Mexico Weekly Flash

Next week…

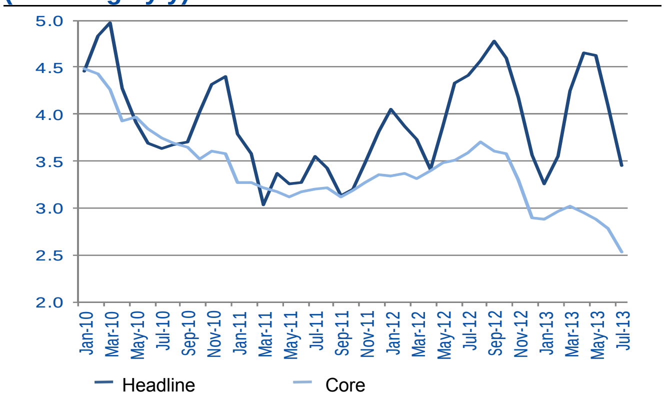
- **The Quarterly Inflation Report is set for release offering the central bank's outlook for economic growth and inflation**

The Bank of Mexico will release its inflation report on Wednesday, August 7 covering the second quarter of 2013. The report will be important given that it will include the bank's outlook for output and inflation - highly important areas in a slowing economy with a substantial drop in inflation that firmly positioned it around Banxico's target range. The level and tone Banxico uses to describe the outlook for the second half of the year will be important with regard to output. In terms of inflation, it will be important to see the outlook for core inflation, having already hit all-time lows.

- **Markets see higher outlook for US growth and the possibility of fewer monetary stimulus packages.**

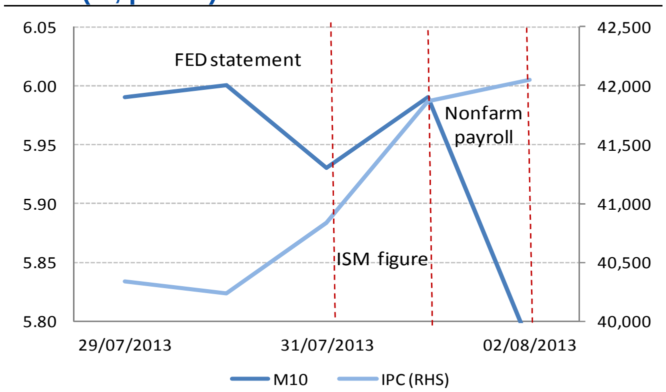
Economic growth prospects for the second half of the year and the likelihood of slower asset purchases by the FED in coming months remain the main factors behind market trading. Higher-than-expected growth in the US economy in the second quarter (1.7 q/q vs. 1.0% q/q) linked to manufacturing output above expectations and lower unemployment benefit applications supported the outlook for a bounce in economic output for the second half of the year. In turn, this led to general upswings on stock markets and a stronger dollar against emerging market currencies mid-week. On the bond market, these figures increased speculation that the FED could slow down its asset purchases in September, leading to higher long-term rates that took the 10-year bond yield to 2.7%. All this even though the FED's statement maintained an unchanged stance on asset purchases. The lower-than-expected growth in non-farm payroll in the US (162k vs 185k) on the last day of the week was linked to the lower likelihood of a reduction in short-term monetary stimulus. This led to gains on stock markets and in some emerging market currencies. Along these lines, the peso closed the week 0.2% up at 12.64 pesos to the dollar, after hitting 12.82 during the week. The 10-year bond yield dropped around 20bp at the end of the week to close below last week's level around 5.76%.

Chart 1
Inflation (% change y/y)



Source: BBVA Research and INEGI

Chart 2
10-year interest rate and IPC Mexican Stock Market Index (%, points)



Source: BBVA Research and Bloomberg

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Calendar: Indicators

Consumer Confidence (August 5)

Forecast: 93.8 pts	Consensus: N/D	Previous: 93.4 pts

Given the recent improvement in retail sales and its strong link to consumer confidence, we expect the index to show a slight improvement (0.4% m/m) and hit 93.8 (93.4 in June). Nonetheless, in annual terms, it will continue to be weak with a decline of -3.5%.

Inflation in July (August 8)

Forecast: -0.08% (3.42% y/y)	Consensus: 0.03%	Previous: -0.06% (4.09% y/y)

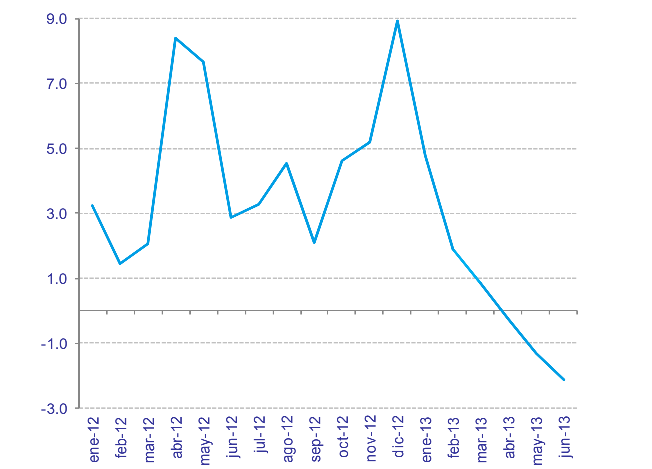
INEGI will release the inflation figures for June on Thursday, August 8, which are expected to confirm the recent decline in inflation. This drop would be explained specifically by an additional fall in the price of agricultural products as supply shocks continue to dissipate. In addition, core inflation will remain stable or could even see a marginal fall given the slack in the economy.

Industrial Output in June (August 9)

Forecast: 0.20% y/y CSV	Consensus: N/D	Previous: 0.5% y/y CSV

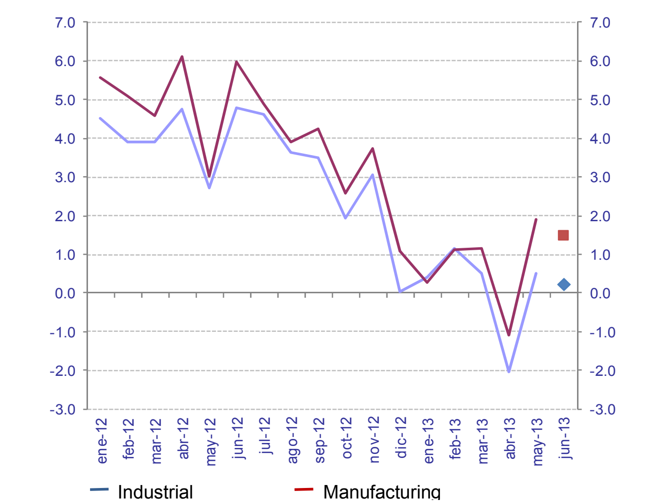
This coming Friday sees the release of industrial output figures for June. These are very important since the figures have a major weight in GDP estimates, in addition to the information rounding off the second quarter of the year. Industrial output is expected to continue expanding in line with US industrial output. Nevertheless, faced with the major slowdown in the first part of the year, in annual terms and corrected for seasonal variation (CSV), we should see very moderate growth of around 0.2%.

Chart 3
Consumer Confidence (% y/y)



Source: BBVA Research and INEGI

Chart 4
Industrial Output and Manufacturing Output (% y/y)



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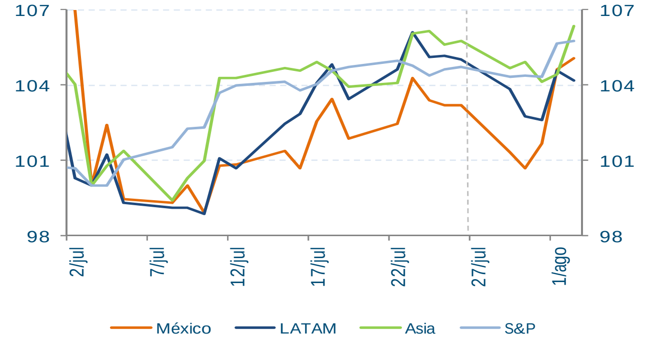
Markets, activity and inflation

- US economic growth in the second quarter came in above expectations which, linked to manufacturing output exceeding expectations, led to gains on stock markets. At the end of the week, the lower-than-expected US job creation figures led to slight losses in developed markets and gains in Mexico with thinking here being that the figures do not support a reduction in monetary stimulus. The peso also reversed its losses.

Chart 5

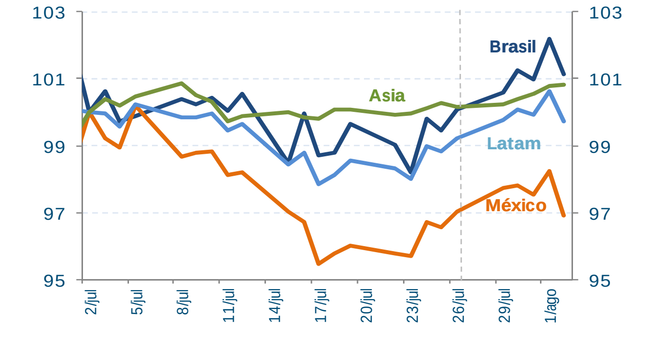
Stock markets: MSCI indices
(July 2, 2013 index =100)



Source: BBVA Research with data from Bloomberg

Chart 6

Foreign exchange: dollar exchange rates
(July 2, 2013 index =100)

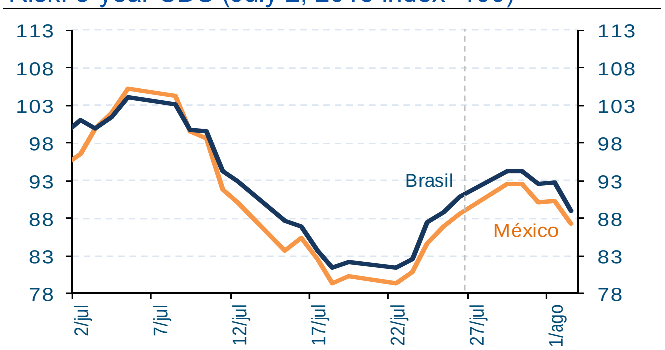


Source: BBVA Research with Bloomberg data NB: LATAM includes Argentina, Brazil, Chile, Colombia and Peru. Asia includes the Philippines, South Korea, Taiwan, Singapore, Indonesia and Thailand.

- The lower-than-expected job creation figures in the US partially reverses the upward bounce in rates over the week due to speculation that monetary stimulus would drop back in September. This is despite the FED giving no signs that a reduction is asset purchases in coming months was likely.

Chart 7

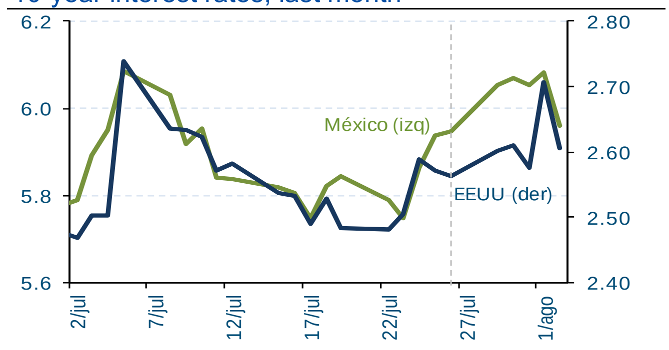
Risk: 5-year CDS (July 2, 2013 index=100)



Source: BBVA Research with data from Bloomberg

Chart 8

10-year interest rates, last month

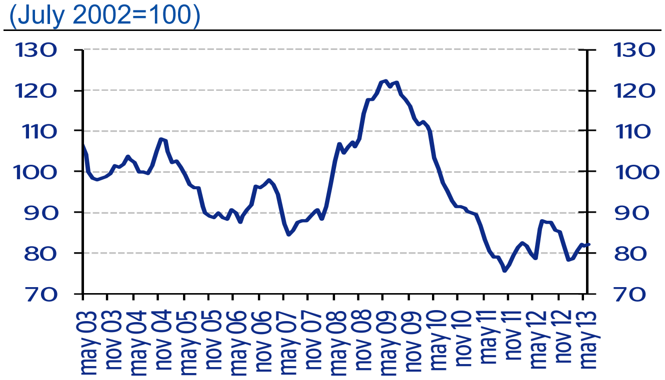


Source: BBVA Research with data from Bloomberg

- Inflation started to drop back decisively 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)

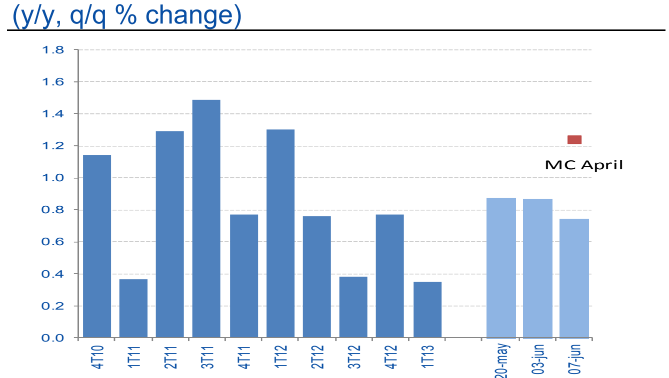


Source: Bloomberg and BBVA Research

*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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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

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

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