BBVA | RESEARCH

Weekly Watch

Mexico

November 18, 2011

Economic Analysis

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Market Analysis

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Next week...

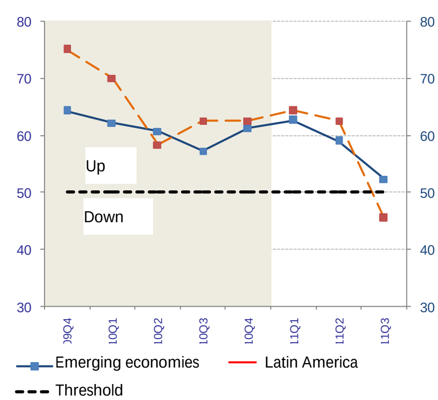
... moving away from Europe nearer the US but with global risk premium exposure

Next week sees the release of 3Q11 GDP figures which, if near the expected 1.2% q/q, should have a similar trajectory this year to those of our main trading partner's (the US) output. Output should have gone from less to more, reflecting the close cyclical links between the two economies and their exposure to common shocks. In turn, the Eurozone area has an opposite outlook in terms of GDP, moving from higher to lower growth over 2011 and with a forecast for practically a standstill or even decline in output in the last quarter of the year. This situation, alongside the close direct contagion channels from Europe to Mexico[1], fails to rule out downward risks for our economy if sovereign debt in the Eurozone continues to increase the sense of persistent global risk. In other words, if this were to mean the start of a period where the availability of finance is too low to cover the solvent demand for funds at reasonable rates.

If global uncertainty continues, potential is high for foreign capital outflows.

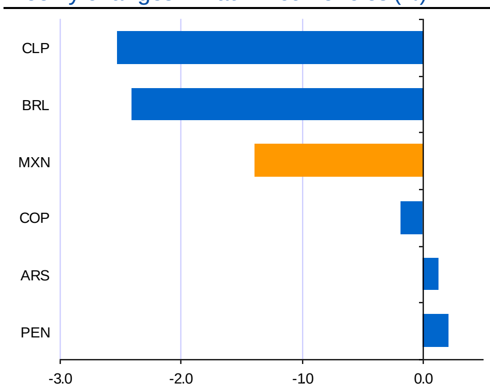
The lack of component factors to ease global uncertainty means continued downgrades to financial assets on domestic markets. This time around, the European debt crisis has affected domestic fixed income instruments which, by showing a positive correlation with the MXN, points to the risk aversion sentiment worsening.

Chart 1
Banking finance offer for international trade in emerging markets
Change compared to previous period



Source: BBVA Research with IIF data, Emerging Markets Bank Lending Conditions Survey. A difference with the survey from 1Q11

Chart 2
Weekly changes in LatAm currencies (%)



Source: BBVA Research and Bloomberg

[1] For more details, see for example, BBVA Research "Mexico Watch" for the second quarter of 2011, available online at www.bbvaresearch.com

Calendar: Indicators

Economic Analysis

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GDP, 3Q11 (Tuesday, November 22)

Forecast: 1.2% q/q 4.2% y/y	Consensus: N.A.	Previous: 1.1% q/q 3.6% y/y

The third quarter ends with better-than-expected output indicators than at the start of the period. The surprise negative figures in the August IGAE were mainly due to particularly depressed industrial output (-1.1% for the month, the lowest since mid-2009) and were compensated in September with positive growth of 1.8% with a good rise in main sectors: manufacturing and construction (1.5% and 2.5% m/m respectively).

In turn, a key indicator for the service sector (64% of the economy's added value) on available income in the formal sector continued to see well-paced growth in the third quarter: an average of 5% for the year in the quarter with positive contributions from both employment and real wages.

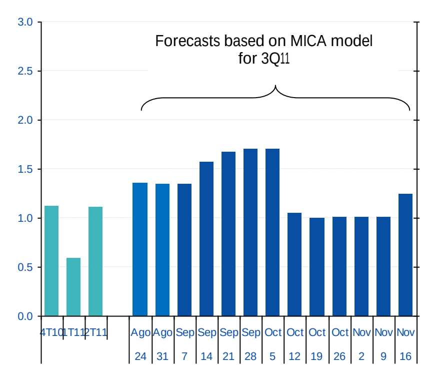
In all, the quarterly forecast for GDP in the 3Q11, in accordance with the MICA-BBVA model, is 1.2% q/q, 0.2 pp above estimates with the information available at the start of the quarter. In the same vein, we expect output to slow in the last quarter of the year to a level near 0.3%, with a probable range between (0.0 and 0.6% q/q). In total, 3.8% for the whole of 2011.

Inflation for the first two weeks in November (Thursday, November 24)

Forecast: 0.98% bi-weekly 3.44% y/y	Consensus: 0.76% bi-weekly	Previous: 0.67% m/m 3.2% y/y

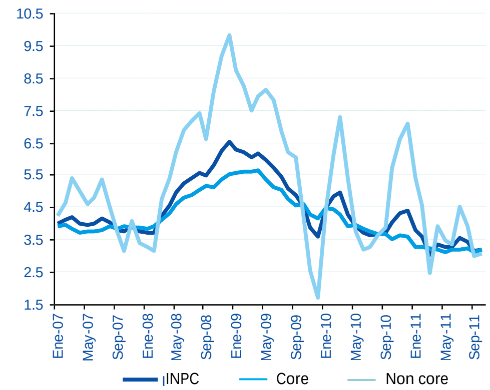
We have increased our growth outlook for prices this month due to the higher-than-expected increase in electricity prices in the face of the end to warm season subsidies and pressures in energy costs. In addition, a seasonal upswing in fruit and vegetable prices will be seen - a normal occurrence given the season. We expect core inflation to see a 0.15% q/q increase (3.12% y/y). This change means that the core component continues to not show pressures in services and non-food goods thanks to the economy's comfortable resources. This avoids pressures on demand and favors a lack of any pass-on to the exchange rate. We expect inflation to be around 3.48% at the end of the year.

Chart 3
BBVA-MICA: forecast for Mexican GDP (q/q % change)



Source: BBVA Research

Chart 4
Inflation breakdown
(y/y % change)



Source: BBVA Research with INEGI data

Markets

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No improvement in the global mood, markets await decisive action in the euro zone

Last week fears of systemic risks in the euro zone intensified when Germany and France failed to reach a political agreement on the role of the ECB as lender of last resort for EU sovereigns in the Eurozone (EZ). Generic 10-year bonds for most of the EZ countries (other than Greece, Ireland and Portugal) posted highs in their spreads against the German Bund. There was a notable fall in demand for Spanish 10-year bonds, and their yield was up to 6.975% (vs. 5.433% at the previous auction). This news, together with statements by Fitch on the risk of banking contagion to the U.S., pushed the favorable US cyclical data (industrial output, unemployment benefit and housing) and the positive valuation of Portugal by the Troika into the background. Markets will keep a close eye on the upcoming Ecofin meetings.

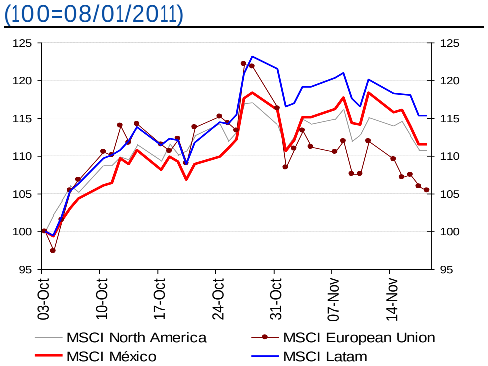
If global uncertainty continues, potential is high for foreign capital outflows

In general, the global scenario continues to favor an exit from risk assets which, this time around, even affected domestic fixed income instruments which, by showing a positive correlation with the MXN, points to the risk aversion sentiment worsening. We believe the range dynamics remain. Nonetheless, the potential for foreign outflows (if the rumors on contagion in the European periphery continue) is high and the devaluation could even be more aggressive. In all, we continue to forecast a moderation in risk premiums toward the end of the month. In this sense, we maintain our forecast of appreciation toward the 13.20 level. Over the week, they could fluctuate between 13.4 and 13.7.

In the face of EZ tensions and favorable US economic data, the Mexican stock market moved down, albeit less than in developed markets

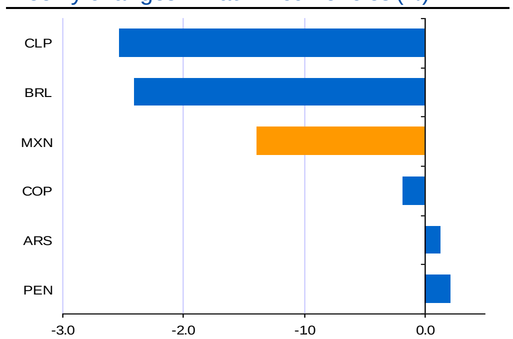
Although the epicenter of turbulence is the EMU, positive readings in cyclical indicators came from the US. This meant the weekly contraction on the Mexican stock market was similar to the Dow Jones and saw a better performance than European markets. We continue to expect market volatility in anticipation of proposals for fiscal consolidation in the U.S. (November 23) and the Ecofin meetings at the end of the month.

Chart 5
MSCI: Selected regions (100=08/01/2011)



Source: BBVA Research and Bloomberg

Chart 6
Weekly changes in LatAm currencies (%)



Source: BBVA Research and Bloomberg

Market Analysis
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Technical Analysis

IPC Stock Market Index

Source: BBVA Bancomer, Bloomberg

The IPC ended the week with a slight bounce from 36,000pts, a psychological support level. However, we believe that there is still a high likelihood of it seeking out the 35,600pts level where it would hit a more important support - the area where the 30- and 200-day rolling averages come together and where we would increase our short-term positions. The alternate scenario would be for the market to maintain the bounce and hit above the 10-day rolling average (36,855pts) which would mark an entry signal. In both instances, we would consider 38,000pts as a target level.

Previous Rec.: This keeps the risk of short-term profit-taking high with supports at 36,000 and 35,600 pts. We have therefore maintained a low short-term investment level.

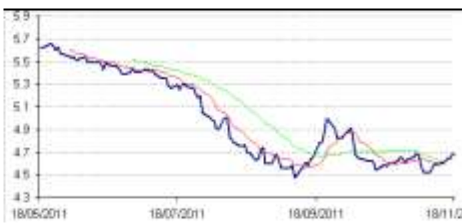
MXN

Source: BBVA Bancomer, Bloomberg

Volatile week with the dollar returning to the MXN13.75 zone The bounce could persist to the MXN13.85 zone where it would hit the second standard deviation with a return to that from two months ago. The first support now sits at MXN13.55.

Previous Rec.: If it continues to trade in the high part of this tranche, we maintain a downward outlook for the dollar to floor levels at MXN13.20 and MXN13.00.

3Y M BOND

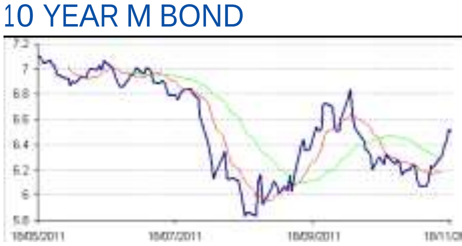


Source: BBVA Bancomer, Bloomberg

3-YEAR M BOND: (yield): Again comes in above the short-term rolling average. The bounce could persist with a target at 4.9% and support at 4.6%.

Previous Rec.: We expect a bounce toward levels around 4.7% and then 4.9%.

10 YEAR M BOND



Source: BBVA Bancomer, Bloomberg

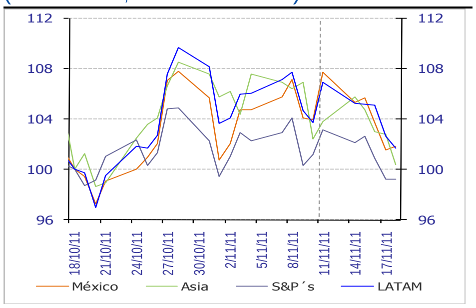
10-YEAR M BOND: (yield): Major upswing breaking through the 30-day rolling average. Important resistance up to 6.8% with support at 6.3%.

Previous Rec.: If it breaks 6.35%, it could set a trend change and seek 6.8%.

Markets

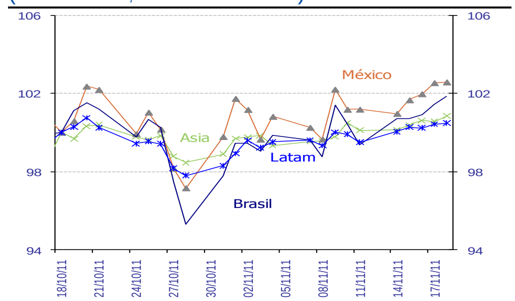
Falls on stock markets and in currencies in a week marked by the lack of agreement between France and Germany on the role to be played by the ECB in solving the current crisis.

Chart 7
Stock Markets: MSCI Indices (October 18, 2011 index=100)



Source: Bloomberg & BBVA Research

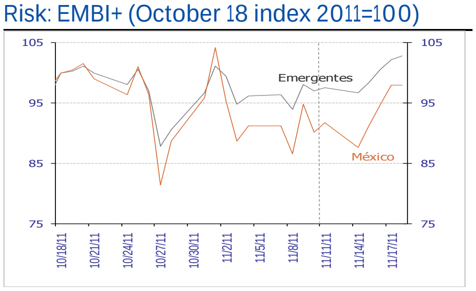
Chart 8
Foreign exchange: dollar exchange rates (October 18, 2011 index=100)



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

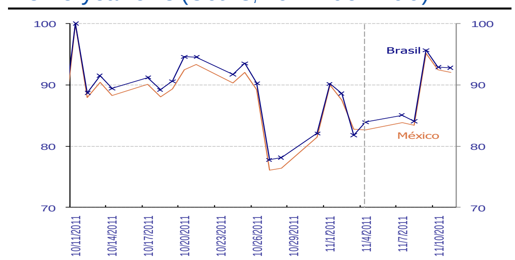
Increase in risk aversion due to Eurozone tension and in spite of better-than-expected economic data from the U.S.

Chart 9
Risk: EMBI+ (October 18 index 2011=100)



Source: Bloomberg & BBVA Research

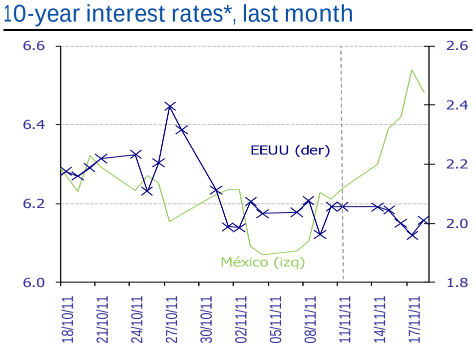
Chart 10
Risk: 5-year CDS (Oct 18, 2011 index=100)



Source: Bloomberg & BBVA Research

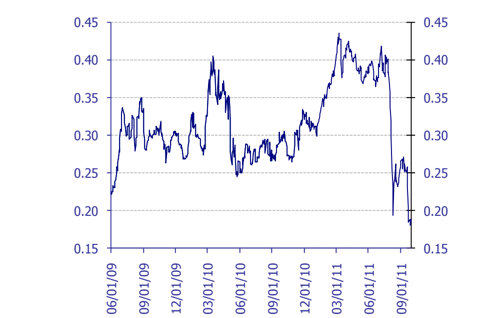
Increase in Mexican interest rates and a decline in US rates over the week in line with the increase in the risk aversion

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)



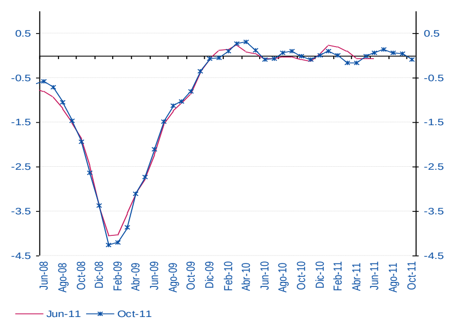
Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

Output holds positive performance, situation indicators point to 3Q11 with quarterly rates around 1%

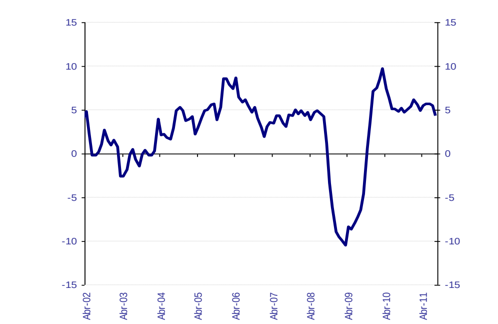
Monetary Conditions relax due to recent exchange rate depreciation

Chart 13
BBVA Research Synthetic Activity Indicator for the Mexican economy



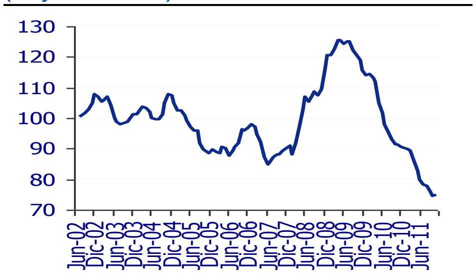
Source: BBVA Research with data from INEGI, AMIA and BEA
Weighted sum of 21 different indicators of activity, expenditure and expectation, based on trend series.

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



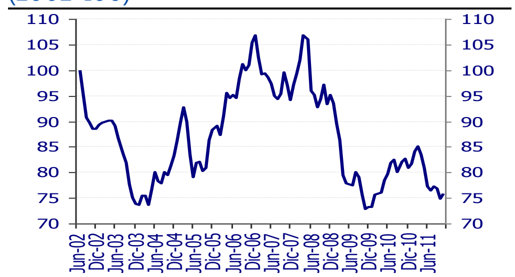
Source: INEGI

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.

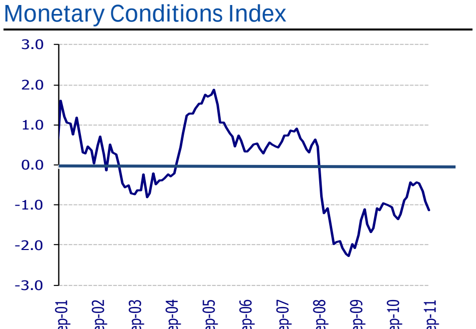
Chart 16
Activity Surprise Index (2002=100)



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.

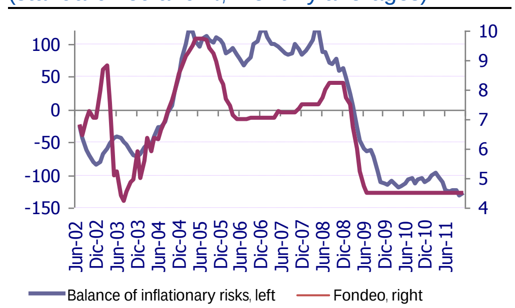
Recent inflationary surprises have been downward, while those concerning economic activity have been mixed.

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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