

# Weekly Watch

Mexico

## Next week...

December 9, 2011

### Economic Analysis

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### ... Banxico offers explanations

The interpretation of the December 2 Board meeting minutes on Friday next week, where the lending rate was held at 4.5%, will be particularly important. This is not because the announced decision was unexpected but rather for the criteria used to get there at a particularly uncertain time with increased exchange rate volatility and the possible effects of this on prices and inflation forecasts. This is even more true when the balance of inflationary risks went from favorable to neutral for the central bank. The minutes will include the different opinions of board members with regard to the repeated relaxation tone in the release while there is a slight increase in inflation in a volatile environment for financial markets. We should recall the weight of some members' opinions which alluded to the cost in terms of credibility in sending signals of a possible monetary relaxation and who have reiterated their position of achieving 3% inflation and reducing medium-term forecasts. We believe Banxico's release and the news this week (in Europe on the agreement for stricter fiscal governance and the development of financial stability tools, albeit with a lack of details and unanimous support, and in Mexico inflation at 3.5% in November) are in line with a cut in the lending rate in the first few months of 2012, coming in at 4%.

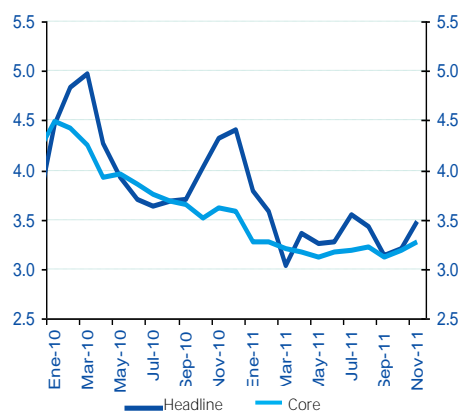
### European Summit: caution beforehand and continuing uncertainty afterward

Global investors remained to the sidelines for new positions for most of the week in expectation of the ECB meeting and the EU summit. Favorable ECB liquidity injections although Draghi's speech rules out the purchase of more sovereign bonds. MXN strengthening bias at the start of the week which was corrected after this statement. More favorable US output data favor a better relative performance on the Mexico stock market.

### Market Analysis

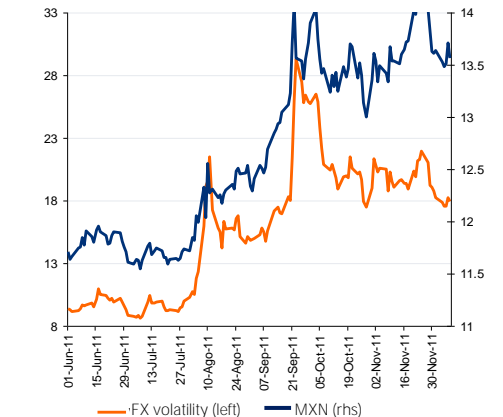
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Chart 1  
Headline and core inflation  
(yearly %)



Source: BBVA Research and Bloomberg

Chart 2  
Mexico: MXN/USD and implied 1-month  
volatility (%)



Source: BBVA Research and Bloomberg

## Calendar: Indicators

### Gross Fixed Investment, September (Monday, December 12)

Forecast: -1.5% m/m 5.5% y/y      Consensus: N.A.      Previous: -0.4% m/m 8.7% y/y

#### Economic Analysis

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### Industrial Production, October (Monday, December 12)

Forecast: 0.3% m/m 4.5% y/y      Consensus: N.A.      Previous: 1.7% m/m 3.9% y/y

Important output indicators are released this week: Monday, December 12 sees investment performance in September and for supply, industrial production in October.

In the first instance, we expect a fall in monthly terms of (-)1.5% in line with relevant indicators which point to there being a continuous fall in capital goods imports and manufacturer confidence in sub-indices as a good time to invest falling in recent months: from 49.5% of manufacturers in July to 42.7% in the last survey (November). In turn, capital goods imports also fell in September from an average falls of (-)0.1% in the June-August quarter to a fall of (-)4.3% m/m in September.

Further, industrial production in October should have moved up around 0.3% m/m which would mean a major slowdown over the previous month (1.7%). Both intermediate goods imports and automotive production slowed in October, the former worsening its fall from (-)0.2% m/m in the previous quarter to 2.2% in October while automotive production fell in October by (-)4.3%, after decreasing by (-)0.1% on average in the three previous months.

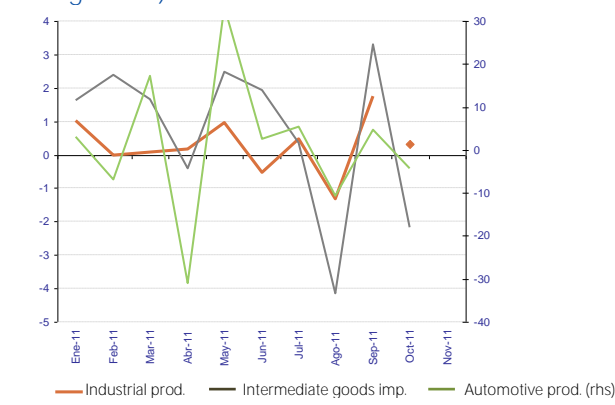
With this information we can corroborate the slowdown in economic output measured by GDP in the last quarter of the year, with a quarterly change we estimate at around 0.3% q/q.

Chart 3  
Investment and Capital Goods Imports (% change m/m)



Source: BBVA Research with INEGI data

Chart 4  
Industrial production and indicators (% change m/m)



Source: BBVA Research with INEGI data

## Markets

### Market Analysis

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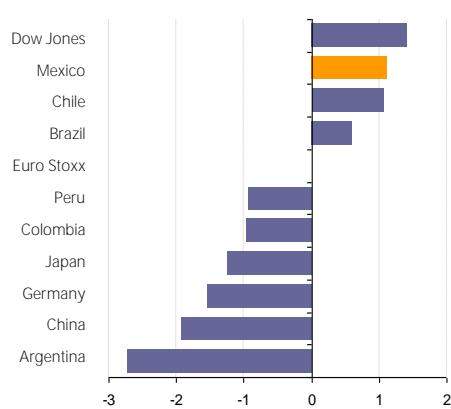
### Caution on the currency markets at the start of the week with adjustments after news from Europe

Similar to emerging LatAm currency markets, the MXN saw some caution over the week prior to two key events: the ECB meeting (December 8) and the EMU leaders summit (8-9) on fiscal agreements. In this sense, trading was marginal and mixed within the 13.55 and 13.50 range mostly in the first three days of the week (vs. 13.61 close previous week) and no clear preference for safe-haven, emerging or other G10 currencies was seen. Although the MXN saw an upward bias in the first few days of the week, this was reversed with losses after Draghi's speech where he quashed the rumor of major purchases of sovereign bonds at the ECB and gave warning of credit restriction risks. Despite this, the MXN ended the week slightly up by 0.32% (13.58). The main driver for the market over the week will continue to be news on Europe. However, the FOMC decision (Tuesday 13) will draw attention, especially in assessing the likelihood of additional stimuli (QE3), as well as signals on some change in its communication. In this scenario, we cannot rule out the MXN fluctuating in a range between 13.3 and 13.75 based on global event biases.

### Global markets continued to see higher risk appetite: Mexico outpaces Asia and LatAm performance

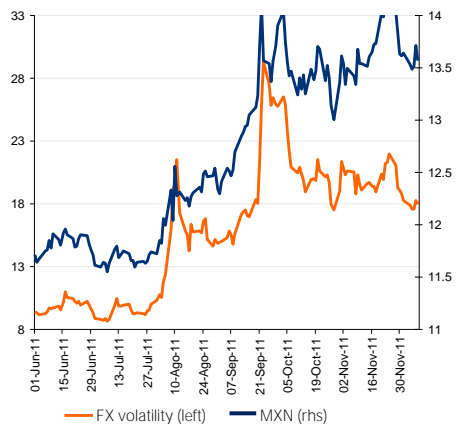
Over the week, global markets continued to see higher risk appetite in general, although less so than what had been seen in recent weeks. All this while markets were trying to decipher the European conflict at the EZ leaders meeting, the ECB's role at its monetary policy meeting and the EBA results on bank capitalization requirements. In general terms, US markets outpaced emerging markets but Mexico did stand out thanks to differentiated cyclical data linked with the US in comparison to other regions. From here on in, economic readings and the performance of sovereign risk will continue to be drivers in the absence of corporate information.

Chart 5  
Stock Markets (% change weekly)



Source: BBVA Research and Bloomberg

Chart 6  
Mexico: MXN/USD and implied 1-month volatility (%)



Source: BBVA Research and Bloomberg

Market Analysis  
Equities

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## Technical Analysis IPC Stock Market Index



The IPC maintains resistance at 37,600pts and support at 36,500pts where the 10- and 30-day rolling averages merge. The setting is favorable (flush) for an upward break so that trading maintains toward levels of at least 38,000pts. Only a change in sentiment placing the IPC below the 30-day rolling average would be of concern, a support tested over the week. The most important issuer on the index (AMX) continues to trade at the 200-day rolling average after a fall of -11%. We believe it should be the strongest driver on the market over coming sessions.

Previous Rec.: The 36,000pts level (around which the 10- and 30-day rolling averages stand) becomes our important support level in the short-term

Source: BBVA, Bancomer, Bloomberg

## MXN

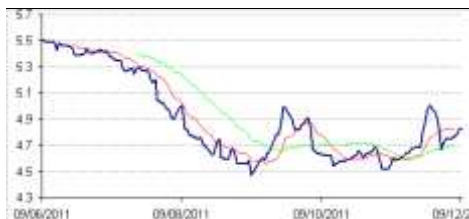


The dollar found a floor at MXN13.50 and started a slight bounce. The bounce does not place it in a short-term upward trend yet since it was not strong enough to take the dollar above the 10- and 30-day rolling averages. Only a close above MXN13.75 would mean a return to MXN14.00. We maintain a floor at MXN13.50 and then at MXN13.30.

Previous Rec.: The oscillating indicators are still seeing high over-selling and so we can see this movement possibly maintaining toward levels around MXN13.30.

Source: BBVA, Bancomer, Bloomberg

## 3Y M BOND

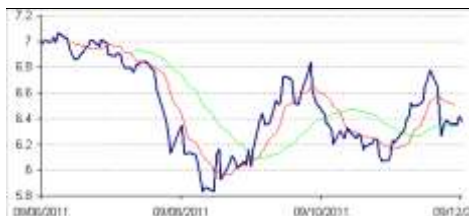


3Y M BOND (yield): Start of a bounce from 30-day moving average. We believe this movement may find resistance around 5%. Floor at 4.7%.

Previous Rec.: May bounce again toward 5%. Stop loss at 4.6%

Source: BBVA, Bancomer, Bloomberg

## 10Y M BOND



10 YEAR M BOND (yield): Slight upturn which may maintain toward an initial resistance at 6.5% and then at 6.8%. Important to watch the 6.3% floor.

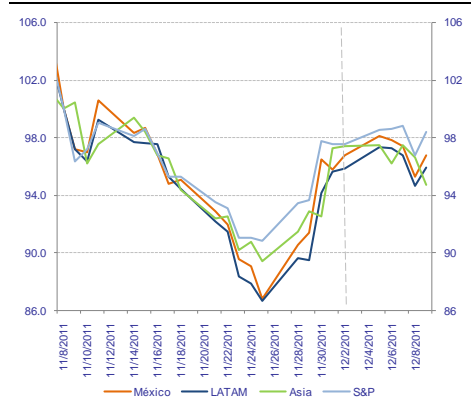
Previous Rec.: We see a new upward movement with a stop loss at the 6.2% level.

Source: BBVA Bancomer, Bloomberg

## Markets

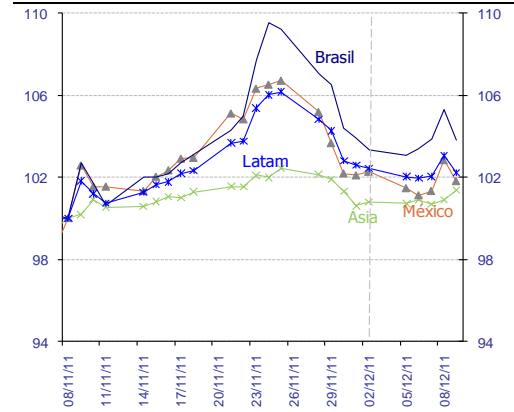
The agreement from the European summit on greater fiscal discipline and an increase in resources for the IMF were welcomed by stock markets. In general, gains were seen and appreciations against the dollar on currency markets.

Chart 7  
Stock Markets: MSCI Indices  
(Nov 8, 2011 index=100)



Source: Bloomberg & BBVA Research

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

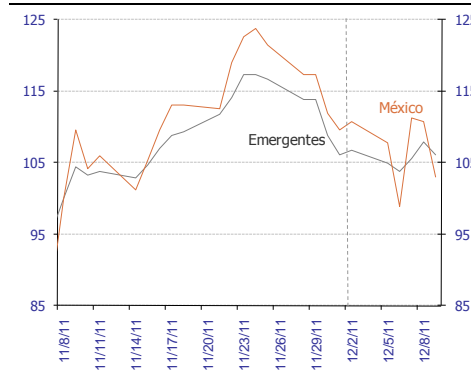


Source: Bloomberg and BBVA Research. Note: LATAM includes Argentina, Brazil, Chile, Colombia and Peru. Asia includes the Philippines, South Korea, Taiwan, Singapore, Indonesia and Thailand. Non-weighted averages

Fall in risk aversion over the week after agreement reached in Europe.

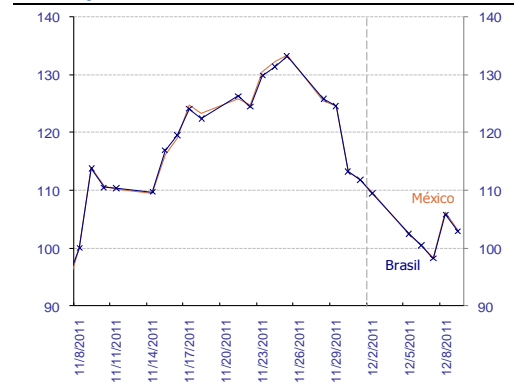
Increase in Mexico's and US interest rates due to greater investor appetite for risk assets.

Chart 9  
Risk: EMBI+ (Nov 8, 2011 index=100)



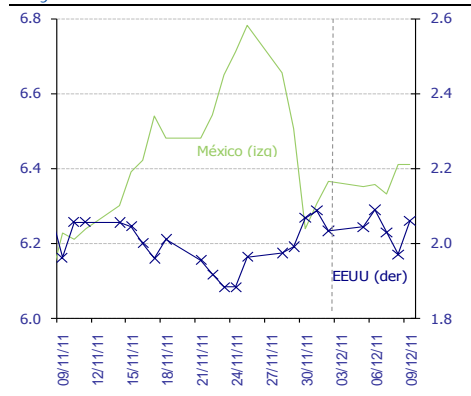
Source: Bloomberg & BBVA Research

Chart 10  
Risk: 5-year CDS (November 8, 2011 index=100)



Source: Bloomberg & BBVA Research

Chart 11  
10-year interest rates\*, last month



Source: Bloomberg & BBVA Research

Chart 12  
Carry-trade Mexico index (%)

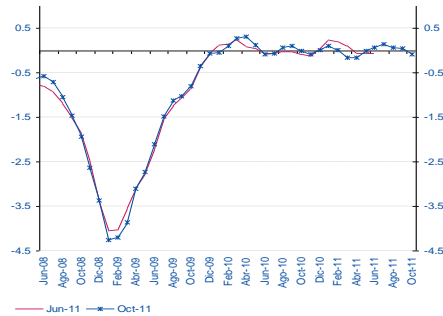


Source: BBVA Research with data from Bloomberg

## Activity, inflation, monetary conditions

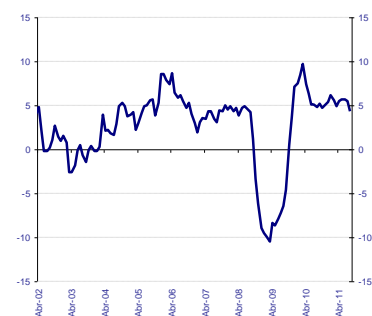
Recent inflationary pressures have been positive, while the situation indicates a point to activity growth rate of around 1%

Chart 13  
BBVA Research Synthetic Activity Indicator for the Mexican economy



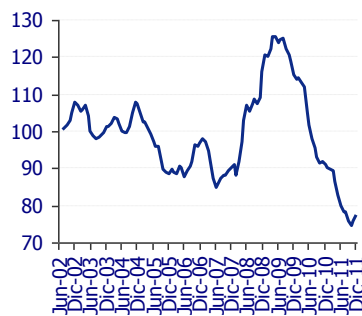
Source: BBVA Research with data from INEGI, AMIA & BEA  
Weighted sum of 21 different indicators of activity, expenditure and expectation, based on trend series.

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



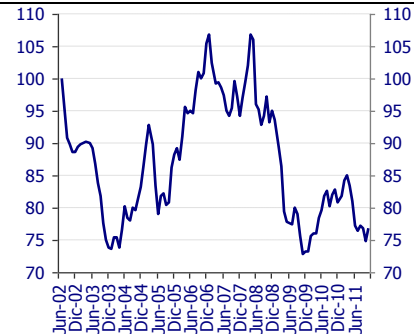
Source: INEGI

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.

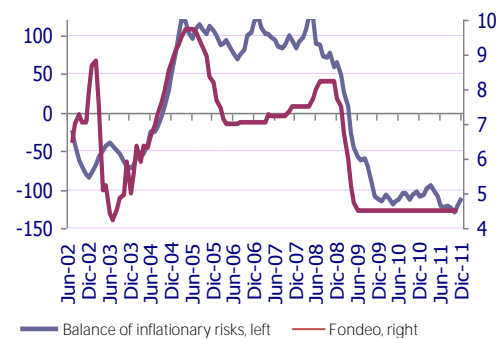
Chart 17  
Monetary Conditions Index



Source: BBVA Research

Monetary Conditions relax due to recent exchange rate depreciation

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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