Mexico Weekly Flash

Next week…

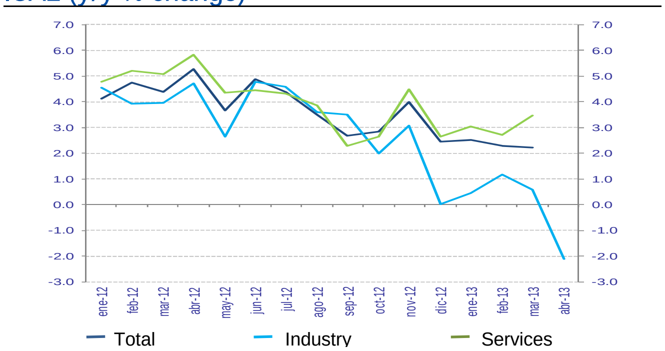
- **The minutes of the monetary policy meeting will help gauge the extent of the more relaxed tone**

Next Friday, Banxico will release the minutes of the monetary policy meeting held on June 7. One of the most important aspects is the opinions of the different members of the Board about the outlook for a deterioration in domestic and U.S. economic activity, above all given that the statement had a relaxed tone in this respect. Another aspect to monitor will be the members' views on Mexico's relative monetary stance. This argument lost weight in the last statement compared with concerns about the economy after the exchange rate lost 6.0%, despite the additional easing by central banks around the world. Finally, we will have to keep an eye on mentions of monetary policy in the U.S. in a context of uncertainty regarding a possible reduction in the Fed's assets purchases. In fact, the Fed will make its monetary policy decision and economic forecasts known on Wednesday June 19.

- **The Fed's tone will determine whether recent market movements will continue or reverse, at least partially.**

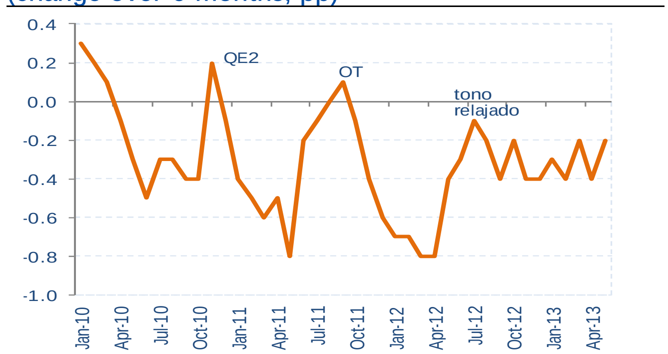
This week the financial markets continued to adjust to the prospects of a possible normalization of monetary policy in the U.S. Volatility remained high in expectation of clearer signals from the Fed. Next week, all attention will focus on the statement following the FOMC meeting and the subsequent press conference. Although we do not expect any change in the rate of asset purchases at present, the tone of the statement will be the key to market reaction. Although we do not expect Bernanke to reverse the signal that if cyclical conditions continue to improve quantitative easing will eventually be reduced, we expect the Fed's tone to be balanced between improvements in the labor market and the mixed nature of the most recent indicators, together with the fall in inflation and reduction in inflation expectations. More clarity on the normalization of monetary policy is needed in the statement to reduce market volatility. A relaxed tone that manages to break the links between movements in the rate of asset purchases with the start of an upward cycle the monetary policy rate would reduce market volatility and could partially reverse recent losses in the most risky assets. In contrast, a restrictive tone in which the Fed does not give the same relative weight to low inflation, falling expectations and downward risks in growth could even heighten current market perceptions that any decision referring to unconventional monetary policies has implications for conventional monetary policy, and as a result the markets are at the brink of an important change in which global liquidity will tend to reduce, which could generate more volatility.

Chart 1
IGAE (y/y % change)



Source: INEGI, Banxico, BBVA Research

Chart 2
Unemployment rate in the U.S.
(change over 6 months, pp)



Source: BBVA Research and Bloomberg. QE2: Second extraordinary monetary easing program. OT=Operation Twist, which extended debt maturities.

Supply and demand of goods and services, 1Q13 (June 19)

Forecast: AD 3.7% y/y	Consensus: N/A	Previous: 5.0% y/y

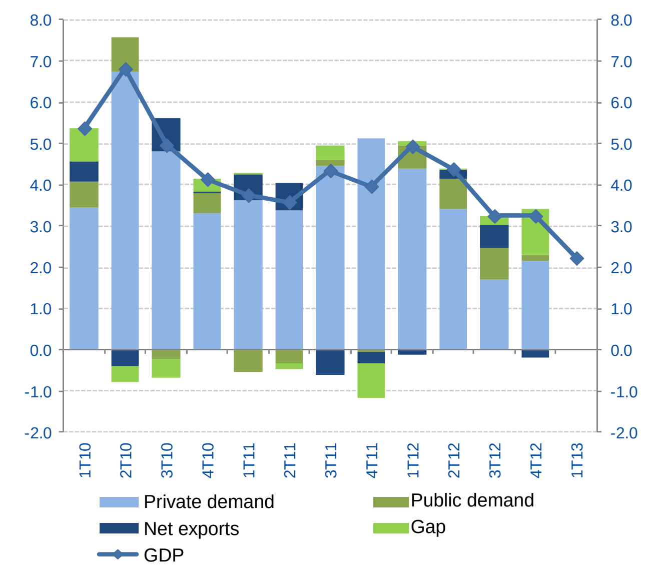
The GDP details on the side of demand components will be relevant for knowing the level of moderation in the components of domestic demand. It should be recalled that in recent months private consumption has performed notably well, influenced by the steady increase in jobs and the maintenance of real wages. At the same time, investment will have continued to perform slightly better than in the last quarter of the year (-0.5% q/q), supported mainly by the growth in the private component of investment, while we believe that the public component would have had a relatively flat growth or even contracted. It is worth mentioning in this respect that capital expenditure in the public sector in real terms over the first three months of the year contracted in the order of -7.5% (-9.4% in the last quarter of 2012). In addition, based on the indicators in the trade balance we know that foreign trade in goods has moderated in manufactures and oil exports. The rate of growth of foreign demand will have moderated even more and we do not rule out that the contribution of net trade has been negative, due to the lower contribution of exports, while imports of goods and capital will have grown more.

Retail stores in April(June 20)

Forecast: -0.1% y/y	Consensus: N/A	Previous: 1.4% y/y

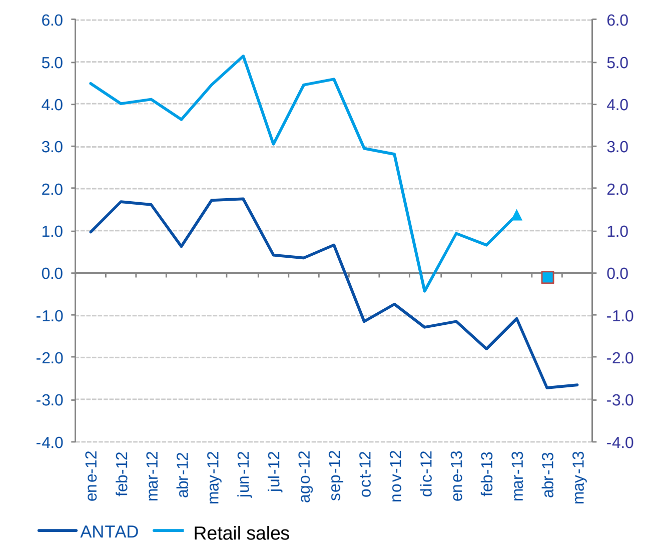
Retail sales will have posted zero or even slightly negative growth in April. It should be recalled that the ANTAD sales indicator contracted as an average in the period April-May by 2.7% on the same period the previous year (based on ANTAD indicators with our own adjustments), so the sales indicator could reflect this significant moderation. Also, employment in the formal private sector has grown in the order of 4%, while wages have risen in real terms by around 0.1%.

Chart 3
Supply and demand of goods and services (y/y % change)



Source: BBVA Research with INEGI data

Chart 4
Retail sales and ANTAD (y/y % change)



Source: BBVA Research with ANTAD INEGI figures

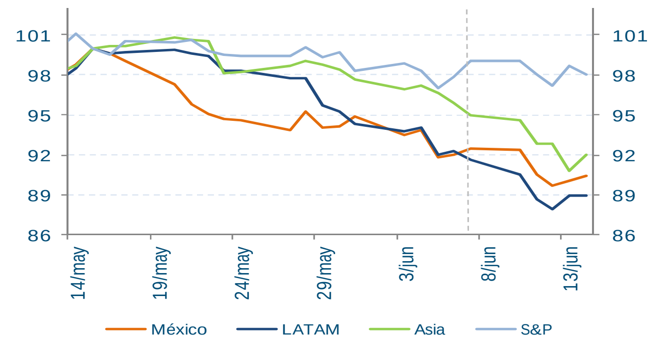
Markets

Last week the MXN was within an operational range of 12.60-13.10, while 10-year M-bonds fluctuated within a range of around 60 bps. This high volatility was again the result of uncertainty regarding the Fed's next monetary policy move and exacerbated by the lack of new statements by its members in this respect. However, the trend showed favorable signs, as toward the close of the week assets recovered and reflected that markets are becoming aware of what the financial and economic implications would be of the Fed really reducing the quantitative stimulus. This would have to be clarified at least partially this week, as we expect the board to continue with a strategy of transparent and convincing communication. In this case, both the MXN and the M-bond curve would have room for greater appreciation, based not only continued lax global policies, but also on local factors (monetary policy expectations, structural reforms). However, the context should be considered to be determined more by cyclical factors, where there is still some uncertainty. This week, on the external front the agenda of economic data will be full, as will the institutional. Meanwhile, in Mexico the market will be awaiting the minutes of the latest monetary policy meeting. All this justifies continuing broad ranges, at least in the short term.

Markets, activity and inflation

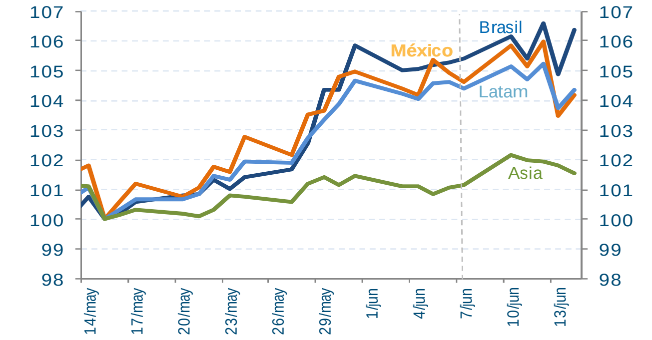
- **Appreciation of the LATAM currencies and rise in stock markets at the end of the week following a fall in asset sales in the face of expectations in the markets that the FED would not reduce monetary easing in the short term. This is on the back of industrial output and consumer confidence figures in the U.S. being below expectations.**

Chart 7
Stock markets: MSCI indices
(May 14, 2013 = 100)



Source: BBVA Research with data from Bloomberg

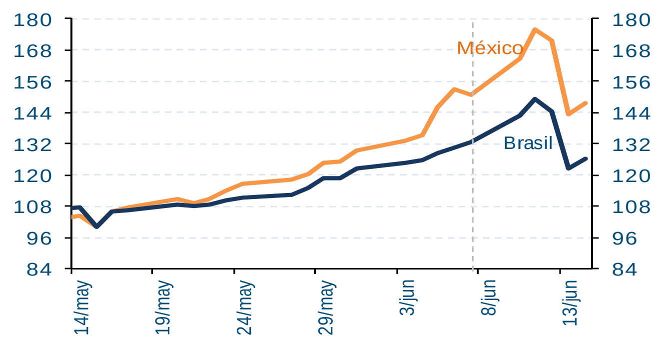
Chart 8
Foreign exchange: dollar exchange rates
(May 14, 2013 = 100)



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.

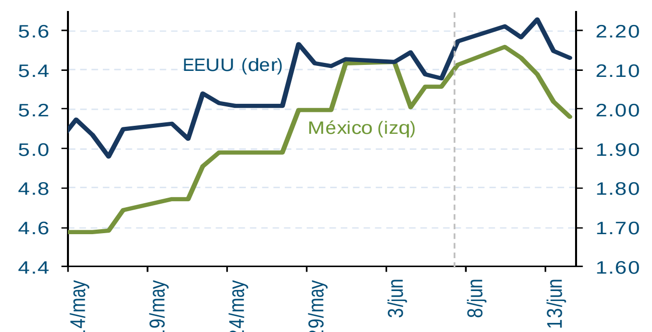
- **Fall in US interest rates at the end of the week on expectations that at its meeting next week the Fed will signal that it will maintain the stimuli. Rates in Mexico in a downward trend as a result of their positive correlation with US T-Bills. Risk aversion eases over the week.**

Chart 9
Risk: 5 year CDS (May 14, 2013 =100)



Source: BBVA Research with data from Bloomberg

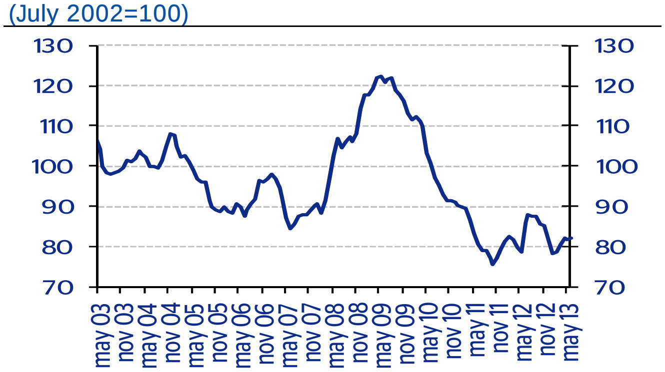
Chart 10
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

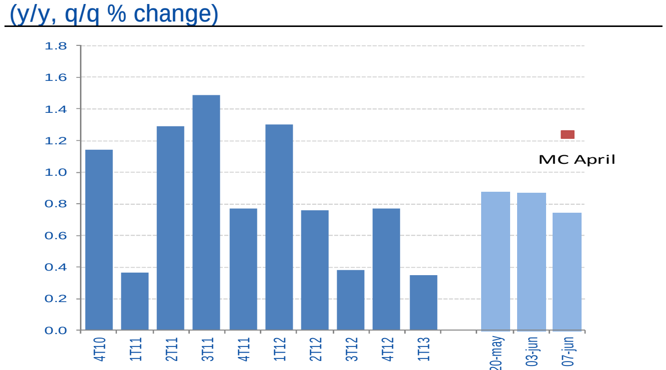
- **Inflation will begin to fall in June and we expect a rebound in activity in the coming quarters following the rapid decline in 1Q13.**

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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