

# Weekly Watch

Mexico

September 9, 2011

## Economic Analysis

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## Next week...

Industrial production will continued to show recovery in the Mexican cycle throughout 2011... at least until July

The only important situation indicator next week will be July's industrial production (INEGI, Monday 12, 8:00 am). Alongside formal employment, these figures are, for their timing, a key reference point to assess the rhythm economic outlook. Some clues as to what may happen in July came from US industrial production which, up to July, did not exactly show a monthly slowdown. In addition, formal employment holding levels for a further month, in August, at 0.3% would be in line with positive industrial production growth in July of 0.5% m/m seasonally-adjusted.

In all, available information to date indicates quarterly growth in the Mexican economy for 3Q11 could come in slightly above the 1.1% seen in 2Q11. Nonetheless, uncertainty in this forecast has a downward bias in line with more recent US cyclical indicators and the performance of confidence indicators for September.

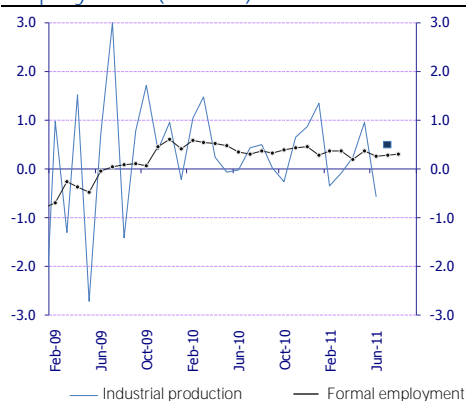
## Market Analysis

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## Budget 2010 presented while markets remain highly volatile

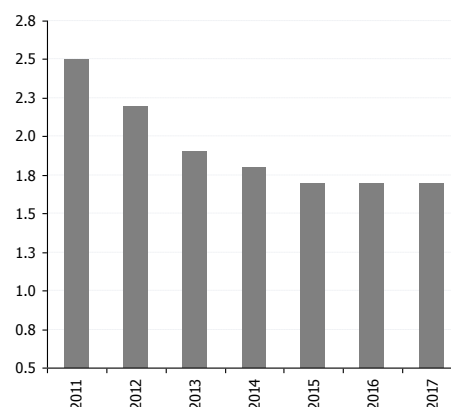
Public sector financial requirements for 2012 are set at 2.6% of GDP, lower than that approved in 2011, and meaning a decline of 0.3%. Based on SHCP assumptions, we believe that the average balance in 2012 on the MBONDS market will be MXN 1.8 trillion pesos, MXN 720 billion pesos for Cetes and MXN 600 billion pesos for UDIBONOS. The gross finance needs from our fiscal year would be 7.9% of GDP (including PEMEX) and 5.9% of GDP (excluding PEMEX and financial brokerage ceiling and development funds). In the Annual Finance Plan 2012, to be released in December, we will see the numbers put forward by the SHCP. Local curves continue highly volatile and moving between monetary expectations and global risks, while the MXN has shown negative performance.

Chart 1  
 Mexico: industrial production and employment (% m/m)



Source: BBVA Research with data from Inegi and STPS

Chart 2  
 Traditional Public Deficit (% GDP)



Source: SHCP

## Market Analysis

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## Markets

### Economic package 2012. A debate on the possibility Banxico cuts lending rate.

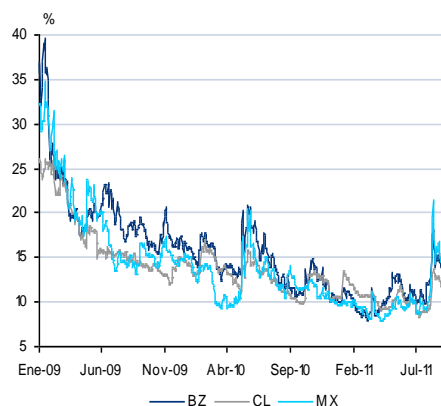
With lower dynamism in US economic growth (1.6% and 2.1% in 2011 and 2012), the Government revises domestic output expansion downward for 2012 to 3.5%, in comparison with the estimated 4.0% for 2011. Public sector finance requirements for 2012 are set at 2.6% of GDP, a lower level to that approved in 2011, meaning a decline of 0.3%. The financial brokerage ceiling for banks and development funds is proposed at 0.4%. Including Pemex debt, the fiscal deficit is forecast at 2.2% of GDP, while if excluded, it would be equivalent to 0.2% of GDP. The estimates were made by taking into account an average oil price of 84.9 USD/barrel, with a production of 2.55mn barrels a day (bpd) and exports of 1.167mn bpd. They use an average USD/MXN rate of 12.2. Based on SHCP assumptions, we believe that the average balance in 2012 on the MBONDS market will be MXN 1.8 trillion pesos, MXN 720 billion pesos for Cetes and MXN 600 billion pesos for UDIBONOS. The gross finance needs from our fiscal year would be 7.9% of GDP (including PEMEX) and 5.9% of GDP (excluding PEMEX and financial brokerage ceiling and development funds). In the Annual Finance Plan 2012, to be released in December, we will see the numbers put forward by the SHCP.

Banxico minutes show a more dovish tone, emphasizing a weak economic recovery in the US and Europe. The Board considers that if economic output slows further with inflation levels near 3%, the likelihood of a looser stance by Banxico at the end of the year increases.

### The MXN closes the week down: positions closed in Chicago

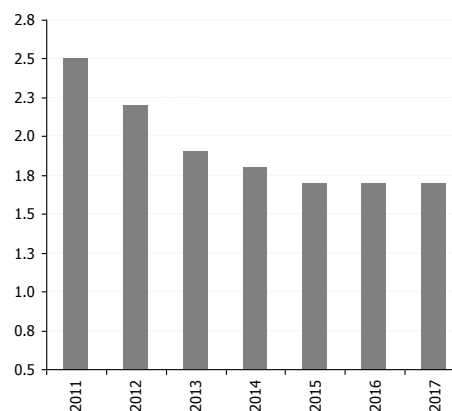
Latin American currencies mostly saw negative performances over the week. This was set by the higher risk aversion in a global scenario based on greater emphasis on fiscal risks in the EU as well as continued uncertainty surrounding the US cycle (even when the market continued to incorporate the chance of a third round of quantitative easing). In turn, for the first time in several months local factors started to act as determining factors in currency trades. The MXN also remained downward with trading continuing to react to the risks of cuts in Banxico's benchmark rates. In all, the close in the zone near 12.70 continues to look high to us and we maintain our correction forecast to at least a new support at 12.50.

Chart 5  
Implied volatility of the BRL, MXN and CLP



Source: BBVA Research with data from Bloomberg

Chart 6  
Traditional Public Deficit (% GDP)



Source: SHCP

Market Analysis  
 Equities

**Technical Analysis**

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## Technical Analysis

### IPC Stock Market Index



Major technical signals at the IPC at the end of the week, operating below the 30-day rolling average (34,103pts) and, especially, below the upward trend line where it has traded since August 8 to September 9. This break would mean the end of the upward bounce with the IPC recovering 3,922pts. From the start of the week, we had signs of a trend change but this was quickly reversed with bounces on Tuesday and Wednesday. At the end of the week coming in below the Monday minimum, we see the market as highly likely to return to an initial support at 33,000pts. To rule out this sign, the market would have to quickly recover levels above 34,104pts.

Previous rec.: 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.

Source: BBVA Bancomer, Bloomberg

### MXN



The dollar ended the week with an upward rally to the MXN12.60 zone, a level that had been a major resistance throughout August. With this new upward break, the following resistance level is set up to MXN12.80.

Previous rec.: Any bounce to the MXN12.50 range should be considered to take positions in favor of the Peso.

Source: BBVA Bancomer, Bloomberg

### 3Y M BOND

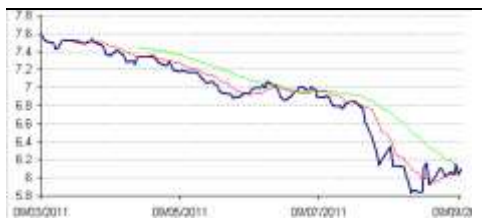


3Y M BOND: (yield): Continued inability to see a bounce and marks a new minimum for the year. In the event of an upturn, resistances to consider come in at 4.65% and 4.84%.

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

### 10 YEAR M BOND



10-YEAR M BOND: (yield): Sideways movement during the week but allowing a close slightly above the 30-day rolling average. Above 6.17% it surpasses weekly maximum with a target at 6.4%.

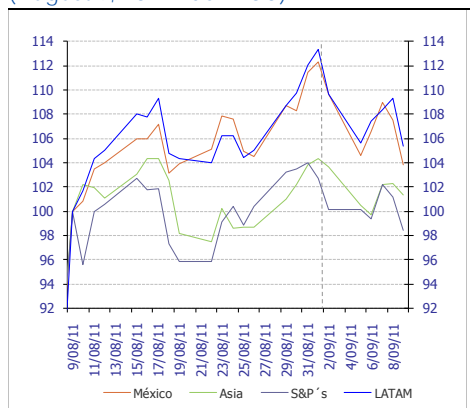
Previous Rec.: Until the 6.21% is broken, the downward trend will continue

Source: BBVA Bancomer, Bloomberg

### Markets

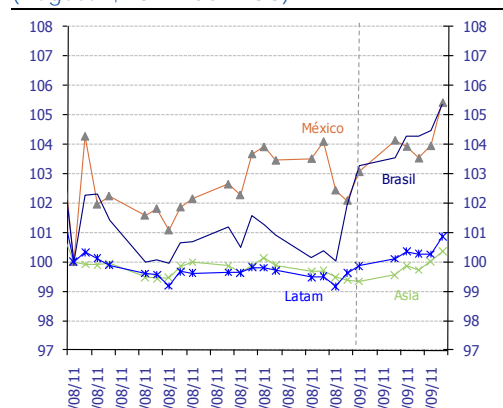
The announcement that the German government is preparing an emergency plan to support banks and insurers in the event of Greek default generated an increased risk aversion which translated to falls on stock markets and devaluation in emerging nations' currencies.

Chart 7  
Stock Markets: MSCI Indices  
(August 9, 2011 index=100)



Source: Bloomberg & BBVA Research

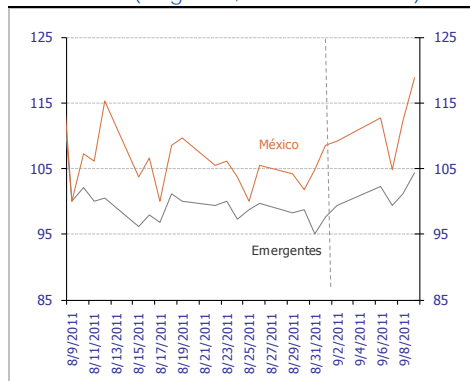
Chart 8  
Foreign exchange: dollar exchange rates  
(August 9, 2011 index=100)



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

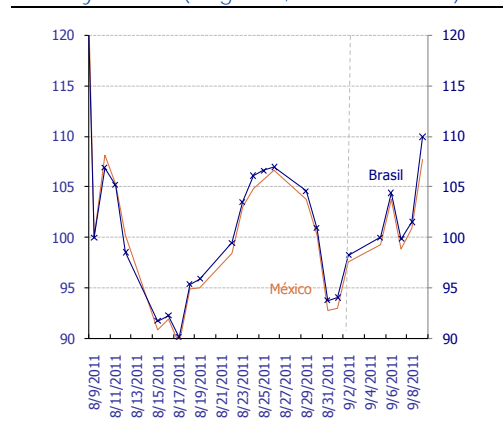
Upswing in risk aversion due to a worsening outlook on the European debt crisis, especially in Greece

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



Source: Bloomberg & BBVA Research

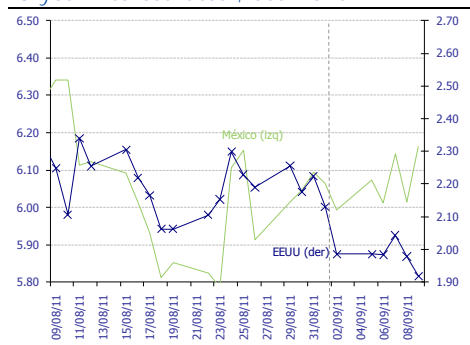
Chart 10  
Risk: 5 year CDS (August 9, 2011 index=100)



Source: Bloomberg & BBVA Research

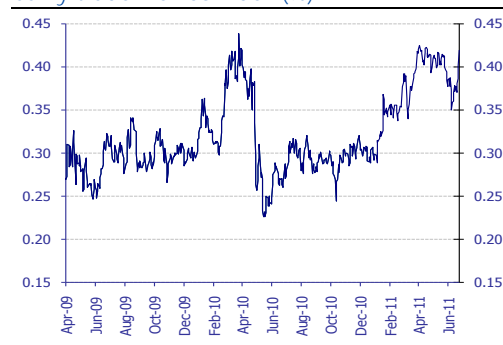
US interest rates fall while Mexico's rise due to investors searching for safe haven assets

Chart 11  
10-year interest rates\*, last month



Source: Bloomberg & BBVA Research

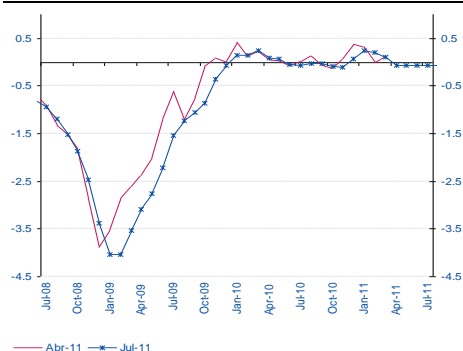
Chart 12  
Carry-trade Mexico index (%)



Source: BBVA Research with data from Bloomberg

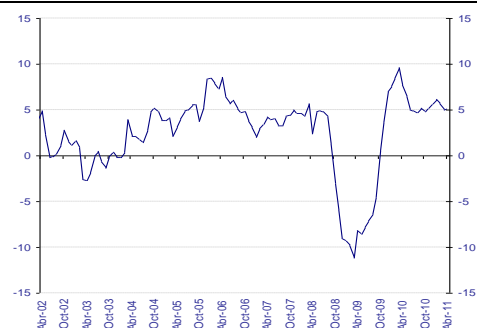
### Activity, inflation, monetary conditions

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.

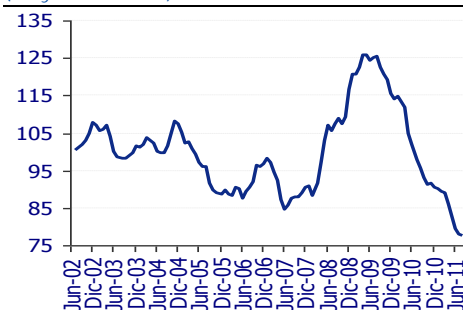
Chart 14  
Advance Indicator of Activity  
(y/y % change)



Source: INEGI

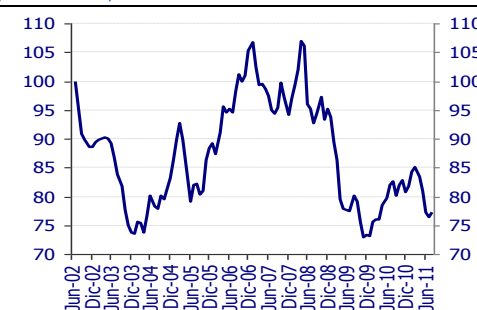
Recent inflationary surprises have been downward, while those concerning economic activity have been mixed.

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.

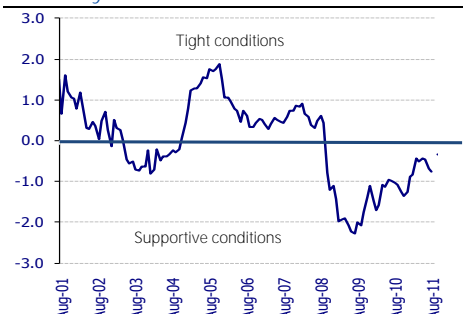
Chart 16  
Activity Surprise Index  
(2002=100)



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.

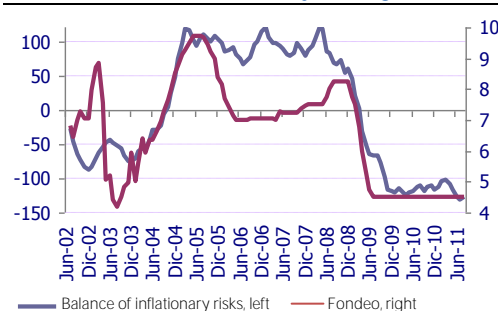
Slight toughening in monetary conditions that is not a sign of increased tightening

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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