Mexico Weekly Flash

Next week…

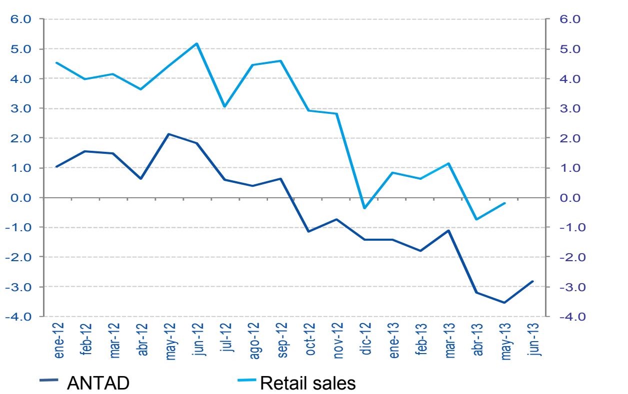
- **Minutes from the Banxico decision meeting will be released showing the level board members assigned to downward risks for output. This could be important for a future assessment of a possible rate cut**

Minutes from the board meeting on the monetary policy decision taken on July 12 will be released this coming Friday, July 26. The tone of the decision statement expresses greater concern over output, highlighting the "rapid and deep" slowdown that has furthered downward risks, in addition to an improvement in the balance of inflationary risks. With this, we could intuit some possible additional loosening. Nonetheless, the final paragraph on monetary policy shows no signs suggesting an imminent cut in the near future as we saw in the January statement. In this sense, the performance in output over the coming months seems crucial for a possible rate cute meaning the minutes may offer further information on this outlook among board members or the necessary elements for a possible cut. In turn, they allow the relative weight assigned to monetary conditions in this volatile financial and economic slowdown scenario to be assessed. Further, next week will also offer data on inflation and output that will contribute to assessing this situation (see next page).

- **The reduction in expectations of an imminent change to non-conventional monetary policy at the Fed after Bernanke's statement drives market sentiment**

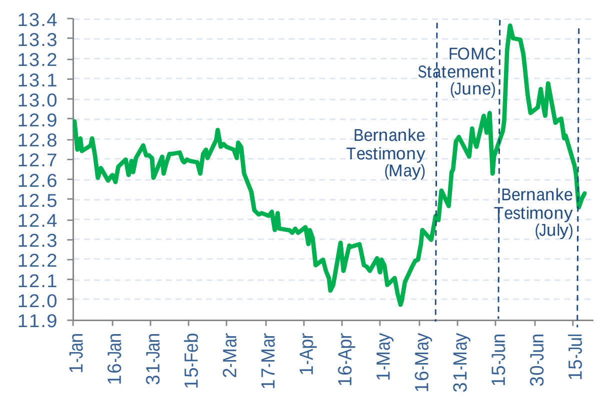
The perception of Bernanke's tone being more relaxed in comparison to the press conference in June boosted risk assets. The key points were: a) the emphasis he gave to normalizing monetary policy not being a "pre-established path" and continuing to depend on data; b) the greater emphasis on inflation; and c) with regard to whether a substantial part of the reductions in measured unemployment were judged to reflect declines in labor force participation rather than gains in employment, it "would be unlikely" that unemployment at 6.5% would be "a sufficient reason" to raise the federal funds rate. The adjustments in the statement seek to maintain flexibility. The 10-year Treasury bill rate fell 10bp after Bernanke's statement and remained at 2.48 until the weekly close (-10bp). The M10 interest rate dropped on the day Bernanke spoke but increased at the end of the week, falling back only 1bp in comparison to last Friday (-1bp). In turn, the peso strengthened significantly (2.2%) returning to the 12.5ppd level.

Chart 1
Retail sales and ANTAD (% y/y)



Source: INEGI, IMEF and BBVA Research

Chart 2
Exchange rate in 2013, peso/dollar



Source: BBVA Research and Bloomberg

Inflation (July 24)

Forecast: 0.23% bi-weekly; 3.76% y/y	Consensus: N/A	Previous: -0.06% m/m; 4.1% y/y

Next Wednesday sees the release of inflation figures for the first half of July. We expect to see a 0.23% bi-weekly rise translated into an annual rate of 3.76%. This comes in below the 4.0% level for the first time since the first two weeks of March. This slowdown in inflation is due to a sharp drop in non-core inflation kept in check thanks to lower fruit and vegetable and egg prices. It is highly likely that in addition to the above-mentioned factors, poultry prices in the first two weeks of July made a negative contribution to inflation after being one of the main causes for higher levels in previous months. We expect core inflation to rise by 0.16% bi-weekly thanks to seasonal increases in prices for tourist services which will be more than off-set by the low prices for goods in general. Despite all this, core inflation continues to fall back at an annual rate and we estimate it coming in at 2.7%. As we have been saying, inflation will likely see a major drop in coming months thanks to supply shocks dissipating and historically low core inflation. We therefore believe it will end the year around 3.6% with a downward bias if output weakens.

Trade balance (July 26)

Forecast: 7272 md	Consensus: N/A	Previous: -470 md

IGAE in May (July 25)

Forecast: 0.6% m/m 1.5% y/y	Consensus: N/A	Previous: -0.8% m/m; 0.5% y/y

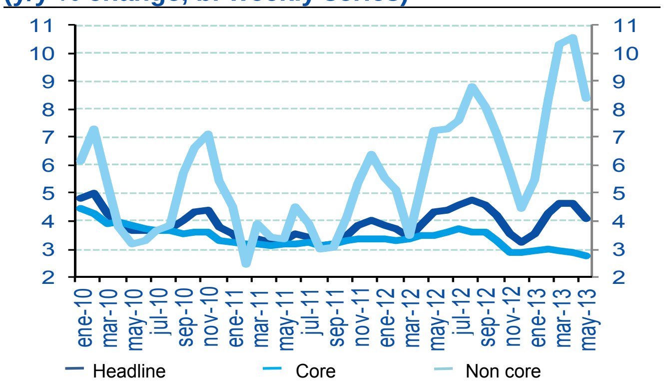
Retail Sales in May (July 22)

Forecast: 0.4% m/m -0.2% y/y	Consensus: N/A	Previous: -0.8% m/m -0.7% y/y

The IGAE for May set for release this week will replicate the upturn in industrial output after the weak figures for April. It should be stated that in the fourth month of the year, the IGAE saw one of the sharpest declines in recent months (the second largest since January 2010 in monthly terms). This decline was due to the major contraction in the industrial sector (-1.8% m/m) which is, in turn, linked to the contraction in manufacturing and construction. In turn, services also saw a negative monthly variation although growth was positive in annual terms. Available indicators on employment and real salaries for the month of May point to employment continuing its growth rate (0.3% m/m) while real wages were slightly lower than in the same period for the previous year. Consequently, and taking into account the expansion in industry, we expect domestic demand and, especially, private consumption indicators (such as retail sales set for release on Monday) to show a recovery which should also be seen in the revenue indicator for the services sector. We estimate performance possibly around 0.4% m/m for retail sales taking into account ANTAD sales (around -0.1% m/m CSV).

Chart 3

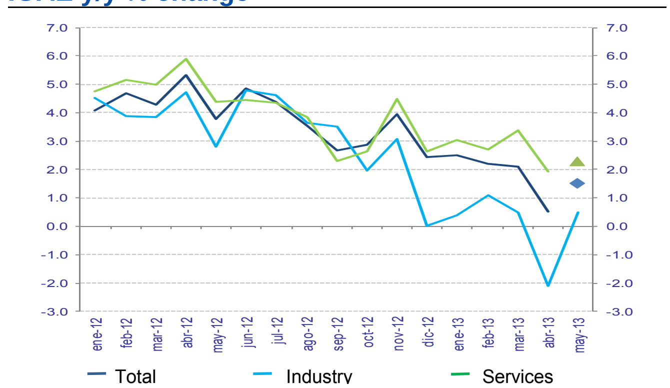
Inflation breakdown (y/y % change, bi-weekly series)



Source: INEGI, Banxico, BBVA Research

Chart 4

IGAE y/y % change

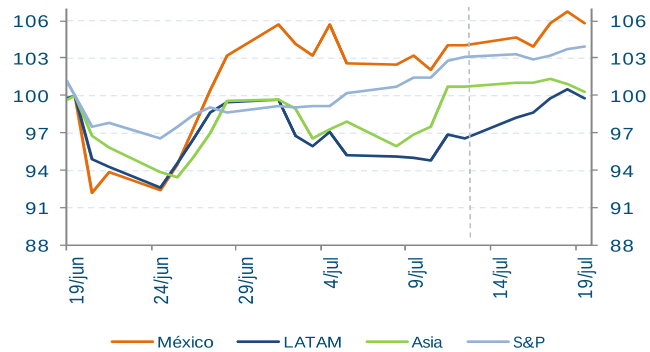


Source: BBVA Research and Bloomberg

Markets, activity and inflation

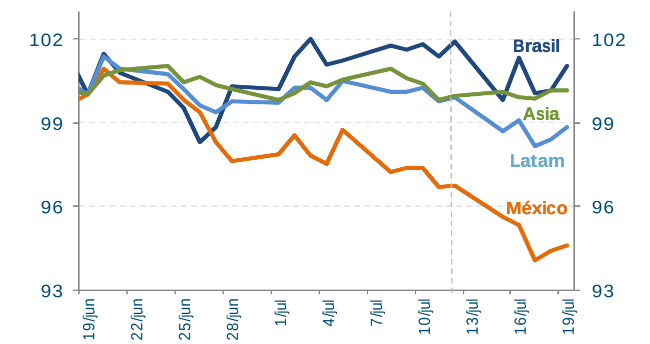
- The Chairman of the Federal Reserve emphasized to the US Congress that the speed of asset purchases by the FED is not predetermined and could increase or reduce depending on economic conditions. The tone of the speech had a decisive impact on stock market gains and stronger LatAm currencies over the week.

Chart 5
Stock markets: MSCI indices
(June 19, 2013 = 100)



Source: BBVA Research with data from Bloomberg

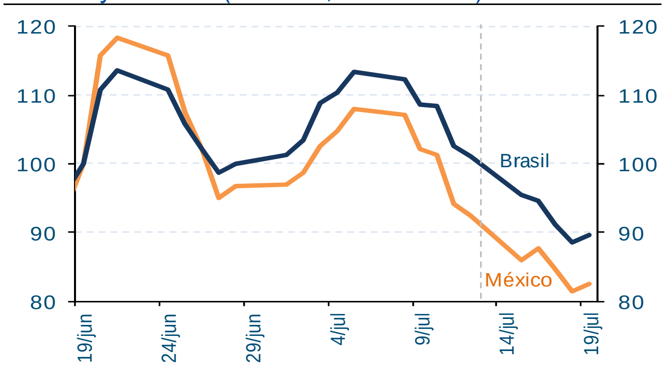
Chart 6
Foreign exchange: dollar exchange rates
(June 19, 2013 = 100)



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.

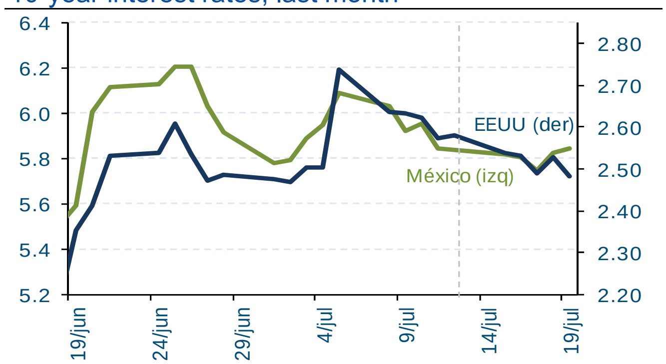
- US rates fell over the week thanks to lower concerns over a decline in the rate of asset purchases happening in the short-term. Rates in Mexico closed with marginal changes over the week, maintaining the high correlation with Treasury bonds, in a setting of lower risk aversion.

Chart 7
Risk: 5-year CDS (June 19, 2013 = 100)



Source: BBVA Research with data from Bloomberg

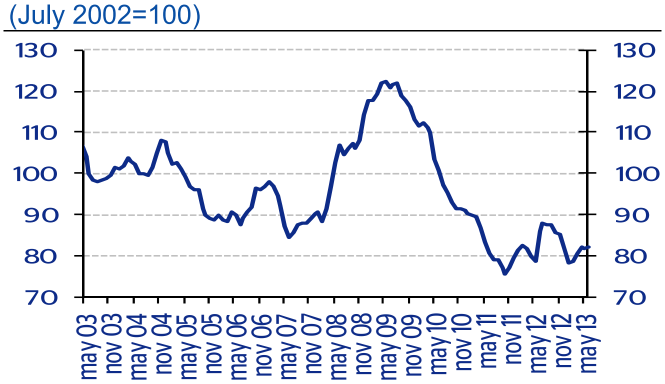
Chart 8
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

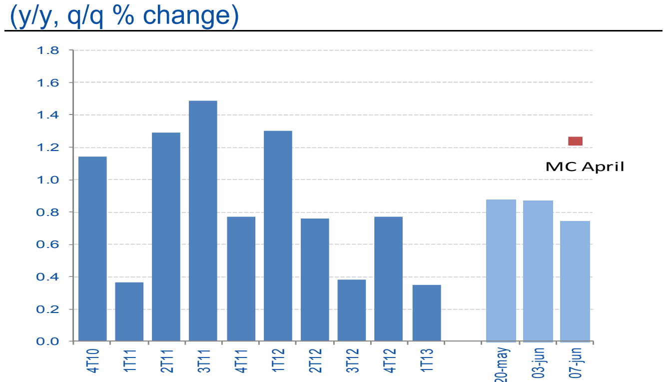
- Inflation will begin to fall in June and we expect a rebound in activity in the coming quarters following the rapid decline in 1Q13.

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

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