BBVA | RESEARCH

Weekly Watch

Mexico

September 23, 2011

Economic Analysis

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Next week...

Growth and Public Finances, an increasingly interesting relationship

Output indicators for the Mexican economy set for release next week (IGAE and construction company output, both for July) should not provide major surprises with regard to GDP growth forecasts for the 3Q11. According to the available information, it is likely to be no less than the 1.1% q/q seen in the previous period. This is in line with the BBVA Research forecast scenario where, as stated last week, Mexico should grow by 3.8% in 2011 and 3.3% in 2012 (for further details see ***BBVA Research***).

An analysis of trade balance and budget deficit data up to August could be more useful, allowing the flow of overseas demand and the status of public finances to be monitored; both of these are linked through the global cycle impact on exports and budget revenue, not only from oil. Insofar as the performance of Mexican budget numbers is seen to be in line with the balanced budget targets and that exports, as it seems up to July, do not suddenly slow down and continue to be a sign of growth in Mexico, the price of domestic financial assets will have better elements of strength in the face of global uncertainty which, since last week, overshadow any chance of positive discrimination.

Market Analysis

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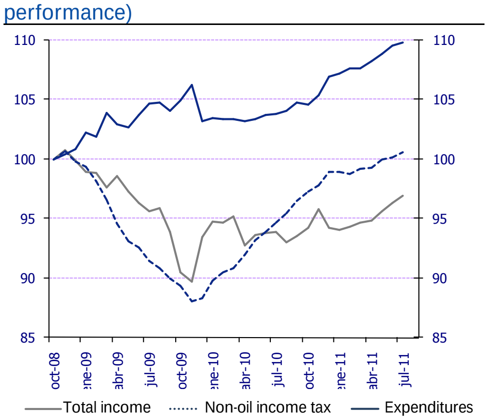
Fed: "Significant risks" to growth and "financial tensions" have an adverse impact on MXN assets

Major reversal in the MXN, IPC and increased interest rates in response to a pessimistic monetary policy statement in the U.S. on the global situation and the lack of a resolution to fiscal problems in developed countries. We cannot rule out the MXN coming in slightly below last week's close (13.56) and Mbonds continuing decorrelated with US treasuries in the face of a slowdown in capital inflows.

Chart 1

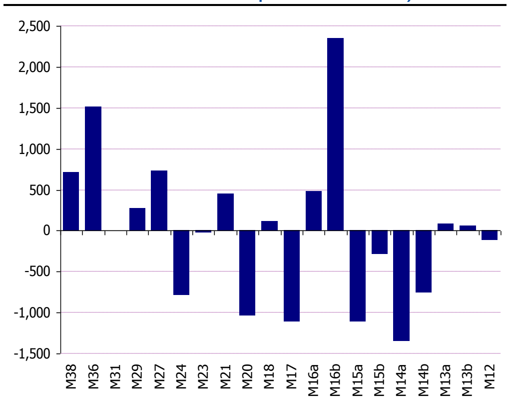
Mexico: Budget Figures (Oct 08=100, real performance)



Source: BBVA Research with SHCP data

Chart 2

Net foreign capital inflows to MBONDS (millions of MXN, accumulated September 19-22)



Source: BBVA Research

Economic Analysis

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Calendar: Indicators

August Trade Balance (September 26)

Forecast -2.237 bn dollars	Consensus: N.A.	Previous: -1.179 bn USD

In terms of year-on-year change, imports of consumer goods grew by 23% on average in the May-July period in comparison to 9% in intermediate goods (strongly linked to foreign demand) and 16% in capital goods. In turn, manufacturing exports were on average 3% lower in the last three months than in the same period last year. With this, the Mexican trade gap will continue to expand given the continued consumer recovery.

IGAE in July (September 22)

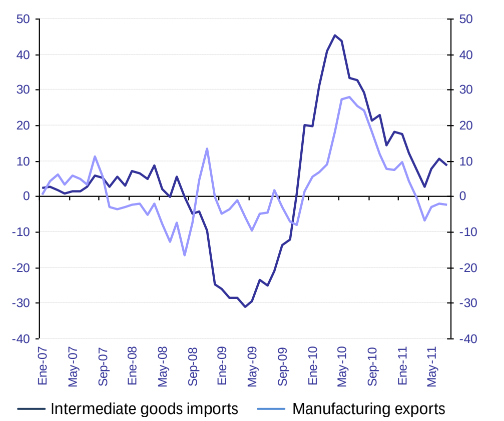
Forecast: 0.4% m/m (3.8% y/y)	Consensus: N.A.	Previous: -0.2% m/m (4% y/y)

The IGAE set to be released this Wednesday will be one of the first "hard" output indicators for the third quarter covering all economic output (manufacturing, services and farming). In turn, with regard to industrial output, we already have the AMIA indicator for automotive production up to August which in said month started to show clearer signs of a slowdown (7.7% y/y vs 14.4% y/y on average over the three previous months).
With the good industrial output figures in July (+0.5%, -0.5% previous), alongside the positive results on the retail survey (0.4% m/m, 0.9% previous) and the services indicator (1.6%, 0.2% previous), we expect the IGAE to have moved slightly upwards in July (0.4%, -0.2% previous). It should be underlined that this is a major result since it is in line with the solid performance in domestic demand and, specifically, private consumption seen in the first part of the year.

Public Finances to August

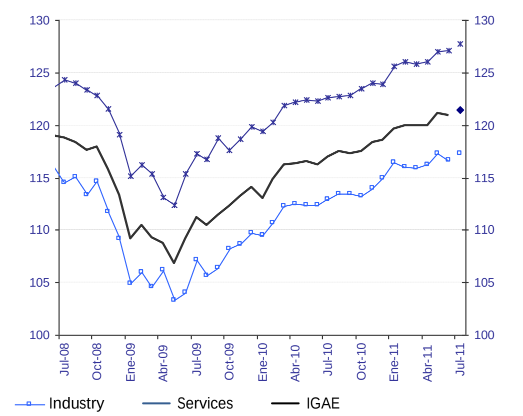
Next week sees the release of the Public Finance report which is important for discovering the path of total revenue and, specifically, tax revenue which have respectively expanded by 5.2% and 1.7% over the year to date. The level of recovery in tax revenue has a major cyclical component. In this way, economic growth is a fundamental factor in reaching the forecast collection level in the 2011 Revenue Law (estimated growth was 3.9% y/y). The growth scenario used for the 2012 Budget is highly relevant here given the downward risks for economic output have increased. The plan sent by the Government to Congress sets out GDP growth at 3.5% and a budget deficit of -2.2% of GDP. Although we believe the growth forecast is very reasonable (our 2012 forecast is 3.3%), we do think that faced with the risks in the global economic outlook, the commitment to budget stability needs to be confirmed. In the face of an unexpected slowdown in economic output, given the cyclical dependency in revenue, cost-cutting should be put in place which, in any case, should not affect priority investment and assistance programs.

Chart 3
Selected Exports & Imports (% change y/y in real USD)



Source: BBVA Research with INEGI data

Chart 3
IGAE, SA (2003=100)



Source: BBVA Research with INEGI data

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Markets

Fed: "Significant risks" to growth and high "financial tensions"...

The announcement by the Fed that it would extend the maturities in its portfolio (sale of USD 400 billion of short-term Treasury notes maturing in under 3 years and purchase of securities with maturities of more than 6 years until June 2012) and reinvest in agency MBS was expected, and the market reacted adversely to the emphasis on "significant risks" to growth and high "financial tensions". This news, combined with indicators that suggest weakness in manufacturing industry in the Eurozone and China, have led to a strong upturn in risk aversion and capital flight from emerging markets. In addition, the week saw downgrades in banks in the U.S. (Bank of America, Wells Fargo and Citi) and Italy, as well as adverse comments on the capitalization needs of European banks by the IMF and the ECB's Systemic Risk Board. This led to heightened fears and growing speculation that measures by the EFSF and ECB on the Greek bailout are imminent in Europe.

...adversely affect the MXN alongside regional currencies...

LatAm currencies saw major falls last week where the MXN moved down less over the 5 days (-3.8%) than currencies in Chile (-7.2), Brazil (-5,5) and Colombia (-4.3). Although the MXN saw greater falls after the Fed's release on Wednesday, it saw corrections at the end of last week in step with A. Carstens' statement that the MXN is "clearly undervalued". Volatility factors will continue over the coming weeks meaning we do not expect a substantial short-term recovery for the MXN which may come in slightly below current levels (13.56).

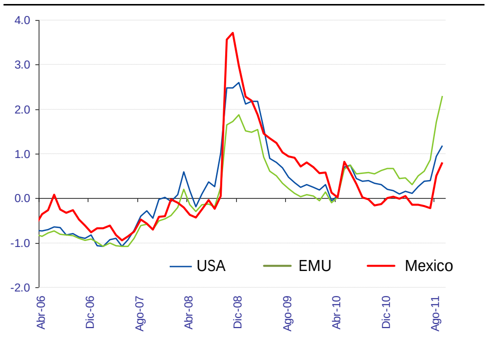
...and a sell bias in domestic bonds

In turn, the greater risk aversion translated as a sell bias for domestic bonds which decorrelated from US treasuries. The technical curve position is negative: capital inflows have lost strength and the domestic capital has been practically absent throughout the year. In line with our forward monitoring of capital inflows onto MBonds markets, this continued to be low in the week of September 19-22 with regard the summer average (MXN226mn). The monthly accumulated flow is near MXN11bn. This reduced inflow speed coincides with the major devaluation in the peso and the bounce in emerging market curves where accumulated yields for the year are close to dissolving.

IPC severely affected and to continue linked to the balance of sovereign risks

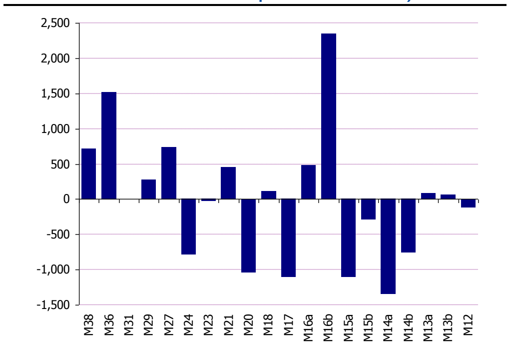
Stock markets around the world were severely affected over the week in response to renewed risk aversion. The Mexican IPC was one of the most affected due to its real link to the U.S. The performance of the stock markets will continue to be closely linked to the balance of sovereign risks, so much so that little could support a positive surprise in the coming corporate earnings season.

Chart 5
Financial Stress Indicator



Source: BBVA Research

Chart 6
Net foreign capital inflows to MBONDS (millions of MXN, accumulated September 19-22)



Source: BBVA Research with Bank of Mexico data

Market Analysis
Equities

Technical Analysis
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Technical Analysis

IPC Stock Market Index

Source: BBVA Bancomer, Bloomberg

The IPC has still not hit yearly minimums (31,700pts) meaning we still believe this is the initial short-term support level. Under this level, the IPC floors would come in at 31,000 and 30,000pts. A negative scenario where the Dow and S&P hit new yearly lows would lead to a downward break through the 31,700pts floor. In the face of this risk, we believe it is better to wait for the IPC to hit these minimums and see a favorable reaction in volume before taking speculative market positions. However, the weekly fall has opened up opportunities at issuers which have moved forward their negative move and which may start to reduce volatility, such as Gmexico and Mexchem.

Previous rec.: We believe there could be a return to this latter resistance level, which corresponds to the highs of August and this month.

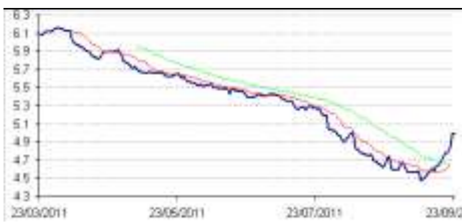
MXN

Source: BBVA Bancomer, Bloomberg

The dollar maintains upward move, breaking technical resistance levels. It ended the week with an adjustment after hitting the MXN14.00 level which may finally turn into a psychological resistance. With high over-buying and trading above any technical band, we believe that the adjustment started on Friday should remain towards levels at MXN13.50 and after at MXN13.00 in the short-term.

Previous rec.: Very significant over-buying in short-term oscillating indicators and a strong dispersion of the dollar against the 30-day rolling average.

3Y M BOND

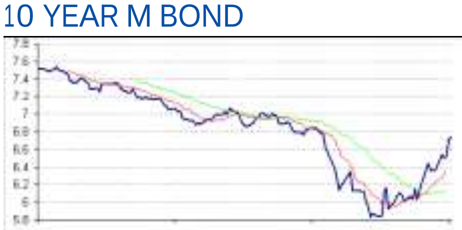


Source: BBVA Bancomer, Bloomberg

3Y M BOND: (yield): Hits the technical bounce and reaches 5% level. This move caused short-term over-buying and we could therefore expect a return to the 4.75% level to then retake the bounce. A move above 5% sets the next target at 5.3%.

Previous rec.: Formation is good and may eventually lead to a change in trend, with the first target at 5%.

10 YEAR M BOND



Source: BBVA Bancomer, Bloomberg

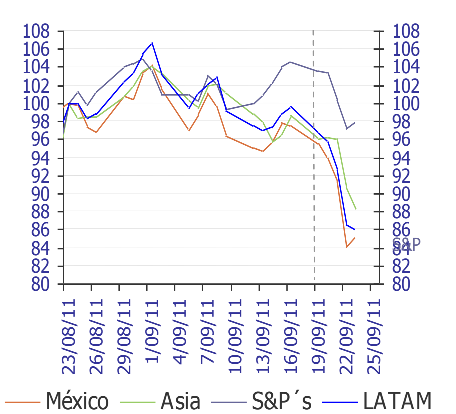
10-YEAR M BOND: (yield): Reached initial resistance at 6.8%. Due to over-buying it could return to 6.5% but may retake the upswing and seek out 7%.

Previous Rec.: The 10-day average crosses and climbs over the 30-day average, meaning the next short-term level can be identified at 6.8%.

Markets

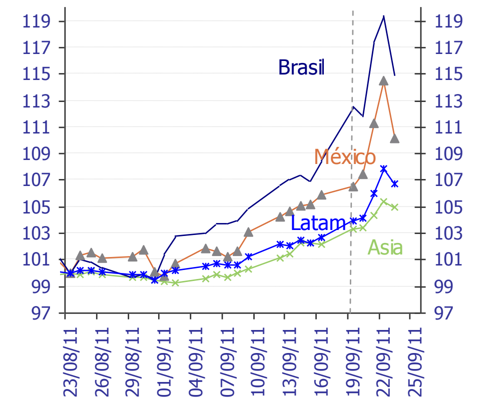
The Federal Reserve statement, where a worsening economic outlook and increased future risks are mentioned, led to a wave of risk aversion affecting emerging currencies and share markets.

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



Source: Bloomberg & BBVA Research

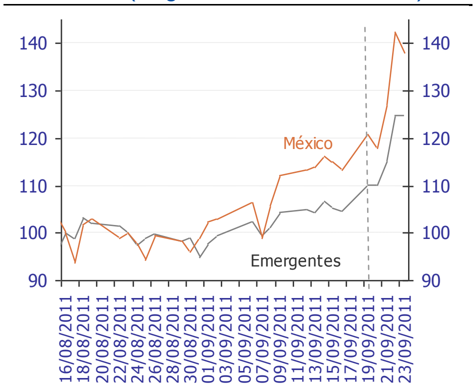
Chart 8
Foreign exchange: dollar exchange rates (August 16, 2011=100)



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

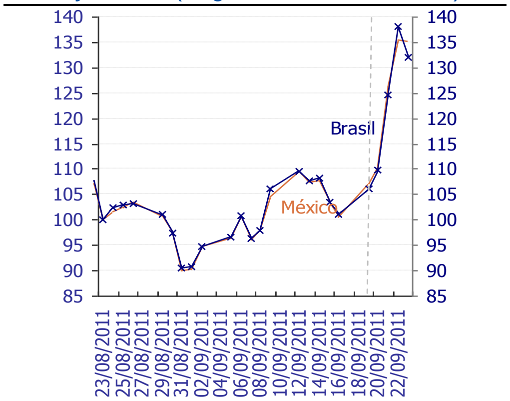
The increased aversion raised risk premiums for bonds from emerging countries.

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



Source: Bloomberg & BBVA Research

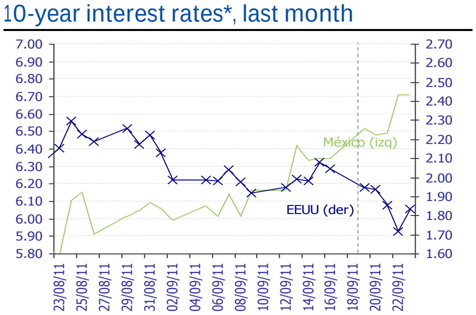
Chart 10
Risk: 5 year CDS (August 16, 2011 index=100)



Source: Bloomberg & BBVA Research

T-Bills saw rate falls as they are considered a safe-haven asset. Despite the increase in aversion, the 10-year Mexican Bond continued to pay at historically low rates

Chart 11
10-year interest rates*, last month



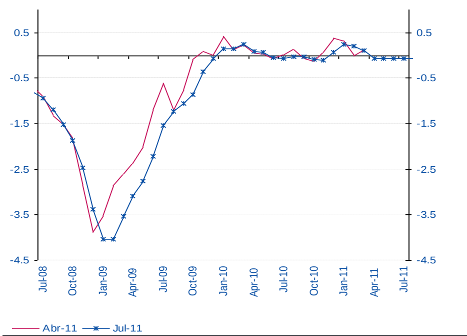
Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

Source: BBVA Research with data from Bloomberg

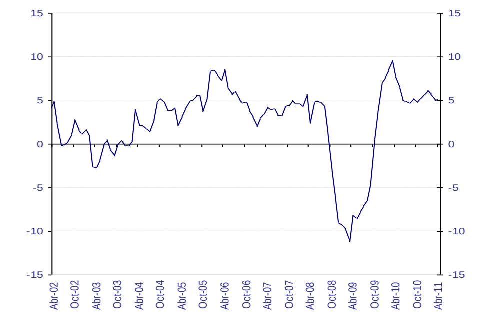
Activity, inflation, monetary conditions

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.

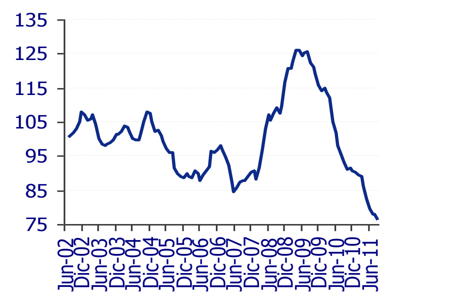
Chart 14
Advance Indicator of Activity (y/y % change)



Source: INEGI

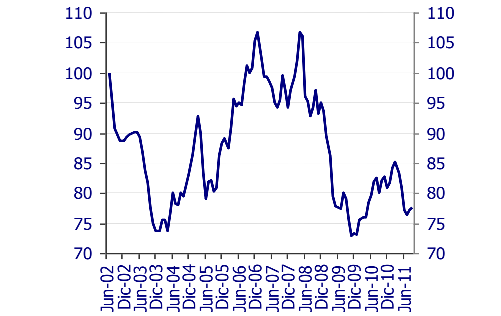
Recent inflationary surprises have been downward, while those concerning economic activity have been mixed.

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.

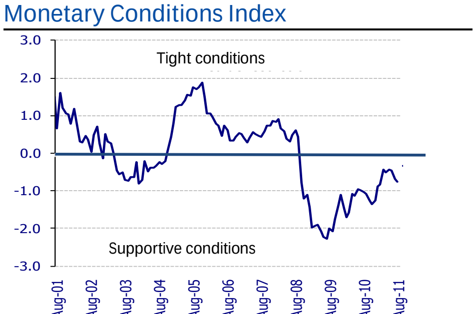
Chart 16
Activity Surprise Index (2002=100)



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.

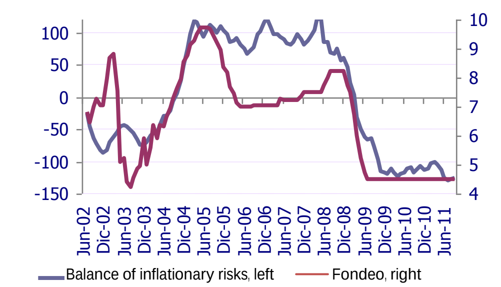
Monetary conditions relaxed slightly due to recent exchange rate depreciation

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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