

Weekly Watch

Mexico

Next week...

A review of the past and an agenda for the future

August 26, 2011

Economic Analysis

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Of particular note in the upcoming week is the Fifth Report on Government by the Presidency of the Republic. This is an annual document that includes the Executive's views on developments in the country, the challenges facing it and its proposals for action. If we were to highlight any particular reform carried out so far this year, it would be the reform of competition regulations, which is still pending implementation in some details. It gives bodies regulating competition in Mexico major investigatory and sanctioning powers to act against monopolistic practices. This should improve the provision of goods and services, making them more abundant and at better prices. It should be noted that countries with a more competitive environment are countries with a higher income per capita.

The most important economic figures will be those on bank credit and the activity of construction companies in July, as explained on the next page.

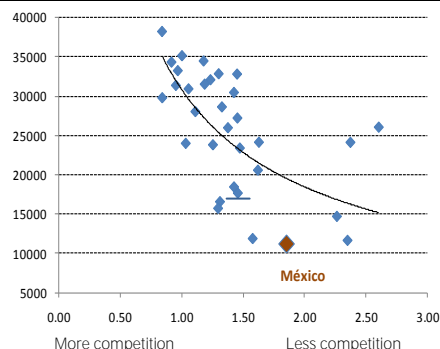
Exchange-rate volatility could continue and the TIIE curve should discount interest-rate cuts (25-50 bps) in response to Ben Bernanke's speech and the more relaxed tone of Banxico's statement.

Market Analysis

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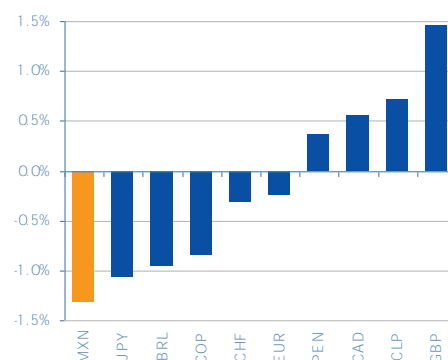
Last week the foreign-exchange market was extremely volatile in response to the varying expectations of Bernanke's speech at Jackson Hole. In particular, the MXN was down over the week in the face of uncertainty regarding the U.S. economic cycle. The TIIE could begin to discount a cut in the bank lending rate of 25-50 bps over the coming months. This would be in response to a more accommodative statement by Banxico, which announced that it could try to prevent monetary conditions from tightening unnecessarily, given the situation of the international financial markets and the domestic economy.

Chart 1
 OECD: GDP per capita and competition, 2008.
 Constant dollars adjusted to PPP and the OECD indicator



Source: BBVA Research with OECD data

Chart 2
 Weekly change in selected currencies (%; neg. = depreciation)



Source: BBVA Research with data from Bloomberg

Calendar: Indicators

Economic Analysis

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Bank credit (July, August 31)

Forecast: 9.7% y/y real

Consensus: -

Previous: 9.4% y/y real

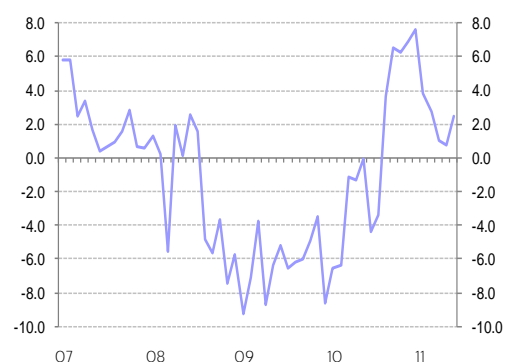
The new figures are expected to indicate that the real annual growth rate of total outstanding bank credit has increased slightly. It could therefore increase from the rate of 9.4% registered in June to around 9.7% in July. Moderate increases are expected in the growth rates of mortgage lending (in June the figure was 4.8%) and in corporate lending (8.9% in June); while consumer finance may be unchanged (12.2% in June). Bank credit needs a favorable macroeconomic environment if it is to expand, and to the extent that this remains in place credit will continue to flow.

Construction Industry Survey (June, August 31)

Next Wednesday sees the publication of the June production figures for construction companies. Given that the construction industry grew at a rate slightly above the economy as a whole in the first half of the year, we expect production in the sector to reflect the same trend (although it should be noted that this figure could in part reflect the statistical effects related to the base of comparison).

Building construction and public works, which are the main components of the industry's GDP, grew at similar rates in the first half of the year. However, we expect that in the second half public works will receive a steady boost due to budget execution at the end of the six-year period, particularly in communication infrastructure and electricity. We continue to believe that the industry will grow at a similar rate to the economy as a whole at the end of the year, or even slightly more.

Chart 3
Volume of production of companies in the construction industry
(y/y % change)



Source: BBVA Research with INEGI data

Market Analysis

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Markets

MXN down in response to cyclical U.S. risks, volatility to continue in the short term

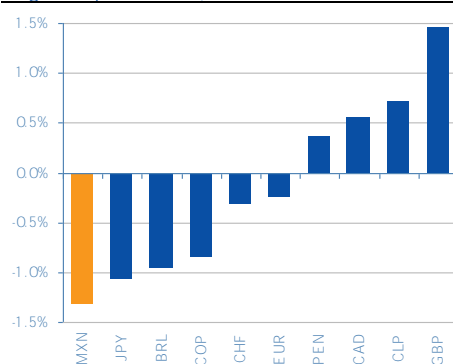
Over last week the foreign-exchange market was extremely volatile in response to the varied expectations related to signals from Bernanke's speech at Jackson Hole. In the event, there were no more specifics on QE3, and it shifted the focus of attention to the next FOMC meeting (September 20-21).

Results were mixed in Latin America over the week, with gains in the COP and CLP (supported by capital flows and rises in commodity prices), while the MXN and BRL were down in the face of uncertainty regarding the U.S. economic cycle. As Bernanke's speech at Jackson Hole was in line with expectations (stress on the tools available for action if the economy needed it), we consider that the current elements continue to justify a high rate of volatility in the short term. In the specific case of the MXN, although a possible global scenario of greater liquidity could produce a bias for appreciation, a Bank of Mexico statement that was more relaxed than expected has reduced the room for a rise in the currency in the short term. We therefore repeat our forecast of movement within the range of 12.1-12.5.

In response to Banxico's monetary policy announcement and the global financial situation, the TIIE curve could begin to discount a cut of 25-50 bps over the coming months

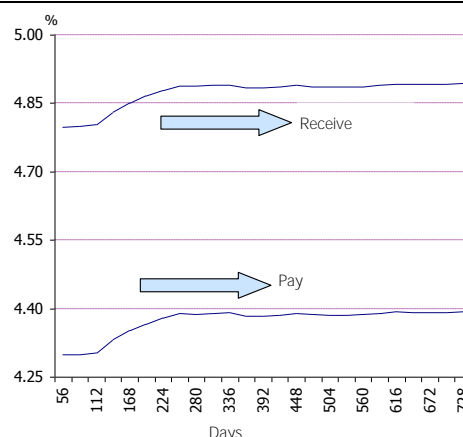
The Bank of Mexico maintained its bank lending rate unchanged, but offered a more relaxed statement that announced it could adjust its monetary policy if conditions became tougher as a result of the situation of the financial markets and a poor economic performance. Currently, the TIIE curve is discounting a cut of 25 bps from November 2011 to August 2013. We consider that the TIIE curve will move towards discounting a cut of 25-50 bps over the coming months. The range of fluctuation for the 26x1 (2-year swap) will therefore be between 4.8% and 4.45%. Meanwhile, we consider that the range of fluctuation of the 130x1 (10-year swap) will be at between 6.15% and 6.60% over the next 3 months. The current levels of the TIIE curve and the M bonds already include a cut in monetary policy. We estimate that there is some more room for adjustment down on the slope, though not much.

Chart 5
 Weekly change in selected currencies (%
 neg. = depreciation)



Source: BBVA Research with data from Bloomberg

Chart 6
 Estimated IRS (TIIE curve) under a prolonged
 monetary pause and with a cut of 50 bps



Source: BBVA Research with data from Bloomberg

Market Analysis
 Equities

Technical Analysis

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Technical Analysis

IPC Stock Market Index



The upturn in the IPC from its low on August 8 has been stronger than that in the U.S. indices. The IPC has recovered nearly 2,300 pts (up 7.2%) from the low, while S&P has recovered by 4.7%. This prevented it from breaking through the 35,000 point zone, where it found an initial resistance, and it fell back by around 1,000 pts at the end of the week. But even with this downturn, it managed to maintain a figure that was above the 10-day moving average (33,900 pts) and maintained the short-term upward trend that it had followed from the start of the month. We would only consider it a bad short-term sign if there was a breakthrough below 33,000 pts.

Prev. Rec.: Though the IPC has not closed under its 10-day moving average (33,160 pts), increased volatility could lead to a fall to levels of between 32,000 and 31,700 pts.

Source: BBVA Bancomer, Bloomberg

MXN

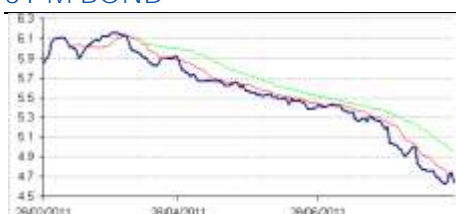


Strong upturn in the dollar over the week to the MXN 12.50 range, increasing the overbuying readings on the oscillators. We believe that the dollar should encounter strong short-term resistance between this level and MXN 12.60 and return to the MXN 12.20 range.

Prev. Rec.: Overbuying remains elevated and we believe that a new correction should come it nears the MXN 12.50 zone.

Source: BBVA Bancomer, Bloomberg

3Y M BOND

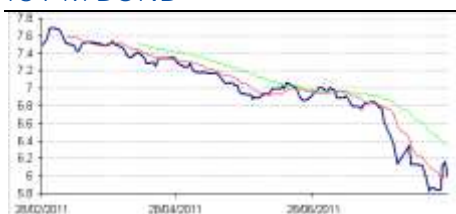


3Y M BOND: (yield): Still cannot maintain its bounce, as it is once more finding resistance in the 10-day moving average. Overselling continues and there is a chance of an upturn, but we would only consider it has changed the trend if it breaks through 4.95%.

Prev. Rec.: Overbuying increases, but a bounce might encounter resistance at 4.8% and 5.06%.

Source: BBVA Bancomer, Bloomberg

10Y M BOND



10Y M BOND (yield): Slight bounce that puts it above the 10-day moving average, but still not at the 30-day (6.3%). As we have commented, only above this level could it be considered a short-term change in trend.

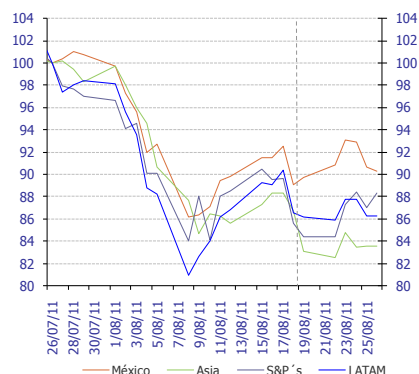
Previous Rec.: Only if it manages to break through the resistance at 6.1% and 6.5% would we consider it a change in trend.

Source: BBVA Bancomer, Bloomberg

Markets

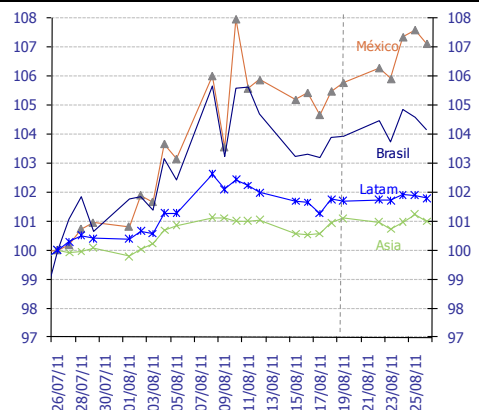
In a week marked by uncertainty regarding the speech by the Fed Chairman on new monetary stimulus measures, stock markets closed the week slightly up and currencies appreciated, although they did not recover the losses sustained at the end of the week.

Chart 7
Stock Markets: MSCI Indices
(July 26, 2011=100)



Source: Bloomberg & BBVA Research

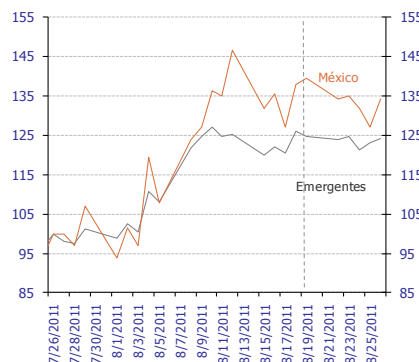
Chart 8
Foreign exchange: dollar exchange rates
(July 26, 2011=100)



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.

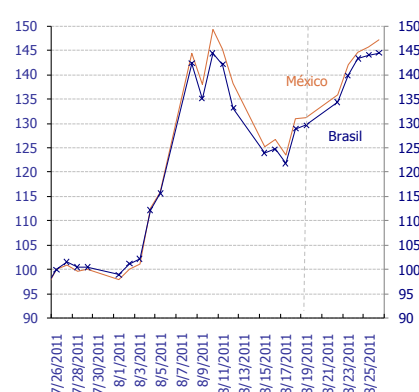
Increase in risk aversion towards the end of the week after the downward revision of U.S. GDP growth figures for the second quarter.

Chart 9
Risk: EMBI+ (July 26, 2011=100)



Source: Bloomberg & BBVA Research

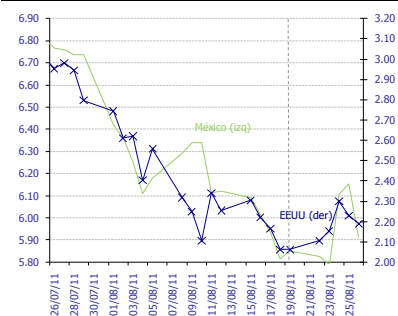
Chart 10
Risk: 5-year CDS (July 26, 2011=100)



Source: Bloomberg & BBVA Research

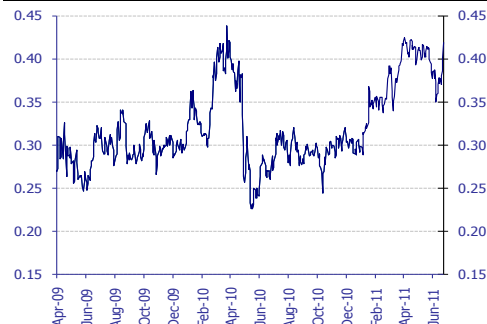
Fall in U.S. rates, mainly due to the downward revision of U.S. growth figures. Fall in rates in Mexico following the more relaxed tone of the Banxico statement, which opens up the possibility of a cut in the bank lending rate

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

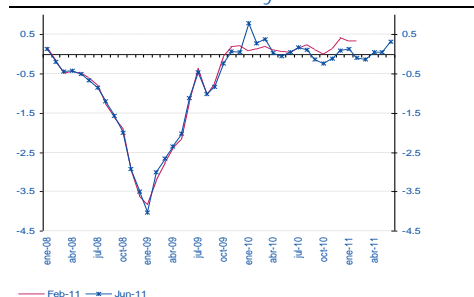


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

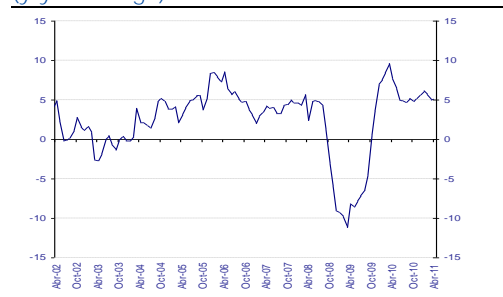
Recent figures on economic activity suggest that the rate of economic growth will be maintained at the start of the third quarter of the year.

Chart 13
BBVA Research Synthetic Activity Indicator for the Mexican economy



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

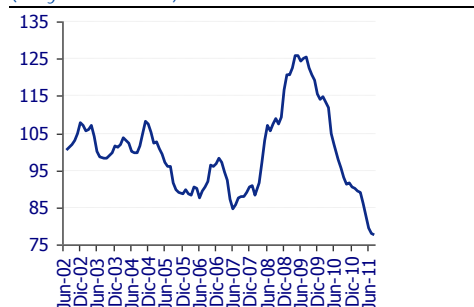
Chart 14
Advance Indicator of Activity (y/y % change)



Source: INEGI

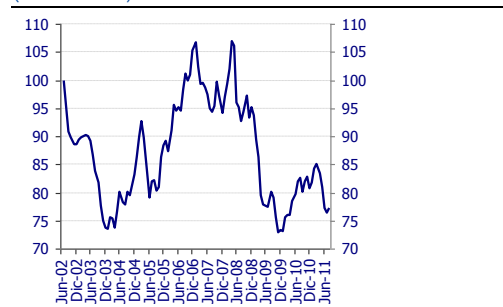
Recent inflationary surprises have been downward, while those of economic activity have been mixed.

Chart 15
Inflation Surprise Index (July 2002=100)



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

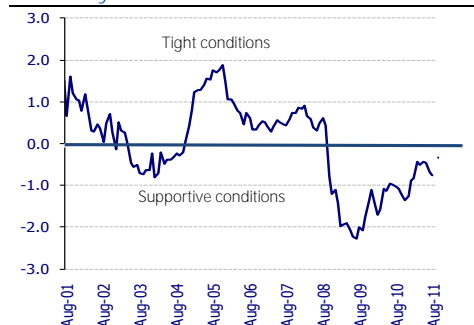
Chart 16
Activity Surprise Index (2002=100)



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

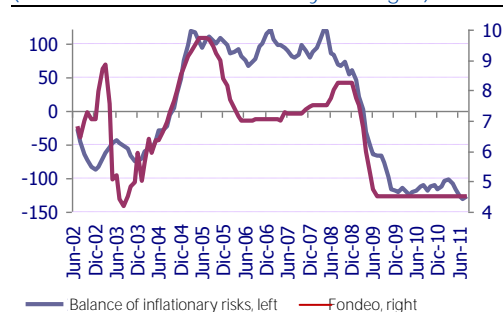
Tougher monetary conditions that are not a sign of increased tightening or relaxation

Chart 17
Monetary Conditions Index



Source: BBVA Research

Chart 18
Balance of Inflationary Risks* and Lending Rate (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 index points to a greater weight of inflationary risks over growth risks and thus a greater likelihood of monetary restriction

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