BBVA | RESEARCH

BBVA Group Economic Research Department

Weekly Watch

Mexico

December 2, 2011

Economic Analysis

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Market Analysis

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Next week...

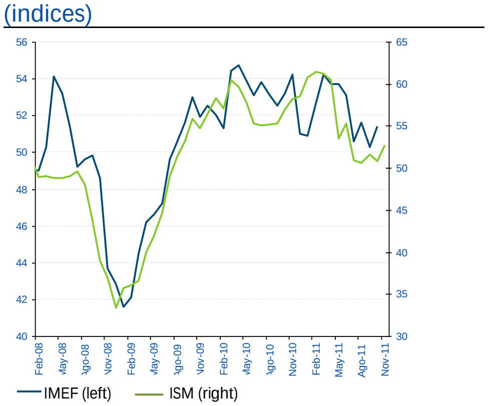
.... with our eyes on Europe

With Banxico's decision on the lending rate being known, the most important issue for the domestic economic outlook this coming week again lies outside the nation's borders. Inflation and output for November are released in Mexico (see details on page 2) which we do not believe are set to change the INPC variation outlook anchored to its core components and an output scenario with positive growth although somewhat below that in the 3Q11 in a highly uncertain global scenario. Not so much regarding the US, where recent manufacturing output data showed a positive surprise, but in Europe, where next week sees another meeting seeking a definitive solution to the sovereign debt crisis. The advances this past week on the EFSF financing capability or the IMF's role will next week need to come with agreements on how exchanges will be made, national budgetary sovereignty lost and be subject to reforms to achieve more accessible funding with a bigger role for the ECB, the EFSF and, in the future, common public debt. The solution found for all this will influence global financing conditions and, therefore, those in Mexico.

Weekly advance in risk assets; markets await the European summit

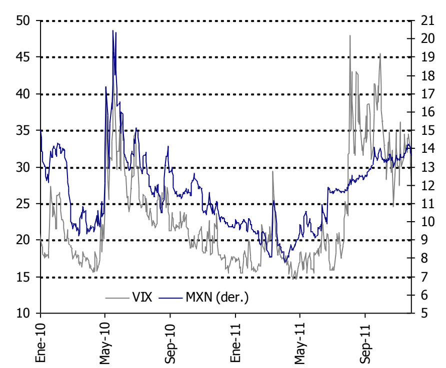
Global markets continue to fluctuate based on the European risk balance which, over the week, moderated. Expectations that the ECB would act as lender of last resort continued on Friday, after Germany and France appeared more disposed to allowing a select group of nations establishing financing agreements with the ECB in exchange for still to be released compliance with certain fiscal rules. The Bank of Mexico's monetary policy meeting was held on Friday which left the benchmark rate unchanged at 4.5% as well as offering a dovish tone in its most recent release.

Chart 1
IMEF and ISM Manufacturing Indicator (indices)



Source: BBVA Research and Bloomberg

Chart 2
VIX vs MXN



Source: BBVA Research and Bloomberg

Calendar: Indicators

Economic Analysis

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November Inflation (Thursday, December 8)

Forecast: 1.1% m/m 3.49% y/y	Consensus: 1.04%	Previous: 0.67% m/m 3.2% y/y

We forecast inflation saw a major bounce in November due to higher electricity prices over the last four fortnights. Up to 69% of the monthly variation in the INPC (1st fortnight in November) has been due to the latter. The rise in rates is due to higher energy prices on international markets and the lower exchange rate. In turn, core inflation also saw a slight upswing in November although outside of specific pressures (tourist services, electricity prices, cell phones, maize-related foodstuffs), non-food goods prices and most services saw a positive performance without upward pressures. This shows the looseness in offer to meet demand in the economy which also limits the exchange rate effect being passed on to prices. We see inflation ending the year at 3.5%, pressures seen recently being temporary and potential risks due to the exchange rate disappearing with a more stable international financial situation.

Formal Private-Sector Employment November

Forecast: 0.3% m/m (4.0% y/y)	Consensus: N.A.	Previous: 0.32% m/m (4.1% y/y)

Consumer Confidence November (December 5)

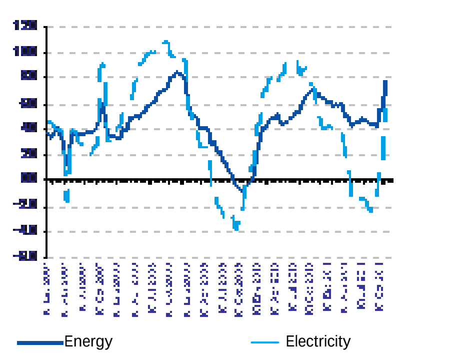
Forecast: 1.2% m/m (93.7 pts)	Consensus: N.A.	Previous: 1.8% m/m (92.6 pts)

This week we will get the outline of confidence outlook for (consumer, producer was released this Friday), employment and automotive output in November.

In general based on the important indicators for reference variables, we do not expect the data to point to a major moderation in output. In fact, producer confidence indicators released on Friday point to a slight moderation in trend sub-indices and the manufacturing orders indicator, although, in turn, the producer confidence indicator itself showed an upturn over previous months, especially with regard to the country's future economic situation.

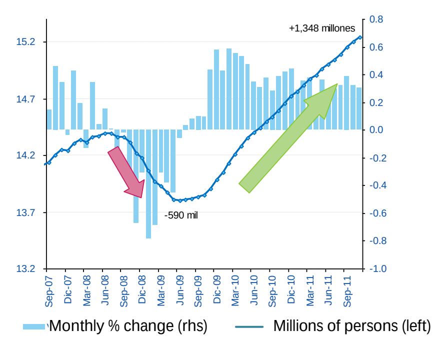
Formal private-sector employment will increase by around 0.3% for the month, taking into account seasonal adjustment. It should be stated that November shows seasonal rises which point to growth of around 90,000 jobs over the previous month. However, once this regular effect is discounted, growth should have come in within expectations and been steady and good. Therefore, we forecast consumer confidence to rise by just slightly less than the previous month. Automotive production data in the last month of the year should be particularly important and foresee some additional slowdown, albeit not likely to be intense, given the industry output signals from the US such a the ISM, which saw a slight upturn in November.

Chart 3
Energy and electricity prices inflation



Source: BBVA Research with INEGI data

Chart 4
Formal Private-sector Employment (Level and % change y/y)



Source: BBVA Research with STPS data

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In anticipation of the European summit

The short-term risks seem to have moderated, at least in anticipation of the next European summit on December 9. This led to a weekly advance in the main risk assets (e.g. S&P rose around 5.3% over the week), a fallback for safe-haven assets (the 10Y UST rose 6bp) and a weaker USD against G10 and EM currencies. Therefore, if this continues, global risk premiums, the stock rally and EM currencies could move up in coming days although we continue to be cautious since the EMU outlook shows not major forward moves. The market will pay close attention to the European Summit on December 9 this week which the market expects to provide final details for implementing the EFSF and which could reveal more details on the ECB's role. On the macro front, the US non-manufacturing ISM will stand out, as will factory orders and retail inventories. Meanwhile in Mexico, consumer confidence, November inflation and the IMEF manufacturing index will be highlights.

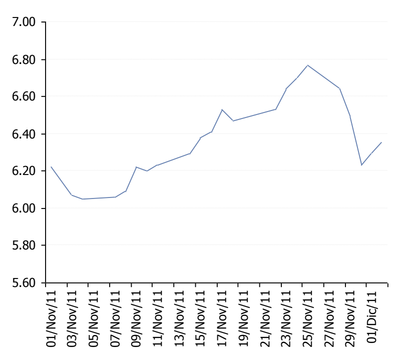
Despite profit-taking, the curves closed with gains

Curves saw a positive week despite the last two days seeing profit-taking which was accentuated due to the Bank of Mexico's decision to hold the lending rate at 4.5%. The European Summit and the possibility that the ECB intervenes on the market remaining open will be key in the coming two weeks. If the global risk premiums remain stable, the space for relaxation will remain open and curves should continue to be positive.

MXN not affected by Banxico's decision: still counter spot on the Chicago market

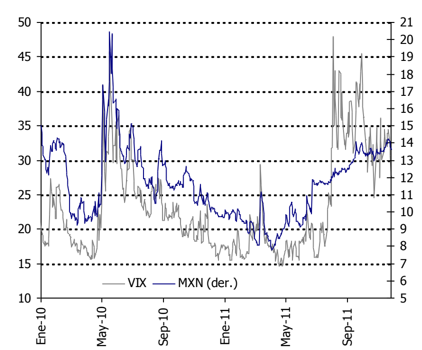
We believe that Banxico's decision on Friday will not likely have long-lasting effects on the MXN since the decision and tone of the release had already been almost completely factored in. This is particularly true given the announcement of intervention on the currency market since we believe stabilizing the exchange rate is the first step to monetary loosening. We continue to see space for the MXN to fall but this will be set (and limited) by global risk aversion or appetite. A reduction in risk premiums favors rapid strengthening since the position continues to be net-short for the MXN at extreme levels (USD 1.3bn on November 29, a record maximum). With the current global scenario and stronger macro figures in the US, the USDMXN will likely fluctuate between 13.30-13.60 in the short-term.

Chart 5
10-year Mexican bond (%)



Source: BBVA Research and Bloomberg

Chart 6
VIX vs MXN



Source: BBVA Research and Bloomberg

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Technical Analysis

IPC Stock Market Index

With the weekly bounce, we can again take into account a positive trend for the IPC, with an upward break of the 10-, 30- and 200-day rolling averages. Despite the bounce, short-term oscillating indicators for the IPC are still not at over-buy levels which allows for a positive outlook and for considering a move toward the 37,600pts level. The 36,000pts level (around which the 10- and 30-day rolling averages stand) becomes our important support level in the short-term. Any return to this should be taken as a new buy opportunity. A downward breakthrough of this level would wipe out the positive short-term trend and our upward outlook.

Previous Rec.: We believe we could see a bounce at the start of next week due to the buy opportunities that may appear in issuers having experienced major punishment

Source: BBVA, Bancomer, Bloomberg

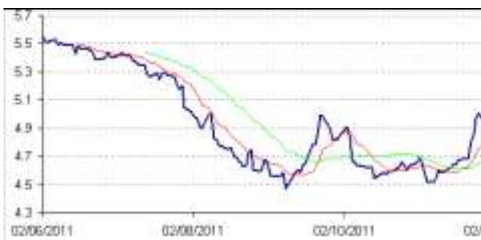
MXN

The dollar sees a major adjustment over the week in response to over-buy signals on short-term momentum indicators. This return even puts it below the 30-day rolling average, although respecting the MXN13.50 floor. The oscillating indicators are still seeing high over-selling and so we can see this movement possibly maintaining toward levels around MXN13.30.

Previous Rec.: Very high over-selling on short-term oscillating indicators, although major resistance sits toward MXN14.50.

Source: BBVA, Bancomer, Bloomberg

3Y M BOND

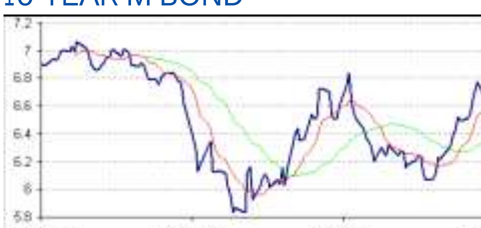


3Y M BOND: (yield): Adjustment responding to major over-buying on oscillating indicators and resistance over 5%. Return to 30-day rolling average where it may again bounce toward 5%. Stop loss at 4.6%

Previous Rec.: We see profit-taking due to over-buying as highly likely. Initial support level at 4.7%.

Source: BBVA, Bancomer, Bloomberg

10 YEAR M BOND



10Y M BOND (yield): Correction toward 30-day rolling average. We see a new upward movement with a stop loss at the 6.2% level.

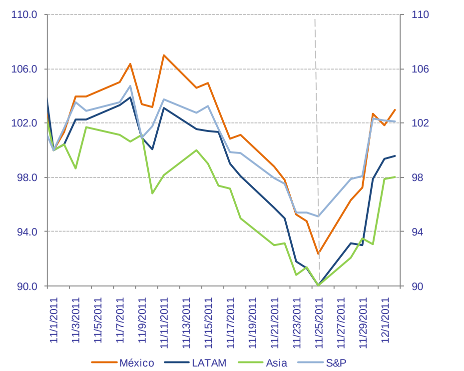
Previous Rec.: We expect profit-taking toward the 6.4% zone. A move above 6.8% sets the next resistance up to 7%.

Source: BBVA Bancomer, Bloomberg

Markets

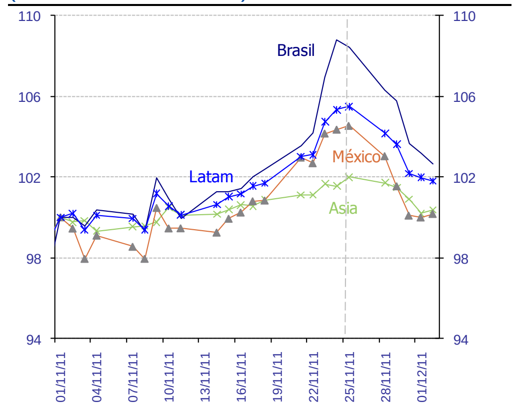
The coordinated action from the FED alongside other central banks to reduce the USD lending costs on the interbank market led to a reduction in risk aversion which sent stock market trends up. In addition, the auctions announced by the Exchange Commission led to a stronger peso over the week.

Chart 7
Stock Markets: MSCI Indices (Nov 1, 2011 index=100)



Source: Bloomberg & BBVA Research

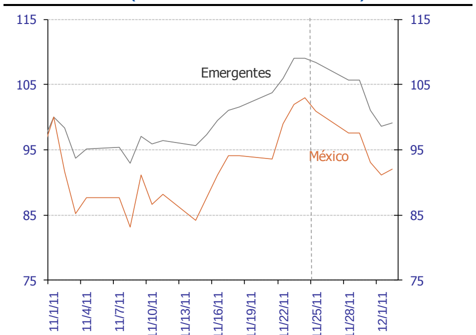
Chart 8
Foreign exchange: dollar exchange rates (Nov 1, 2011 index=100)



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

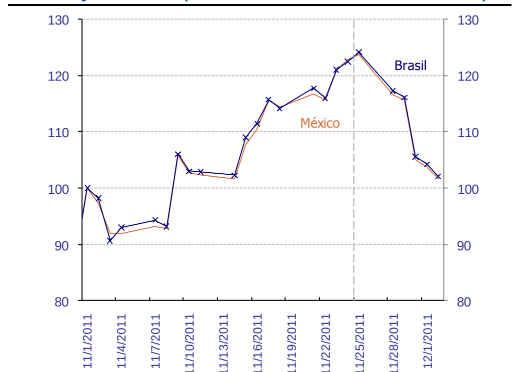
A reduction in risk aversion over the week. All eyes will be on the European Summit in the coming week

Chart 9
Risk: EMBI+ (Nov 1, 2011 index=100)



Source: Bloomberg & BBVA Research

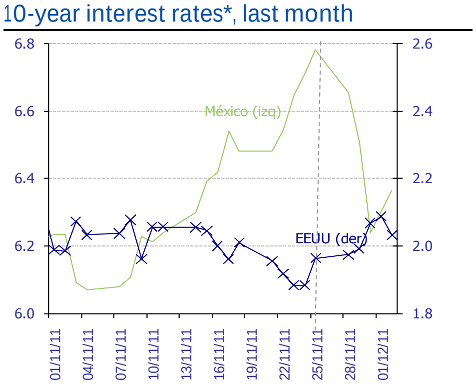
Chart 10
Risk: 5-year CDS (November 1, 2011 index=100)



Source: Bloomberg & BBVA Research

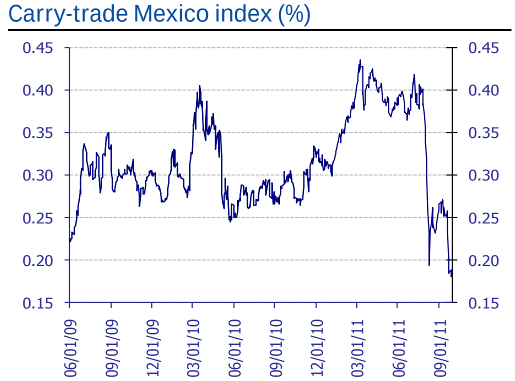
Fall in Mexican interest rates and a rise in Treasury rates in the face of lower risk aversion after the reduction in the dollar financing rate.

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

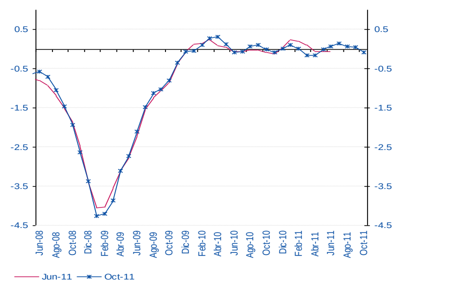


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

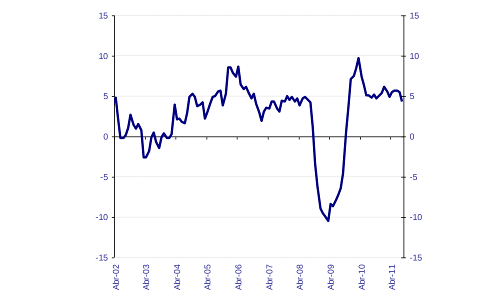
Output holds positive performance, situation indicators point to 3Q11 with quarterly rates around 1%

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.

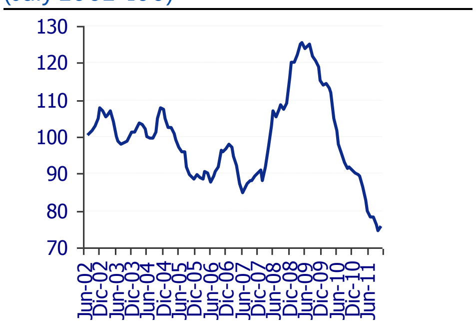
Chart 14
Advance Indicator of Activity (% change y/y)



Source: INEGI

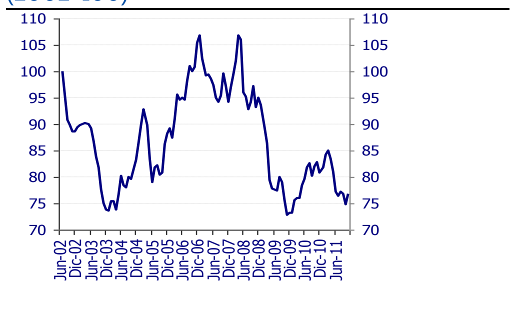
Recent inflationary surprises have been downward, while those concerning economic activity have been mixed.

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.

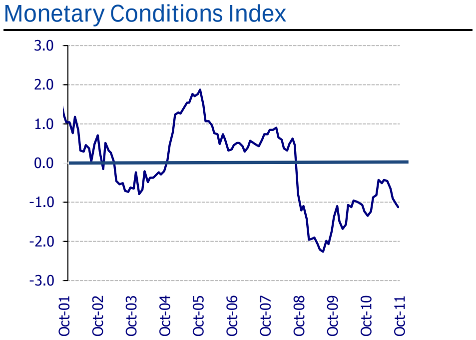
Chart 16
Activity Surprise Index (2002=100)



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.

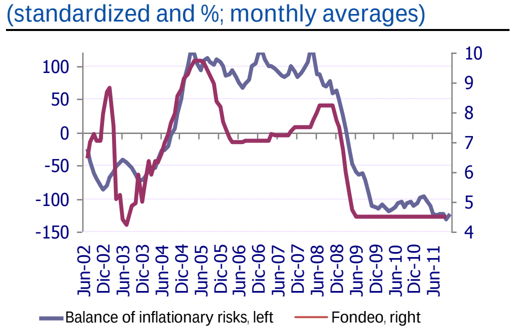
Monetary Conditions relax due to recent exchange rate depreciation

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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