Mexico Weekly Flash

Next week…

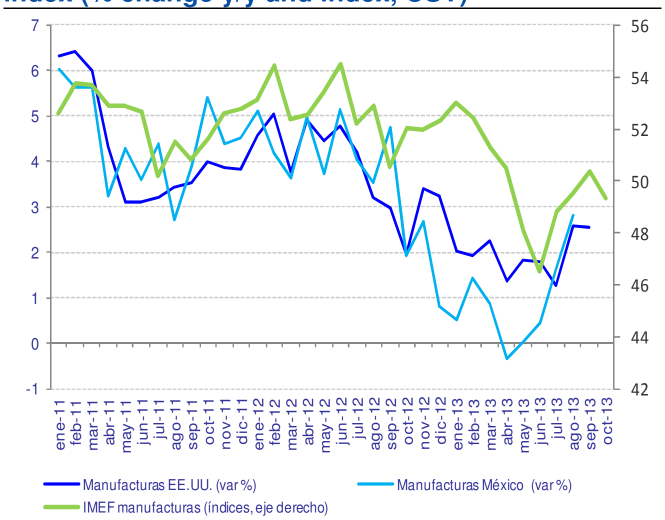
- **Banxico set to release its quarterly inflation report which will set out its growth and inflation forecast - highly important in this backdrop of a slowdown and fiscal reform**

Banxico is set to release its inflation report for the third quarter of 2013 on Wednesday this coming week. The forecast range for growth this year is expected to be reduced significantly after the decline in GDP in the second quarter of the year made it almost impossible to hit the previous central bank estimate of between 2.0 and 3.0%. In addition, with improvement in some economic output variables, attention will need to focus on the GDP growth estimate for the third quarter of this year, expected to come in around 0.8% q/q. In terms of inflation, central bank forecasts for 2014 will be important, especially taking into account the recently approved fiscal measures. At BBVA Research we expect this impact to come in between 0.4 and 0.6%.

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

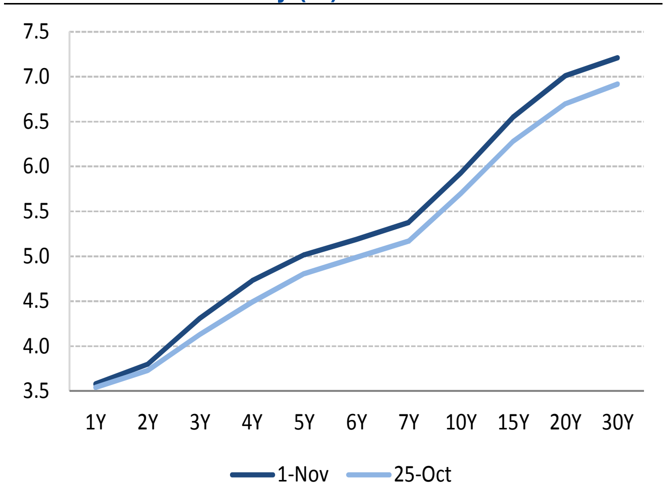
Movement on financial markets over the week was mainly influenced by the Federal Reserve's (FED) monetary policy statement. As expected, there was no change to the asset purchase rate, which will remain at USD 85 billion per month, or to job and inflation levels that need to be hit before any increase in federal fund rates is considered. Nonetheless, markets saw the tone of the statement as slightly less relaxed given that it maintained some optimism regarding economic output and recovery in the job market. In addition, it repeated that more evidence of a sustained improvement in the economy will be expected before starting to taper the asset purchase rate. Consequently, and with expectations of lower-than-expected monetary stimulus, markets responded with higher interest rates and lower demand for risk assets. The Mexican peso fell back 1.37% over the week and again went above 13 pesos per dollar, while the 10-year bond yield increase 32 basis points over the week to close above 5.9%.

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
Yield curve at maturity (%)



Source: BBVA Research with Bloomberg data.

Calendar: Indicators

Consumer and producer confidence in October (November 4)

Forecast:		
Consumer: (92.5 pts.), -1.2% m/m, CSV	Consensus: N/A	Previous: (93.9 pts.), -2.1% m/m, CSV
Producer: (52.6 pts.), -1.4% m/m, CSV	Consensus: N/A	Previous: (53.2 pts.), -2.8% m/m, CSV

INEGI is set to release the consumer and producer confidence indices for October this coming Monday, November 4, the first for the fourth quarter of 2013. On the one hand, taking into account the negative performance in retail sales in August (-2.3% y/y and 0.58% m/m, corrected for seasonal variation, CSV) and the slight increase in formal job creation to September (0.1% m/m, CSV), we should likely expect the consumer confidence index to drop and hit 92.5 points (93.9 pts in September), CSV. On the other, due to the slight improvement in manufacturing output in August (0.4% m/m, CSV), but with a negative IMEF manufacturing indicator up to October (-2.1% m/m, CSV), we estimate that the producer confidence index will hit 52.6 points (53.2 pts. in September), CSV.

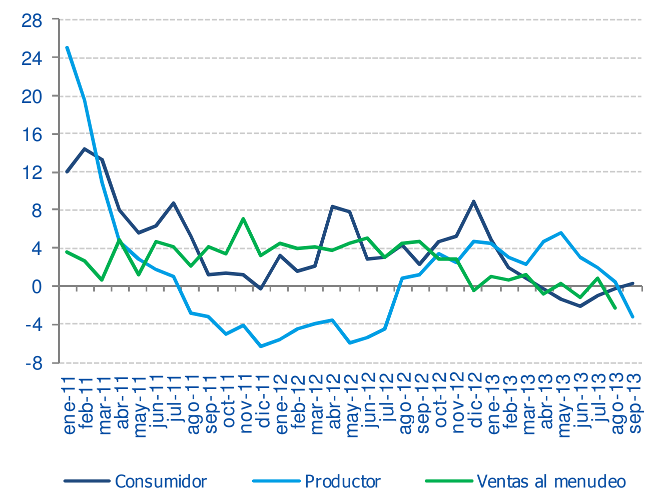
October inflation (November 7)

Forecast: 0.43% (3.31% y/y)	Consensus: 0.50%	Previous: 0.38% (3.39% y/y)

The inflation figure for October will be released on Thursday, and will continue to show stability in year-on-year inflation with no demand pressures. In monthly terms, we expect a 0.43% increase in headline inflation and 0.15% in core inflation. For the core component, we expect the trends seen during the first two weeks to have consolidated with a slowdown in price increases for other goods (BBVAe: 0.04%) in the goods subindex and a more important increase in other services (BBVAe: 0.25%) after the deflation seen in this component over the last two months (-0.42% on average). In terms of non-core inflation, we believe the major rise due to the start of the seasonal increase in energy prices was already seen in the first two weeks of the month and the next major increase will be seen in the first two weeks of November when the electricity subsidy is removed in the other cities where it applies. With all this, annual inflation will drop slightly to 3.31% (vs. 3.39% in September) while core will also see a slight decline to 2.44% (compared to 2.52% in September).

Chart 3

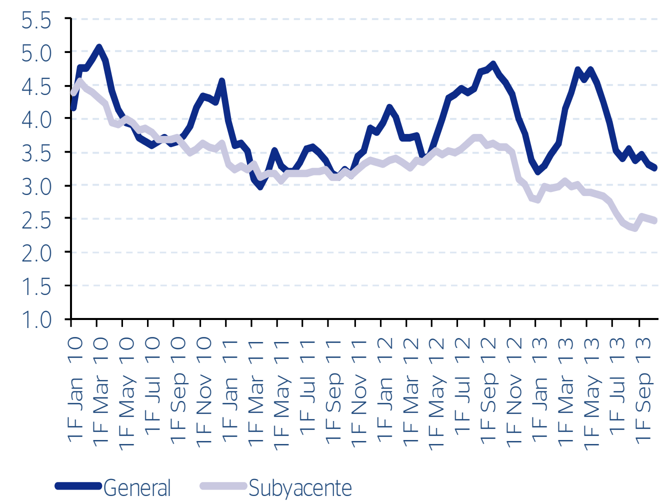
Consumer, producer and retail sales confidence (% change y/y, CSV)



Source: BBVA Research with IMEF data. CSV=Corrected for seasonal variation.

Chart 4

Headline and core inflation (% change y/y)

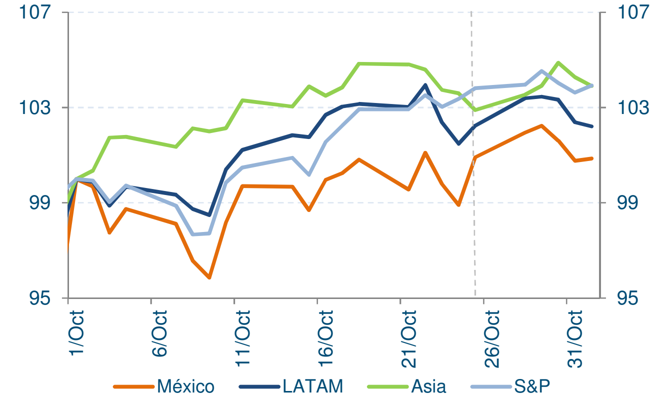


Source: BBVA Research with INEGI data.

Markets, activity and inflation

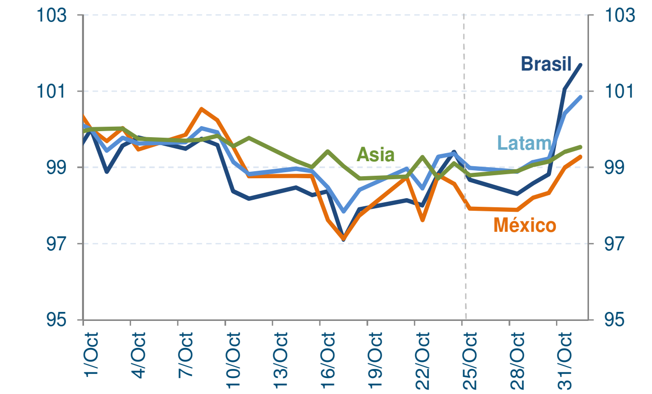
- Losses on stock markets and weaker currencies in emerging markets due to a less relaxed tone in the margin from the Federal Reserve. This increased speculation surrounding an expected cut to the asset purchase rate.

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



Source: BBVA Research with data from Bloomberg

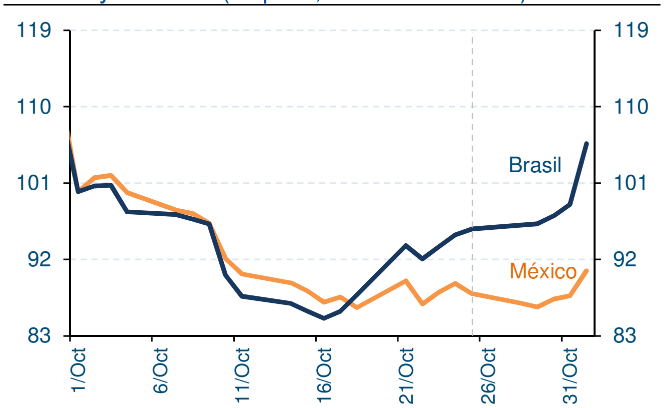
Chart 6
Foreign exchange: dollar exchange rates
(September 25, 2013 index=100)



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.

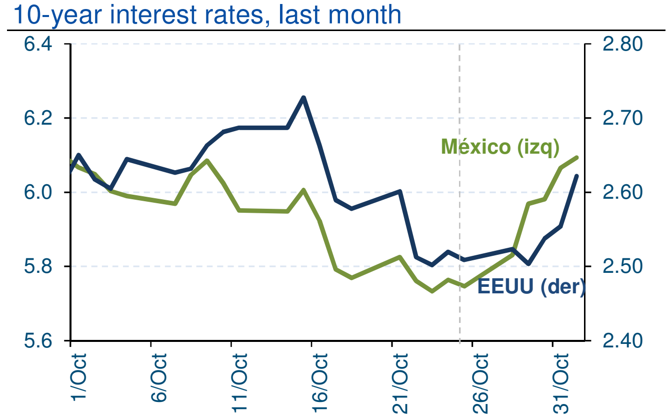
- Higher long-term interest rates in the US and Mexico in light of a possible reduction in global liquidity at the FED. In line with this, global risk aversion bounced.

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



Source: BBVA Research with data from Bloomberg

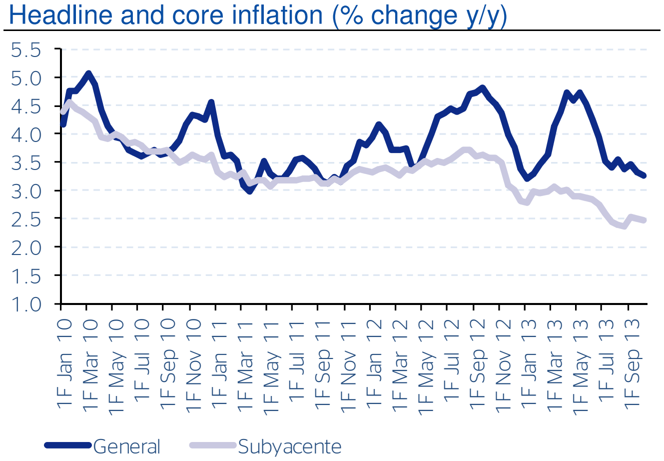
Chart 8
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

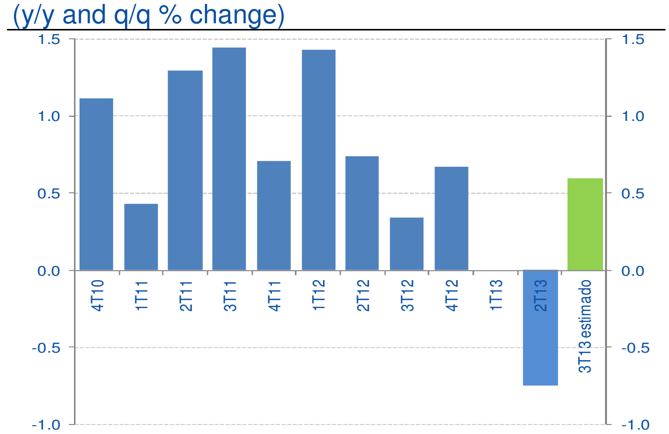
- Headline inflation saw a surprise drop and core inflation has remained around 2.5% in recent months. Output data point to a slight recovery in the third quarter and the start of the fourth.

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: BBVA Research with INEGI data.

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