Mexico Weekly Flash

Next week…

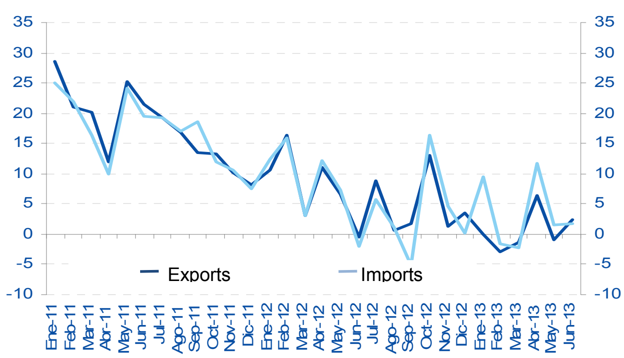
- **Export and public spending figures will be released and help weigh up whether the recovery in the third quarter of the year is underway.**

GDP growth figures released this week showed that the slowdown in the first part of the year was larger than previously thought, bringing GDP growth for the first half the year in at just 1.0%. The factors behind this slowdown include lower domestic demand and the drop in public expenditure. The second half of the year is expected to see growth move up thanks to higher growth in these variables. This is why the export performance and public expenditure figures for July will be important for weighing up whether the third quarter of the year is already experiencing a better performance (see page two for more details on forecasts for these variables). In addition, the VAT collection figures could be an important indicator to assess performance in consumption.

- **The minutes from the FED meeting led to increased volatility on financial markets. Its statements will continue to have major weight looking forward.**

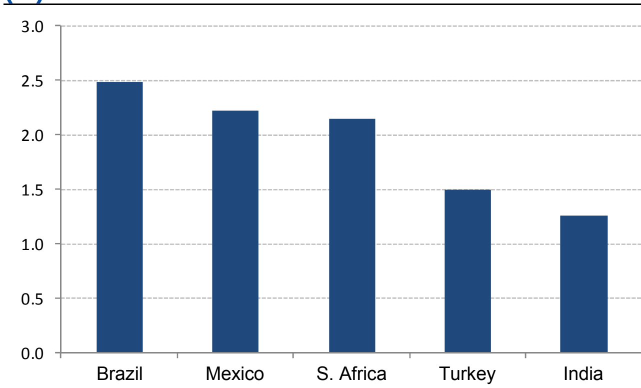
Expectations that September sees the FED start to taper its asset purchase rate increased after the meetings from the last monetary policy meeting showed nearly all Open Market Committee members in favor of tapering asset purchases toward the end of the year if economic improvements are seen. These expectations led to such a sizeable increase in US interest rates that the yield on the 10-year Treasury bill hit its highest level for the last two years, coming in at 2.89% at close of business on Wednesday. This increase was reflected in Mexican government bonds whose 10-year paper hit above 6.3%. On stock markets, the outlook for higher rates linked to reduced forecasts on lower revenue reports from some US corporations led to losses while the minutes increased volatility on the currency market, leading to general losses across emerging market currencies. Specifically, the peso lost over 2.0% at the close on Wednesday, a decline not seen since June 19, taking the dollar to trade at 13.26 pesos per dollar. At the end of the week, lower-than-expected new housing sales in the US and different comments by FED members around the tapering of asset purchases had an impact on the peso strengthening to a level below 13 pesos per dollar.

Chart 1
Mexican exports & imports (% change y/y)



Source: BBVA Research and INEGI

Chart 2
Depreciation of emerging currencies on August 21 (%)



Source: BBVA Research, Bloomberg.

Calendar: Indicators

July Trade Balance (August 26)

Forecast: -517 md	Consensus: -900 md	Previous: 856 md

Next Monday INEGI will release trade balance figures for July. We expect to see slow annual growth in both exports and imports (2.4% and 2.7% respectively) mainly due to the standstill in industrial output in the US (0.0% m/m in July) and weak domestic demand. With regard to the trade balance, we therefore believe it should come in slightly negative in July as imports of intermediate goods in July may point to a slowdown in manufacturing exports.

July Monthly Public Finances Report (August 30)

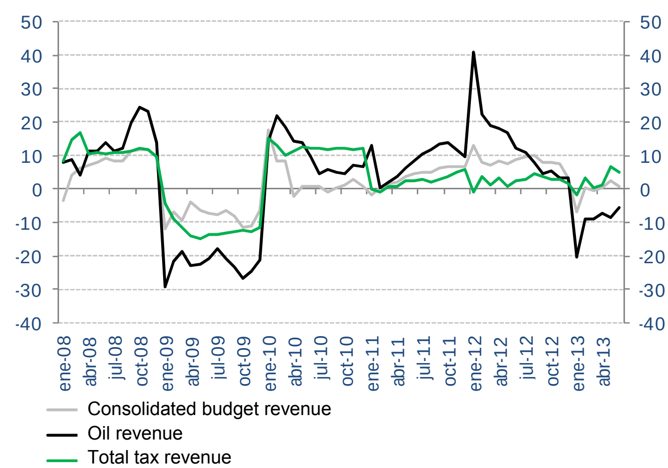
Forecast: n/a	Consensus: n/a	Previous: -75.6204 billion

The public finance report for July will be published next Friday. On the revenue side, figures could provide clues on a possible improvement in economic performance at the start of 1Q13. As the chart shows, after the major decline in both oil and tax revenue at the start of the year, the trend has reversed which, if consolidated, would point to PEMEX output halting its decline and/or the exchange rate increasing with regard to oil revenue, and the economic weakness seen in 1Q13 beginning to dissipate at the start of 3Q13 in terms of tax revenue. Nonetheless, the improvement seen in the latter has been mainly in response to better ISR tax revenue performance (14.6% y/y on average in May-June vs. -0.9% y/y from January to April) which has been offset by lower VAT revenue (-5.6% y/y on average in May-June vs. -2.1% y/y from January to April; -7.0% y/y in June). In this way, the pointers that VAT revenue provides on a possible upturn in economic output at the start of 1Q13 will be especially important. In a similar fashion, public expenditure will be important to watch if the underspend continues to reverse for projected spending (-9.2% y/y on average in 1Q13 vs. -5.7% y/y in 2Q13; -4.5% y/y in June) and if non-project expenditure remains on its upward trend from recent months (-11.4% y/y on average in 1Q13 vs. -1.9% y/y in 2Q13; +3.0% y/y in June). If these two trends are confirmed, this would support our forecast that the contraction in public expenditure will reverse in the second half of the year.

Chart 3
Mexico Imports (% change y/y)

Source: BBVA Research and INEGI

Chart 4
Public Revenue (% change y/y)

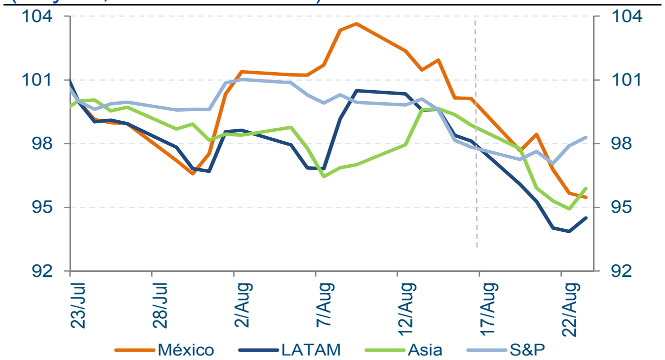


Source: BBVA Research, SHCP

Markets, activity and inflation

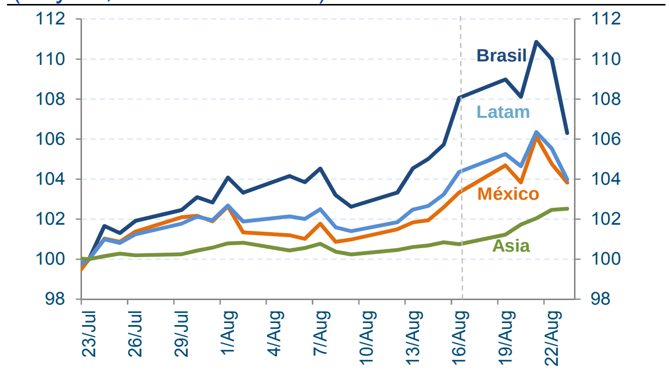
- The minutes from the last FED monetary policy meeting showed that almost all FOMC members agreed on tapering the asset purchase program this year if substantial economic improvements are seen. This led to falls on stock markets and weaker emerging currencies. Lower-than-expected housing sector figures from US toward the end of the week had an impact on weakening emerging currencies and some stock markets.

Chart 5
Stock markets: MSCI indices
(July 23, 2013 index =100)



Source: BBVA Research with data from Bloomberg

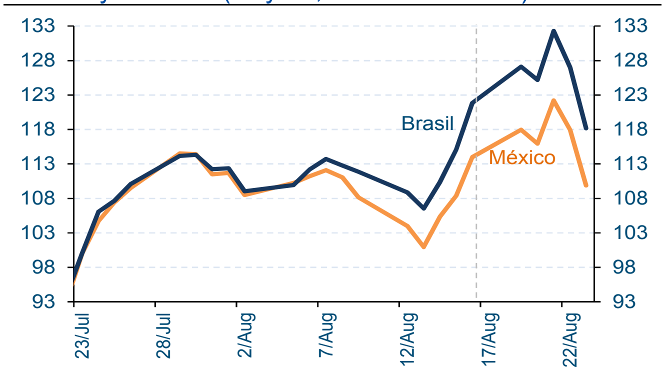
Chart 6
Foreign exchange: dollar exchange rates
(July 23, 2013 index =100)



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.

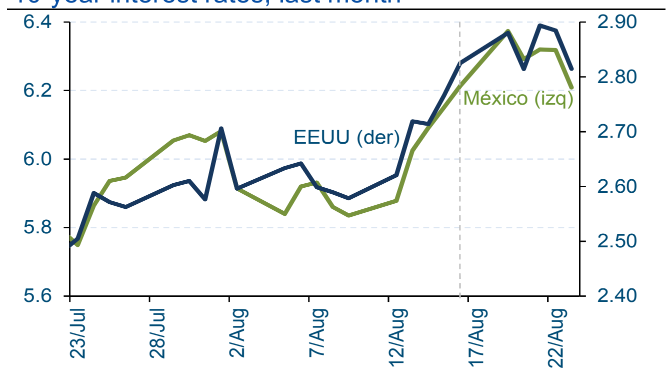
- US rates increased to their highest level for the last two years in response to the FED minutes. Rates in Mexico also moved up in line with US Treasury bonds. Risk aversion saw a marginal increase at the end of the week.

Chart 7
Risk: 5-year CDS (July 23, 2013 index=100)



Source: BBVA Research with data from Bloomberg

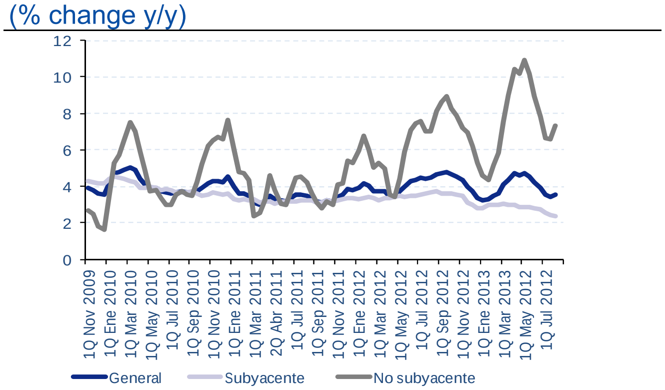
Chart 8
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

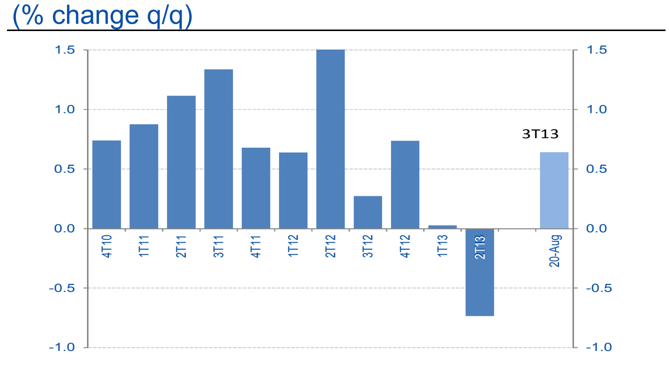
- Inflation remains stable with the core hitting an all-time low below 2.5%. Economic growth is expected to see a bounce this quarter.

Chart 9
Inflation Breakdown
(% change y/y)



Source: INEGI and BBVA Research

Chart 10
Observed and estimated GDP 3Q13
(% change q/q)



Source: BBVA Research.

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