Mexico Weekly Flash

Next week…

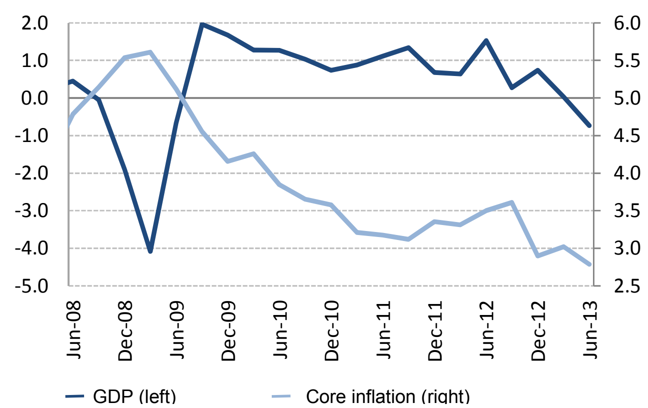
- **Banxico will release its monetary policy decision in a setting of lower growth and high volatility**

This coming Friday sees Banxico release its monetary policy decision. Declining economic output in the second quarter of the year (-0.75% q/q) and the downward revision for the first quarter (0.0% q/q) point to growth this year possibly coming in below the Banxico forecast range of 2-3%. Given the subsequent slack in the economy, no demand pressures are forecast. Annual inflation remains at 3.5% while core inflation has hit an all-time low: 2.38%. These conditions leave the central bank with room for a lending rate cut although the higher volatility on financial markets and the outlook for higher output in the second half of the year could limit a decision along these lines. The possible tapering of asset purchases by the FED and the geopolitical tensions in the Middle East have this month led to a weaker exchange rate by around 4.5%, in addition to a decline in short-term government bond holdings. In short, the outlook for a monetary rate cut at the coming meeting remains based on the major decline in output and the drop in inflation. Nonetheless, uncertainty surrounding the result of the next FED meeting, economic performance in the second half of the year and a possible US intervention in Syria could mean a cut in September is avoided. In a setting of uncertainty, low growth and inflation, the next statement should maintain a relaxed tone.

- **Risk assets continue under pressure now due to geopolitical tensions**

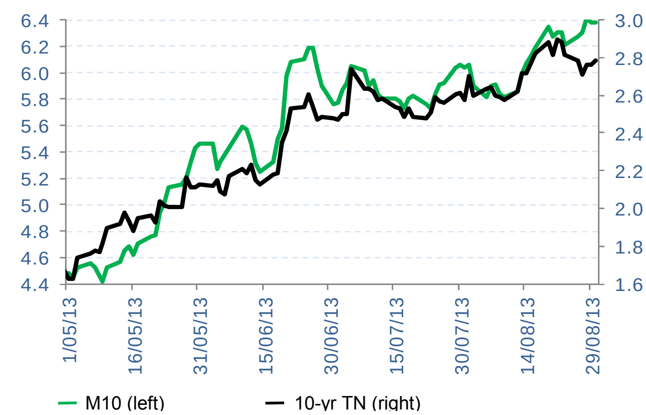
After the major moves in recent weeks, yields on Treasury bonds stabled this week: the 10-year T-bill fluctuated in a narrow range and ended the week 3bp below its level last Friday. In comparison, risk assets continued to see pressure (e.g. the M10 rate rose 10bp over the week and the peso declined 3.3%) due to tensions in the Middle East which have been added to a possible tapering in monetary stimulus at the FED. Nevertheless, after the US and the UK failed to garner sufficient public and political support for a military intervention in Syria, risk assets recovered some of their recent losses. Geopolitical tensions are set to continue in coming weeks and US interest rates could move up again in a favorable economic backdrop meaning risk assets will remain under pressure.

Chart 1
GDP growth and core inflation (%q/q and %y/y respectively)



Source: BBVA Research and INEGI

Chart 2
10-year interest rates (%)



Source: BBVA Research, Bloomberg.

Calendar: Indicators

Consumer and Producer Confidence (September 4)

Forecast:		
Consumer: -2.4% y/y (94.0 pts. CSV)	Consensus: N/A	Previous: 1.0% y/y (95.7 pts.)
Producer: -1.5% y/y (54.0 pts. CSV)	Consensus: N/A	Previous: 2.1% y/y (55.1 pts.)

INEGI will release the producer and consumer confidence indices and the manufacturing orders indicator for August on Wednesday, September 4. Given the decline in retail sales in July and its strong link to consumer confidence, we expect the index to come in slightly worse and hit 94.0 (95.7 pts in July) with figures corrected for seasonal variation (CSV). In turn, due to the slowdown in manufacturing and the economy in general, we expect the producer confidence index to hit 54 points (55.1 pts in July). It is well-known that the "current economic situation for the country and businesses" and "future economic situation for the country and businesses" sub-indices have dropped for three months in a row. In addition, the manufacturing orders sub-index shows caution among manufacturers regarding future economic performance.

IMEF Indicator for July (September 2)

Forecast: 49.9 pts.	Consensus: 50	Previous: 48.5 pts.

The IMEF Indicator is an index that predicts very short-term moves in economic output. It will be released this week and should provide a snapshot of the level of the slowdown in economic output given the recent declines. According to our forecasts, the IMEF will continue to point to a weaker business climate with moderate monthly growth forecast at 2.9% m/m.

Family remittances (September 2)

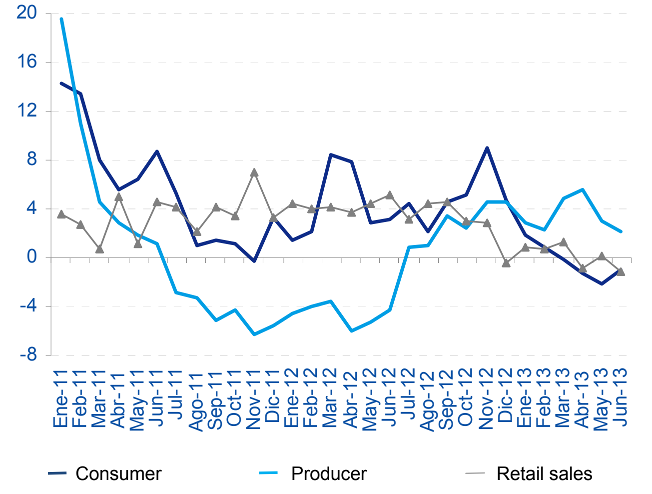
Forecast: 1.797 b.d.	Consensus: 1.810 b.d.	Previous: 1.945 b.d.

On Monday, September 2, Banxico will release figures on remittances received by families in Mexico in July. Job figures in the US, where most Mexican migrants live, point to a slight recovery. The seasonally adjusted unemployment rate in July in the US fell to 7.4%, its lowest level since the end of 2008. This could also favor employment among Mexican migrants and, subsequently, remittances sent to Mexico. In turn, uncertainty surrounding the debate on migration reform in the US House of Representatives, the major migration controls at the border and inside the country, and the higher peso in July are factors that could have had a negative impact on the flow of remittances to Mexico.

In this sense, our forecasts point to July seeing remittances to the country coming in at 1.797 billion dollars, an annual drop of -3.5% and a monthly drop of -7.6% over the previous month (1.945 bd). If this new decline is confirmed, remittances would have seen 13 months of consecutive declines at an annual rate, although given the improvements in US job figures, this run may see a surprise reversal.

Chart 3

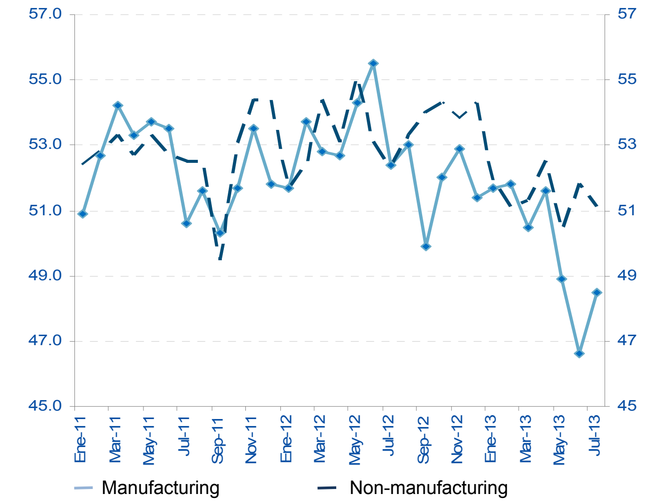
Consumer, producer and retail sales confidence (% y/y CSV)



Source: BBVA Research with INEGI data.

Chart 4

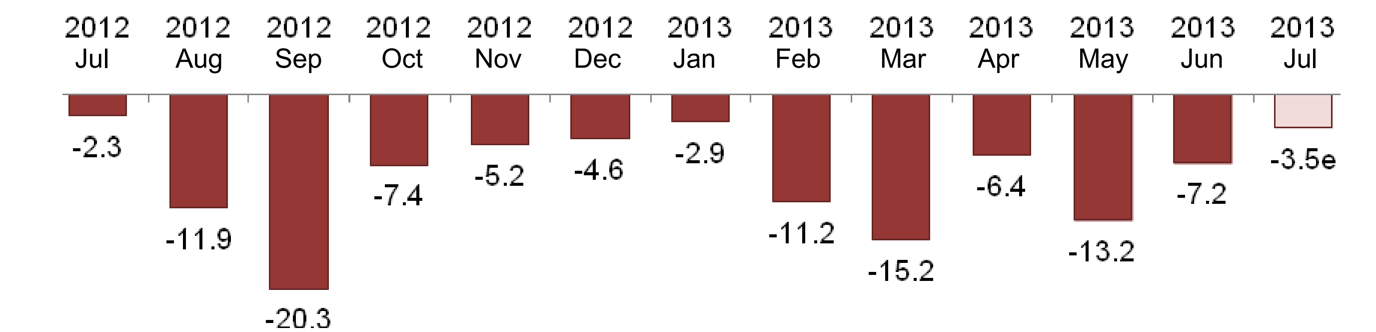
IMEF manufacturing and non-manufacturing indicator (index)



Source: BBVA Research with IMEF data.

Chart 5

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

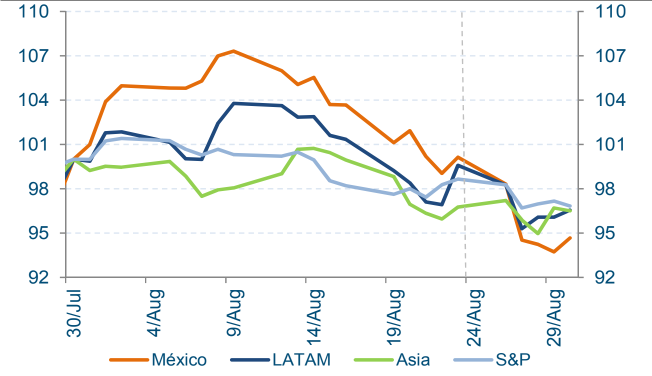


Source: BBVA Research with Banxico data. e: estimate.

Markets, activity and inflation

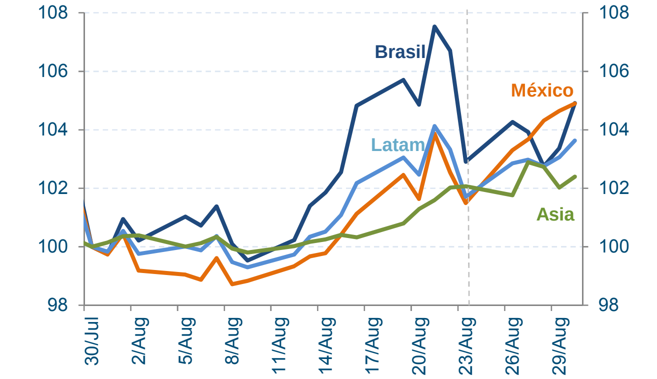
- Possible intervention by the US and other allies in Syria added uncertainty regarding a possible reduction in the FED's monetary stimulus packages, just a few weeks from its monetary policy statement. In this context, risk aversion saw moves in recent days leading to losses on stock markets and depreciations in LatAm currencies. The peso fell 3.3% over the week.

Chart 6
Stock markets: MSCI indices (July 30, 2013 index =100)



Source: BBVA Research with data from Bloomberg

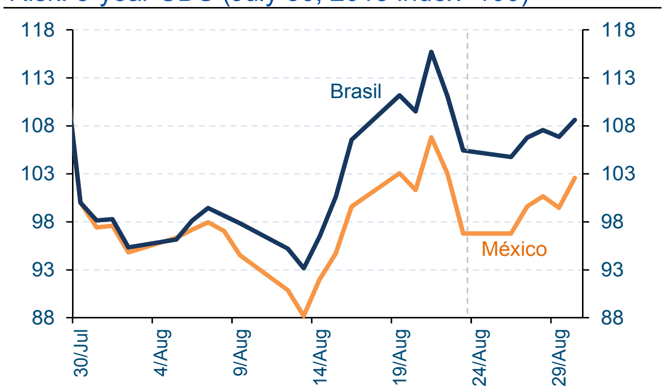
Chart 7
Foreign exchange: dollar exchange rates (July 30, 2013 index =100)



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.

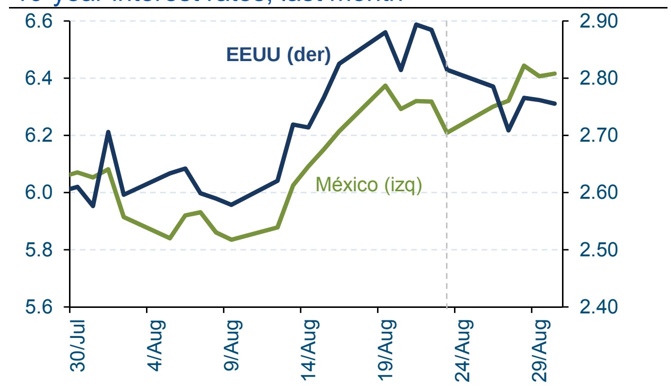
- US interest rates decline while Mexican rates increase due to greater global risk aversion. All eyes on the markets will be on the US non-farm payroll figures next week.

Chart 8
Risk: 5-year CDS (July 30, 2013 index=100)



Source: BBVA Research with data from Bloomberg

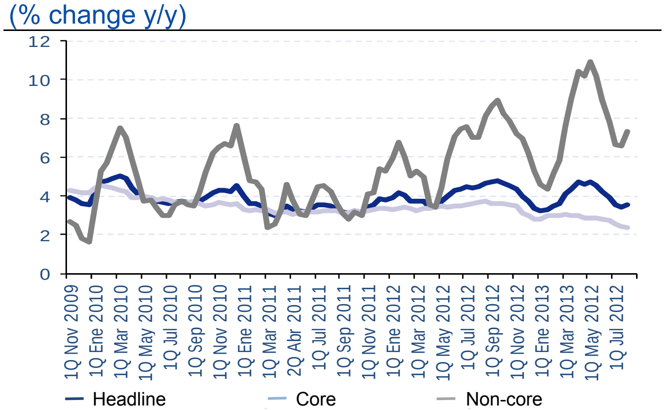
Chart 9
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

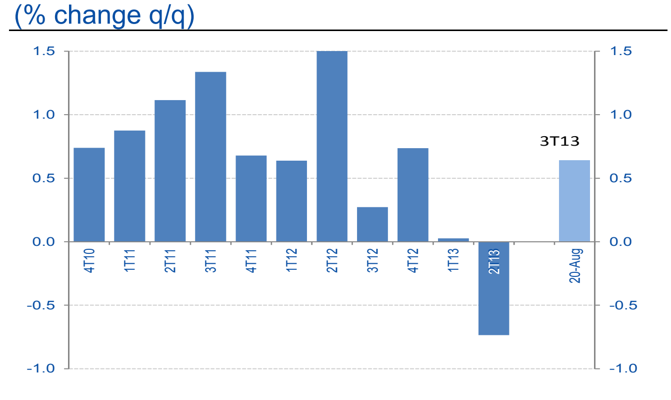
- Inflation remains stable with the core hitting an all-time low below 2.5%. Economic growth is expected to see a bounce this quarter.

Chart 10
Inflation Breakdown (% change y/y)



Source: INEGI and BBVA Research

Chart 11
Observed and estimated GDP 3Q13 (% change q/q)



Source: BBVA Research.

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