Weekly Watch

Mexico

September 2, 2011

Economic Analysis

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Next week...

... Checking to see if the global scenario change had an impact on employment and consumer confidence in August

The coming week sees the release of August data for formal sector employment by the Department of Labor and consumer confidence by Inegi. Five weeks on from the change of sentiment on financial markets, in line with lower growth in the US, we will need to see if this is starting to show domestically in terms of job creation (highly sensitive to the overseas manufacturing cycle in the formal sector). Consumer confidence could also be affected, at least in the indicator on future outlook for both households and the country in general. In any case, the expected growth figure bias for 2011 and 2012 has moved down and only the size of the impact remains to be seen.

August inflation will also be released, which should not be important on the market unless we see a downward surprise move, as happened in the first fortnight of the month. The minutes from the last Banxico meeting will be more important, showing a more accommodating tone pointing to a possible rate reduction in the economic scenario worsens or the financial outlook puts pressure on monetary conditions. Further, the Government's 2012 economic package to be presented to the House will need to see an initial analysis.

Market Analysis

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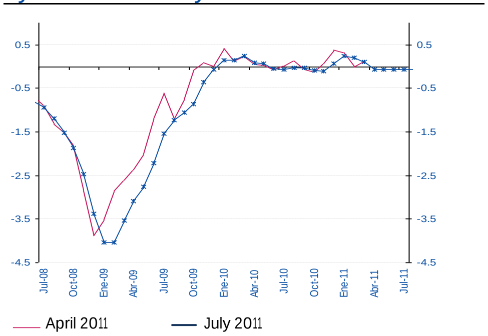
...MXN gains reversed quickly after bad US job data, leading to major demand for fixed income instruments

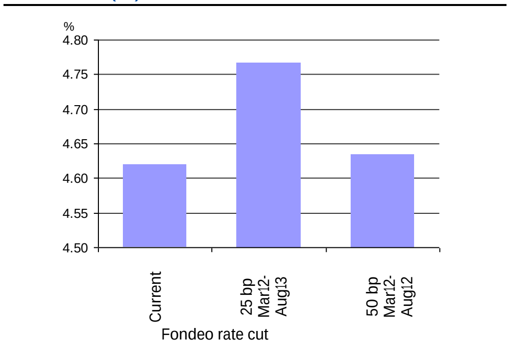
Last week the MXN again saw major volatility, fluctuating due to US economic data. In this sense, after seeing favorable moves at the start of last week, the MXN largely reversed its gains after US job data was released. The MXN remains within a narrow trading range between 12.20 and 12.50. Cyclical risks drove major demand in fixed income instruments leading to domestic curves hitting minimum levels which are not in line with the current lending rate (4.50%). This shows they have incorporated a laxer monetary stance.

Chart 1
Synthetic Activity Indicator



Source: BBVA Research with OECD data

Chart 2
13x1 swap range under different monetary scenarios (%)



Source: BBVA Research with data from Bloomberg

Economic Analysis

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Calendar: Indicators

August Inflation (September 8)

Forecast: 0.17% m/m (3.43% y/y) Consensus: 0.23% m/m Previous: 0.48% m/m Jul

Next week sees the release of inflation data in August which we expect to have slightly decreased in annual terms, moving from July's 3.55% to around 3.45% y/y in August. This favorable move is due, on the one hand, to core components, specifically non-food goods, real estate services and other services being at very low levels thanks to slack on factor markets and relative exchange rate stability. On the other hand, agricultural product prices throughout August moved down, contributing to core inflation breaking its upward trend in annual terms. We restate our forecast for inflation to end the year around 3.5% y/y, a forecast which could even move down if we see a negative output effect.

Formal Private-Sector employment in August

Forecast: 0.3% m/m (4.1% y/y) Consensus: N.A. Prev: 0.3% m/m (4.2% y/y)

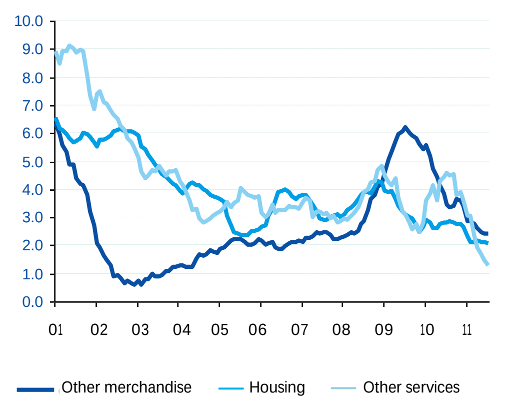
Formal private-sector employment performance has been highly satisfactory from the start of the recovery with this improvement spreading among sectors. The most recent data show that variations across all sectors were around 0.3%. This good performance meant the creation of over 1.2 million jobs in formal private-sector employment since the start of the recovery. The strength this indicator showed is key to the improvement of domestic demand indicators such as private consumption and retail sales. We see it continuing at a solid rate.

Consumer Confidence in August (September 5)

Forecast: 1.2% m/m (95.3 pts) Consensus: N.A. Previous: 1.9% m/m (94.2 pts)

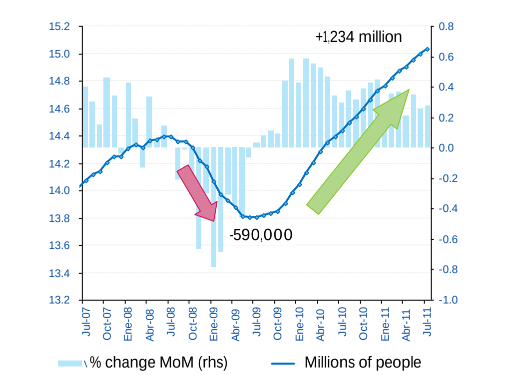
With three consecutive months of growth and stable formal job creation rates and real wages starting to improve, we expect consumer confidence to continue to see improvements, although rates could come in below those in previous months. Monitoring of the sub-index of the possibility of purchasing durable goods will be especially important, this being more linked to future output outlook.

Chart 3
Selected core inflation components (% change y/y)



Source: BBVA Research with INEGI data

Chart 3
Formal Private-Sector employment (millions of people and % change m/m)



Source: BBVA Research with INEGI data

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Markets

MXN reverses gains after release of bad US job data...

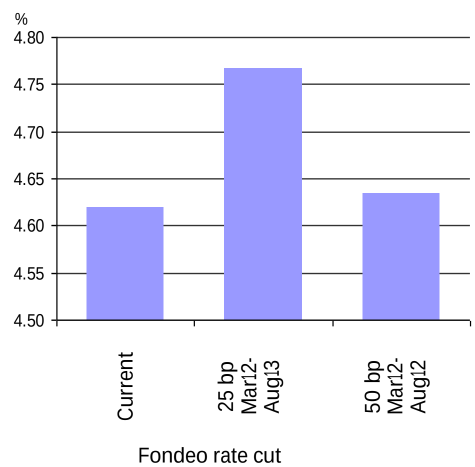
Last week the MXN again saw major volatility, fluctuating due to US economic data. In this sense, the currency showed better relative performance at the start of the week; however, the non-farm payroll data (Friday 2) led to a reversal in most of these gains. In short, the MXN remains within a trading range which, recently, has narrowed (12.20-12.50). Any break in these levels will depend on monetary policy expectations from the Fed and Bank of Mexico.

In all, we highlight two elements which, in the short term, favor long MXN positions before any return to the high part of the range: 1) the long MXN non-commercial position saw marginal falls in the last two weeks (USD54mn to Tuesday, August 30) and is currently at minimums from September 2010, limiting the closing position space and 2) the options auction at the end of the month by Bank of Mexico showed results pointing to positive sentiment toward the MXN: a premium of 61.72 and an over-demand ration of 3.3. In this way, despite the negative US output data, we see space for corrections toward the 12.20 zone in the short term.

...and major demand is seen for fixed income instruments

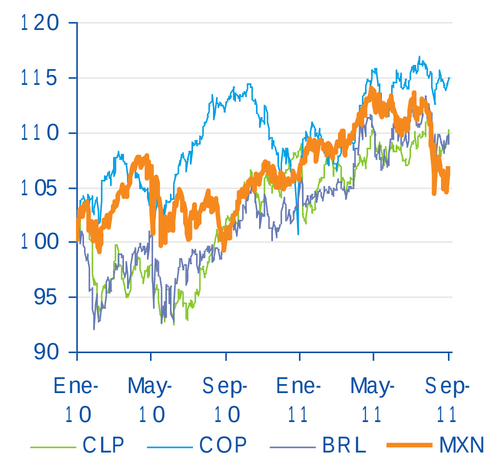
The Fed minutes released last week led to expectations that additional monetary measures could be implemented. This led to a sell bias on fixed income markets. Nonetheless, negative US data reprised cyclical fears at the end of last week leading to major demand for fixed income instruments. We believe domestic curves are at minimum levels which are not in line with the current lending rate (4.50%). This shows they have incorporated a laxer monetary stance. For example, if we take a scenario of a 25bp/50bp cut in interest rates from March 2011 to August 2012 (something we do not currently see), the 1-year swap (13x1) would trend to around 4.77%/4.63%, while this instrument hit 4.62% at close on Friday. We therefore see buying fixed as attractive.

Chart 5
13x1 swap range under different monetary scenarios (%)



Source: BBVA Research with data from Bloomberg

Chart 6
Relative performance of LatAm currencies (Jan 1, 2011 index=100)



Source: BBVA Research with data from Bloomberg

Market Analysis
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Technical Analysis

IPC Stock Market Index

The 36,000pts zone represented important resistance since it was the August high before the rout. The 200-day rolling average comes in at 36,300pts. The market hit the short-term upward range to the upper limit where it has traded since August 8. This led to over-selling in short-term oscillating indicators. The formation comprising the 'doji' candlestick and that for Friday suggest a higher adjustment. We believe that a support level we could consider to increase positions is from 34,600pts, where the IPC will again be in the lower part of the short-term range. A downward break through 34,00pts would wipe out the positive trend. The IPC short-term trend indicator is up meaning this adjustment needs to be seen as a purchase opportunity.

Previous rec.: We would only consider it a bad short-term sign if there was a breakthrough below 33,000 pts.

Source: BBVA Bancomer, Bloomberg

MXN

The dollar saw an adjustment mid-week coming in below the 10-day rolling average. Although it did not hit the MXN12.20 floor, oscillating indicators continue to point down. Any bounce to the MXN12.50 range should be considered to take positions in favor of the Peso.

Previous rec.: We believe that the dollar should encounter strong short-term resistance between MXN12.50 and MXN 12.60 and return to the MXN 12.20 range.

Source: BBVA Bancomer, Bloomberg

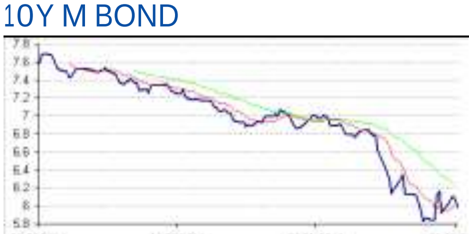
3Y M BOND

3Y M BOND: (yield): Continued inability to see a bounce and marks a new minimum for the year. In the event of an upturn, resistances to consider come in at 4.65% and 4.84%.

Previous rec.: 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%.

Source: BBVA Bancomer, Bloomberg

10Y M BOND



10-YEAR M BOND (yield): Slight bounce over the week but without marking a change in trend, as it continues operating under the 30-day rolling average. Until the 6.21% is broken, the downward trend will continue

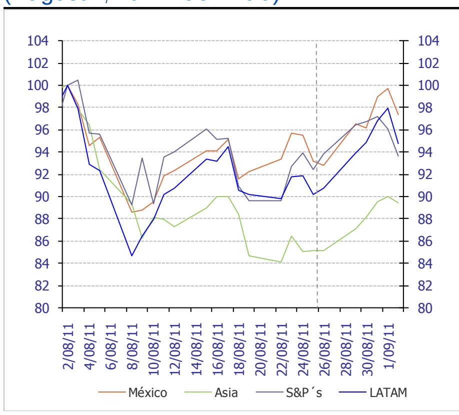
Previous Rec.: As we have commented, only above this level could it be considered a short-term change in trend.

Source: BBVA Bancomer, Bloomberg

Markets

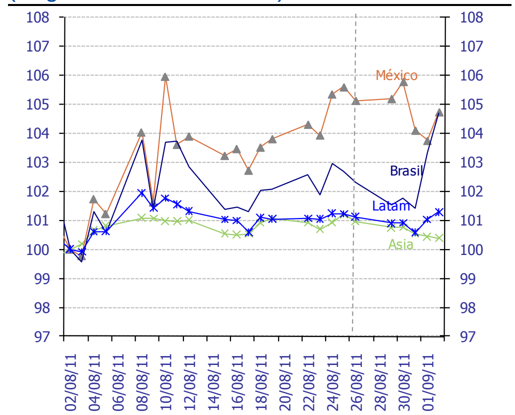
Rout on stock markets and currency falls after release of lower-than-expected US non-farm payroll data.

Chart 7
Stock Markets: MSCI Indices (August 2, 2011 index=100)



Source: Bloomberg & BBVA Research

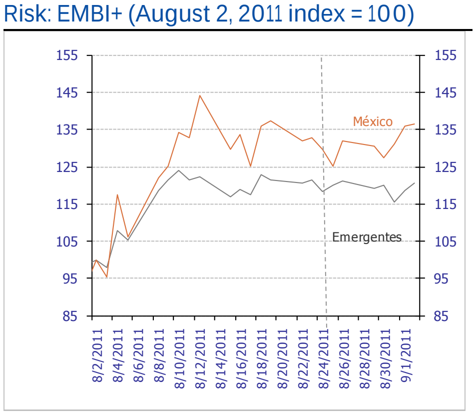
Chart 8
Foreign exchange: dollar exchange rates (August 2, 2011 index=100)



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

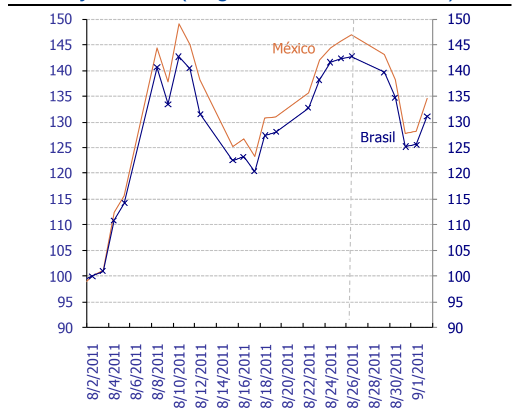
Risk aversion rise due to US job figures pointing to lower growth

Chart 9
Risk: EMBI+ (August 2, 2011 index = 100)



Source: Bloomberg & BBVA Research

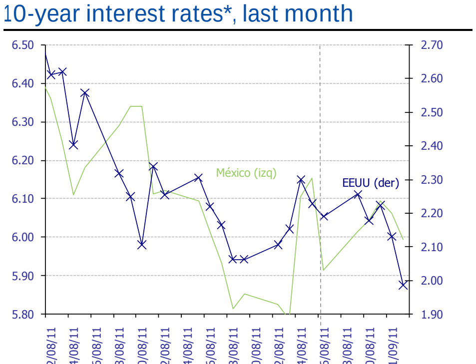
Chart 10
Risk: 5 year CDS (August 2, 2011 index=100)



Source: Bloomberg & BBVA Research

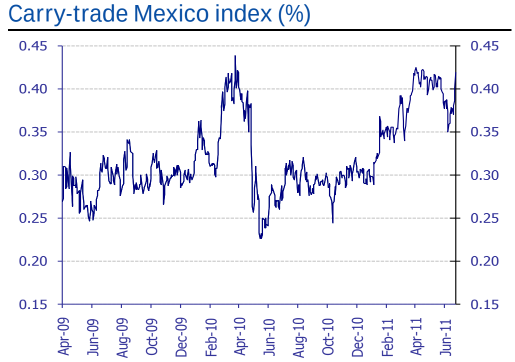
Rise in rates in the USA and Mexico due to lower appetite for risk instruments

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

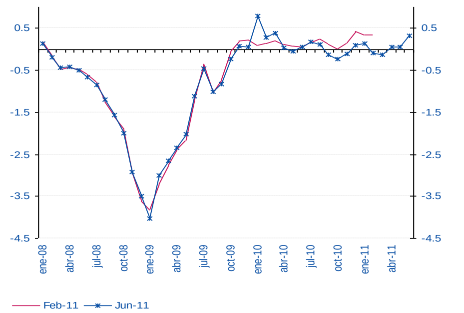
Chart 12
Carry-trade Mexico index (%)



Source: BBVA Research with data from Bloomberg

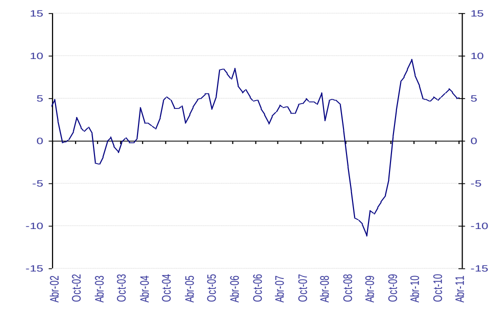
Activity, inflation, monetary conditions

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.

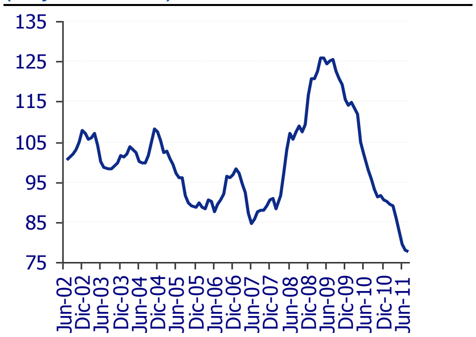
Chart 14
Advance Indicator of Activity (y/y % change)



Source: INEGI

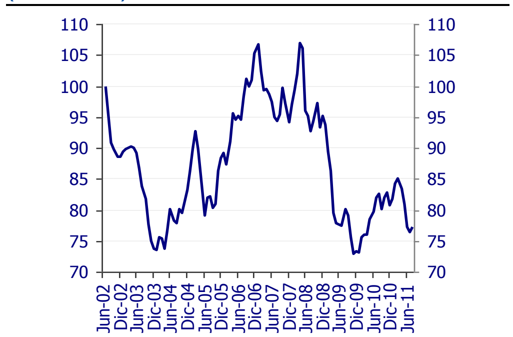
Recent inflationary surprises have been downward, while those of economic activity have been mixed.

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.

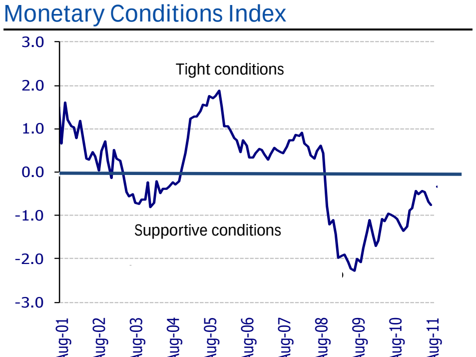
Chart 16
Activity Surprise Index (2002=100)



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.

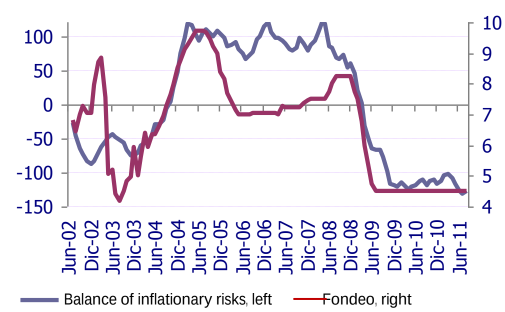
Tougher monetary conditions that are not a sign of increased tightening or relaxation

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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