Mexico Weekly Flash

Next week…

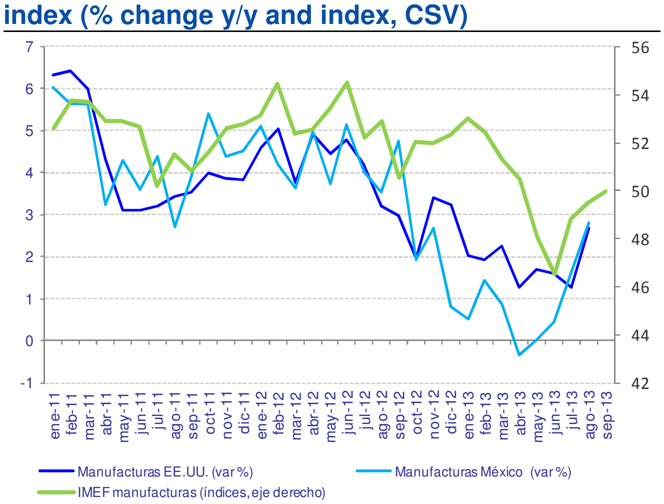
- ### Initial output data for the fourth quarter

This Friday sees the release of the IMEF indicator for October set to provide early signs on output in the third quarter (see page 2). In addition, next week will be full of US economic data that should show how far foreign demand could slow. On the one hand, Monday sees the release of industrial output figures for September with expected 0.4% m/m growth in line with the increase in the ISM manufacturing index. On the other, retail sales figures for September are due out on Tuesday with analysts forecasting a new decline. Furthermore, Wednesday sees the release of the FED's Open Market Committee monetary policy statement. Compared to the previous statement, there is market and analyst agreement on the most recent output and employment figures not pointing to lower asset purchase rates. Moreover, given the recent fiscal agreements moved the debate surrounding the debt ceiling to next February, the idea there will be no change in unconventional monetary policy measures until 2014 has taken on relevance.

- ### The negative surprise in September's job figures in the US boosted higher risk assets this week

After the new debt ceiling was approved in the US last week, weaker-than-expected data this week, specifically job creation in September, gave a new boost to assets perceived as higher risk. The negative surprise in non-farm payroll for September in the US released on Tuesday (+126,000 vs. an expected +180,000) led to a near 9bp drop in the 10-year Treasury note rate - a move accompanied by a 5bp decline in the M10 bond rate (see chart). In turn, and in response to expectations of a start to the tapering of asset purchases by the Federal Reserve in answer to these job figures (most market players now expect this to start in March 2014), the peso strengthened by 1.1%. Looking forward, the slight global recovery seen in recent indicators accompanied by high liquidity for more months than expected just a few weeks ago, could continue to provide some support to high risk assets in the near future. In any event, Mexican financial variables will continue to move in line with market perceptions on future changes to unconventional monetary policy at the Fed.

Chart 1
Manufacturing output and IMEF manufacturing index (% change y/y and index, CSV)



Source: BBVA Research with INEGI, Bloomberg and IMEF data. CSV=Corrected for seasonal variation.

Chart 2
10-year interest rates (%)

Source: BBVA Research and Bloomberg.

Calendar: Indicators

Family remittances in September (November 1)

Forecast: 1,749 md.	Consensus: 1,680 md.	Previous: 1,911 md.

Recent family remittance figures point to a recovery trend in job levels in the US. According to the US Department of Labor, the unemployment rate in the country came in at 7.2% in September, the lowest since the end of 2008, which could have been seen in higher employment among Mexican migrants in the US, where most remittances to Mexico originate. In addition, the lower peso in September in comparison to the previous two months could also lead to positive incentives to send more remittances to Mexico. In this sense, BBVA Research estimates remittances in September could see 5.3% annual growth, equivalent to income of 1.749 billion dollars, which could represent the second positive annual change this year.

September Monthly Public Finances Report (October 30)

Forecast: n/a	Consensus: n/a	Previous: -113,902.0 billion

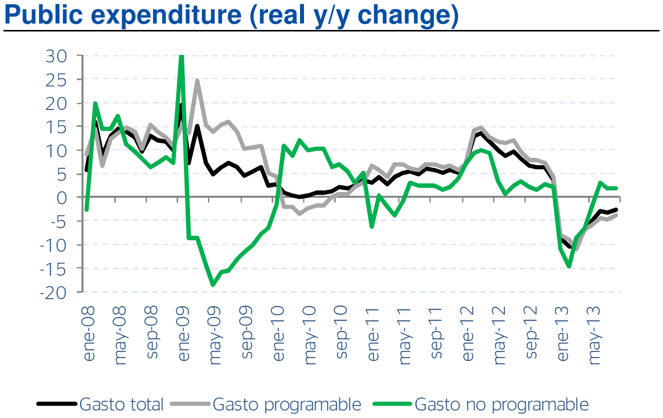
On the revenue front, the public finance report could provide additional pointers that confirm the gradual recovery in the economy at the end of 3Q13. After the major decline in both oil and tax revenue at the start of the year, the trend in recent months has seen a turning point for both oil (-12.6% y/y real in 1Q13, -7.1% in 2Q13, -4.8% in July-August) and tax revenue (0.7% y/y real in 1Q13, 4.4% in 2Q13, 5.4% in July-August). This trend continuing would point to the economic weakness seen in 1Q13 showing an ongoing easing toward the end of the third quarter. With regard to tax revenue, although VAT has continued to show weakness to present (-7.4% y/y on average during July-August vs. -5.9% in 2Q13), the greater strength in the service sector suggested by the IGAE in August points to it possibly seeing an improvement. It will also be interesting to see if the revenue seen again comes in above that budgeted in 3Q13, as was the case in 2Q13. In turn, public expenditure will be important to watch if the underspend seen in 1Q13 continues to reverse. Although projected expenditure has continued to contract in real year-on-year terms, the trend is for recovery (-9.2% y/y real on average in 1Q13, -5.7% in 2Q13, -4.3% in July-August) while non-projected spending has already seen growth in 3Q13 (-11.4% y/y real on average in 1Q13, -1.9% in 2Q13, +1.9% in July-August). If this trend in recent months is confirmed, our forecast that the contraction in public expenditure will reverse in the second half of the year, particularly in 4Q13, would be supported.

IMEF manufacturing indicator for October (November 1)

Forecast: 50.3 pts, 0.7% m/m, CSV	Consensus: N/A	Previous: 49.9pts., 0.8% m/m, CSV

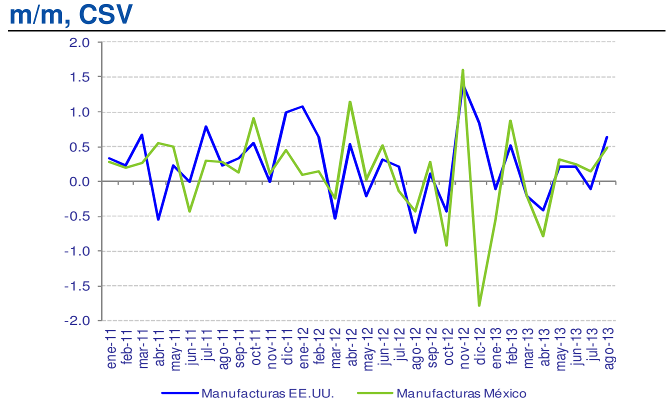
On Friday, November 1, the IMEF manufacturing indicator will be released. This is a forward indicator on the performance of economic output in the country toward the fourth quarter of 2013. The monthly growth in manufacturing output in Mexico in August (0.5% m/m, CSV) and in the US (0.6% m/m, CSV) point to the IMEF manufacturing index showing an improved business climate with expected monthly growth of 0.7% CSV.

Chart 3
Public expenditure (real y/y change)



Source: BBVA Research, SHCP

Chart 4
Mexican and US manufacturing output, % change m/m, CSV

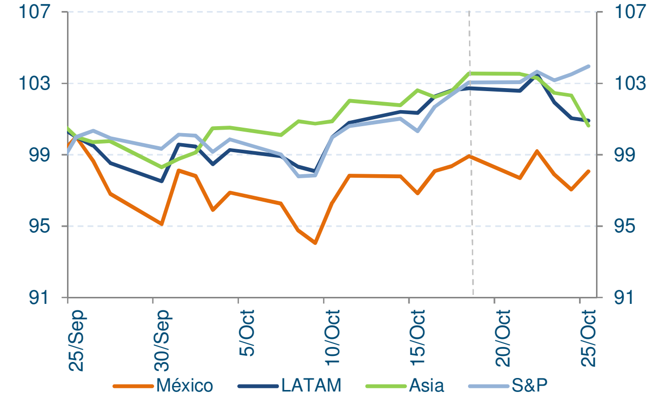


Source: BBVA Research with INEGI and Bloomberg data. CSV=Corrected for seasonal variation.

Markets, activity and inflation

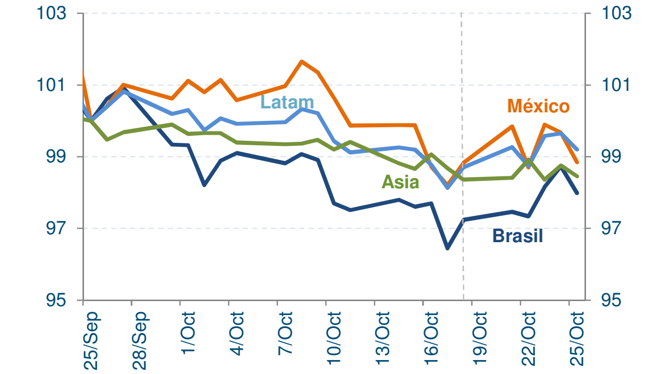
- The lower-than-expected US employment figures for September increased expectations on markets that the FED will maintain its asset purchase rate into 2014. Consequently, gains were seen on stock markets and emerging currencies strengthened. The peso seems to have also strengthened thanks to Banxico's message on no more cuts to the policy rate.

Chart 5
Stock markets: MSCI indices
(September 25, 2013 index=100)



Source: BBVA Research with data from Bloomberg

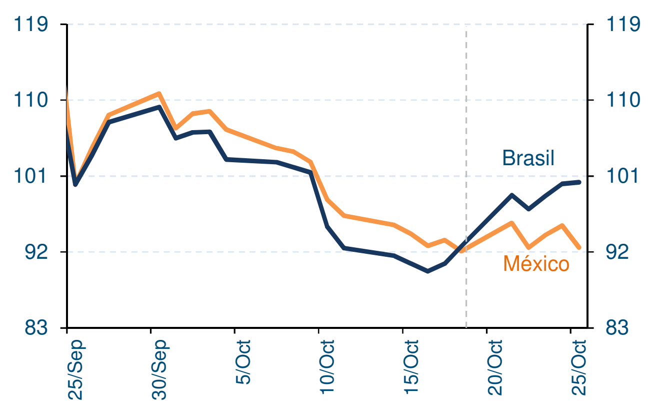
Chart 6
Foreign exchange: dollar exchange rates
(September 25, 2013 index=100)



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.

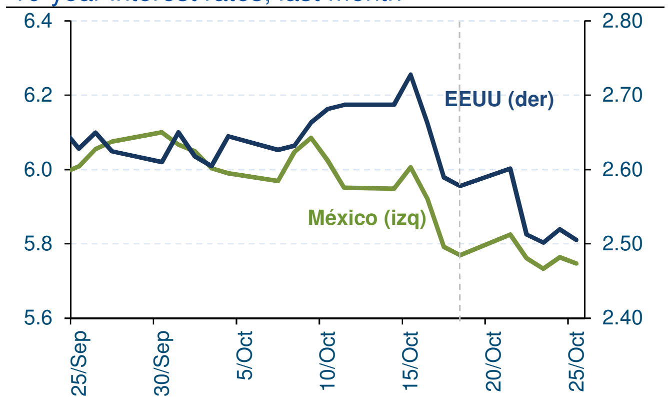
- Decline in long-term interest rates in expectation that global liquidity will continue into 2014.

Chart 7
Risk: 5-year CDS (Sep 25, 2013 index=100)



Source: BBVA Research with data from Bloomberg

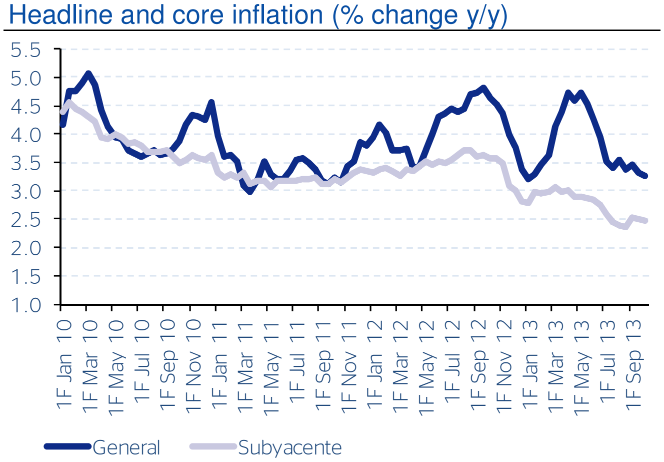
Chart 8
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

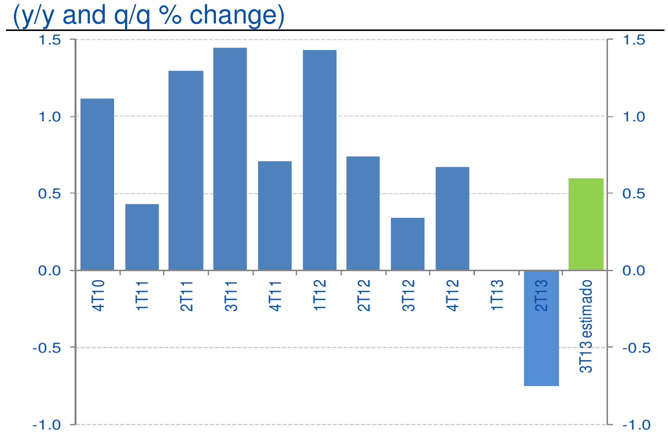
- Headline inflation saw a surprise drop and core inflation remained around 2.5% in recent months. Industrial output for August confirmed a slight upswing in the third quarter.

Chart 9
Headline and core inflation (% change y/y)



Source: INEGI, BBVA Research.

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



Source: INEGI, BBVA Research.

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