

Weekly Watch

Mexico

September 15, 2011

Economic Analysis

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Next week...

Inflation, expenditure and budget debate

The important economic indicators released next week will be inflation figures for the first fortnight of September, indicating what tone Banxico statements may have in future, which have been more relaxed since late last month. The GDP figure could also endorse the performance from demand in 2Q11, with a particular focus on household spending, which in a very uncertain overall climate looks to be one area that could buoy demand.

Also, there will be parliamentary debates over the next few weeks concerning the 2012 budget proposal submitted by the Federal Government. This is now a key issue for the domestic economy, as the country especially now needs to safeguard its commitment to fiscal stability and the credibility of public debt data, with a low deficit and contained debt levels. All while not forgetting the potential for a more clearly defined fiscal policy that, as well as being committed to stability, could further ease the impact had by the current cycle and improve the provision of public services, basic infrastructure and education.

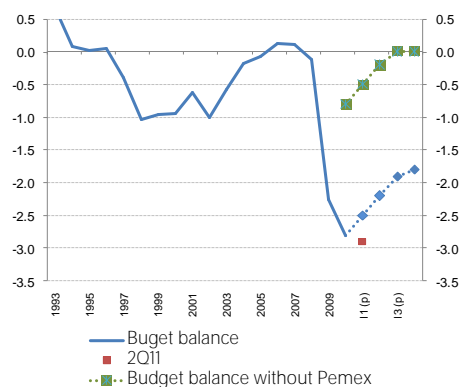
Market Analysis

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Devaluation of the MXN despite declining risk in the E.U., decorrelation with other assets at risk

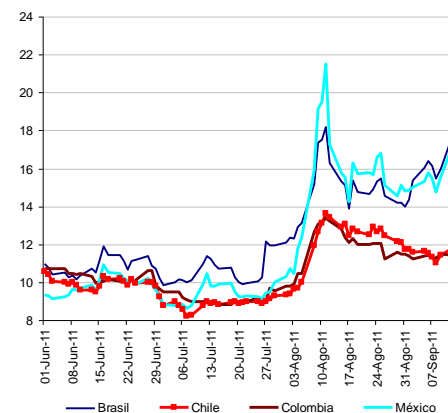
There has been greater appetite for risk in developed countries, thanks to the prospects of German and French support for Greece; coordinated global liquidity measures from central banks to underpin global liquidity in dollars, and possible action by the Fed. Although the Mexican stock market has benefitted from all of this, the MXN has not reflected this moderation in risk and may continue to show a wide fluctuation range. In fixed-income, the local debt curves rose from minimum levels but still discount a more relaxed monetary stance.

Chart 1
 Mexico: budget balance (% of GDP)



Source: BBVA Research with SHCP data

Chart 2
 LatAm: Implied 1-month exchange-rate volatility



Source: BBVA Research

Calendar: Indicators

Inflation for the first two weeks in September (22 September)

Forecast: 0.32% bi-weekly (3.27% y/y)

Consensus: 0.49% bi-weekly

Previous: 0.39% m/m

Economic Analysis

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Next Thursday we will hear inflation data from the first two weeks in September (INPC fore.: 0.32% bi-weekly; Core INPC: 0.25% bi-weekly). We expect inflation to decelerate in annual terms against the previous fortnight to levels close to 3.3%. This decline in inflation is due both to baseline factors, such as the fact that there has been no demand pressure, and economic factors such as a drop in fruit and vegetable prices in wholesale markets, which is surprising for this time of year. Thus, although lower than expected inflation over the next two fortnights would tend to depress the consensus year-end forecast (3.55% y/y), we should be cautious with regard to this figure due to the volatility of core prices. Overall, the performance of inflation in 2011 should be considered satisfactory and consistent with the rate of economic recovery.

Retail Sales and Services Indicator from July (21 September)

Fore. Sales -0.2% m/m, (3.0% y/y)

Consensus: N.A.

Previous: 0.7% m/m (4.6% y/y)

Decline in retail sales and the services indicator. The average variation in the retail sales indicator was 0.15% in the first six months of the year, in contrast with the 0.6% growth of the second half of 2010. In the third quarter 2011 employment is expected to continue to buoy household spending indicators. For the aggregate services indicator we expect growth of 0.3% m/m (3.8% y/y).

Components of 2Q11 GDP demand (22 September)

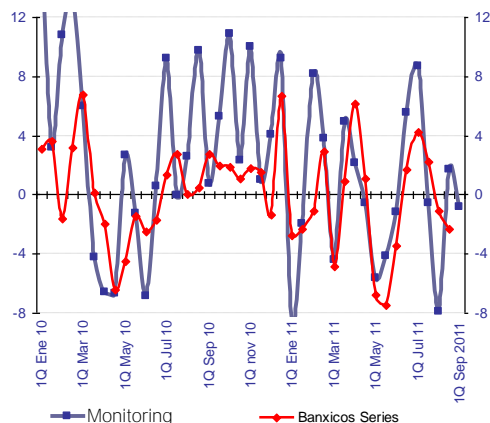
Forecast: 1.8% q/q (5.7 y/y)

Consensus: N.A.

Previous: 0.7% m/m (5.6 y/y)

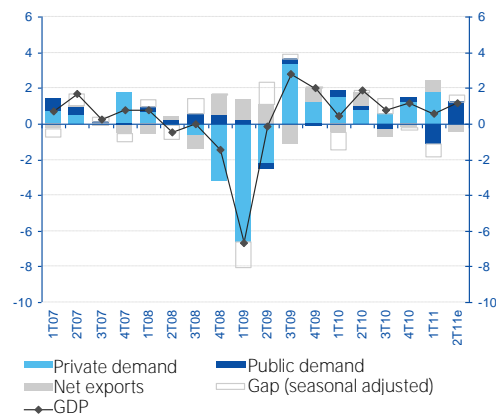
Considering the GDP growth figure on the supply side (1.1% q/q), we believe domestic demand will have played a significant role in driving the recovery from the previous 0.6%. In this regard, public investment is expected to recover, which would come on top of the growth of household spending on consumption. Meanwhile, we believe that the net quarterly contribution from the foreign sector to economic growth has been slightly negative.

Chart 3
Inflation in fruits and vegetables and monitoring of wholesale prices BBVA Research (Ch. % q/q)



Source: BBVA Research with data from INEGI and SE

Chart 3
GDP: demand components (q/q % change and components)



Source: BBVA Research with INEGI data

Markets

Market Analysis

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Risk moderation amid expectations of global policy measures...

A number of events has led to an improvement in the mood among investors: the support offered by Sarkozy and Merkel to Greece; the extension of the austerity program in Italy; the ECOFIN meeting; the possibility of bond purchases by China; and the announcement of coordinated liquidity measures in USD by the central banks of the U.S., euro zone, Britain, Japan and Switzerland. As a result there has been an increase in appetite for Spanish debt issues, a rally in favor of the EUR and a rise in the 10-year German bund from record lows. Nonetheless, the E.U. sovereign debt situation and risk of contagion to the financial system still looms large. As a result, volatility will remain until agreements are implemented and reforms in Greece are seen to be firmly in place. Likewise, the markets are anticipating announcements from the Fed meeting (Sept. 20-21) concerning extending the duration of its portfolio (and possible coordination with the Treasury, "Operation Twist"). This has led to record demand for 30-year notes.

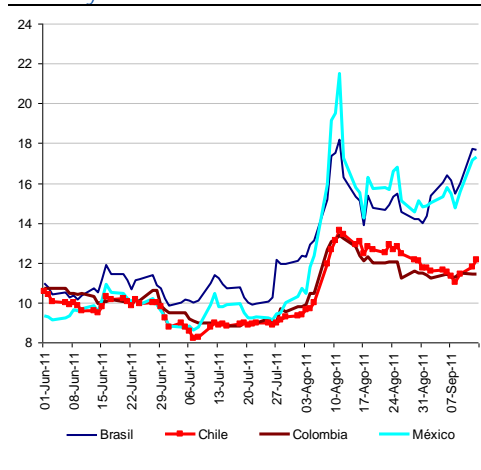
... but a relative decline in the MXN similar to other currencies in the region...

The MXN fluctuated widely over 5 days, between 12,65 and 13,00, closing the week with losses due to news regarding the EU sovereign situation. However, other types of risk assets (e.g. equity) recovered over the course of the week, suggesting that appetite for risk has not yet consolidated. In fact, the JPY continues to gain, as does the CHF, while the main beneficiary of risk moderation has been the EUR. For the MXN we continue to see a wide transaction range (12.8 and 13). However, the Fed meeting could cause us to see prices towards to the low end of the range.

... volatility in fixed-income

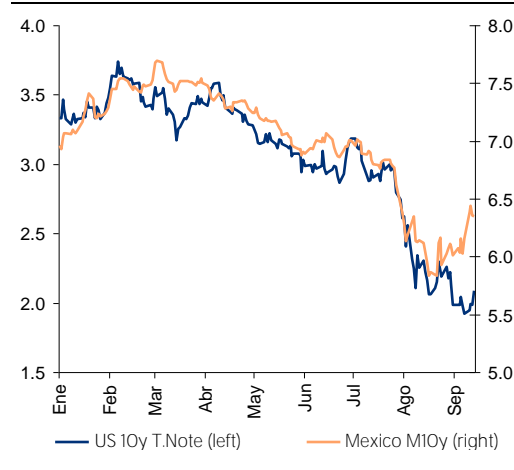
In fixed-income, last week there was strong volatility on the markets due to the global factors mentioned above, reflected in a changeable attitude towards risk, ranging from appetite to aversion, and subsequently a selling trend for debt curves. In this context, at the aggregate level local debt curves showed an upward correction from lows that, as we have mentioned in the past, even discounted a more lax monetary stance.

Chart 5
LatAm: Implied 1-month exchange-rate volatility



Source: BBVA Research with data from Bloomberg

Chart 6
Fixed income 10-year bonds, Mexico and U.S. (%)



Source: BBVA Research and Bloomberg

Market Analysis
Equities

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Technical Analysis CPI



After beginning the week with a significant intraday bounce, the CPI managed to sustain its positive trend over the rest of the week to close with a positive balance of +4%. It thus managed to close the week trading above the 10 and 30-day moving averages, offering positive signs for the short term. Resistances at 35,200 pts and later at 36,000 pts. We believe there could be a return to this latter resistance level, which corresponds to the highs of August and this month. Several heavyweight issuers for the CPI (Tlevisa, Walmex, Bimbo, Amx, Gfnorte, Bolsa) managed to position themselves above the 30-day moving average, leading us to maintain our short-term positive view.

Previous Rec.: To cancel out this negative signal, the market would have to quickly recover levels above 34,104pts.

Source: BBVA, Bancomer, Bloomberg

MXN



The dollar recorded a strong gain over the year, breaking through the resistance at MXN12.80 and hitting the short-term ceiling at MXN13.00. This led to very significant overbuying in short-term oscillators and a strong dispersion of the dollar against the 30-day moving average. We expect the supports at MXN12.80 and 12.60 to be tested again.

Previous Rec.: With this new upward break, the next resistance level is set at MXN12.80.

Source: BBVA, Bancomer, Bloomberg

3Y M BOND

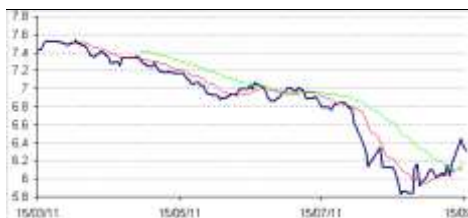


3-YEAR M BOND: (yield): Slight upturn in the week, putting the bond above the 10-day moving average, but still not over the 30-day average (4.7%). Formation is good and may eventually lead to a change in trend, with the first target at 5%.

Previous Rec.: The resistance levels to watch in the event of bounces are at 4.6% and 4.8%.

Source: BBVA, Bancomer, Bloomberg

10 YEAR M BOND



10-YEAR M BOND: (yield): Strong weekly bounce that places the bond over the 10 and 30-day moving averages, setting a trend change in the short term. The 10-day average crosses and climbs over the 30-day average, meaning the next short-term level can be identified at 6.8%.

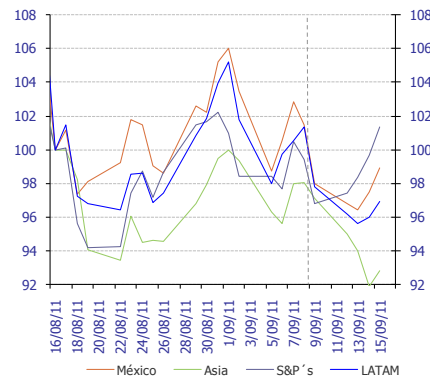
Previous Rec.: Above 6.17% it breaks through weekly maximums, with a target at 6.4%.

Source: BBVA Bancomer, Bloomberg

Markets

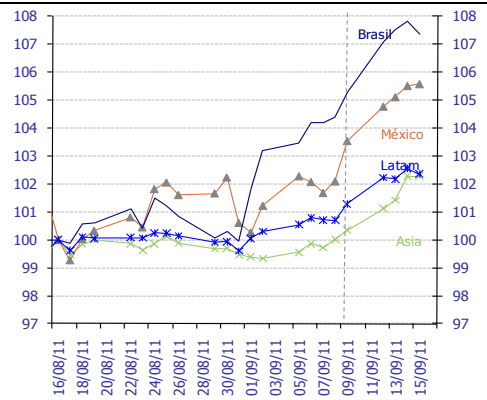
An announcement from the European Central Bank, coordinated with the FED and other central banks, that credit would be granted to European banks to ensure sufficient liquidity for the rest of 2011 led to gains on the stock markets. The peso depreciated slightly in a volatile trading session

Chart 7
Stock Markets: MSCI Indices (August 16, 2011=100)



Source: Bloomberg & BBVA Research

Chart 8
Foreign exchange: dollar exchange rates (August 16, 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

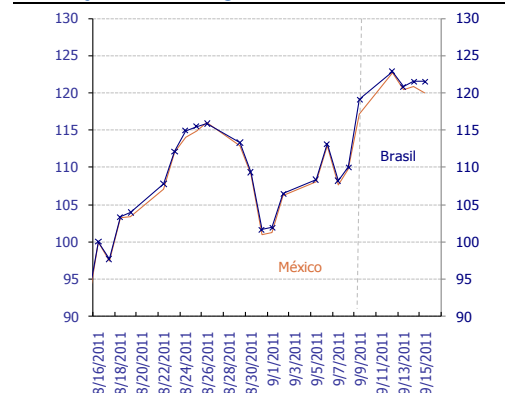
A slight decline in risk aversion, thanks to the European Central Bank's announcement

Chart 9
Risk: EMBI+ (August 16, 2011 index = 100)



Source: Bloomberg & BBVA Research

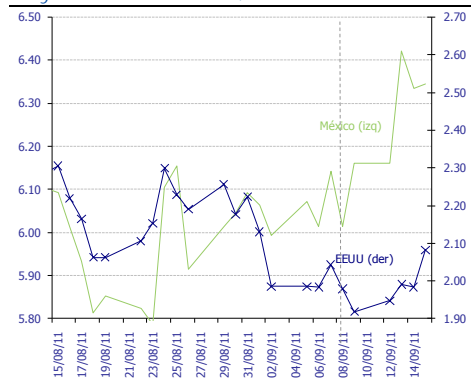
Chart 10
Risk: 5 year CDS (August 16, 2011 index=100)



Source: Bloomberg & BBVA Research

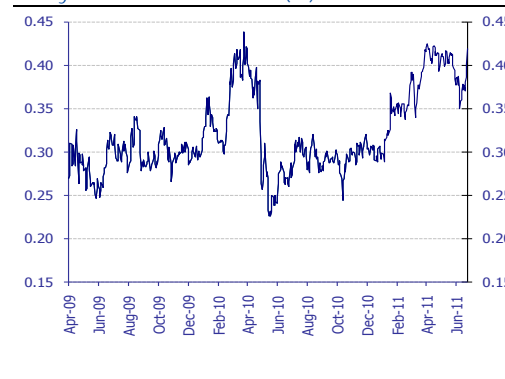
Rise in US interest rates due to greater appetite for risk. The rates in Mexico registered a slight gain

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

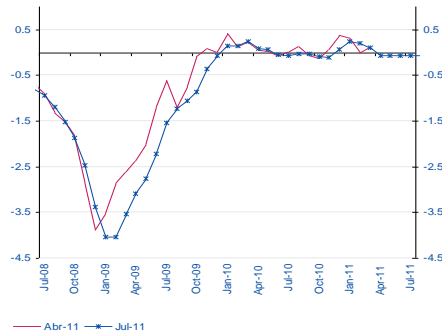
Chart 12
Carry-trade Mexico index (%)



Source: BBVA Research with data from Bloomberg

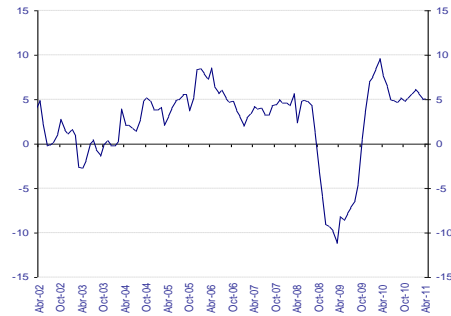
Activity, inflation, monetary conditions

Chart 13
BBVA Research Synthetic Activity Indicator
for the Mexican economy



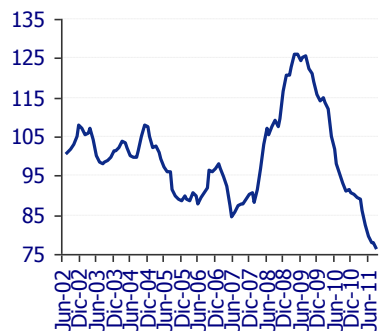
Source: BBVA Research with data from INEGI, AMIA and BEA
Weighted sum of 21 different indicators of activity, expenditure and expectation, based on trend series.

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



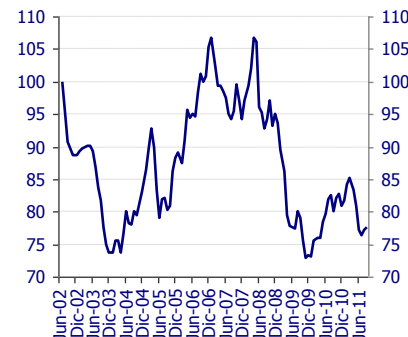
Source: INEGI

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)

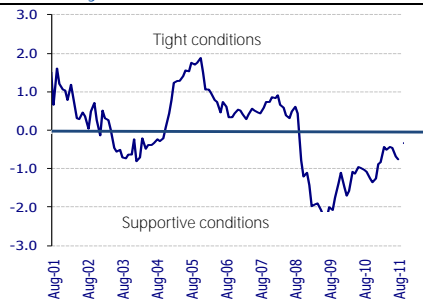


Source: BBVA Research with Bloomberg data. Difference between recorded data and the Bloomberg consensus for seven activity variables in Mexico. Standardized index. Rises (falls): positive (negative) surprises.

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

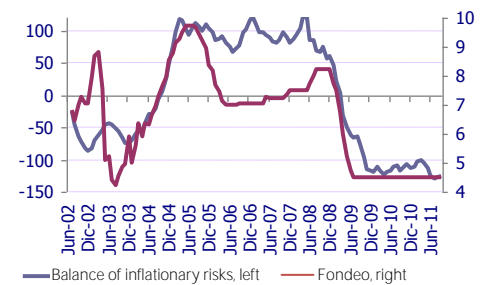
Monetary conditions relaxed slightly due to recent exchange rate devaluation

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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