

Mexico

# Weekly Watch

February 11, 2011

## Next week...

**Economic Analysis**

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**Growth in formal private-sector employment slightly slower at end of last year, although holding on to positive trend**

Last week the Department of Labor published the January results for formal private-sector employment. Employment growth fell slightly short of forecasts (0.4% BBVA, 0.3% Recorded, seasonally-adjusted figures), which represents a 5.1% annual change. The employment trend in the manufacturing sector held up with high growth rates (0.6% mom, 0.5% in 4Q10), while employment in the services sector, which accounts for around 60% of formal employment, and in the construction sector slowed down considerably (0.2% services in January, 0.3% in 4Q10; 0.1% construction in January, 0.7% in 4Q10). On the positive side, the contribution of permanent workers continues to grow, which could be interpreted as a sign of strong recovery.

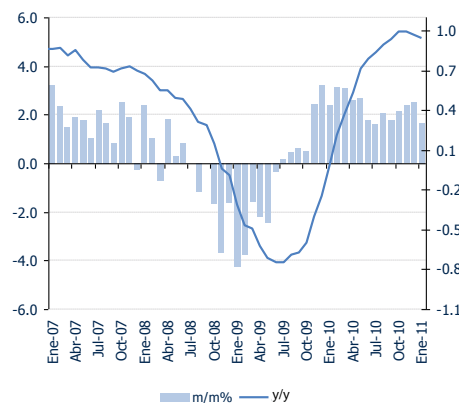
With the results from January, the wage bill continues to improve, albeit limited by the performance of real wages, which, with the results from December (January not available yet) continued to record a negative year-on-year change (-0.5% yoy). This is the main factor holding back a recovery in domestic demand.

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**Curves record heavy volatility, FX curves to a lesser extent.**

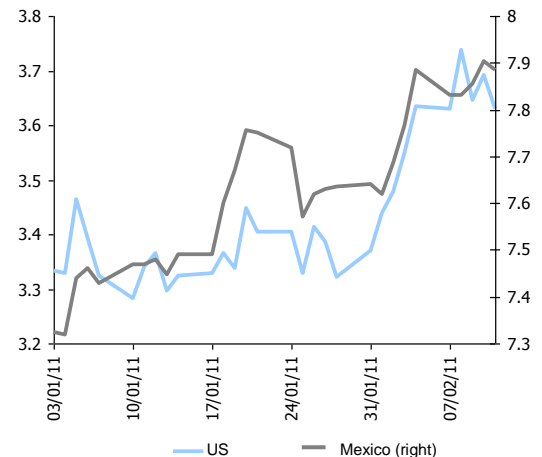
There was a dramatic volatility in curves during the week. This volatility moved to the local curve, in which the shifts in the curve (up and/or down) continue to pivot around the middle part. Next week will be laden with information in the US, and so this volatility could increase. We recommend opening long positions in the long part, and short positions in the middle part, and/or long positions over short terms versus selling in the middle part of the MBonds curve. Only if the results record a positive surprise would the middle part gain worth compared to short terms (reverse butterfly spread). Economic information in the US could trigger an appreciation in the peso, which could be limited by risks of closing speculative positions in the derivatives market.

Chart 3  
**Formal private-sector employment (% change, yoy and mom)**



Source: Banxico

Chart 2  
**Daily treasury and 10-year bond yield (%)**



Source: BBVA Research with Banxico data

Market Analysis

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Markets

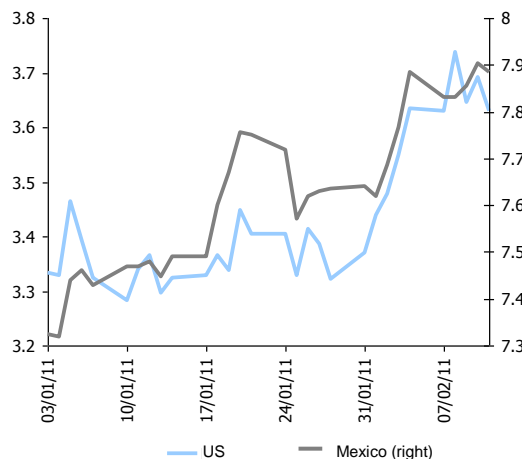
Curve volatility continues

Strong volatility in local curve linked to treasury movements. The shifts in the curve continue to pivot around the middle part. This degree of curvature suggests that the steep climb between long and short terms is coming to an end, although still with some way to go. Long or short butterfly strategies are therefore the successful ones, depending on whether the curve moves up or down. Next week will be laden with information in the US, and so this volatility could increase. We recommend opening long positions in the long part, and short positions in the middle part, and/or long positions over short terms versus selling in the middle part of the MBonds curve. Only if the results record a positive surprise would the middle part gain worth compared to short terms (reverse butterfly spread).

Positioning determines how the peso behaves

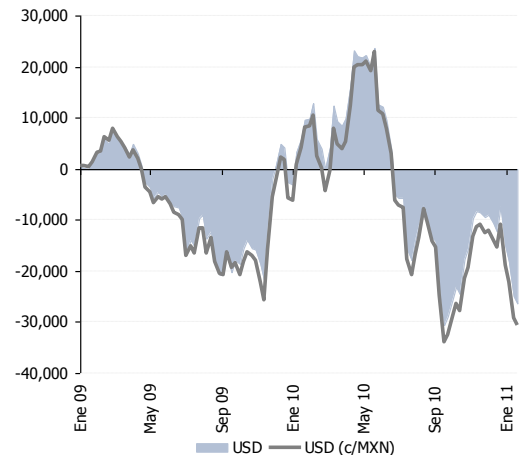
1) By last Tuesday the MXN long speculative positions recorded an increase of US\$15mn and stayed around US\$4.3bn, even though the currency had recorded a 0.3% depreciation in the reference period and 2) Banxico's remaining options had still not been exercised (amounting to US\$310mn to date). However, on the basis that the USD short position versus a basket of 7 currencies (CAD, EUR, AUD, CHF, JPY, GBP and MXN) is US\$26bn and that the 12M average is the USD short position at US\$3bn, there is a risk of closing short-term positions. This seems to be underway already in the case of the core currencies (especially the EUR and the JPY), which might have reacted to a positive trend in the US in terms of cycle and risk aversion factors during the week. Against this background, we would see the currency supported in the 11.95 area if the economic news flow in the US is able to act as a catalyst to break through the low part of the 12.0-12.11 range. Furthermore, on Friday the Secretary for Finance announced that there is a possibility of increasing the monthly amount of US\$600mn put option auctions. However, the currency ended with a 0.3% appreciation. The possibility of an increase in the auction amounts had already been considered and even included in the price. In fact, the confirmation that no other type of intervention will be made (neither directly or via capital control) continues to support the currency.

Chart 5  
Daily treasury and 10-year bond yield (%)



Source: BBVA Research with Banxico data

Chart 6  
USD net speculative positions (US\$m)



Source: BBVA Research with data from Bloomberg

Mexico City, February 4, 2011

**Market Analysis  
Equities**

Technical Analysis

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**Technical Analysis**

**CPI Stock Market Index**



Source: BBVA, Bancomer, Bloomberg

CPI: CPI weekly return, coming across a first support level between 36.500 and 36.600 points. We can expect a new upturn to the 30-day moving average, although we would only consider a change in trend as soon as it can break through 38.000 point levels. We recommend taking positions and taking advantage of this pull-back, and increasing them if the trend changes. If the double dip is not consolidated, the next support level is at 35.800pts, where we again recommend increasing positions.

Previous recommendation: At this time, this upturn can only be considered a pull-back to a resistance level. Only until it is exceeded can we consider a change in the short-term trend with a new target of 39,000 points.

**MXN**



Source: BBVA, Bancomer, Bloomberg

MXN: Attempt to rebound during the week was unable to break through the 10- and 30-day moving averages. The downtrend remains, and we can expect a return to the floor level between P\$11.95 and P\$12.00. In the event of an upturn, resistance would be at P\$12.08 and then at P\$12.20.

Previous recommendation: The trading range in the coming days is between P\$11.95 and P\$12.05.

Source: BBVA, Bancomer, Bloomberg

**3Y M BOND**

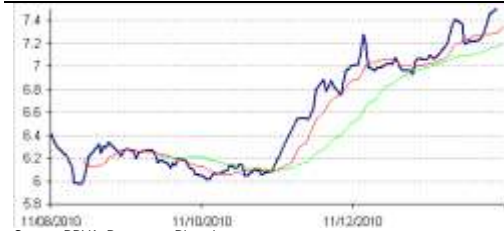


Source: BBVA, Bancomer, Bloomberg

3Y M BOND (yield): Returns to 6% resistance with possibilities of breaking through, which would put the previous maximum of 6.2% as the resistance.

Previous recommendation: We believe that the upturn may end at the earlier maximum of 6%, with support at 5.7%.

**10Y M BOND**



Source: BBVA, Bancomer, Bloomberg

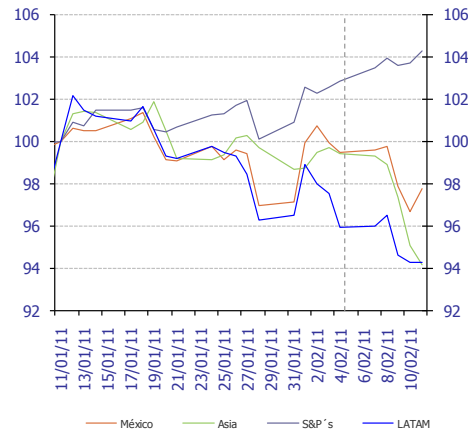
10Y M BOND (yield): Another week of upturns, which records a new high for the year and puts 7.7% as the next resistance.

Previous recommendation: We see a possible return to 7.1% before the resistance is broken.

Markets

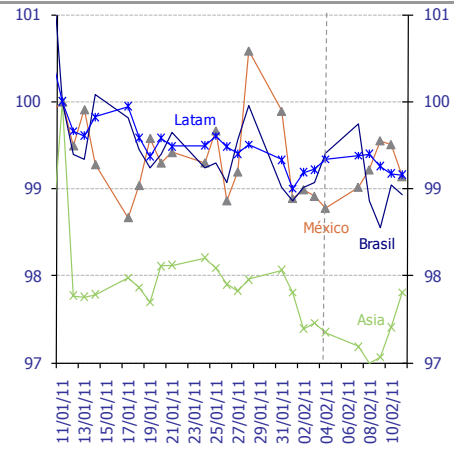
Rise in stock markets linked to a fall in geopolitical risk and better than expected figures regarding US consumer confidence. The peso is appreciating in line

Chart 5  
**Stock markets: MSCI indices (Jan 4 2011 index = 100)**



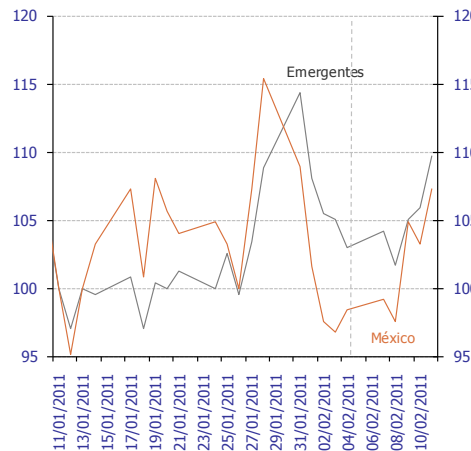
Source: Bloomberg & BBVA Research

Chart 6  
**Foreign exchange: Dollar Exchange Rates (Jan 4 2011 index =100)**



Source: Bloomberg and BBVA Research. Note: LATAM includes Argentina, Brazil, Chile, Colombia and Peru. Asia includes the Philippines, South Korea, Taiwan, Singapore, Indonesia and Thailand. Non-weighted averages.

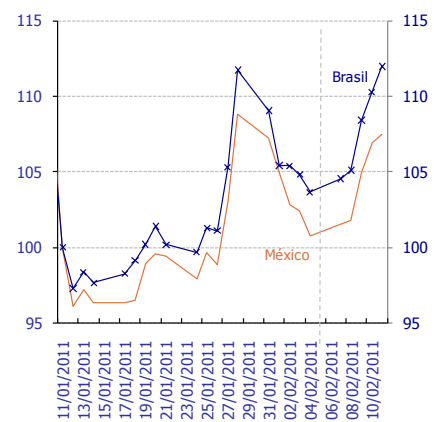
Chart 7  
**Risk: EMBI+ (January 4, 2011 index = 100)**



Source: Bloomberg and BBVA Research.

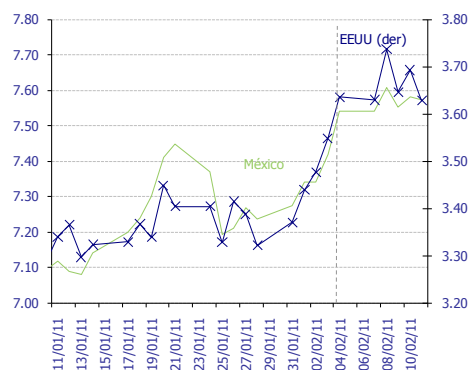
Rise in risk aversion during week, limited by glimpses of a solution to the conflict in Egypt

Chart 8  
**Risk: 5-year CDS (January 11 2011 index =100)**



Source: Bloomberg and BBVA Research.

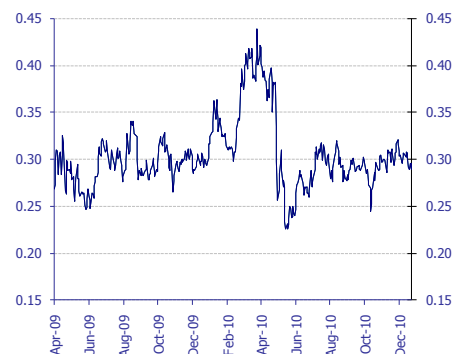
Chart 9  
**10-year interest rates\*, last month**



Source: Bloomberg and BBVA Research

Fall in US rates in spite of reduction in global risk, partly due to uncertainty in the short-term regarding the situation in Egypt. Rates in Mexico are moving in line

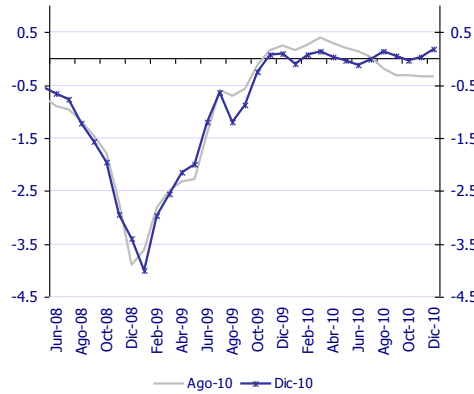
Chart 10  
**Carry-trade Mexico index (%)**



Source: Bloomberg and BBVA Research

## Activity, inflation, monetary conditions

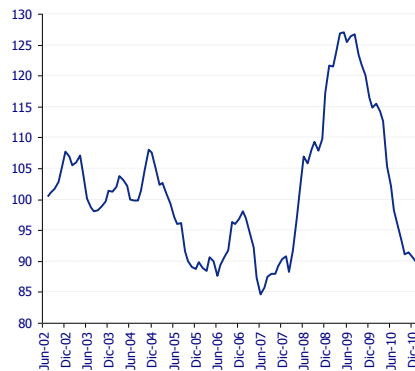
Chart 11  
BBVA Synthetic Activity Indicator of activity for the Mexican economy



Economic activity in Mexico recorded slight upturn towards the end of the year with a general slowdown trend

Source: BBVA Research with data from INEGI, AMIA and BEA. Weighted sum of 21 different activity indicators, expenditure and expectations, based on trend series.

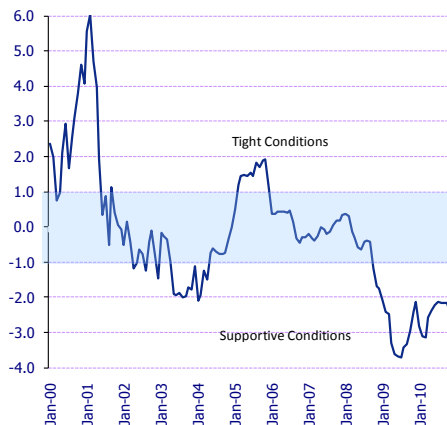
Chart 13  
Inflation Surprises Index (July 2002=100)



Inflation surprises fell throughout most of 2010, while activity surprises were moderate.

Source: BBVA Research with data from Banxico from the monthly surveys on the expectations of economic specialists in the private sector.

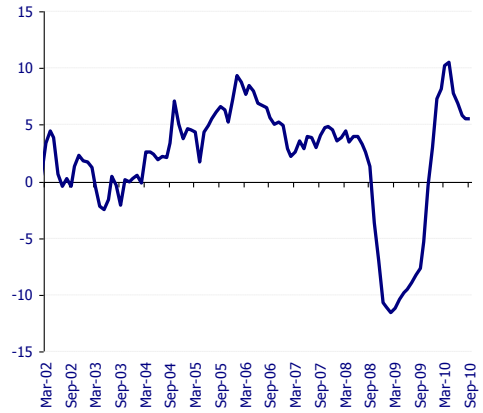
Chart 15  
Monetary Conditions Index



The monetary conditions in which the economy is moving are accommodative. No upward movements are therefore expected to the reference rate in the short term

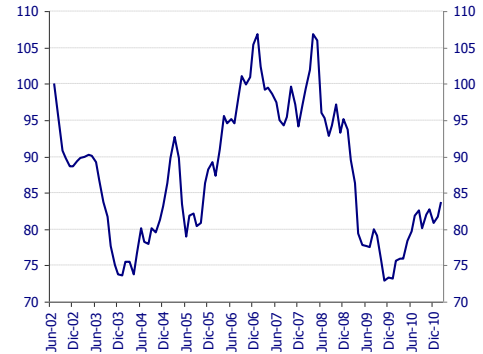
Source: BBVA Research

Chart 12  
Advance Indicator of Activity (% y/y change)



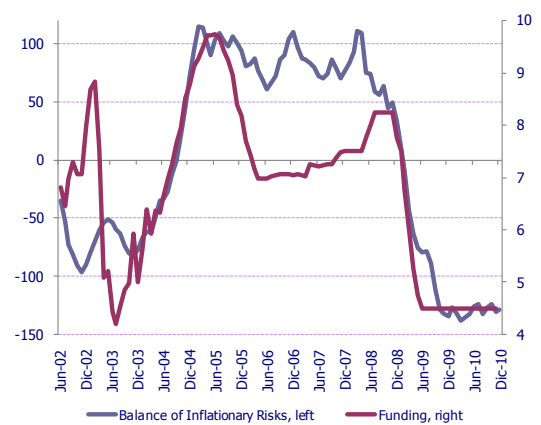
Source: INEGI

Chart 14  
Activity Surprise Index (2002=100)



Source: BBVA Research with data from Bloomberg. Difference between recorded data and the Bloomberg consensus for seven activity variables in Mexico. Standardized index. Rises (falls); positive (negative) surprises.

Chart 16  
Balance of Inflationary Risks\* and Funding (standardized and %; monthly averages)



Source: BBVA Research. \*Standardized, weighted index (between inflation and economic growth); uses economic indicators for activity and inflation. A rise in the IBR signals greater weight of inflationary risks over those of growth and, therefore, more likelihood of monetary restriction

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