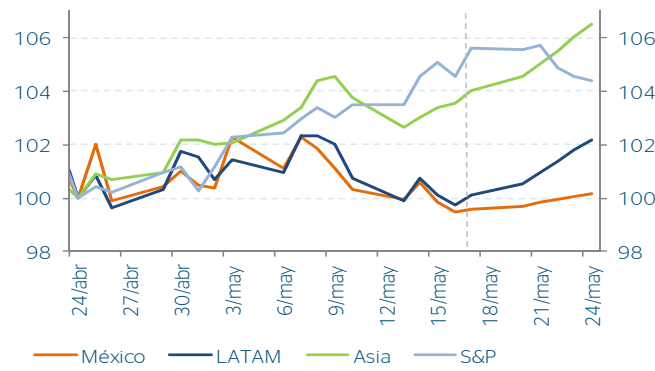


Source: BBVA Research with INEGI data

Markets, activity and inflation

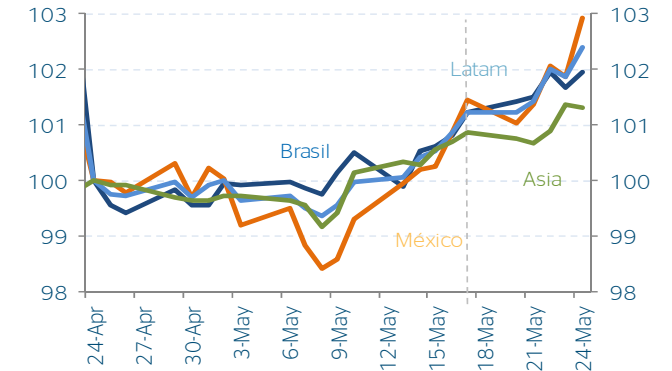
- **Markets bounced strongly in response to the possibility that the Fed may slow the pace of asset purchases in the coming months: the dollar strengthened**

Chart 7
Stock markets: MSCI indices
(April 24, 2013 index=100)



Source: BBVA Research with data from Bloomberg

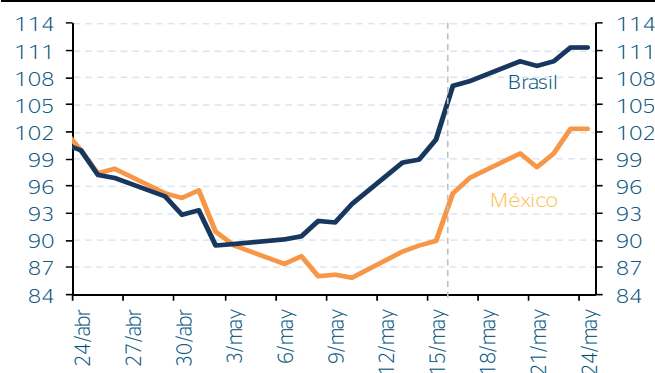
Chart 8
Foreign exchange: dollar exchange rates
(April 24, 2013 index=100)



Source: BBVA Research with Bloomberg data. Note: LATAM includes Argentina, Brazil, Chile, Colombia and Peru. Asia includes the Philippines, South Korea, Taiwan, Singapore, Indonesia and Thailand.

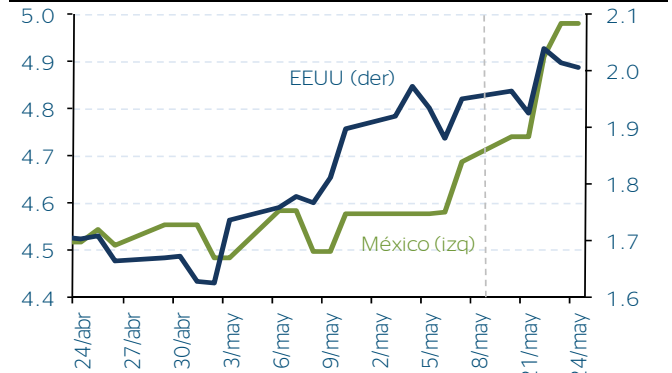
- **The 10-year Treasury interest rate increased 11 bp following the Fed's statement, which seems to have confused investors. The outflow of the most risky assets was accompanied by an upturn in emerging market CDS and interest-rate hikes.**

Chart 9
Risk: 5-year CDS (April 24, 2013 index=100)



Source: BBVA Research with data from Bloomberg

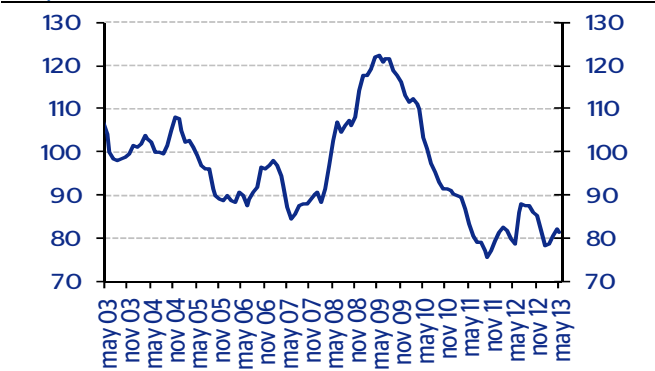
Chart 10
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

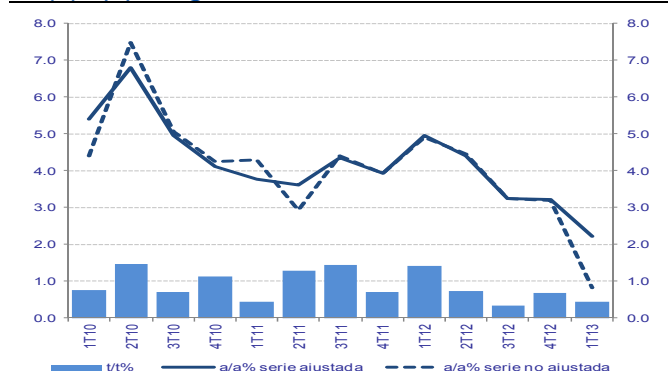
- **Inflation will begin to fall in June and we expect a rebound in activity in the coming quarters following the rapid decline seen in 1Q13.**

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



Source: Bloomberg and BBVA Research
*This measures the deviations in inflation in relation 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
(% y/y, q/q change)



Source: BBVA Research

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