Mexico Weekly Flash

Next week…

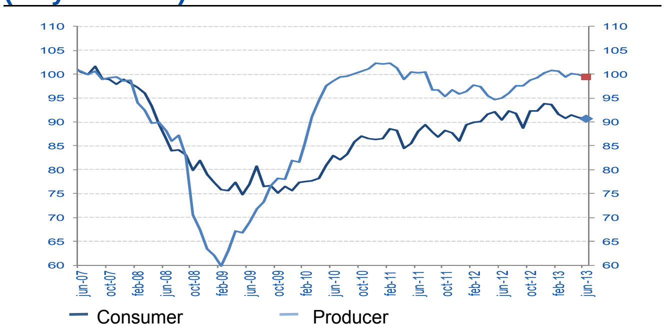
- **Confidence indicators for June will be one of the signals of the level of moderation in economic activity**

Producer and consumer confidence indicators to be released this week will be important due to their timeliness (June) and help indicate the level of deterioration in economic activity in the second quarter. The IGAE registered a significant drop in May, with a monthly fall of 0.8%, equivalent to an annual rise of 0.5%, the lowest rise since November 2009. This deterioration was mainly due to contraction in the industrial sector (down 1.7%), linked largely to slowing foreign demand affecting mainly manufacturing; it was also hit by limited progress in key industries such as construction. We expect producer confidence to reflect this loss in strength with a deterioration in expectations (down a monthly 0.5%). On the consumption side, stability in job creation (0.3% m/m in May), with minimum progress in real wages will lead to a deterioration in confidence equivalent to -0.2% m/m for June, which in turn will be reflected in lower rates of growth for private consumption for the second quarter.

- **There will be some stabilization in financial variables this week, which could continue over the coming weeks, but the transition period to a revaluation of risk is here to stay**

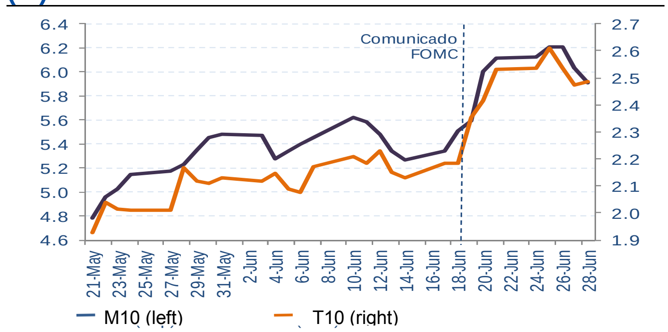
There were calming statements by some members of the Fed this week (e.g. Dudley repeated the Fed's actions will depend on the data and that the withdrawal of quantitative easing will be a flexible process). However, the change in the Fed's tone and its continued intention to withdraw QE earlier than expected (Bernanke said that an unemployment rate of 7.0% would be consistent with the end of QE, and that the 6.5% threshold continues to be a condition for the Fed to begin to raise the Fed fund rate) implies that the transition period toward a new normality, with lower liquidity and possibly higher interest rates and thus a revaluation of risk, is here to stay. One sign of this is that despite the stabilization of the financial variables this week, with the 10-year T-bond rate falling 12 bps from its high, leading to gains in risky assets, the statements by some members of the Fed have had a small effect on market expectations with respect to the first rise in Fed rates, which continues to be discounted for 1Q15; in fact, a positive probability of it occurring in 4Q14 has already been assigned. Given that the Fed's attention is focused on the unemployment rate, the publication of the June data next Friday will be key to the movement of the financial variables in the near future.

Chart 1
Confidence: Consumer and Producer (July 07 = 100)



Source: INEGI, Banxico, BBVA Research

Chart 2
10-year interest rates since Bernanke's statement (%)



Source: BBVA Research and Bloomberg

Calendar: Indicators

Family remittances (July 1)

Forecast: USD 2,091m	Consensus: USD 2,248m	Previous: USD 1,902m

On Monday, July 1, Banxico will present the figures for remittances in May 2013. There were factors in the month that could favor the inflow of remittances, such as Mother's Day in Mexico, a weaker peso against the dollar in the second half of May, and more jobs for Mexican migrants in the United States. In annual terms, we estimate a fall of around 10.7%, making 11 consecutive months of falls in the annual rate in dollars. The year-on-year fall for the month can mainly be explained by the comparison base, given that May 2012 was the month last year with most remittances (USD 2,342.5 million), and one of the highest ever monthly figures. Thus in the first five months of the year remittances could post a cumulative fall in annual terms of over 10%. In the following months lower falls and perhaps even rises will probably be seen, due to the exchange rate and some job gains for Mexican migrants.

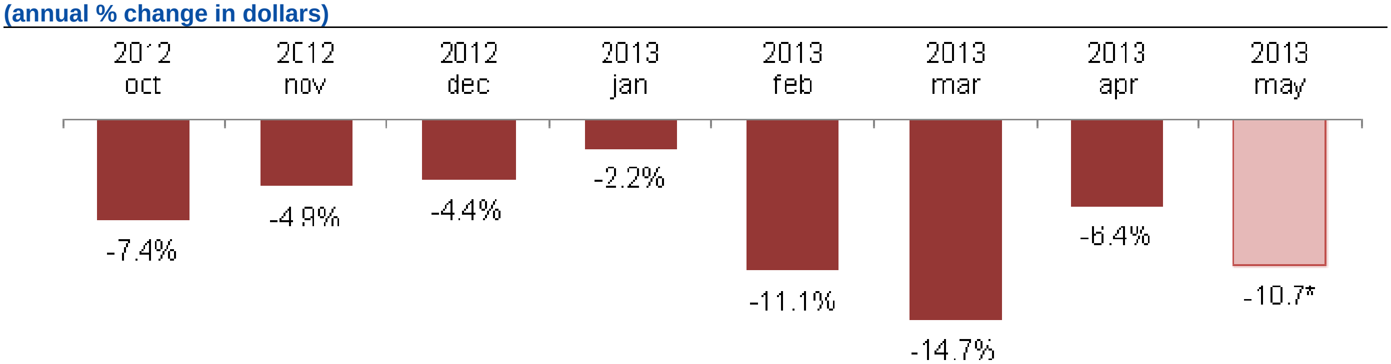
Consumer confidence for June (July 3)

Forecast: -0.2% m/m, 95.4 pts	Consensus: N/A	Previous: -0.5% m/m, 95.5 pts

Producer confidence for June (July 3)

Forecast: -0.5% m/m, 55.7 pts	Consensus: N/A	Previous: -0.2% m/m, 56.0 pts

Chart 3
Family remittances to Mexico, July 2012-February 2013 (annual % change in dollars)



Source: BBVA Research with Banxico data

Markets

The positive close of the exchange rate last week did not follow the general trend for depreciation in emerging currencies. In fact, it gained by around 0.2% at the close. Despite losing ground for most of the day, the currency could break through the 13.0 barrier and thus show a possible favorable trend, from a technical point of view in the next few days. This improvement was a reaction to the opinion on the cycle and liquidity expressed by some members of the Federal Reserve, although the MXN was also benefited by the announcement that Mexico would have a greater weight in the EMBIG due to its fundamentals. This week will be important in terms of the flow of economic news. In Mexico the IMEF manufacturing indicator will be released, and will probably continue to point to a greater weakness in economic activity. At the same time, the series of indicators to be published in the U.S., above all those relating to manufacturing and jobs, will have a major effect on the MXN. The currency gains of last week could be maintained if the macroeconomic figures suggest the economy is recovering. However, we will have to keep an eye on fluctuations in the fixed-income market, given that any loss in USTs could trigger a reduction in financial flows. However, as of last Thursday, the balance continued to be positive. In general, we expect the MXN to continue within a broad range over the next few days.

We estimate that the volatility of the flows will reduce gradually, but that the flows will still be positioned on the Mexican curve. This movement in the flows was reflected in the rally in local rates, above all at week-end. In our opinion, we expect a pause next week, given the very full economic agenda, but the curves will continue to flatten, though not to the extent recorded in April.

Chart 4

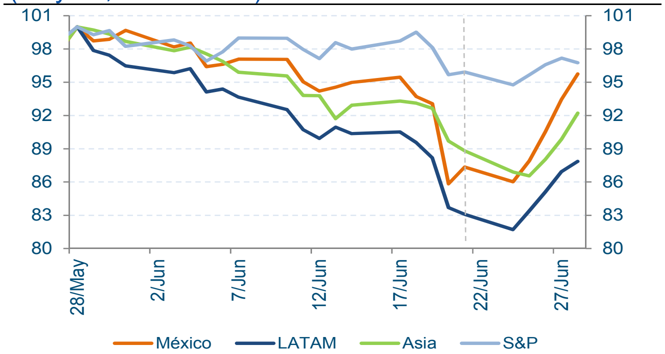
10-year M-bond and USD/MXN
(% and peso/dollar)

Source: BBVA Research with Banxico data

Markets, activity and inflation

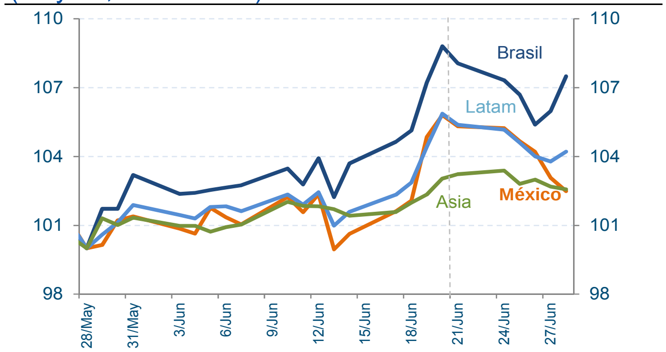
- The downward revision of GDP growth in the U.S. in the first quarter and the comments of a number of the members of the Federal Reserve system with respect to monetary policy remaining relaxed for a considerable time influenced weekly gains in stock markets and the appreciation of LATAM currencies.

Chart 5
Stock markets: MSCI indices
(May 28, 2013 = 100)



Source: BBVA Research with data from Bloomberg

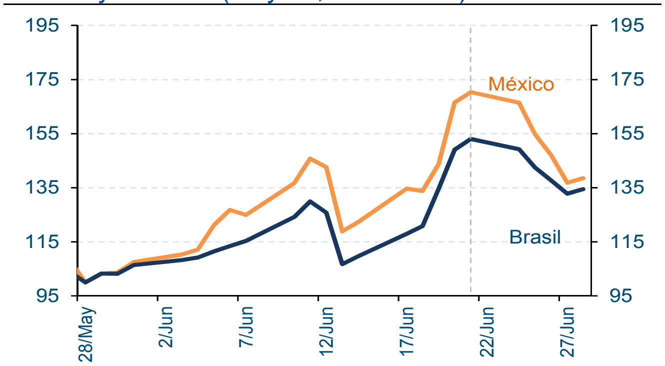
Chart 6
Foreign exchange: dollar exchange rates
(May 28, 2013 = 100)



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.

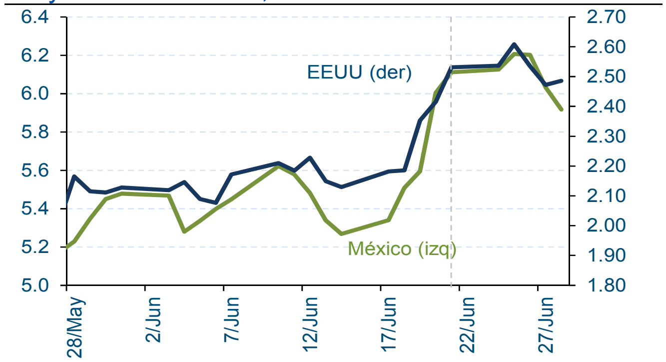
- Fall in interest rates in Mexico and the U.S. over the week influenced by expectations that the monetary stimulus will be maintained for longer. Risk aversion has therefore been reduced.

Chart 7
Risk: 5 year CDS (May 28, 2013 =100)



Source: BBVA Research with data from Bloomberg

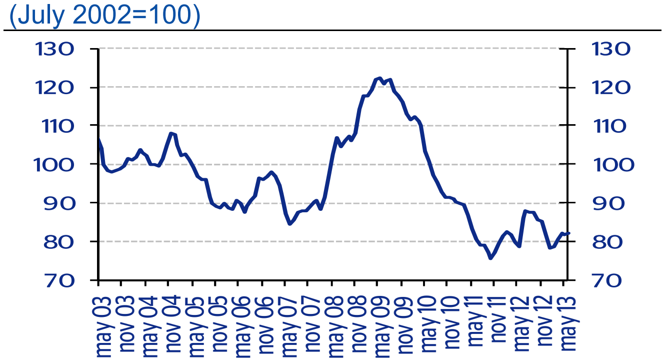
Chart 8
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

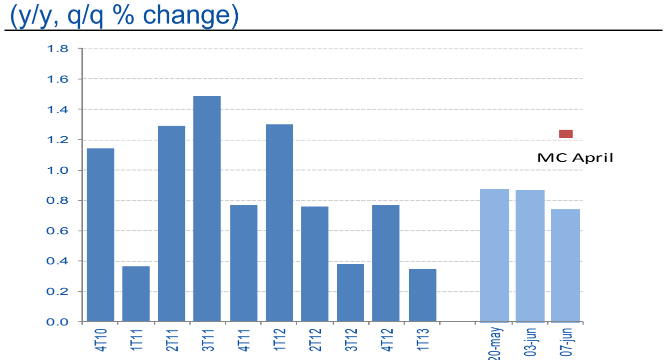
- Inflation will begin to fall in June and we expect a rebound in activity in the coming quarters following the rapid decline in 1Q13.

Chart 9
*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 10
Observed GDP
(y/y, q/q % change)



Source: BBVA Research

Arnoldo López Marmolejo
arnoldo.lopez@bbva.com

Javier Amador Díaz
javier.amadord@bbva.com

Iván Martínez
ivan.martinez.2@bbva.com

Pedro Uriz Borrás
pedro.uriz2@bbva.com

Cecilia Posadas
c.posadas@bbva.com

Claudia Ceja
claudia.ceja@bbva.com

Ociel Hernández
ociel.hernandez@bbva.com

Juan Luis Ordaz Díaz
juan.ordaz@bbva.com

Juan José Li Ng
juan.li@bbva.com

BBVA | RESEARCH | Av. Universidad 1200, Col. Xoco, Mexico 03339 D.F. | researchmexico@bbva.bancomer.com | www.bbvaresearch.com

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