Mexico Weekly Flash

Next week…

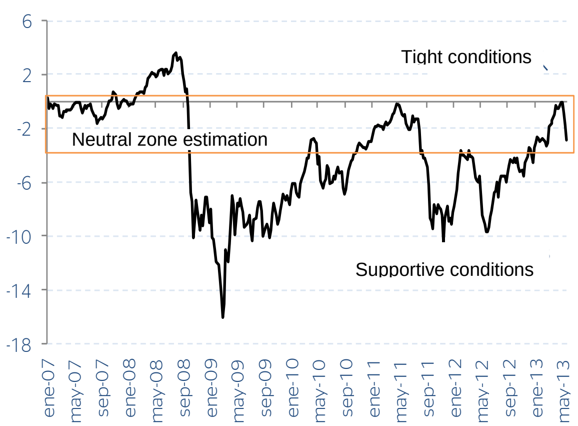
- **The decision on monetary policy will be released; no change is expected in the rate, but with a more relaxed tone, mainly due to economic activity**

The GDP growth figures for the first quarter (2.2% y/y), the lowest annual rate of growth since 2009, confirm the signs of weakness in economic activity, above all in the manufacturing sector. At the same time, there are mixed signs in the U.S., with the indicators of manufacturing activity down and the indicators of consumer confidence up. In addition, although some central banks around the world continue to reduce their reference rates, market expectations that the Fed will slow down its asset purchases has led the peso to lose more than 6.0% between May 8 to date. This is in turn reflected in an easing of monetary conditions. Given this, attention will have to be paid to how the Banxico statement talks about Mexico's relative monetary policy stance; and the Fed's statement will also have to be taken into account as an element in making monetary policy decisions. Finally, inflation is expected to begin a downward trend to under 4.0% at the end of July, and core inflation should remain at around 3.0%. This behavior of inflation, combined with a statement with a relaxed bias, and weak domestic activity in an environment of continued liquidity, will leave room for additional easing of the monetary rate in the second half of the year.

- **The markets continue to discount the Fed's exit strategy as imminent, without taking into account that the Fed has indicated that the recovery must be sustainable first**

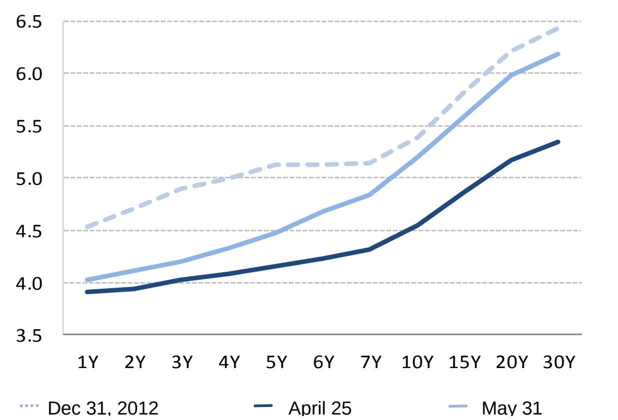
The movement of financial variables in recent weeks is similar to that during an episode of risk aversion, with a significant difference: on this occasion the interest rates on US bonds are rising, not falling. This makes the current episode different and indicates that what is happening in the markets is a revaluation of the risks of financial assets in a global economic context in which the probability of major threats to financial stability (break-up of the euro, fiscal insolvency in the U.S., major slowdown in the Chinese economy) has fallen substantially. What is being discounted is that the Fed will begin to reduce the monetary stimulus. Favorable surprises in the U.S. data (consumer confidence and housing prices) have contributed to this perception, extended the upward movements in interest rates in emerging markets and led to the depreciation of their currencies. Attention will now have to be paid to the Fed statement.

Chart 1
Monetary conditions index
(% change on January 2000)



Source: Banxico, INEGI and BBVA Research

Chart 2
Yield curve at maturity (annual %)



Source: BBVA Research and Bloomberg

Calendar: Indicators

May inflation (June 7)

Forecast: -0.39%	Consensus: -0.40%	Previous: 0.07%

This coming Friday sees the release of the May inflation figures. Headline inflation is expected to show its first annual fall as supply shocks ease. Core inflation is expected to remain anchored at levels of around 3.0%.

May consumer and producer confidence (June 4)

Forecast: Consumer 0.6% (98.3 pts)	Consensus: N/A	Previous: 1.4% (97.7 pts)
Forecast: Producer 0.3% (56.5 pts)	Consensus: N/A	Previous: 1.0% (56.4 pts)

The consumer and producer confidence indicators for May are to be published this week. We consider that consumer confidence will have grown by 0.6% m/m in May, influenced by the good performance of employment in the formal private sector (0.3% m/m in April, 0.2% m/m as an average in the first three months of the year). It will be important to learn the performance of the indicator of willingness to acquire durable goods. So far this has remained stable, thus indicating that private consumption may remain stable in the second quarter of the year.
We consider that producer confidence will reflect the relatively good results of indicators such as automotive production and the IMEF indicator: monthly expected growth is 0.3%. However, it is worth recalling that the confidence indicator is at a lower level than two years ago, in line with the falling trend in the manufacturing sector.

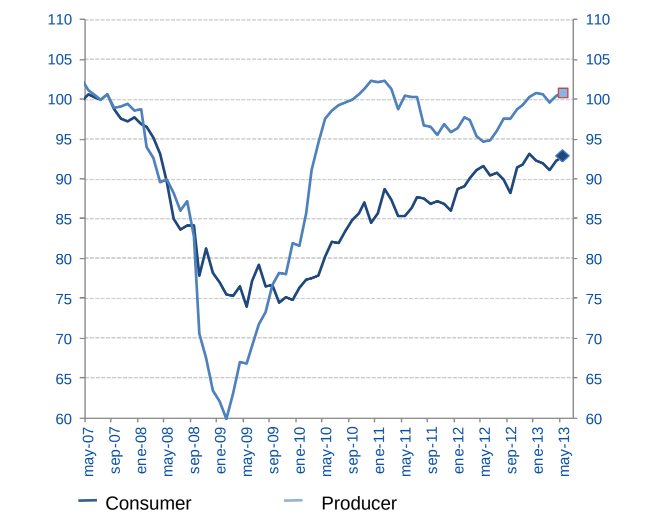
Remittances in April (June 3)

Forecast: USD 1,598m	Consensus: USD 1,868m	Previous: USD 1,784m

In March 2013 remittances fell by 14.7%, and in April we expect a bigger fall, as the exchange rate strengthened by 2.6% on March, and because there would also be a greater comparison effect, as in April 2012 remittances grew by 8%, while in March they did so by 1.7%. We therefore consider that Mexico will have received around USD 1.6 billion dollars in April, a fall of over 20%, one of the highest ever on record.

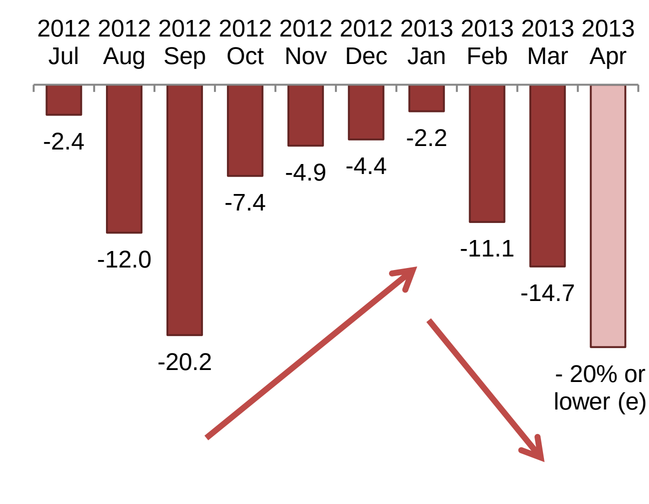
http://www.bbvaresearch.com/KETD/fbin/mult/130531_FlashMigracionMexico_32_eng_tcm348-390394.pdf

Chart 3
Confidence: Consumer and Producer (July 07 = 100)



Source: BBVA Research with INEGI data

Chart 4
Remittances (% annual change in dollars)

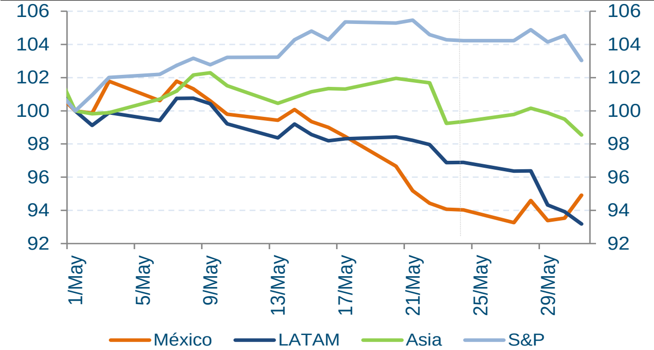


Source: BBVA Research with Banxico figures; e: estimate by BBVA Research

Markets, activity and inflation

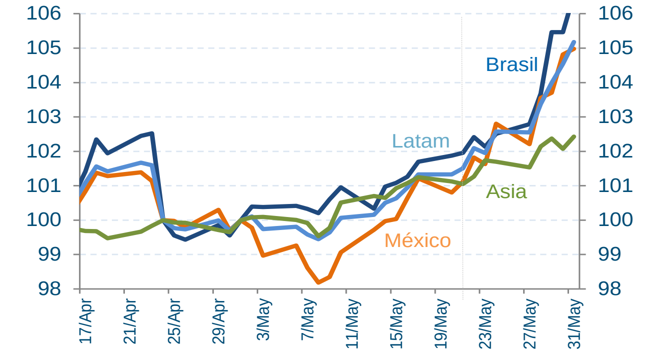
- **Consumer confidence and housing price figures above expectations in the U.S. have increased speculations regarding a possible reduction in the pace of the Fed's asset purchases, which in turn impacts currency depreciation and a rise in interest rates.**

Chart 7
Stock markets: MSCI indices
(April 30, 2013 = 100)



Source: BBVA Research with data from Bloomberg

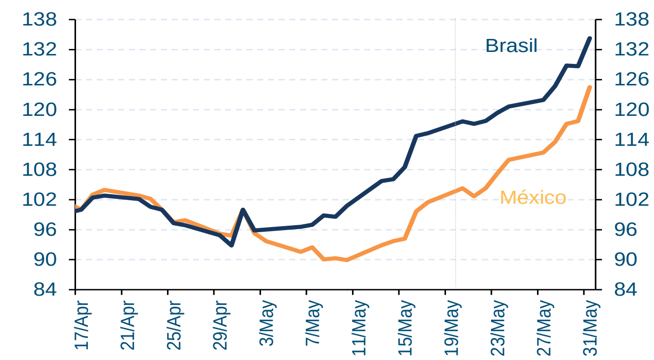
Chart 8
Foreign exchange: dollar exchange rates
(April 30, 2013 = 100)



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.

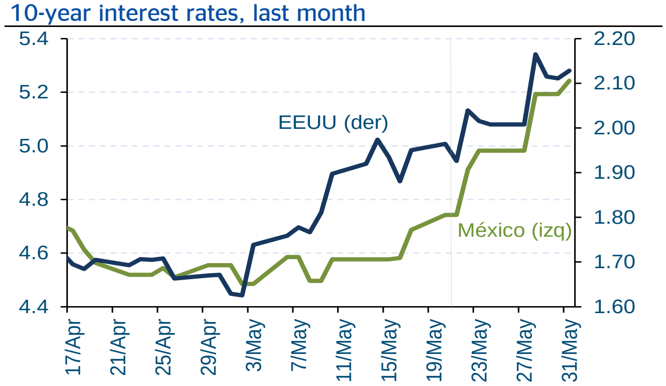
- **Rise in interest rates in the U.S. to their highest levels since April 2012, with a combination of favorable economic data and the possible reduction in demand for bonds by the Fed. Rates in Mexico are still strongly correlated to US T-Bills.**

Chart 9
Risk: 5-year CDS (April 30, 2013 = 100)



Source: BBVA Research with data from Bloomberg

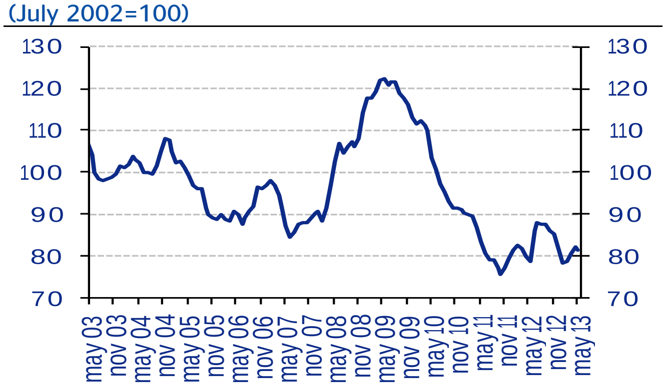
Chart 10
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

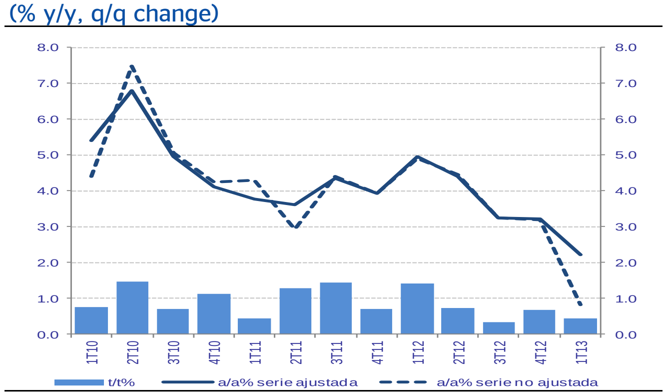
- **Inflation will begin to fall in June and we expect a rebound in activity in the coming quarters following the rapid decline seen in 1Q13.**

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



Source: Bloomberg and BBVA Research
*This measures the deviations in inflation in comparison to market-forecast figures, adjusted 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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