BBVA | RESEARCH

BBVA Group Economic Research Department

Weekly Watch

Mexico

October 28, 2011

Economic Analysis

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Next week…

… assessing the US output cycle level at the start of 4Q11

After a week of better-than-expected news on concerns affecting markets, this week will again mean a test for US cycle strength with non-farm payroll figures and manufacturing output for October. The week just ended saw the US growth rate rise in 3Q11 although this does not mean an escape from downward bias in forecasts on a deleveraging scenario for households and uncertainty to be resolved on fiscal matters that could have an impact on confidence. In turn, the Eurozone again got down to work on solving the short-term solvency and liquidity problems in public debt and the strength of banks, as well as long-term issues of governance, especially in fiscal matters. In Mexico, the Budget continued through the house with approval in the Senate of the Law on Revenues without any major new additions to what was already released. In terms of economic indicators, attention will need to be paid domestically to the first signs from the fourth quarter on consumer confidence and manufacturing figures for October. They will likely be in line with an output scenario showing positive albeit lower variations than in the previous quarter.

A week of high financial tension ends positively

Market Analysis

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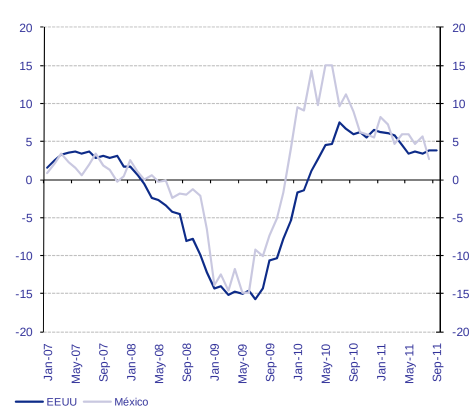
The sovereign and financial risks in Europe have been the main determining factors to domestic market performance in fixed income and currencies. In this way, we believe the measures agreed at the European Monetary Union summit last week are a huge step in the right direction, favoring a slowdown in risk premiums in the short term and domestic assets. In short, there are still some risks in the area. In addition, we would expect US indicators and monetary policy forecasts (international and domestic) to start to see greater attention.

Chart 1
Manufacturing output Mexico US (% change y/y)



Source: BBVA Research

Chart 2
Implied 1-month volatility in the MXN

Source: BBVA Research and Bloomberg

Calendar: Indicators

Economic Analysis

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US: Non-farm payroll & unemployment rate (October: November 4)

Forecast: 105,000; 9.1%	Consensus: 100,000; 9.1%	Previous: 103,000; 9.1%

Mixed economic reports in October point to little improvement in employment and modest growth in non-farm payroll for the month. Despite upward revisions to 3Q output data, businesses continue to announce planned job cuts. Manufacturing jobs data were mixed, pointing to employment growth being weak in the sector. In turn, government job cuts are likely to continue. Early unemployment applications remained at around 400,000 but have not fallen below this level since September. Taking into account these job market trends, we do not expect to see a fall in the jobless rate. There are few market expectations for employment data but very low payroll figures could re-ignite fears over a high unemployment rate.

Mexico: Formal private-sector employment (October)

Forecast: 0.32% (4.1% y/y)	Consensus: n/a	Previous: 0.39% (4.2% y/y)

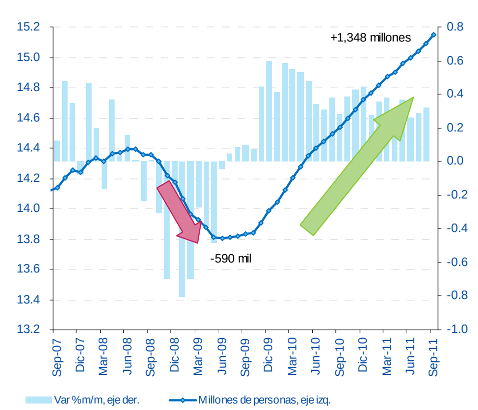
With a slowdown in industrial production, growth in the rate of job creation is likely to fall slightly despite being buoyant recently. It should be stated that job creation was excellent in services and in manufacturing with average monthly changes of around 0.4 and 0.2% respectively in the previous three months. Since the start of the year until September, around 427,000 jobs have been created and almost 1.35 million since the start of the economic recovery.

Mexico: Consumer and Producer Confidence (October)

Forecast: Cons -0.5% (90 pts)	Consensus: n/a	Previous: -1.5% (90.7 pts)
Forecast: Manu: -0.8% (53.5 pts)	Consensus: n/a	Previous: -0.4% (53.9 pts)

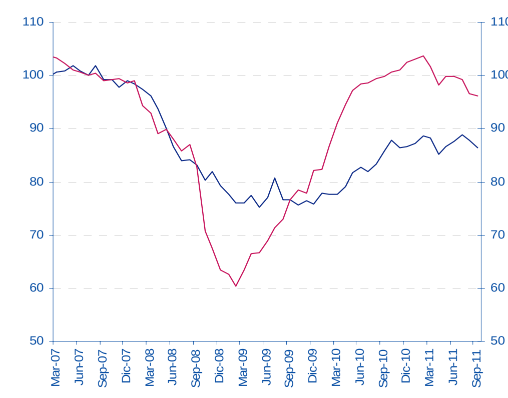
If the lower job creation is true, alongside a slowdown in the positive contribution seen in all real salaries, these would be factors contributing to lower consumer confidence towards the last quarter of the year.
Lower industrial output linked to a slowdown in foreign demand, as well as continuing doubts surrounding a recovery in US economic output, will contribute to moderating manufacturer spirits.

Chart 3
Formal Private-sector Employment (Level and % change y/y)



Source: BBVA Research with IMSS data

Chart 4
Confidence: consumer and producer (Jul07=100)



Source: BBVA Research with Banxico and INEGI data

Markets

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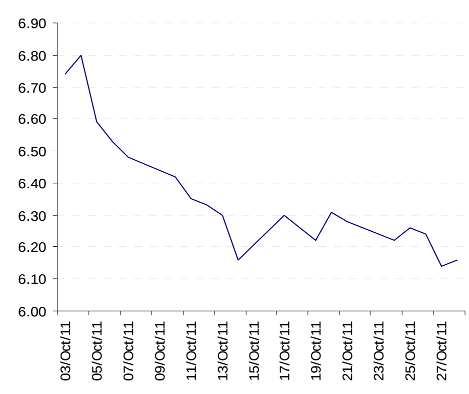
Downward interest rates

Since the European ministers summit ended last week, the MXN has appreciated by 4.5% and the curve level has fallen over 10bp. Spreads between the MBOND and UST have returned to levels from early August (380bp). It is important to underline that the weighted spread for MXN hedging cost (carry-trade indicator or differential adjusted by risk forecast) has not seen major increases in recent sessions. This mean the fall in implied volatility in options has come in with a similar size to that for spreads. But volatility remains far above levels at the end of August meaning if the market continues to move risk premiums down and these lead to a lower exchange hedge cost, the rates spread should become more attractive and lead to it hitting minimums of 340bp.

MXN sees one of the highest weekly falls due to Eurozone risks ...

The MXN ended last week with a strengthening of around 4.9% in response to the agreements reached at the European Union summit. In the first days, cross transactions performed with high volatility (especially for the intraday), however at the close they benefitted from the greater global risk appetite. In fact, 1M implicit volatility fell by 3 vegas during the week and returned to levels from mid-September of 17%. Positions in the CFTC did not show major changes over the previous week. Nonetheless, the data from the days after the EU announcements are still to be factored in. In short, the currency remains with a positive bias and its extension will now depend on US economic indicators and new details on the EFSF mechanism.

Chart 5
10 year Bond interest rate



Source: Valmer

Chart 6
Implied 1-month volatility in the MXN

Source: BBVA Research and Bloomberg

Market Analysis
Equities

Technical Analysis
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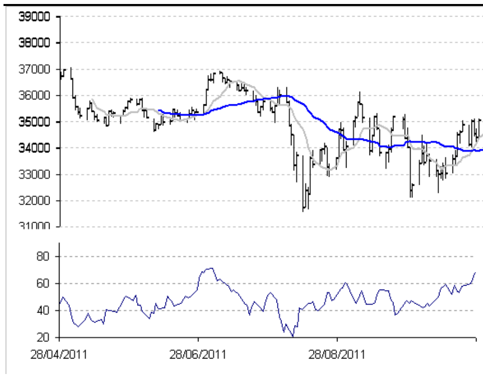
Technical Analysis

IPC Stock Market Index

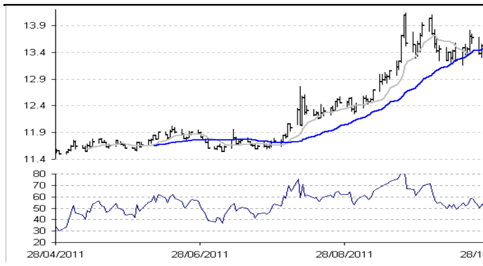


Source: BBVA Bancomer, Bloomberg

Now operating upward, the resistance levels we should be considering for the IPC are the July high (36,917pts) and then the April high (38,000pts). Before hitting these resistance levels, we see the market as likely to see a pull-back to support levels. The bounce the market has seen from 32,000pts has led to readings of over-buying in several oscillating indicators (RSI by 70pts and CCI by 185pts) which supports the profit-taking outlook. Any return to the 36,000pts level should be considered a new entry opportunity. We therefore recommend profit-taking at positions reaching resistances and waiting for a return to support levels to then increase investment levels

Previous Rec.: The 10-day rolling average has crossed upward the 30-day, a short-term positive technical signal supporting an upward forecast.

MXN

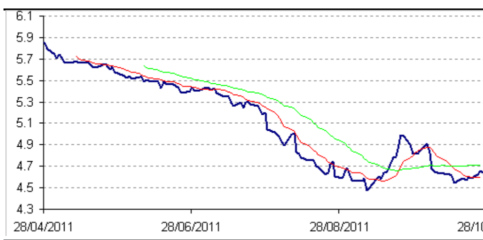


Source: BBVA Bancomer, Bloomberg

Fall in the dollar over the week coming in below the 10- and 30-day rolling averages and below the MXN13.20 floor. This sets the MXN13.00 level as a short-term objective. If this floor is broken, the downward move may extend toward MXN12.60, although we believe there may be a bounce up to MXN13.20 before this break.

Previous Rec.: We believe it should retake the adjustment and seek levels near MXN13.00 over the coming week.

3Y M BOND

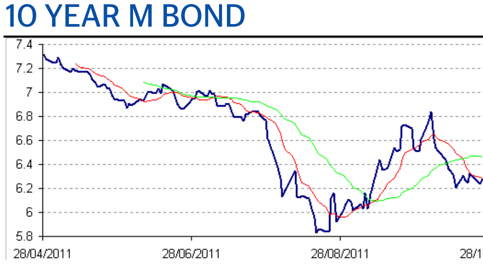


Source: BBVA Bancomer, Bloomberg

3-YEAR BOND: (yield): Reached 4.5% levels and starting to change trend. It may mark a "double bottoming out" to retake the bounce move. This would be confirmed with an upward break from 4.7% to seek out 5%.

Previous Rec.: Major support from where it could again bounce; however, we would consider a stop loss if it breaks downward.

10 YEAR M BOND



Source: BBVA Bancomer, Bloomberg

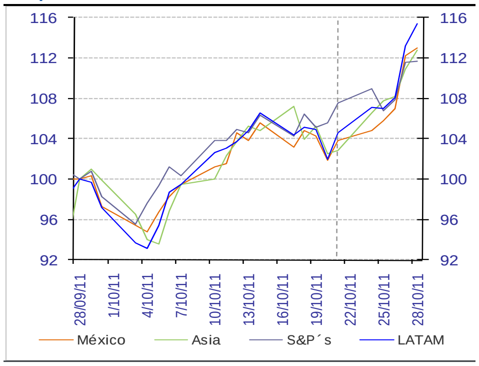
10 YEAR M BOND: (yield): Short-term downward trend remains still coming in below the short-term rolling averages. Floors at 6% and 5.85%. It would have to break up to 6.5% for a trend change.

Previous Rec.: Support could be up to 5.9% and resistance at 6.4%.

Markets

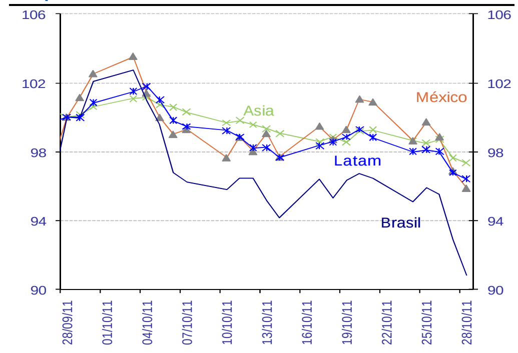
The lack of details on the measures announced by European authorities to alleviate the debt crisis created uncertainty which led to slight falls on stock markets. In turn, better-than-expected consumer confidence data influenced a rise in the exchange rate.

Chart 7
Stock Markets: MSCI Indices (Sep 28, 2011 index = 100)



Source: Bloomberg & BBVA Research

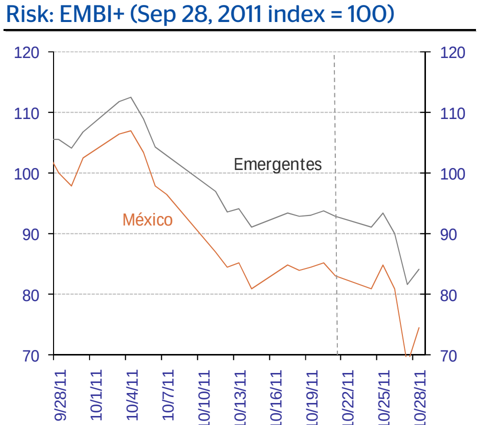
Chart 8
Foreign exchange: dollar exchange rates (Sep 28, 2011 index = 100)



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

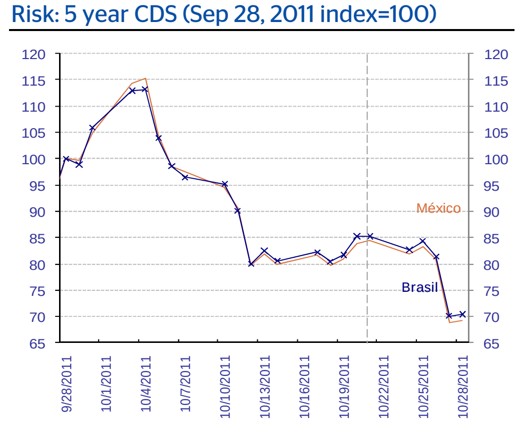
Fall in risk aversion over the week in the face of optimism over a quick solution to the European debt crisis

Chart 9
Risk: EMBI+ (Sep 28, 2011 index = 100)



Source: Bloomberg & BBVA Research

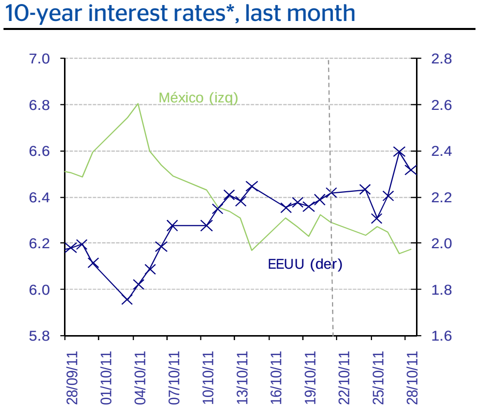
Chart 10
Risk: 5 year CDS (Sep 28, 2011 index=100)



Source: Bloomberg & BBVA Research

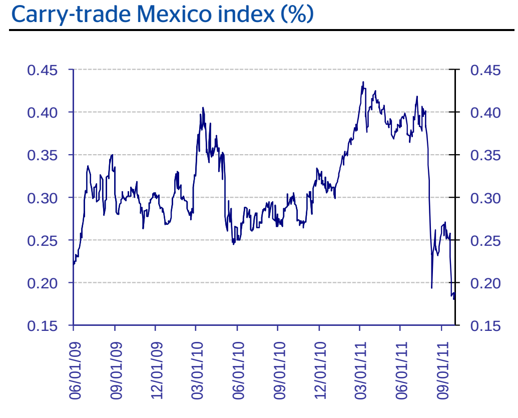
Slight upswing in rates in Mexico toward the end of the week after a fall subsequent to the approval of new measures to solve the crisis in Europe. US rates rise over the week in the face of higher risk appetite

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

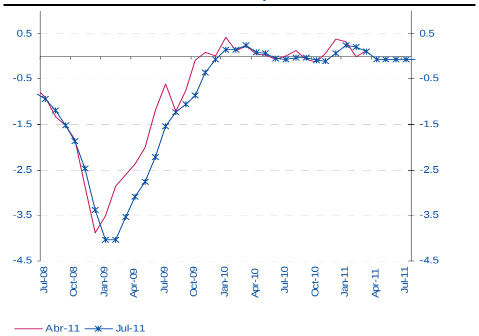


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

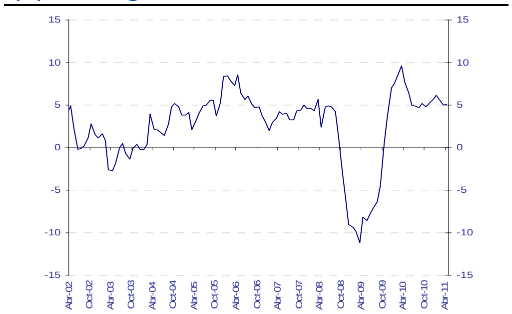
Output holds positive performance, situation indicators point to 3Q11 near to 2Q quarterly rate

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.

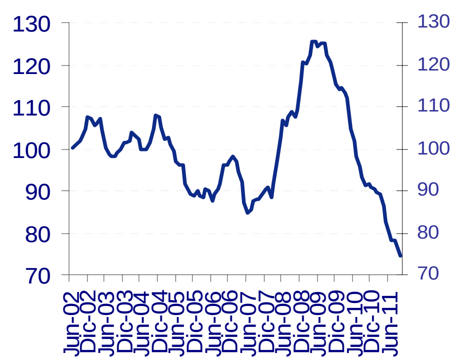
Chart 14
Advance Indicator of Activity (y/y % change)



Source: INEGI

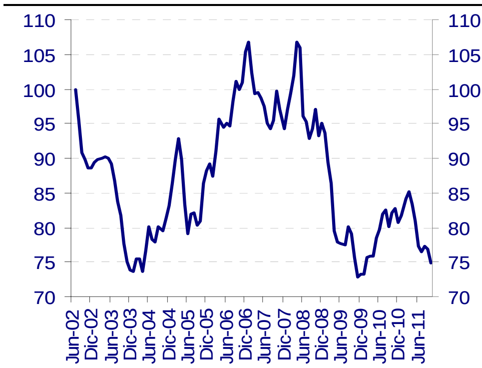
Recent inflationary surprises have been downward, while those concerning economic activity have been mixed.

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.

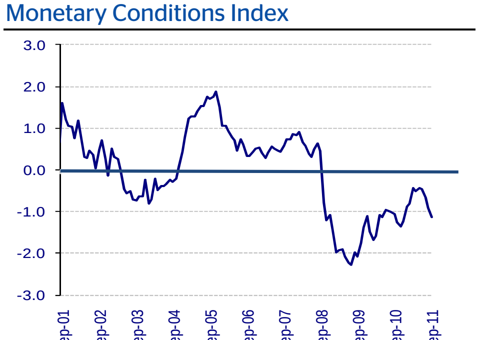
Chart 16
Activity Surprise Index (2002=100)



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.

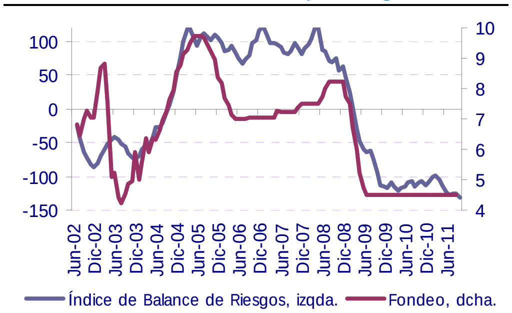
Monetary Conditions relax due to recent exchange rate depreciation

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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