RESEARCH

Mexico Economic Outlook

Fourth quarter 2012
Economic Analysis

- Decisive steps by the central banks have cleared the global panorama. However, economic policies will continue to consolidate the recovery
- Despite the recent global moderation, Mexico maintains a favorable outlook for growth for this and next year, supported by the positive performance of employment and financing
- Inflation will return to below 4.0% as the persistence of supply shocks diminishes

BBVA Bancomer

Content

Closing date: November 1, 2012

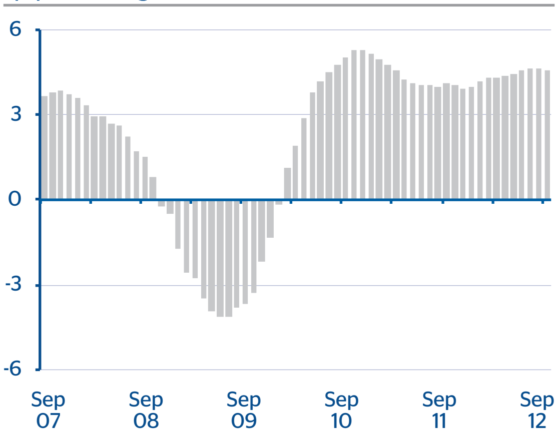
1. Summary

Mexico maintains its favorable outlook for growth for this year and the next, despite the recent moderation of global activity

The decisive steps taken by the central banks have cleared the global panorama. Nevertheless, economic policies must continue in order to consolidate recovery. The BBVA Research base scenario, expects the world economy to continue improvement in terms of GDP growth, expected to be 3.5% in 2013 (3.2% in 2012, and a 4.1% average for the 2010-2012 period). This mild expansion is underpinned by lower risk aversion as a result of the actions taken by the central banks, particularly the European central bank. Despite this, three factors that could deteriorate these perspectives are worth considering, 1) the most worrisome is a resurgence of the problems in Europe, which would bring back fears of a disruption of the euro; 2) the threat in the U.S. of the so-called “fiscal cliff”, a package to reduce public spending and a tax increase with a value of 4% of GDP, which would automatically become effective in the early part of 2013 and would again push the U.S. economy into a recession; and 3) a sharp slowdown of the emerging economies, particularly China and those economies based on exports of commodities, for which demand, in turn, depends on China.

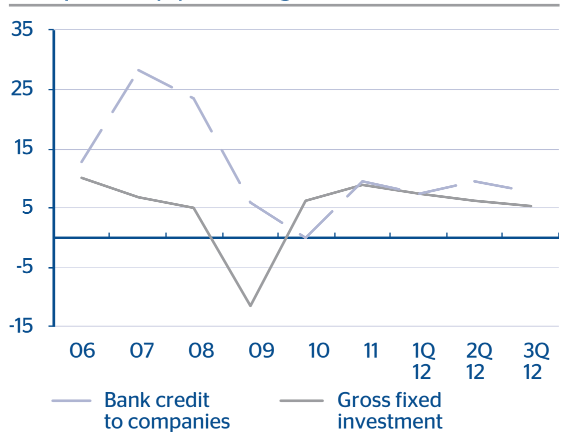
Despite the recent global moderation, Mexico’s outlook for growth is 3.7% for this year and 3.0% for next year, based on favorable performance in employment and financing. In the second half of the year, signs of moderation in external demand have been observed, among which a slowdown in manufactured exports and a decline in remittances coming into the country are particularly significant. Nevertheless, average growth of 4.3% in the first part of the year, a labor market that has continued to generate employment, and a gain in the share of Mexican exporting companies in the U.S. market have contributed to maintaining a positive growth outlook for the Mexican economy. In the last twelve months, 700,000 jobs have been created in the formal private sector, contributing to an average rate of formal job creation in the first nine months of the year that has been the most dynamic of the last three years. The positive performance of the labor market has been reflected in a favorable performance of private consumption. It is significant that both the growth of consumption as well as of investment have been favored by stable financial conditions and the flow of credit to households and companies. With respect to market share, in the second quarter of the year, Mexico’s share of manufactured imports in the United States was 12.6%. the highest in Mexico’s history.

Graph 1
Formal employment (y/y % change)



Source: BBVA Research with INEGI data

Graph 2
Gross Fixed Investment and Bank Credit to Companies (y/y % change)



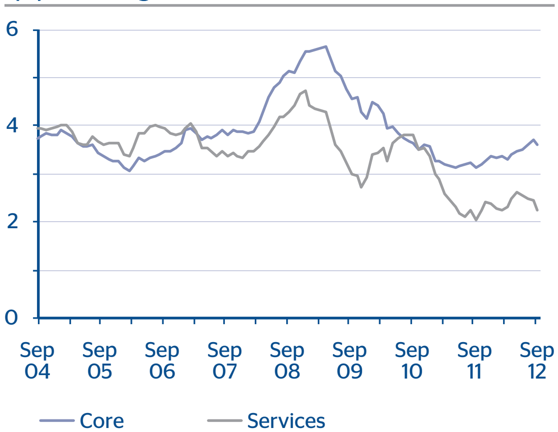
Source: BBVA Research with Banxico and INEGI data.

The outlook for 2013 for the Mexican economy considers moderate economic growth for the U.S. of 1.8%. Nevertheless, the uncertainty remains regarding the outlook for the U.S. economy, This is due mainly to the possible implementation at the beginning of the year of an intense program of fiscal consolidation, previously approved by Congress, which would slow down economic activity and increase volatility in the international financial markets. .Delaying the start of this adjustment program would require that Congress reach an agreement in the month following the presidential election. Despite the difficult external conditions, Mexico has been successful in maintaining fiscal and monetary issues focused on stability, which has made it possible to maintain the debt and the public deficit within limits and inflation low, policies that will probably be maintained in the future.

Inflation will return to levels below 4.0% as the persistence of supply shocks diminishes. At the month of September, inflation was at 4.8%, the result of continuous supply shocks that have affected prices, such as the outbreak of the avian flu in the western part of the country and high international grain prices, partly due to the drought in the United States. Nevertheless, core inflation remains anchored at 3.6% and the sub-index of prices excluding food and energy products is scarcely 2.2%. Inflation is expected to begin a process of convergence toward the variability range around the central bank target starting in the fourth quarter of this year, allowing the annual inflation rate to stand at around 4.2% in December. Nevertheless, given the intensity of the supply shocks, it is estimated that inflation will descend to clearly below 4.0% toward the second quarter of 2013, to continue declining until it reaches 3.6% at the close of next year. In this scenario of convergence, it is expected that the inflation differential between Mexico and the U.S. will be reduced, as a result of an appreciation of the peso, moderate and stable economic cycles in both countries and lower international grain prices in an environment of global moderation. This, considering that BBVA Research estimates show that these variables are among the main determining factors of this differential.

Graph 3

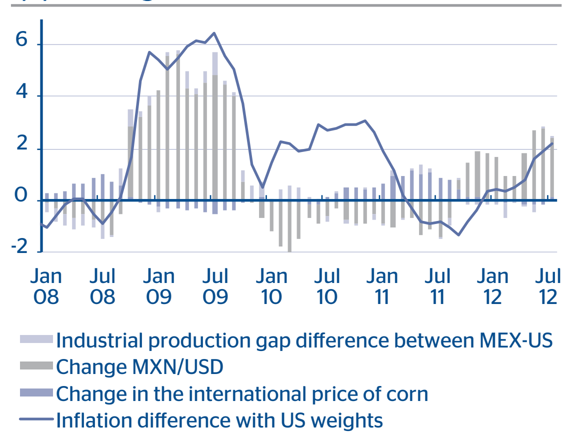
Trimmed inflation: core inflation and inflation not considering food and energy (y/y % change)



Sourcee: BBVA Research and Banxico

Graph 4

Decomposition of the inflation differential between Mexico and the United States (y/y % change)



Source: BBVA Research. It refers to the difference in inflation based on U.S. weighting factors..

Although the inflation level exceeds the upper limit of the central bank's target interval, the transitory nature and not the core aspect of this increase is an element of support for the decision to maintain the monetary pause. Moreover, so far there is no evidence that these increases have generated second round effects as can be seen in the services inflation sub-index, barely above 2.0%, and in the medium-term inflation expectations anchored at around 3.5%. Moreover, BBVA Research estimates suggest that in the process of determining the monetary rate, the central bank considers whether the inflation upturn is derived from supply or demand pressures and takes into account that the monetary stance of the U.S.Federal Reserve will remain unchanged for a long time, which in an environment of anchored core inflation and expectations that the federal funds rate of the Federal Reserve will remain without change for a long time, supports the outlook of a monetary pause. Nevertheless, given that inflationary risks are biased upward in the short term, in case of evidence of second round effects, the monetary stance could tighten.

With regard to the financial markets, the result of global uncertainty, the exchange rate will maintain levels similar to the current ones, closing the year at 12.90 pesos per dollar. Interest rates on medium and long-term government debt will increase slightly in an environment of moderation of economic activity.

2. Global scenario: bold actions by central banks make tail-risk scenarios less likely

Central bankers to the rescue; other policy makers should follow suit

Against a backdrop of high uncertainty and threats to the world economy recovery, over the past months, authorities across the world –in particular central bankers in the eurozone and the US– have taken significant steps forward. **Those bold measures have spared the world economy from a systemic event that would have been comparable with the financial developments of late 2008**. Both central banks have built a bridge to a new institutional environment in the case of Europe, and to a new fiscal pact in the US; these actions have paved the way for other policy makers to use their room for manoeuvre. However, the FED's actions are more open-ended than the ECB's due to different conditionality: strict fiscal fulfilment is compulsory in Europe, whereas labour market improvement is the objective in the US.

"... whatever it takes..."

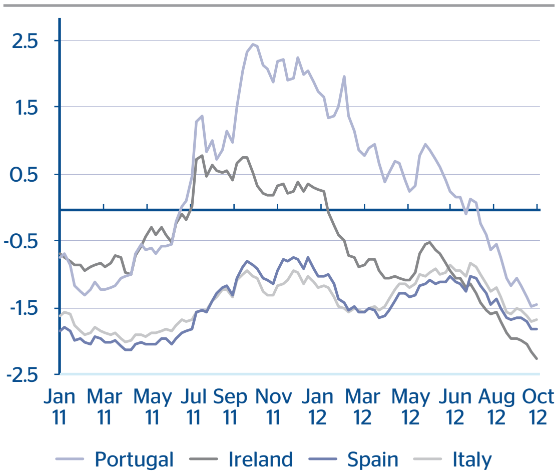
In our view, when the European Central Bank (ECB) President, Mario Draghi, announced the implementation of a new bond-purchase program (Outright Monetary Transactions, or OMT) in late July, the institution took a decisive step to put an end to the debt crisis in Europe. Under certain conditions (see our September ECB Watch for further details), the ECB could intervene in the secondary sovereign-debt markets. The ECB's move came after a eurozone summit in June where leaders reached some agreements to reinforce the currency union: a broad roadmap towards a single banking supervision, far-reaching plans covering fiscal issues and growth-supporting measures.

The rationale behind the Draghi announcement is clear. Yields on some peripheral bonds are elevated because markets are partly pricing in eurozone break-up fears, compromising the ECB's mandate amid a severe financial fragmentation. Since that is "unacceptable," the ECB has committed itself to buy unlimited quantities of sovereign bonds of those countries that seek financial aid from Europe's funds (European Financial Stability Fund & European Stability Mechanism) with "strict and effective conditionality." The existence of a lender of last resort under fiscal conditionality dispels fears of the reversibility of the euro in its current configuration.

However, the ECB move was more decisive than anticipated. Under extreme market pressure and looming euro break-up fears, some action from European leaders and the ECB had long been expected. The OMT program makes the ECB a credible backstop. We consider that break-up fears are not justified now as long as this process continues. Tensions in financial markets have eased significantly since June (see Chart 5) and, in our view, the maintenance of this situation in spite of recent adverse market events is proof of its capacity to dispel doubts.

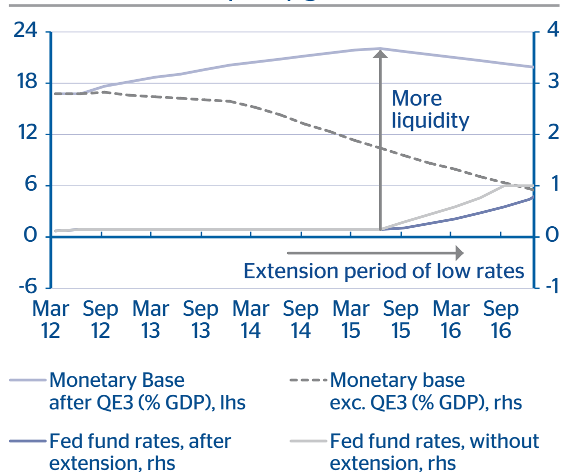
Other elements have recently reinforced the currency union in Europe. First, the permanent fund that will deal with any new bailout in the eurozone (the ESM) has been put in place, after the German Constitutional Court backed Germany's involvement. **Second, the process for achieving a banking union in Europe (as set last June at a Eurogroup meeting) continues moving forward, although grinding slowly.** The implementation of a full banking union consists of four different elements: joint supervision, common regulation, a common body for banking resolution and a pan-European deposit-guarantee scheme. Given the scale of the task ahead, the full implementation is likely to be a long-lasting process. Yet European leaders agreed to set a calendar for banking supervision by January and more details are due to be agreed on at the Eurogroup meeting in December. In June they had agreed **on direct banking recapitalization from the ESM, something that we deemed key in order to eliminate the risk emerging from the sovereign-banking feedback loop**. However, there are other ways to reach the overriding goal of preventing regulatory ring-fencing and the goal of breaking the sovereign and bank risk that can be also explored. Certainly, the banking-union project needs to move forward fast.

Graph 5
Financial Stress Index for eurozone countries[1]



Source: BBVA Rresearch

Graph 6
QE3 and extended policy guidance



Source: BBVA Rresearch

At the end of the process, we think the eurozone may eventually come up with a full package that will reinforce its governance. As we have long argued, it should comprise a banking union, a fiscal union and a lender of last resort to prevent fragmentation. Progress has been made on all of these fronts. Probably that progress has not been ambitious enough to revert the current dynamic quickly. Yet, policy makers seem committed enough to the process and we think the worst of the crisis may, at last, be over. In the short term, the ECB's program and the ESM support under fiscal conditionality creates a benchmark to deal with difficult funding situations that countries such as Italy and Spain could face. At the same time, the proper implementation of the banking-union plans and further definition of the fiscal-union design will be a key factor to the long-term sustainability of the eurozone.

"... as long as needed..."

With the US economy growing at low rates, the unemployment rate remaining persistently high and amid huge uncertainty in Europe, a pre-electoral gridlock over how to bring the whopping US deficit down was the last thing the US economy was in need of. Against this backdrop, the Fed did not hesitate. First, and in accordance with its "forward-guidance policy," the Fed announced that it intends to keep rates at its current low levels at least until mid-2015. Second, the Fed announced a new round of quantitative easing (QE) to support growth and employment recovery.

[1] The BBVA Research Financial Stress Index (FSI) is a synthetic indicator that summarizes movements of: risk measures (5-year CDS, CDS of non-financial corporations and financial debt), volatility (stocks, interest rates and exchange rates) and liquidity stress (spread between interbank rate and free-risk asset at 3-months term).

This further monetary loosening will be different from previous rounds. First, the Fed will purchase mortgage-backed securities (MBS) rather than Treasuries in an attempt to improve financial conditions for households. Second, the Fed will continue with this policy for a considerable period of time, even after the recovery strengthens and the labour market improves substantially; i.e., it will not give up buying MBS when growth starts picking up (see our US Fed Watch for further details).

In our view, by embarking on QE3 and extending policy guidance, the Fed is buying insurance against the "fiscal cliff," but it is not a silver bullet if not accompanied by fiscal actions. In our baseline scenario, an agreement will be reached to avoid the complete package of automatic spending cuts and tax hikes from taking place. Yet we also expect some form of fiscal consolidation that will drag the economy down. With QE3 and policy guidance, the Fed does its part to give the economy the boost it needs to avoid slipping back into recession in 2013. In fact, according to our estimates, monetary loosening could contribute just a few tenths of a percentage point (pp) to GDP growth in 2013, but from 2014 onwards the effect will be more substantial. Regarding inflation, the impact will be small and delayed (see chapter 4 of this report). However, it seems to us that the FED's tolerance to higher inflation will depend on growth and labour market improvement.

The potential effects of QE3 are not restricted to the US economy. As previous programmes showed, they prompt inflows to emerging economies, decreasing risk premia, and lowering funding costs in those countries, boosting the availability of credit, their growth rates and also their inflation. Our estimates show that QE3 (plus the Draghi effect) could have a lower impact than QE1 due to comparative evolution of risk premium and capital inflows in the emerging economies. In any case, that will depend on domestic-policy response to capital inflows.

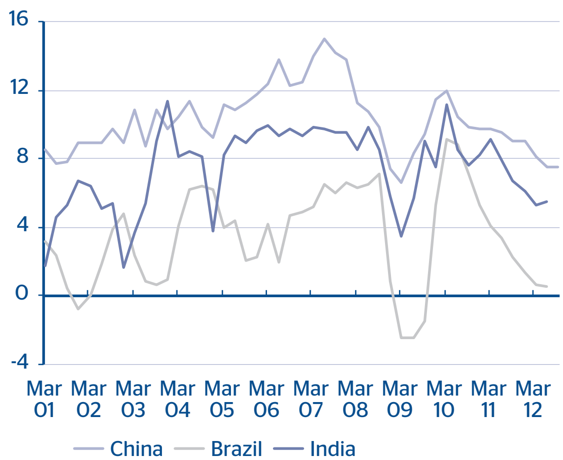
Central bankers' responses are not enough to bring the global economy back to a firm expansion

The world economy may have avoided decelerating to the slowest growth in the last 30 years (apart from the 2009 great recession) but the low growth environment continues. The advanced economies have been losing momentum since 2011 as one should expect given the current deleveraging environment. More recently the emerging economies have been hit too. In this regard, the trade channel has been intense in bringing exports and GDP growth down (see Graph 7).

Certainly that is the case in the three largest emerging economies. Brazil's economy almost stalled in the first half of the year; India's GDP grew by 5.3 and 5.5% y/y in the first and second quarter, respectively, the slowest pace since the beginning of 2009; and in the third quarter of the year the Chinese economy slowed to a rate of 7.4%, the lowest growth rate since 2009 although the most recent data points to a bottoming-out.

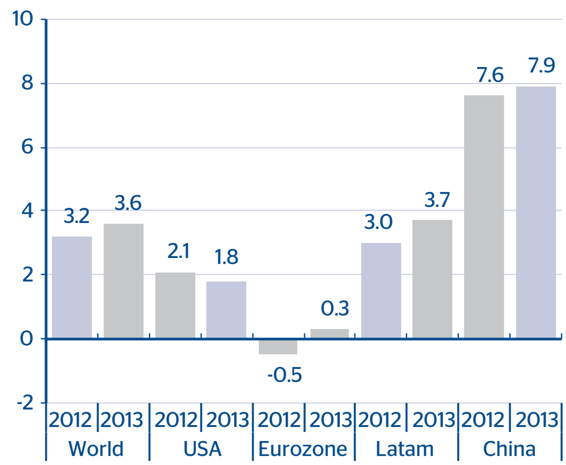
However, the actions that have been taken by central banks in the US and in the eurozone are partly dispelling some doubts and improving the outlook. Under our baseline scenario, growth in the eurozone is likely to gain momentum entering 2013. Although the eurozone's GDP will decrease in 2012 (-0.5%), it will rebound slightly in 2013 (+0.3%). In the US, we have maintained our forecasts: growth will remain at around 2% in 2012 and 2013. The main downward revision in our October scenario corresponds to China (by -0.2 pp in 2012 and -0.4 pp in 2013), although its growth rate will remain close to 8% both years due to expected policy stimulus to compensate partially the slowdown it is experiencing. Other emerging economies will make up for this slack: the outlook for growth in Latin America is revised slightly upwards in 2013, when the region will grow by 3.7%, up from a 3% growth rate in 2012.

Graph 7
Emerging economies: GDP growth rate (% y-o-y)



Source: BBVA Research and Haver

Graph 8
GDP growth rate



Source: BBVA and Haver

All in all, **the world economy is expected to continue undergoing a soft recovery with a GDP growth between 3% and 3.5%. Yet this scenario relies on several key assumptions,** in particular on whether European policy makers will deliver on their commitments.

First, this scenario assumes that the recent wrangling over financial supervision does not substantially affect June's agreements, so **the vicious link between sovereign and bank risk is broken and the monetary policy transmission, which in the eurozone is conducted mainly by banks, works again.**

Second, **we assume that the mechanism in place to eliminate the "convertibility risks" is activated in full if needed**. This will keep yields in peripheral economies contained, but substantial reductions will happen at the same time as Europe progresses in its new institutional arrangement and the commitments are fulfilled.

The ESM/ECB's intervention could be enough to bring Spanish and Italian yields back to levels consistent with the mid-term sustainability of the public debt, and to levels that will make reforms have a long-lasting impact. This implies that both countries retain investment-grade ratings and deliver on their fiscal commitments or are granted extensions to meet them (ideally in terms of their structural fiscal balances). On this issue, it should be considered the risk from negative feedback loops between fiscal adjustment and economic growth and also the possibility that negative fiscal multipliers may be higher than previously expected, at least in the short-term.

Finally, in this scenario, Greece will continue being part of the euro, which will, in turn, require further support from Europe by additional funding and/or a longer period to fulfil fiscal conditionality. Based on past experience, too many things could still go wrong, **but policy makers tend to find solutions to Europe's problems when crunch time approaches.**

3 Mexico maintains its growth outlook for this year and the next, based on employment and financing

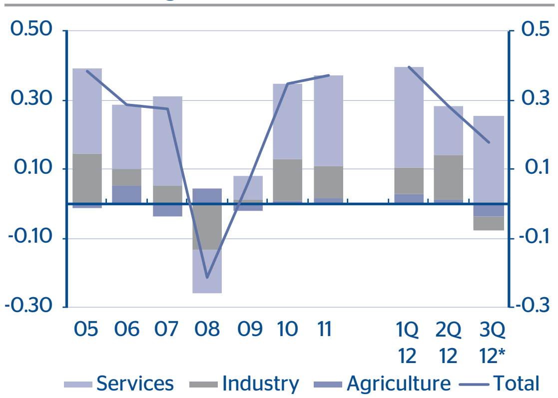
3.1 Mexico, positive growth, although with a pattern of moderation

During the third quarter of the year, economic activity continued to grow, although at a lower rhythm than in the first two quarters. The data available for this third quarter, related with both external and internal stimuli indicate that signs of moderation have accentuated after the first half of the year.

It should be recalled that after annual growth of 3.9% in 2011, the variations in the first and second quarters of this year were 4.6% and 4.1%, respectively. By production sectors, the dynamic between the industry and services sectors were similar and positive. For the third quarter, and with data from the Global Indicator of Economic Activity through the month of August, the contraction in secondary activities is of note, which has implied a reduction in the contribution of the industrial sector to aggregate growth of the economy. Thus, the monthly change in industry has dropped from 0.4% in the second quarter to (-)0.1% in the third quarter, so that when we confirm GDP growth data in terms of production, on November 16 we can confirm the lower contribution of industry to growth since the first quarter of 2009. All told, the estimate that involves all the variables of activity available, indicates that GDP might have expanded between 0.5% and 0.9% in the third quarter.

Graph 9

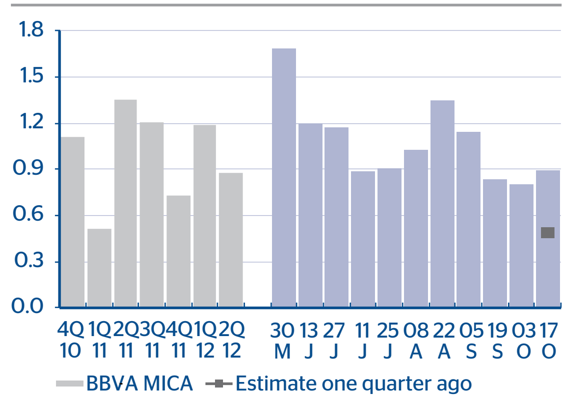
Activity: contribution to growth (m/m % average)



* Data available through August
Source: BBVA Research with INEGI data.

Graph 10

BBVA-Research MICA activity indicator in real time in 3Q12



MICA refers to the BBVA Research model to forecast GDP in real time
Source: BBVA Research with INEGI data.

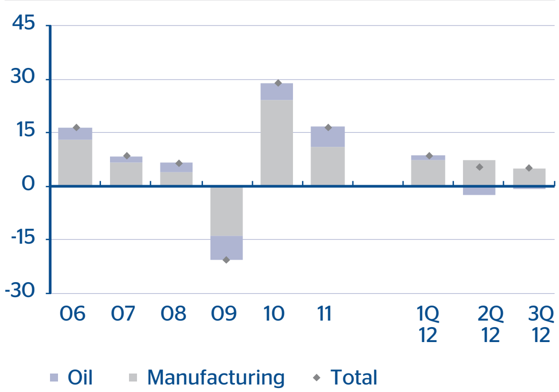
... derived mainly from external demand

Among the external stimuli, moderation has been evident both in manufacturing and in oil exports as well as in remittances entering the country. Total exports of goods grew 4.2% in the third quarter, below that of annual 8.6% and 5.2% expansions in the first and second quarters. The main source of moderation were manufacturing exports, which represent slightly more than 80% of exports of goods and for which the annual change in 3Q12 was 4.9% (7.5% in 2Q12). At the second quarter of the year, Mexico continued to gain share in the U.S. market, with 12.6% of manufacturing exports in that country, which compares favorably against the 12% average Mexican share in 2011 and which, in fact, is the highest share in Mexico's history.

The gain in Mexico's share of exports in the U.S. is attributed to the increase in durable goods exports, which in 2Q12 grew 3.5%, with exports of goods such as transportation equipment (25% of the total), electronic equipment (19%), oil and gas (13.5%) and electrical equipment (7.3%) were particularly significant. It should be noted that durable goods represent 87% of Mexico's exports.

In this period, for the second consecutive quarter, a contraction in annual terms was observed in oil exports, although lower than in the previous quarter: an annual y/y change of (-)13,8% in 2Q12, (-)4.4% in 3Q12. In the last two quarters, both the average price as well as the volume of crude oil exports have been lower than in the previous year, with the lower volume exported particularly significant, from an average of 1,360 barrels daily in 2010, to 1,235 barrels on average in 3Q12. The price of the Mexican mix has also not contributed to increasing the value of exports in dollar terms per barrel, which, on average, has been 3.2 dollars lower in the third quarter of 2012 than in 2011. Thus, total exports of goods were $30.6 billion dollars, while imports were $30.2 billion, with which the result in the trade balance in September was a surplus of $0.4 billion dollars: a surplus of $1.6 billion dollars in the oil balance and of (-)1.1 in the non oil.

Graph 11
Exports (y/y % change and contribution to growth)



Source: BBVA Research with INEGI data

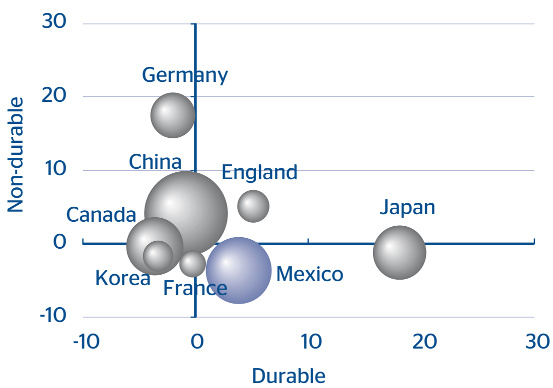
Graph 12
Value of oil exports (y/y % change and contribution to growth)

Source: BBVA Research with INEGI data

Another source of resources from abroad are remittances. With information through August, these posted one of the most important contractions (the greatest since February of 2010). After expanding in 2011, along the order of 7.2% y/y, the annual average drop has been (-)7.2% in the July-August period. Two factors influenced this behavior: on one hand, the lower employment rate of Mexican workers in the U.S.

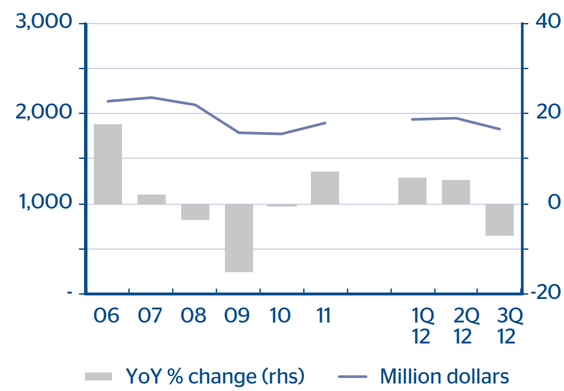
labor market, which between July and August of this year contracted an average 2.5% in annual terms, and, on the other, the peso/dollar exchange rate in a context of appreciation (13.1 ppd on average in the third quarter, 13.6 ppd in the second quarter), Mexican migrant workers tend to send fewer dollars.[1]

Graph 13
Market Gain or Loss and Manufacturing Share in the U.S. 2Q12 (The size of the ball indicates the share in the U.S.)



Source: BBVA Research with data from the U.S. Department of Commerce

Graph 14
Income from Remittances (Millions of dollars and y/y % change)



Source: BBVA Research with INEGI data

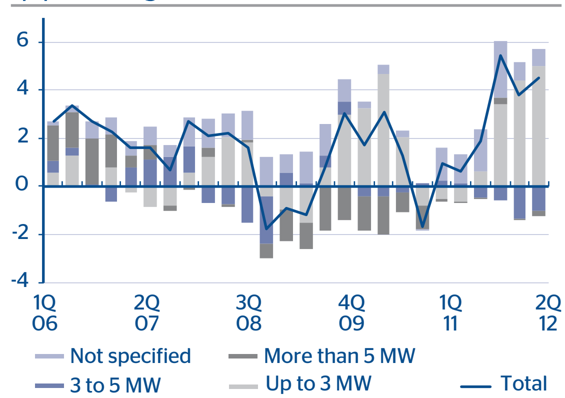
... domestic demand posts a positive surprise: the key is employment

Among the domestic stimuli, the dynamic of job creation is worthy of mention, both in the formal private sector of the economy (workers affiliated in the Mexican Social Security Institute, the IMSS) as among the rest of employed individuals. In the first group, employment has grown at an annual rate of 4.6%, even greater than the average in 2011 (4.2%). Formal employment growth has meant an increase of something more than two million workers, from the lowest point of the crisis episode of 2009 (June '09) up to September 2012. Moreover, among the rest of those employed the dynamic has also been positive, with data available up to 2Q12 and annual expansion at 4.5%.

Graph 15
Total Wages (y/y % change and contributions)

Source: BBVA Research with IMSS data

Graph 16
Employment by income level (y/y % change and conributions)

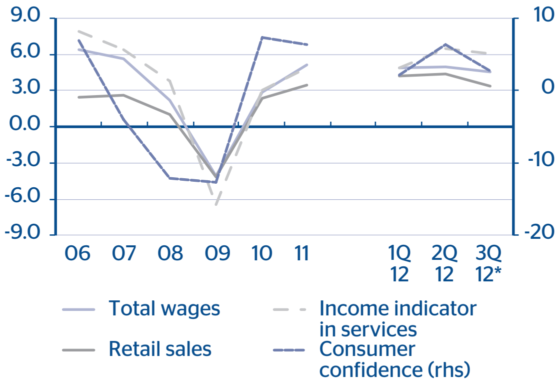


Source: BBVA Research with INEGI data

[1] See Economic Watch: Why have remittances to Mexico declined
http://www.bbvaresearch.com/KETD/fbin/mult/121017_ObsMigracionMexico_33_eng_tcm348-359795.pdf

Graph 17

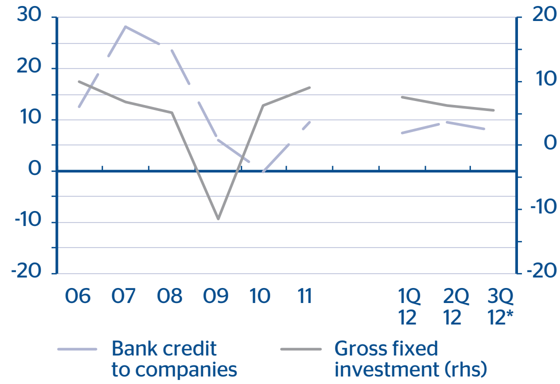
Total Wages, consumer confidence and retail sales (y/y % change)



Source: BBVA Research with INEGI and IMSS data

Graph 18

Gross Fixed Investment and Bank Credit to Companies (y/y % change)



Source: BBVA Research with INEGI and Banxico data

The positive course of formal employment growth is the main element behind the annual increae in total wages. In contrast, wages in real terms, were on average (-)0.2%, lower than a year ago this third quarter, by which its contribution to total wages was negative. The same, but to a greater extent, occurred in the average income of total persons employed, which was on average 1% lower than a year ago (figures up to 2Q12). Thus, in terms of income levels of those employed, it is noteworthy that in contrast with job creation, these levels have remained at low levels: of the 48.4. million workers employed in 2Q12, 67% received between zero and three minimum wages, while 82% received from zero to five minimum wages.

So far this year, consumer confidence has continued growing compared to the previous year, which is reflected in turn in the good dynamic of private consumption, which has expanded at 6% quarterly, on average (around 4% annually) in the first two quarters; more timely indicators of domestic demand and in particular of private consumption correponding to the third quarter (through August) indicate that it would have continued to grow, although at a lower rate than in the first quarters. In terms of investment, that of private origin has been particularly significant in quarterly growth, while public investment fell in the first quarter of the year. It is significant that for both consumption and investment, stable financial conditions and of credit flows have contributed to the continued growth of these components.

Going forward, and in line with the base scenario, we note the positive growth of the economy in an environment of global moderation. As in the previous quarter, we maintain our growth forecast at around 3.7% for 2012 and 3.0% for 2013, in view of the external risks still latent, mainly related with the possibility of greater moderation of growth in the U.S.

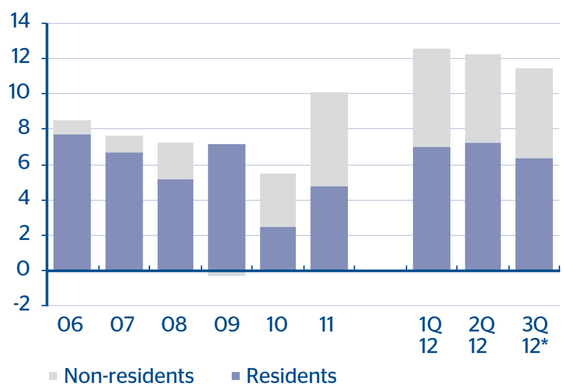
On the aspect of financing sources for the economy, with information through August 2012, resources for financing the economy will continue rising, in particular broad financial savings (defined as M4 minus bills and coins, including the public sector) increased in real terms in the third quarter, around 11.5% annually, although somewhat below the two previous quarters (12.4% on average in the first six months), so that the moderation trend also prevailed in this aggregate. From the increase in broad financial savings in the two-month July-August period, 6.4 points have been through residents (fundamentally contributing voluntary savings) and 5.1 through non-residents (mainly in government securities):

Moreover, in the first six months and in particular the second half of the year, the flow of the accumulation of international reserves continued to grow, representing around 3% of GDP, while the public sector, including states and municipalities had an annual flow of resources along the order of 2% of GDP and the private sector around 1.5%. It should be noted that the balance of resources used by the public sector has been increasing since 2007, to almost 37% of the total in 2Q12, above that of the resources used by the private sector, equivalent to 33% of GDP. Within the private sector, the use of resources by companies is of note, with a trend upward which was accentuated starting at the beginning of the economic recovery in 2009. In turn, resources to households have increased mainly through resources for housing.

Thus, the flow of financial resources, both internal as well as external will continue to further growth, althoug we do not rule out a slight moderation due to slower growth toward the second half of the year.

Graph 19

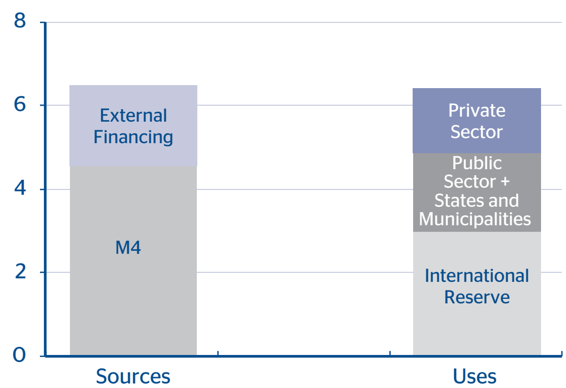
Total Wages; consumer confidence and retail sales (y/y % change)



Source: BBVA Research with INEGI and IMSS data

Graph 20

Flow of sources and use of resources of the economy (% of GDP 2q12)

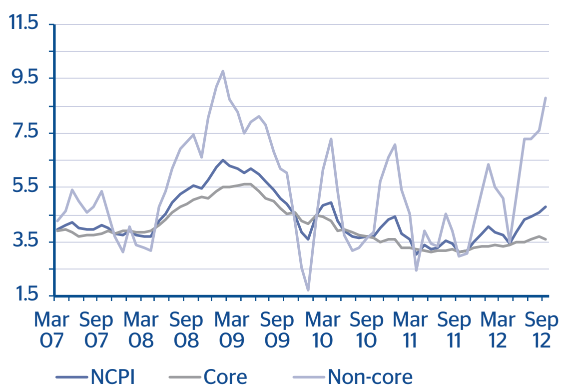


Source: BBVA Research with Banxico data

3.2 Inflation to return to below 4.0% as the persistence of supply shocks decreases

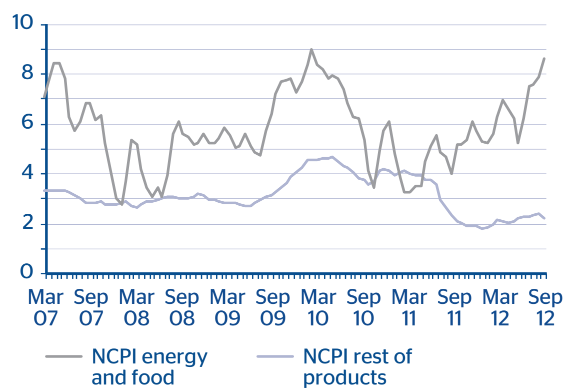
Upon reaching an annual rate of 4.8% y/y in September, inflation completed its fourth month above 4.0%. Its quarterly average was 4.6% y/y, above the level of the upper limit of the 3.0% variability range target set by the central bank. However, this performance in reality cannot be attributed to generalized price increases. Rather, it is due to the ongoing shocks that have been experienced by some product categories, which have led to high inflation in recent months. As proof of this assertion, core inflation posted only a slight increase in the quarter, rising from 3.5% to 3.6%, a growth that is solely attributable to the increase in the commodities sub-index. Another element that indicates that the rise in inflation is not due to generalized price increases can be obtained by compiling one sub-index for food and energy and another for the rest of the products. The food and energy sub-index, involving products that are very exposed to turbulences on the supply side, both locally as well as internationally, posted 8.6% growth y/y in September, while the increase in prices of the rest of the products was only 2.2% y/y. The food and energy sub-index accounts for 40% of the CPI basket in terms of weight, while the rest of the products comprise the remaining 60%.

Graph 21
Inflation and its components (% change, y/y)



Source: BBVA Research with INEGI data

Graph 22
NCPI – food and energy and the rest of the products (% change, y/y)



NCPI ;National Consumer Price Index
Source: BBVA Research with INEGI data

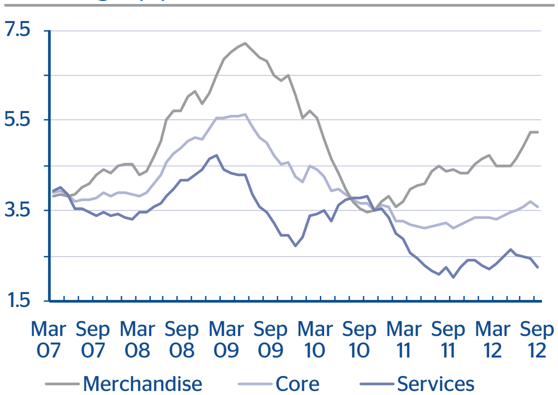
Recent inflation behavior has been very uneven among its different components. Moreover, within the sub-components of core inflation there are important differences, which has been the case since the last quarter of 2010. On the one hand, commodity prices have increased, growing 5.2% y/y in September, while on the other hand, inflation for services, for the 20th consecutive month was below 3.0%, dipping to 2.3% y/y in the same month.

Prices of commodities in the third quarter were affected by a new upturn in processed food prices and the continued growth of inflation in the rest of the commodities, which began in October 2011. Following a reduction in inflation in the fourth quarter of 2011, prices of processed foods experienced a new surge in the third quarter of 2012, with growth at 6.8% y/y from the 6.4% increase posted in the second quarter. This behavior can be attributed to a new increase in grain prices worldwide that occurred in June, which has generated new pressures on these prices. While this rebound appears to have less strength than the inflationary increase in 2011, it has been a factor in the downward rigidity of inflation. The prices of the rest of the commodities (a component that excludes food) experienced an upward adjustment after their growth reached 1.93% y/y in October, the lowest level since June 2006, with an average inflation of 3.8% y/y in the 3Q12. This behavior has responded primarily to two factors; first, the ongoing yet weak recovery experienced by consumption since 2010, and second, that the depreciation of the peso since September 2011 has averaged 8.5% y/y.

Meanwhile, the increase in service prices has been below 3.0% y/y since February 2011 and in the third quarter of 2012 even experienced a slight slowdown, with growth declining to 2.4% from 2.6% y/y in the second quarter. Within the services category, housing and education prices remain very stable around their year's average of 1.9% and 4.4% y/y respectively, while inflation in the rest of the services slowed down sharply, with growth declining from 2.7% y/y in 2Q12 to 2.3% in 3Q12. The behavior of other service prices can partly be explained by the good performance of the telecommunications sector, in which increased competition has helped lower prices, which has led to an overall decrease of 5.6% y/y on average during 2012, which had a -0.2% average effect on headline inflation during the year. Prices of services continue to reflect the leeway prevailing in the economy, since even though consumption has recovered, unemployment remains above its pre-crisis level and the growth in real wages has been modest. Nevertheless, the effect of increased competition in some sectors in maintaining this low level of inflation is not negligible.

Graph 23

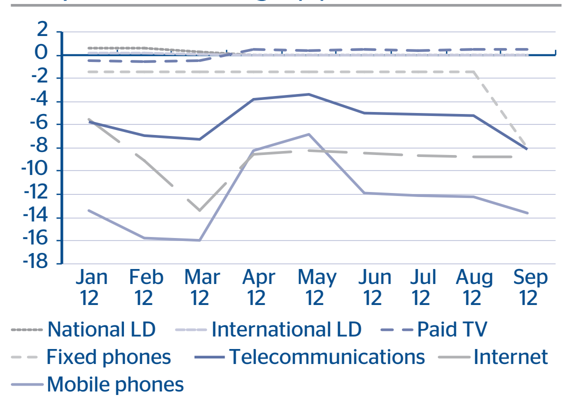
Core inflation and its components (% change, y/y)



Source: BBVA Research with INEGI data

Graph 24

Price growth in telecommunications and its components (% change, y/y)



Source: BBVA Research with INEGI data

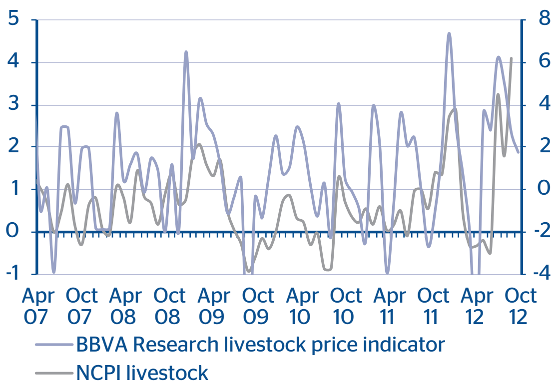
In contrast, non-core inflation experienced strong growth during the 3Q12, increasing from 5.3% y/y in the previous quarter to 7.9%, a behavior spurred by rising agricultural and meat prices and to a lesser extent by an increase in energy inflation. Agricultural prices have had a negative performance during the last five months, which has raised the category's annual inflation to 13.4% in September. Part of this increase can be attributed to slight seasonal imbalances between the months of planting and harvesting, but overall it appears that the productive conditions that have prevailed in the countryside during the year are less favorable than in 2011. Meanwhile, prices of meat products grew 12.7% on average in the year, and after reaching their annual low in June, once again experienced new growth since July, which raised annual inflation in this category to 17.7% in September. This new increase is primarily due to the sharp rise in egg prices, following the discovery of an outbreak of avian influenza in western Mexico in June, but the new rebound in grain prices worldwide in the past few months has also helped to pressure producer prices of beef and pork.

Prices of energy products also posted rapid growth during the 3Q12, from 7.7% y/y in the second quarter to 8.0% y/y. This growth was mainly due to the increase in prices for electricity and liquefied petroleum gas, consistent with the rebound in oil prices this year and the programmed slight but continual increases in gasoline prices. Meanwhile, natural gas prices continued to decline in the third quarter, which helped to partially contain energy inflation.

Finally, the prices of rates and fees set by the local governments again slowed their growth, from 0.4% y/y in the second quarter of 2012 to 0.1% y/y in the third quarter, attributable to a context marked by the absence of pressures on the public finances of sub-national governments underpinned by oil prices, which, on average have been above the price programmed in the federal budget (85 dpb approved in the budget vs. 103.2 dpb observed). The good performance of this sub-component also helped contain the rise in inflation during the year.

Graph 25

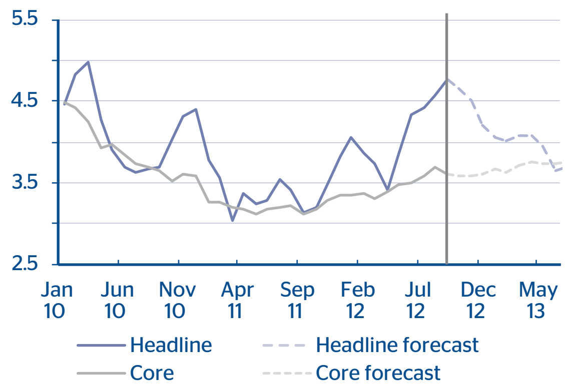
BBVA Research and NCPI meat prices index (% change, y/y)



Source: BBVA Research with INEGI and SNIIM data

Graph 26

BBVA Research inflation scenario (% change, y/y)



Source: BBVA Research

BBVA Research's inflation scenario for the rest of the year expects that the growth in prices will begin to converge with the central bank's variability range as of the 4Q12, and will reach an annual rate of 4.2% in December of this year. But given the intensity of the shocks that have led inflation rates to surpass this range, it is projected that it will not clearly fall below 4.0% until the second quarter of the year, to continue downward to a rate of 3.6% at the end of 2013. For core inflation, we estimate that it will remain contained and will fluctuate between 3.6% and 3.8% in the next three quarters to finally decline during the 4Q13 to close the year at very close to 3.5%. This scenario is primarily based on a gradual subsiding of supply shocks that have affected inflation, in a context in which economic activity expands with enough strength to generate demand pressures in commodity prices, which even though they are not expected to decline rapidly in 2013, should at least remain very stable and with an exchange rate that appreciates slightly. Upside risks to inflation include a possible additional rebound in commodity prices worldwide, a peso depreciation during periods of global risk aversion, and the possibility of a sharp increase in rates set by local governments seeking additional revenue at the beginning of their administrations. As a downside risk is the possibility of a new recessive period globally that would affect the country's growth and increase the slack in the economy.

Inset 1: Determining factors in the inflation differential between Mexico and the United States

The Mexican economic cycle is closely linked to that of the United States. However, this link is not so obvious when comparing the performance of consumer prices between the two countries, and, therefore, it is important to identify the main factors that determine the inflation differential between these nations.

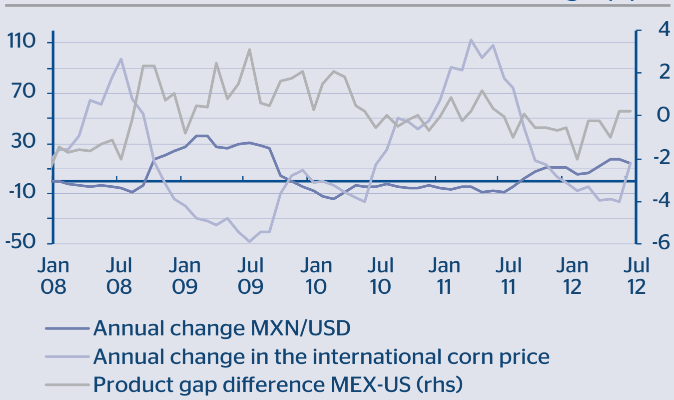
In recent years, U.S. inflation has remained low, at 1.6% on average since 2009, and close to the 2.0% that the market feels is the Federal Reserve's target, with the exception of the period between April and December 2011, when it rose above 3.0% due to a sharp rise in oil and grain prices. In the same period, in Mexico, inflation has averaged 4.3% y/y, exceeding 4.0% in 48% of the months due to constant supply and exchange rate shocks during this time. Nevertheless, inflation in Mexico fluctuated within the Banco de México's range of variability throughout all of 2011 and was even very close to the average level of the 3.0% target.

The inflation differential between two countries is not exactly comparable because of differences in consumption patterns between each nation's population. This leads to the consumption of different products being uneven and the spending earmarked for each item being different. Therefore, in order to avoid the distortion generated by the presence of different consumption baskets between the countries, and so that the inflation differential between Mexico and the United States better reflect the differences in the evolution of their respective prices, a national consumer price index for Mexico was prepared based on the expenditure weights used in the United States. This spread has been experiencing a major decline since the late 1990s, although, at the same time, only in brief periods has the differential been close to zero, thus, in general, indicating high volatility.

To explain the determining factors behind this price differential, a model has been prepared using as explanatory variables the annual percentage change in the exchange rate, the spread between the industrial production gap in the two countries in order to control for differences in the cycle, and the annual variation in international corn prices. As can be seen in the graph below, these variables generally explain the inflation differential between Mexico and the United States. The exchange rate is usually the variable that explains the lion's share of this differential. This can occur due to the high degree of opening of the Mexican economy and because the strength of this market makes it one of the first variables that adjust to changes in the economic environment, for example, making imports more expensive in a currency devaluation that results from greater global risk aversion. In addition, the spread between the industrial production gaps also explains part of the difference between the respective evolution of prices. This is because in Mexico, the cycle is generally more volatile, and therefore the price pressures it generates are usually more pronounced. Finally,

Graph 27

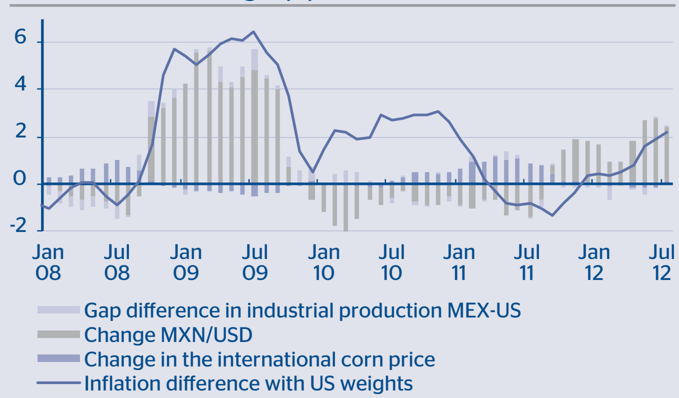
Behavior of the explanatory variables of the inflation differential between Mexico and the U.S. (% change, y/y)



Source: BBVA Research, Bloomberg, and Haver. This refers to the inflation differential based on U.S. expenditure weights.

Graph 28

Breakdown in the inflation differential between Mexico and the U.S. (% change, y/y)



Source: BBVA Research

corn prices generate a high degree of vulnerability in relation to the inflation differential, more specifically, changes in the global supply of this input (and in some other grains) can have a more direct effect on prices in Mexico because the United States is one of the largest agricultural producers in the world.

Nevertheless, there are other factors that can affect the inflation differential that are difficult to encompass in a model. For example, at the beginning of 2010 the value added tax (VAT) rate in Mexico was increased from 15% to 16%. This increase, despite representing a modest effect on the tax rate, implied an upward shift in the differential, leading to an increase in its level throughout the year. However, following this period, the variables included in the model correctly explain the behavior of the differential.

In conclusion, the inflation differential between Mexico and the United States can mainly be attributed to the structural differences between the economies, among the most important of which are those linked to the productive structure of each country. Even though it has not been possible for this differential to close completely, it is important to emphasize that price stability in Mexico, as well as the flexible exchange rate policy that was adopted as of the 1990s, have helped maintain the international competitiveness of the productive sector, strengthening the country's economy.

3.3 Monetary pause in an inflation environment of over 4.0%

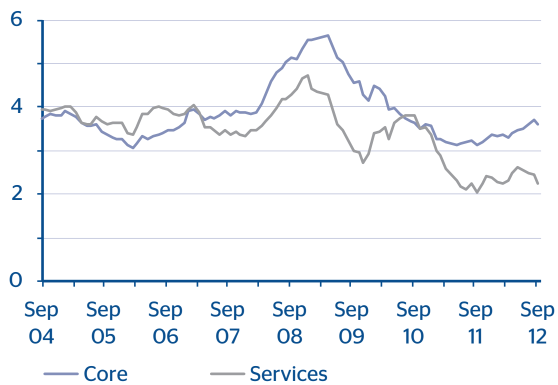
In an environment where inflation is now higher than the target and the downward risks for global growth continue, the monetary policy rate reaches its third year unchanged. Since last June, various supply shocks in agricultural, livestock and energy prices have taken inflation to over 4.7%. Even though this level surpasses the upper limit of the variability interval of the inflation target, the temporary nature and not that of core inflation, is the shock that has constituted support elements for the decision to maintain the monetary pause. In addition, at this time there is no evidence that these increases have generated second round effects, as can be seen in the core inflation level of around 3.6%, and in the services sub-index inflation rate of barely over 2.0%. On the other hand, medium-term inflation expectations, a relevant value in inflationary targets, remains anchored at around 3.5%, a sign that analysts coincide, at this time, with the transitory nature of the shock. It should be noted that when introducing in estimates of reaction functions of the central bank, inflation measures that allow separating supply shocks from demand pressures, such as core inflation and inflation excluding food and energy, a prolonged monetary pause is obtained as a result (See Chart "Non-traditional determining factors of the monetary policy rate").

In terms of activity, growth has been maintained with some signs of moderation, while the risks on the world economy continue. Growth in domestic activity continues based on consumption and private investment, which in the second quarter grew at annual rates of 3.6% and 6.4%, respectively. The growth in employment and credit continues to be an element of support for this growth. Nevertheless, the most recent data on manufacturing exports and automobile production are giving signs of moderation from external demand, while the looseness in the markets of the economy is maintained.. At the level of the world economy, even though the global aversion to risk has decreased after the European Central Bank implemented additional steps to provide liquidity, doubts still persist regarding the implementation of the rest of the measures to solve the debt crisis in Europe and the deterioration of the economic situation in several countries of the euro zone. In addition, the risk remains that the U.S. Congress will not be able to postpone the steps for cutting back expenditures and raising taxes, programmed for the early hours of 2013 (known as the fiscal cliff). All of these risks regarding economic activity represent another factor for maintaining expectations of a monetary pause.

In this environment of inflation of over 4.0%, the central bank adopted a more restrictive tone in its last communiqué. This hardening of tone is reflected, when indicating that should supply shocks and both headline and core inflation persist and not confirm their descending course, an adjustment upward would proceed in the monetary policy rate. It should be indicated that, even though, these arguments denote a hardening of tone, the central bank emphasized that the risk balance for both domestic and global growth, also deteriorated in view of the greater intensity of the downward risks for world growth. In this environment of greater inflationary upward risks in the short term, although lower in the medium term, it is important to recall that in the minutes of the monetary policy meeting of September, it was seen that within the Board of Governors, there is discussion regarding whether there are elements that suggest a contagion of the supply shocks to core inflation. Also, there is debate regarding the costs and benefits of whether monetary policy acts as a consequence of supply shocks. As another element, it should be mentioned that in accordance with BBVA Research estimates, the easing of the monetary position of the FED affects the level of the funding rate downward in Mexico (See document: "Banxico, the FED and the Market", published September 25th, 2012, by BBVA Research).

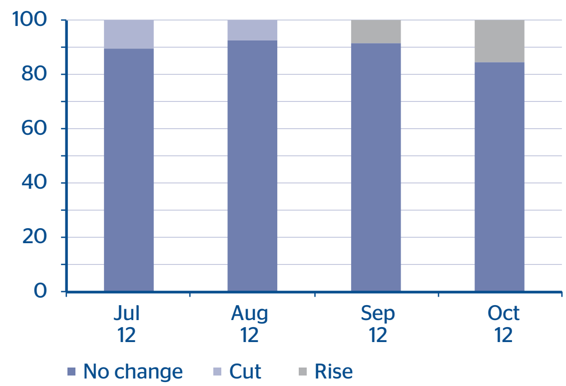
Currently, the BBVA Research scenario maintains GDP growth of 3.0% for 2013 and an inflation rate that will remain at over 4.0%, at least until the first quarter of next year, to later drop to levels of around 3.5% toward the end of the year. In this growth scenario which does not suppose demand pressure on prices, on supply shocks that dissipate and on high liquidity at a global level, we maintain our outlook that the monetary pause will remain during 2013. Nonetheless, the possibilities increase significantly of a rise in the reference rate should inflation resume its upward trend

Graph 29
Core inflation and services sub-index inflation



Source: BBVA Research and INEGI

Graph 30
Expectations of movement in the monetary policy rate in the coming six months (analysts %).



Source: Survey of financial markets analysts' expectations .

Inset 2: Non-traditional determining factors behind the monetary policy rate

The current combination of inflation above 4.0% for the past four months, with an economic growth outlook for this year of close to 4.0% would suggest that there are conditions in place for adopting a tighter monetary approach. In fact, an analysis of the monetary policy rate using reaction functions based on the traditional determining factors (inflation gap and output gap) lead to signs of a tightening of the monetary stance, which, for the time being, are not clear in the central bank's communiqués. This suggests the possibility of a change in the process by which the central bank determines the monetary rate. Specifically, the following questions are posed: are there variables in addition to the traditional variables that the central bank might consider in the process of determining the monetary policy rate?, Has the process of determining the rate varied over time as a result of a change in local or global economic conditions?

In order to answer these questions and based on the central bank's recent communiqué, nontraditional variables are included in a reaction function analysis. These functions, also called monetary policy rules, are as follows:

$$i_t = (1-\rho)(\alpha) + (1-\rho)\,\beta\,(E[\pi_{t+n} - \pi^*_{t-n}]) + (1-\rho)\,\gamma\,(E[y_{t+k} - y^*_{t+k}]) + \rho\,(i_{t-1}) + \nu_t$$

in which i_t is the monetary policy rate, α represents the nominal long term equilibrium interest rate, π_t iindicates inflation, π^*_t, is the inflation target, y_t, is the annual GDP growth rate, y^*_t, represents the potential output of the Mexican economy. E[] denotes the expected operator value, ρ measures the graduality at which interest rates are adjusted, and ν_t represents the stochastic error. The t sub-index indicates the time period, while k and n represent the number of periods lying ahead in the output gap and the inflation gap, respectively.

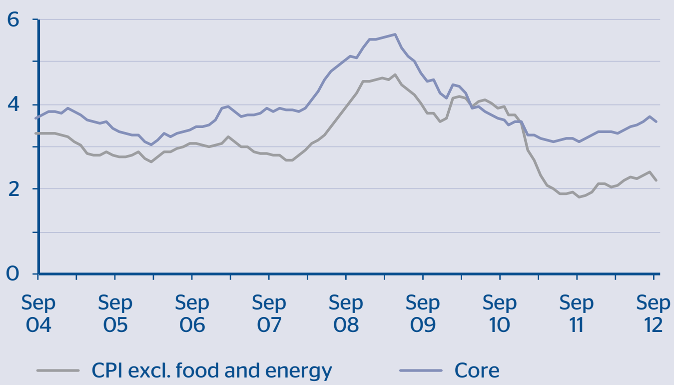
One of the arguments for keeping the funding rate unchanged in the current inflation scenario is that, for the time being, no adverse effects have been seen on the formation of medium-term expectations. By incorporating the inflation gap in the reaction function, based on expectations for six and 12 months in the future in substitution of contemporary inflation numbers (forward-looking monetary policy), statistically significant results are obtained. That is, the results confirm that inflation expectations are of great importance in determining the monetary rate.

At the same time, in the minutes of its last meeting, most of the members of the Board of Governors of the central bank noted that the nature of inflationary shocks is relevant in determining the monetary rate. This is based on the assumption that monetary policy is ineffective in containing inflationary pressures generated by the supply side. Therefore, the monetary rule should include an inflation gap based only on the core component of inflation, with significant results. As an alternative measurement of demand pressures on prices, the inflation gap is included, based on a price index that excludes food and energy, with this variable being comparable to the definition of core inflation in the United States. This gap is also statistically significant and has gained weight since 2008. These results suggest that even if the inflation target is in terms of headline inflation and given the changing economic conditions, it is to be expected that a central bank will not base its monetary policy decisions solely on an inflation variable, but rather on a combination of several such indicators with weights which can change over time, and that it will place emphasis on those variables that factor in demand pressures, particularly to the extent that inflation is around its target range.

Finally, given the recent announcement by the Fed that it would increase monetary support measures, it is important to know to what extent these decisions influence Banxico's stance, especially after the central bank noted in its communiqués that an unnecessary tightening of monetary conditions could make a less restrictive approach advisable. To this end, the model tries to factor in a looser monetary stance on the part of the Fed through using different variables such as the annual percentage growth of the broadest monetary aggregate (M1), the annual percentage change of the assets in its balance sheet, and the real monetary policy rate. The results show that each of these variables is important, and therefore it can be concluded that a looser monetary policy in the United States is associated with a downward effect on the monetary rate in Mexico.

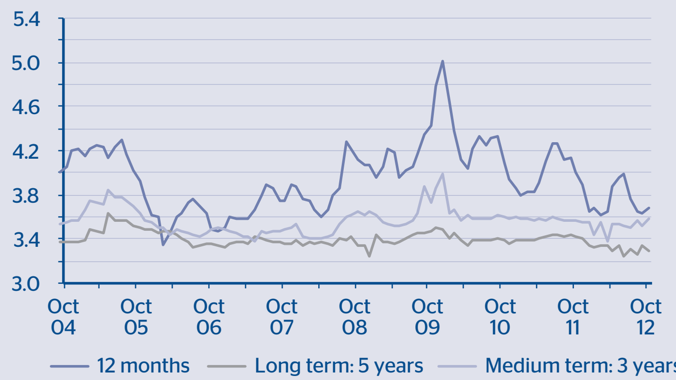
To summarize, the statistical analysis of monetary rules allows us to conclude that the process of determining the monetary rate, in addition to considering the traditional components, namely the inflation gap and product gap, also includes the following variables as complementary elements: i) inflation expectations, ii) in the recent period, inflation measures that allow for separating supply shocks from demand pressures on prices, and iii) the Fed's monetary stance.

Graph 31
Trimmed inflation: core and inflation excluding food and energy (% change, y/y)



Source: BBVA Research and INEGI

Graph 32
Inflation expectations (%)



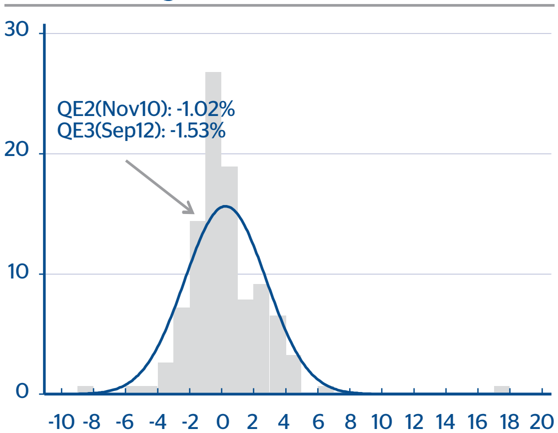
Source: BBVA Research with Infosel data

The exchange rate and medium- and long-term interest rates will remain restrained in the coming months in an environment of high global liquidity and moderate growth

In recent months, the U.S. economy has shown signs of weakness both in activity and in employment. As a result, the Open Market Commission of the Federal Reserve, in its announcement of monetary policy of September, reduced its growth perspective for 2012 from between 1.9% and 2.4% to between 1.7% and 2.0%; it implemented a new program of monetary easing (QE3) through the purchase, without pre-established limits, of mortgage-backed securities (MBS) and anticipated that the historically low level of the federal funds rate is possible, guaranteed at least until the middle of 2015. The goal of these new stimuli is to improve mortgage financing conditions, to foster this sector, support consumption, and, finally, to improve conditions in the U.S. labor market. It should be mentioned that, according to the FED, the extraordinarily low level of interest rates for a prolonged period does not imply that growth expectations are deteriorating.

The monetary easing programs in the U.S. have contributed to an increase in global liquidity that is reflected in the entry of flows and an appreciation of the currencies in the emerging markets. For example, in the month after the announcements of monetary easing in November 2010 and September 2012, the Mexican peso appreciated against the dollar by 1.0% and 1.5%, respectively. The monetary easing program announced in September 2010 concluded in June 2011, a period when the Mexican peso appreciated 4.7%. Nevertheless, this appreciation was influenced to a large extent by the positive surprises in economic activity in the U.S. and the improvement in the growth perspectives of that country in the first half of 2011. In contrast, on this occasion, the risks associated with the financial crisis in Europe and weak growth in the U.S. reduce the probabilities of a similar appreciation.

Graph 33
Average of monthly changes in the peso-dollar exchange rate (m/m % change)



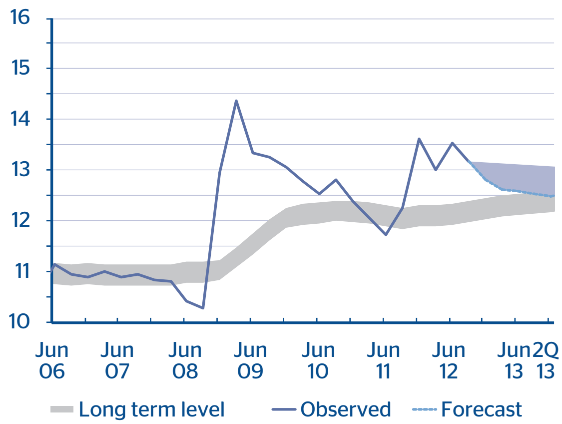
Source: BBVA Research and Bloomberg

Graph 34
Surprise index of activity in the U.S. and the peso-dollar exchange rate (index and pesos per dollar)

Source: BBVA Research and Bloomberg

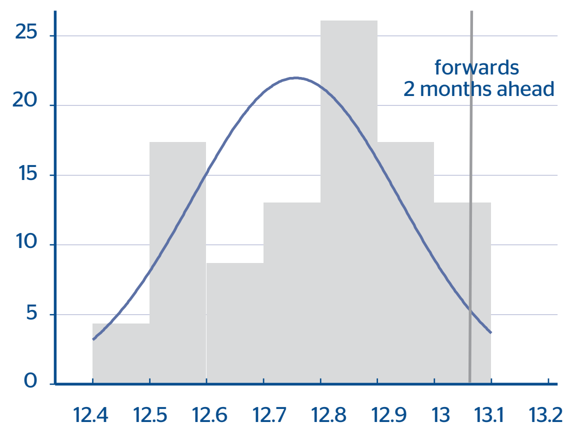
As a result, in an environment where the sources of risk for the global economy have decreased and growth in the U.S. is maintained moderate and stable, it is expected that the exchange rate will close the year at 12.91 pesos per dollar. The expectation at December 2012 of the financial markets reflected in the peso forwards is of 13.06 pesos per dollar, while that of the analysts is of around 12.8 pesos per dollar with a slight bias toward appreciation. Going forward, to the extent that global conditions are normalized, the peso should tend toward a long-term level of around 12.5 pesos per dollar.

Graph 35
MXN/USD: level observed and long-term level (pesos per dollar)



Source. BBVA Research

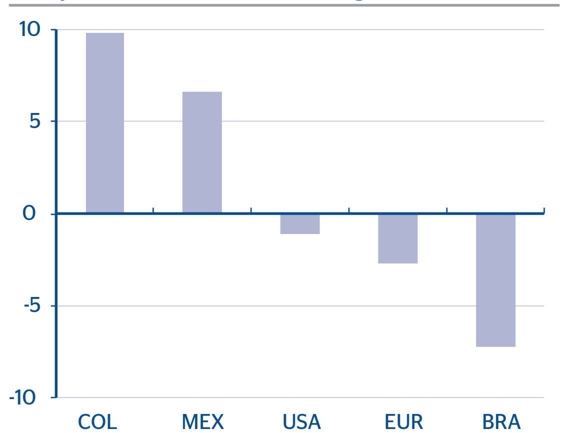
Graph 36
Expectation of analysts and in peso forwards on the exchange rate through December 2012 (ppd)



Source: BBVA Research and survey of expectations of financial market analysts.

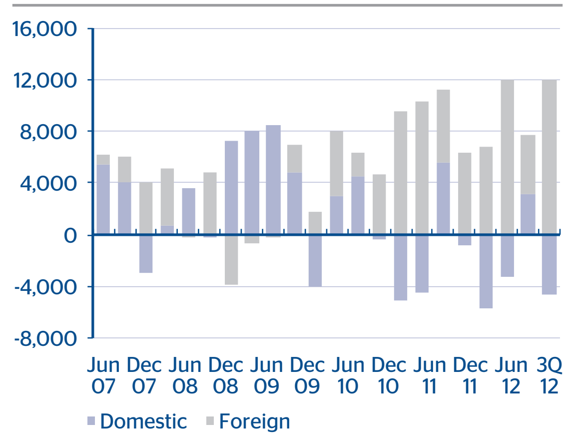
In the last year, the real risk-adjusted short-term yield in dollars has been positive in several countries of Latin America, among which Mexico is significant, which contrasts with yields close to zero or even negative in several developed countries. In Mexico's case, the monetary pause at 4.5%, stable inflation, a peso appreciation (5.1% y/y in October; Brazil -12.7% y/y) and a low sovereign risk level have supported the strong entry of foreign capital flows. During the third quarter of 2012, the entry of foreign flows in the fixed rate market reached its highest historic level with close to US$12 billion. Entry flows were concentrated in the M bond market, which also reached its highest level of capital entry flows in its history, with US$8.1 billion.

Graph 37
Real annual yield rate for each 100 bp of risk (y/y % adjusted for inflation, exchange rate and CDS)



Source: BBVA Research & Bloomberg. It considers the bond at one year

Graph 38
Flows to fixed-income securities by origin (millions of dollars)

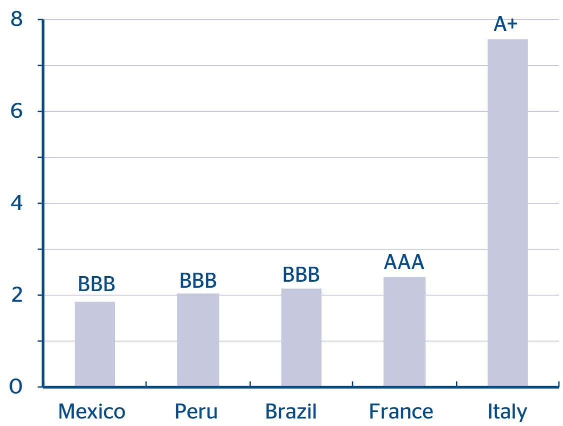


Source: BBVA Research and Banxico.

Medium- and long-term government rates in Mexico have remained low, the result of the prevailing global liquidity, the reduction of global risk aversion and a lower perception of sovereign risk. To the extent in which the uncertainty of a new episode of global risk has decreased as a result of more conclusive steps by the European central bank to provide liquidity and of the governments to implement financial adjustments, the short-term behavior of rates of Mexico has been similar to that of the U.S. Also, the -credit risk perception for Mexico observed in the financial markets is low compared to that of other countries, both emerging and developed, even when compared with countries with an equal or better credit rating. Among the factors where Mexico compares favorably with other countries, of note are an orthodox banking system that has allowed the public sector to maintain low debt and fiscal deficits, a solvent banking system, growth expectation of around 3.5% on average for 2012 and 2013, and the perspective of implementing structural reforms. For example, estimates show that the high level of global liquidity and low perception of credit risk

Graph 39

Implicit probability of default in loan agreements, non-compliance (%)



Source: BBVA Research, Bloomberg and Fitch Ratings.

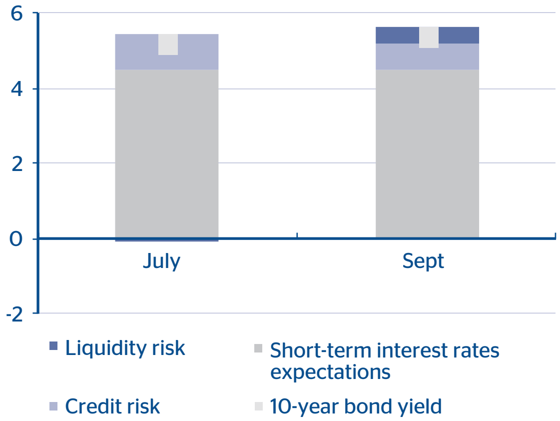
Graph 40

Rate of the 10-year government bond: Mexico and the U.S. (%)

Note: The shaded areas correspond to periods of better correlation in view of an increase in risk aversion..
Source: BBVA Research and Bloomberg

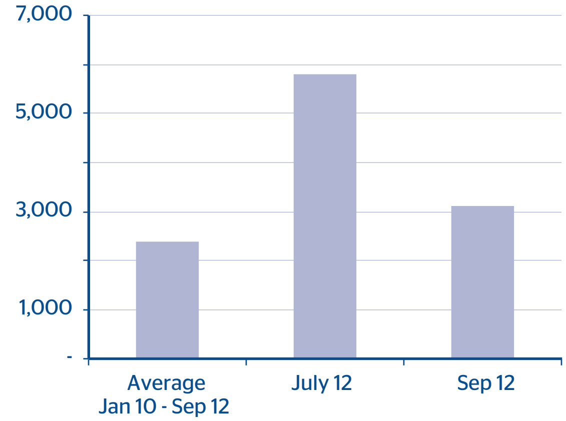
have delimited the 10-year rates, placing them at a lower difference by 100 basis points compared to the 1-year rate. Even though the rate level is still low, liquidity has decreased very slightly, as can be observed in a higher difference between the purchase and sale rate of the 10-year bond and the lower foreign flows to fixed-rate securities in September, compared to July. Global liquidity and moderate growth will be maintained in the coming months, which will result in slight variations in the medium- and long part of the curve, which is why we expect that the 10-year bond rate to close the year at a level close to 5.5%.

Graph 41
Breakdown of the 10-year bond yield: estimate (%)



Source: BBVA Research

Graph 42
Foreign flows to fixed income securities (billions of dollars)



Source: BBVA Research and Banxico

4. Indicators and forecasts

Chart 1

Macroeconomic forecasts: Gross Domestic Product

(YoY growth rate)	2009	2010	2011	2012	2013
United States	-3.1	2.4	1.8	**2.1**	**1.8**
EMU	-4.3	1.9	1.5	**-0.5**	**0.3**
Germany	-5.1	4.0	3.1	**0.9**	**1.3**
France	-3.1	1.6	1.7	**0.1**	**0.5**
Italy	-5.5	1.8	0.5	**-2.4**	**-0.6**
Spain	-3.7	-0.3	0.4	**-1.4**	**-1.4**
UK	-4.0	1.8	0.9	**-0.1**	**1.3**
Latin America *	-2.2	6.2	4.3	**3.0**	**3.7**
Mexico	-6.1	5.4	3.9	**3.7**	**3.0**
Brazil	-0.3	7.6	2.7	**1.6**	**4.2**
EAGLES **	4.0	8.4	6.7	**5.2**	**5.8**
Turkey	-4.9	9.2	8.5	**3.0**	**4.5**
Asia Pacific	4.1	8.2	5.8	**5.2**	**5.5**
China	9.2	10.4	9.2	**7.6**	**7.9**
Asia (exc. China)	0.8	6.7	3.5	**3.7**	**3.9**
World	-0.6	5.1	3.9	**3.2**	**3.5**

* Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela
** Brazil, China, India, Indonesia, Korea, Mexico, Russia, Taiwan, Turkey
Source: BBVA Research

Chart 2

Macroeconomic forecasts: inflation (Avg.)

(YoY growth rate)	2009	2010	2011	2012	2013
United States	-0.4	1.6	3.1	**2.0**	**2.1**
EMU	0.3	1.6	2.7	**2.5**	**1.8**
Germany	0.2	1.2	2.5	**2.1**	**1.8**
France	0.1	1.7	2.3	**2.3**	**1.7**
Italy	0.8	1.6	2.9	**3.4**	**2.3**
Spain	-0.3	1.8	3.2	**2.5**	**2.3**
UK	2.2	3.3	4.5	**2.7**	**2.1**
Latin America *	6.4	6.4	8.1	**7.6**	**8.1**
Mexico	5.3	4.2	3.4	**4.2**	**3.9**
Brazil	4.9	5.0	6.6	**5.3**	**5.3**
EAGLES **	2.8	5.3	6.0	**4.4**	**4.5**
Turkey	6.3	8.6	6.5	**8.9**	**5.5**
Asia Pacific	0.3	3.6	4.7	**3.3**	**3.4**
China	-0.8	3.3	5.4	**3.0**	**3.6**
Asia (exc. China)	1.0	3.7	4.3	**3.4**	**3.3**
World	2.2	3.8	5.2	**4.2**	**4.0**

* Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela
** Brazil, China, India, Indonesia, Korea, Mexico, Russia, Taiwan, Turkey
Source: BBVA Research

Chart 3

United States indicators and forecasts

	2010	2011	2012	2013	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12
Macroeconomic Indicators												
GDP (real % change)	2.4	1.8	**2.1**	**1.8**	1.8	1.9	1.6	2.0	2.4	2.1	**2.1**	**1.5**
Personal consumption (real % change)	1.8	2.5	**1.8**	**1.7**	3.1	2.7	2.5	1.9	1.8	1.9	**1.8**	**1.7**
Gov. consumption (real % change)	0.6	-3.1	**-1.9**	**-0.2**	-2.3	-3.2	-3.8	-3.3	-2.2	-2.2	**-1.8**	**-1.5**
Gross fixed investment (real % change)	-0.2	6.6	**9.2**	**6.2**	4.8	4.3	8.4	9.0	11.9	9.9	**8.1**	**7.2**
Construction	-3.7	-1.4	**11.3**	**8.4**	-3.2	-7.1	1.4	3.9	9.3	10.4	**13.1**	**12.3**
Industrial prod. (real annual % change)	5.4	4.1	**3.8**	**1.7**	5.4	3.6	3.3	4.1	4.4	4.8	**3.2**	**2.8**
Current account balance (% of GDP)	-3.1	-3.1	**-3.0**	**-3.3**	-3.2	-3.2	-2.9	-3.1	-3.5	-3.0	**-2.6**	**-2.7**
Final annual inflation	1.5	3.0	**1.9**	**2.3**	2.7	3.6	3.9	3.0	2.7	1.7	**2.0**	**1.9**
Average annual inflation	1.6	3.2	**2.0**	**2.1**	2.1	3.4	3.8	3.3	2.8	1.9	**1.7**	**1.8**
Primary fiscal balance (% of GDP)	-8.9	-8.7	**-7.7**	**-5.0**				-8.7				**-7.7**

Note: **Bold** figures are forecast
Source: BBVA Research

Chart 4

Indicadores y Pronósticos México

	2010	2011	2012	2013	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12
Economic Activity												
GDP (seasonally-adjusted series)												
Real annual % change	5.5	3.9	**3.7**	**3.0**	3.9	3.8	4.2	3.9	**4.6**	**4.1**	**3.4**	**2.9**
Per inhabitant (US dollars)	9,568	10,404	**10,771**	**11,918**	10,778.1	10,965.1	9,850.9	9,949.3	**10,732.4**	**10,187.6**	**10,799.7**	**11,214.9**
US$ billions	1,033	1,132	**1,181**	**1,316**	1,172.8	1,196.2	1,078.8	1,093.7	**1,184.2**	**1,128.4**	**1,183.9**	**1,229.5**
Inflation (average, %)												
Headline	4.2	3.4	**4.2**	**3.8**	3.5	3.3	3.4	3.5	3.9	**3.9**	**4.6**	**4.5**
Core	3.9	3.2	**3.5**	**3.7**	3.2	3.2	3.2	3.3	3.3	**3.5**	**3.6**	**3.6**
Financial Markets (eop, %)												
Interest rates												
Bank funding	4.5	**4.5**	**4.5**	**4.5**	4.5	4.5	4.5	4.5	4.5	**4.5**	**4.5**	**4.5**
28-day Cetes	4.5	4.4	**4.2**	**4.5**	4.3	4.3	4.3	4.4	4.3	**4.4**	**4.2**	**4.2**
28-day TIIE	4.9	4.8	4.8	5.9	4.8	4.9	4.8	4.8	4.8	**4.8**	**4.8**	**4.8**
10-year Bond (%, average)	8.0	6.8	**5.7**	**5.9**	7.5	7.0	6.4	6.3	6.2	**5.9**	**5.4**	**5.4**
Exchange rate (average)												
Pesos per dollar	12.7	12.5	**13.1**	**12.6**	12.0	11.6	12.7	13.6	12.9	**13.6**	**13.1**	**12.8**
Public Finances												
*FRPS (% of GDP)	-3.5	**-2.7**	**-2.6**	**-2.3**	--	--	--	-2.7	--	--	--	**-2.6**
External Sector[3]												
Trade balance (US$ billions)	-721	-293	**-1,871**	**-3,847**	2,013	1,328	-3,827	-684	**1,878**	**-482**	**-4,283**	**-4,597**
Current account (US$ billions)	-1,114	-2,768	**-3,207**	**-4,763**	-2,735	-1,100	-4,965	-2,273	**1,184**	**-3,723**	**-4,101**	**-6,186**
Current account (% of GDP)	-0.4	**-1.0**	**-1.0**	**-1.4**	-1.0	-0.4	-1.7	-0.8	**0.4**	**-1.2**	**-1.3**	**-1.9**
Oil (Mexican mix, dpb, eop)	72.3	101.1	**94.8**	**91.7**	93.0	105.6	101.2	104.5	**110.5**	**101.2**	**83.9**	**83.4**
Employment												
Formal Private (annual % change)	3.7	4.3	**4.4**	**3.3**	4.9	4.2	4.2	4.1	4.4	**4.6**	**4.6**	**4.1**
Open Unemployment Rate (% active pop.)	5.4	5.2	**5.1**	**4.8**	5.2	5.4	5.3	5.0	5.1	**5.1**	**5.1**	**5.2**

Continues on next page

Mexico indicators and forecasts

	2010	2011	2012	2013	1Q11	2Q11	3Q11	4Q11	1Q12	2Q12	3Q12	4Q12
Aggregate Demand [4] (annual % change, seasonally-adjusted)												
Total	9.0	4.7	**4.4**	**4.9**	5.1	4.6	4.8	4.1	**5.0**	**4.1**	**4.4**	**4.3**
Domestic Demand	5.5	4.1	**3.2**	**3.8**	3.5	3.6	4.9	4.2	**4.6**	**3.6**	**2.7**	**2.1**
Consumption	4.6	4.0	**3.0**	**2.7**	4.4	3.6	3.9	3.9	**4.0**	**3.4**	**2.6**	**2.3**
Private	5.0	4.5	**3.4**	**2.8**	4.9	4.4	4.4	4.3	**4.2**	**3.6**	**3.0**	**2.7**
Public	2.4	0.6	**0.9**	**2.0**	1.3	-1.3	0.7	1.8	**2.4**	**1.8**	**0.2**	**-0.6**
Investment	6.3	8.4	**6.0**	**6.5**	8.8	9.9	9.0	6.2	**9.0**	**6.3**	**4.1**	**4.6**
Private	6.3	12.3	**5.1**	**5.8**	14.5	17.5	10.6	7.1	**7.7**	**5.4**	**1.8**	**5.5**
Public	6.1	-1.9	**8.7**	**8.4**	-5.8	-9.2	4.2	3.8	**13.1**	**9.0**	**11.6**	**1.9**
External Demand	21.7	6.8	**7.7**	**7.8**	11.4	8.3	4.5	3.5	**5.9**	**5.3**	**8.8**	**10.7**
Imports	20.7	6.8	**6.5**	**10.3**	8.9	7.1	6.5	4.7	**6.1**	**4.0**	**7.3**	**8.5**
GDP by sectors (annual % change, seasonally-adjusted)												
Primary	2.9	-2.9	**4.4**	**1.9**	-2.6	-9.3	0.1	0.3	**5.6**	**9.5**	**1.8**	**1.0**
Secondary	6.2	4.0	**3.5**	**2.4**	4.8	4.2	3.6	3.4	**4.4**	**3.6**	**3.2**	**2.7**
Mining	1.2	-1.9	**0.5**	**-0.1**	-2.6	-2.0	-3.5	0.6	**0.3**	**-0.4**	**2.0**	**0.1**
Electricity	10.1	5.5	**2.0**	**2.2**	9.9	7.6	2.9	2.2	**2.1**	**1.2**	**2.5**	**2.4**
Construction	-0.1	4.8	**4.2**	**2.9**	5.6	3.9	5.3	4.7	**4.9**	**5.1**	**3.6**	**3.0**
Manufacturing	10.0	5.2	**3.8**	**2.8**	6.2	5.4	5.3	3.7	**4.0**	**4.4**	**3.5**	**3.2**
Tertiary	5.5	4.2	**3.6**	**3.0**	4.2	3.7	4.8	4.2	**4.0**	**4.5**	**3.2**	**2.9**
Retail	13.1	7.7	**4.9**	**4.1**	8.1	8.4	8.2	6.1	**6.6**	**5.4**	**4.2**	**3.3**
Transportation, mail and warehouse	7.6	3.4	**3.8**	**3.7**	3.3	3.2	3.8	3.4	**5.0**	**3.8**	**3.0**	**3.4**
Massive media information	1.6	6.6	**4.8**	**3.7**	5.3	6.0	8.0	7.1	**4.7**	**6.5**	**3.3**	**4.7**
Financial and insurance	13.1	5.4	**8.6**	**5.8**	4.8	1.3	8.0	7.3	**12.2**	**12.4**	**5.7**	**4.4**
Real-estate and rent	1.9	2.1	**1.9**	**0.9**	1.8	1.9	2.1	2.4	**1.3**	**2.4**	**2.0**	**1.9**
Prof., scientific and technical servs.	-1.1	5.8	**2.9**	**2.7**	3.6	7.2	5.4	7.0	**4.7**	**0.4**	**3.4**	**3.3**
Company and corporate management	4.9	5.8	**6.5**	**5.0**	4.4	7.3	4.4	7.1	**6.8**	**4.2**	**7.4**	**7.4**
Business support services	1.5	4.2	**4.1**	**3.5**	3.8	4.4	4.6	4.1	**2.6**	**5.3**	**4.5**	**4.1**
Education	0.2	1.5	**1.7**	**1.9**	-0.2	1.2	2.7	2.5	**1.4**	**0.8**	**2.3**	**2.3**
Health and social security	0.7	1.7	**1.8**	**1.4**	1.0	2.9	2.8	0.0	**2.2**	**1.7**	**1.8**	**1.5**
Cultural and sport	5.9	6.6	**3.0**	**3.2**	8.2	7.3	5.9	5.2	**2.0**	**4.1**	**3.0**	**2.8**
Temporary stay	3.2	2.6	**3.4**	**2.0**	0.6	2.4	3.1	4.3	**4.5**	**4.4**	**3.0**	**1.8**
Other services, except government activities	1.0	4.0	**4.1**	**2.3**	3.0	4.5	4.2	4.2	**5.0**	**4.7**	**3.4**	**3.3**
Government activities	3.1	-0.8	**1.1**	**0.8**	0.3	-5.1	-0.8	2.6	**3.2**	**2.0**	**-0.3**	**-0.5**

1: Residential investment
2: Fiscal balance (% GDP)
3: Accumulated, last 12 months
4: Base 1993=100; GDP by sector base 2003=100. The observed data of the primary sector, secondary and tertiary seasonally-adjusted by INEGI, the rest own seasonally-adjusted
dpb: dollars per barrel
*FRPS: Financial Requirements of the Public Sector
na: not available
Note: **Bold** figures are forecast
Source: BBVA Research with Federal Reserve, Bureau of Labor Statistics, Banco de Mexico, INEGI and SHCP data

This report has been produced by

Editor
Arnoldo López
arnoldo.lopez@bbva.com

Cecilia Posadas
c.posadas@bbva.com

Pedro Uriz
pedro.uriz2@bbva.com

Iván Martínez
ivan.martinez.2@bbva.com

With collaboration of:
Economic Scenarios

BBVA Research Mexico
Av. Universidad 1200
Colonia Xoco
C.P. 03339 México D.F.
Publications:
E-mail: researchmexico@bbva.bancomer.com

These and other BBVA Research publications are available in English and in Spanish at: www.bbvaresearch.com

Other publications: