# Weekly Watch

## Mexico

December 16, 2011

Economic Analysis

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# Next week...

## Relevant demand indicators: slowdown in view

This week sees the release of **retail sales** and the **aggregate services indicator** for October as well as the **unemployment rate** for November. This information will help outline output performance at the end of the year. We see domestic demand indicators having slowed (see details on page 2) and we do not even rule out the services indicators having fallen over the previous month. Both instances are due to a slowdown in formal employment growth. In addition, indicators such as consumer confidence and, especially, the sub-index of the possibility of purchasing a durable good in November saw the sharpest fall since mid-2009 in monthly terms (-7.2% m/m).

In turn, with regard to the job market and in expectation of November data, the jobless rate in October seemed to be a turning point toward lower levels. Nonetheless, the number of workers in underemployment, those working fewer hours than they would like, continues to rise which highlights the need to sustain domestic demand.

Market Analysis

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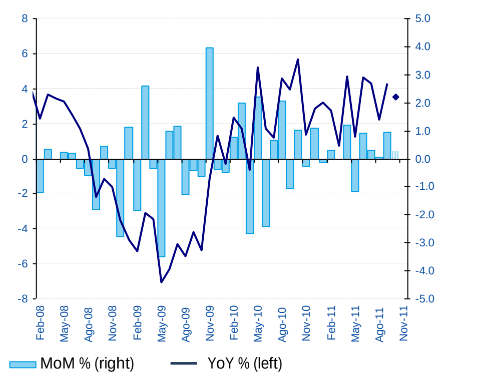
## Uncertainty in Europe, good US data and Banxico minutes on the radar

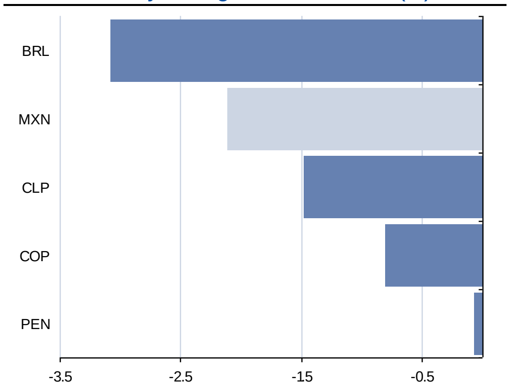
The ups-and-downs in risk sentiment over the week (uncertainty in the EU with possible ratings downgrades vs. US economic data) ended with a downward bias for the MXN. In turn, the Banxico Minutes show a more neutrally positioned Board with a worsening in the output risk balance although with divisions on the risk balance evolution. This could lead to opportunities on the TIIE (interbank equilibrium rate) curve if there is a bounce.

Chart 1
Retail Sales (% change y/y and m/m)




Source: BBVA Research and INEGI

Chart 2
LatAm: Weekly changes in currencies (%)




Source: BBVA Research and Bloomberg on Friday

# Calendar: Indicators

Economic Analysis

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## Retail sales October: (Tuesday, December 20)

| | | |
|---|---|---|
| Forecast: 0.27% m/m 3.5% y/y | Consensus: N.A. | Previous: 0.95% m/m 4.3% y/y |

## Services Indicator October (Tuesday, December 20)

| | | |
|---|---|---|
| Forecast: -0.13% m/m 7.8% y/y | Consensus: N.A. | Previous: 0.90% m/m 7.6% y/y |

## Goods and Services Supply and Demand, 3Q11 (Wednesday, December 21)

| | | |
|---|---|---|
| Forecast: 1.1% q/q 3.4% y/y | Consensus: N.A. | Previous: 1.1% q/q 4.8% y/y |

Although in quarterly change terms we expect output components such as private consumption and all aggregate demand to have remained near previous quarterly changes, the annual trend should be lower than in previous quarters. In turn, we believe that net exports should see a positive quarter for growth in comparison with the previous quarter and in line with the still-good goods and services exports rate and no-as-good imports, especially capital goods.

## Inflation 1st fortnight in Nov (Thursday, December 22)

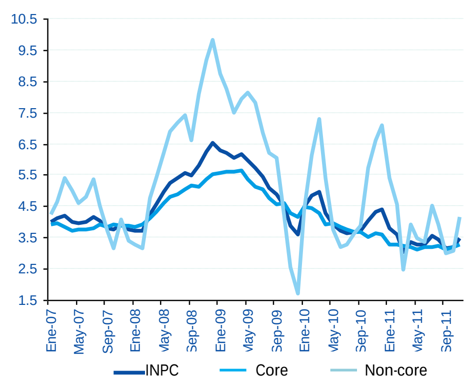
| | | |
|---|---|---|
| Forecast: 0.36% bi-weekly 3.69% y/y | Consensus: 0.34% bi-weekly | Previous: 1.08% m/m 3.48% y/y |

Since October, inflation has moved up in annual terms due mainly to non-core factors such as prices for electricity and livestock products such as beef. We believe inflation will end the year around 3.57%. However, the first fortnight of the month will see a major bounce in annual terms due to inflation in the same two week period last year being abnormally low. Despite this, the bounce will see a partial reversal in the second half of the month. Core inflation will remain stable in the short-term since the upward risks appear to be very limited as the economic recovery remain stagnant. In short, 2011 has been highly positive in terms of inflation despite there having been different risk factors (mainly external) over the year. Some of the rising risks such as a lower peso and offer shocks in some domestic markets such as maize remain although the lack of demand pressures should avoid inflationary pressure over the coming months.

## Unemployment Rate, November (Thursday, December 22)

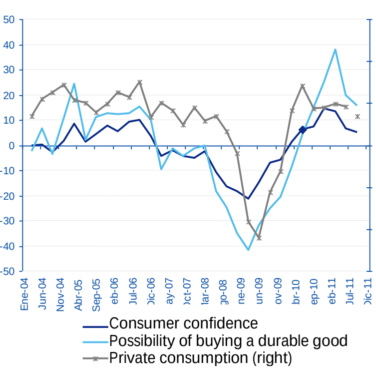
| | | |
|---|---|---|
| Forecast: 4.9% | Consensus: N.A. | Previous: 4.8% |

Chart 3
Inflation breakdown (% change y/y)




Source: BBVA Research with INEGI data

Chart 4
Consumer confidence and private consumption (% y/y change)




Source: BBVA Research with INEGI data

# Markets

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## "There will be no quick fix" for the Eurozone (Merkel)...

The negative mood on the financial markets continued last week, with the possibility that S&P and Moody's could downgrade countries in the EU as decisive measures were not taken at the last summit (8-9 December). Although the summit involved progress towards a new fiscal compact (e.g. limits on structural deficits and near-automatic sanction procedures for incompliance), it also made clear the differences between countries and the difficulties each will have to tighten fiscal legislation. In particular, in France fears have heightened about a downgrade as it has the biggest debt (85% of GDP) among countries with a similar rating and its financial institutions are highly exposed to the debt of countries with bigger sovereign problems (EUR 681 billion, according to the BIS). On the question of cycles, the favorable economic data published in the U.S. stood out (unemployment benefit applications, the Fed's manufacturing surveys) as did those in Europe (PMI). In contrast, economic prospects in China continue down. This makes monetary easing more likely in 2012.

## ... meaning a negative bias in the exchange rate (USDMXN)

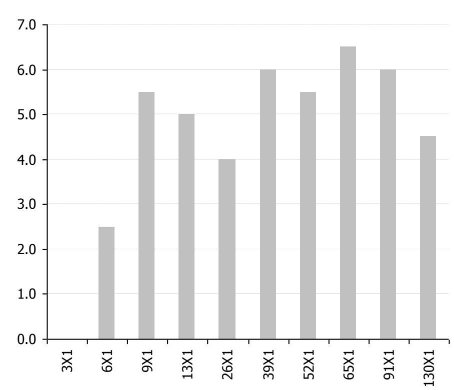
As with other Latin American countries, the MXN showed a negative bias last week, amid high volatility reacting to varying news from Europe and US data. At the start of the week, aversion rose due to a possible downgrade for France which was partly corrected thanks to economic data released in the US. Although the MXN maintains one of the highest betas among Latin American currencies, the currency's losses were limited by the possibility of foreign-exchange intervention by Banxico. We see the MXN continuing to react more to global factors and fluctuating in a weekly range of 13.62 to 13.88.

## Banxico Minutes: a more neutral stance but risk for growth stand out

The minutes show that the monetary stance remains neutral with a strong bias for economic weakness. There is lost of talk on the path for balance risks. With this, we understand that they remain open to a possible rate change in either direction. Although chances remain of a monetary easing in 1Q12, the likelihood for this being in January is low. The market is currently pricing in a pause in 2012 or even a 25bp rise to the TIIE curve volatility.

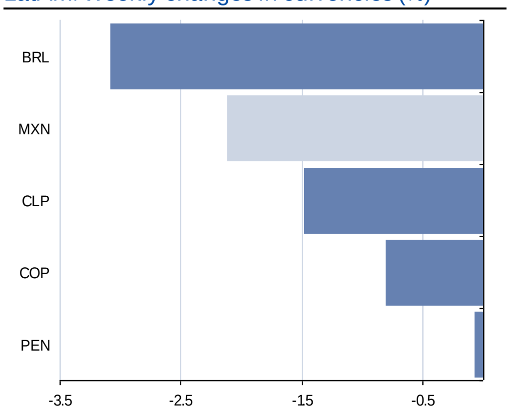
Despite the Board leaving the possibility open for the lending rate, we believe economic forecasts are not in line with this. We cannot even rule out a fall in the output balance which could then open up the chances of receiving TIIE if there is a bounce in the curve.

Chart 5
### Change in TIIE curve basis points after Banxico minutes




Source: BBVA Research and Bloomberg

Chart 6
### LatAm: Weekly changes in currencies (%)




Source: BBVA Research and Bloomberg, information from Friday

Market Analysis
Equities

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# Technical Analysis

## IPC Stock Market Index

The IPC closed the week trading below the 30-day rolling average (36,477pts) with a view to testing a new floor in the 200-day rolling average, coming in at 35,500pts. The slight bounce in the last session of the week meant the IPC closed above 36,000pts. However, in order to ease short-term movement pressure, it really needs to recover to levels above the 30-day rolling average and change the outlook for a return to the 36,700pts level. The 10-day rolling average continues to trade above the 30-day and, in turn, several AAA issuers have returned to floor levels (Amx at the 200-day rolling average and Femsa, Tlevisa and Walmex at the 30-day). This could help us to see this reaction.

Previous Rec.: Setting is right for an upward break. Only a change in sentiment placing the IPC below the 30-day rolling average would be of concern.

Source: BBVA, Bancomer, Bloomberg

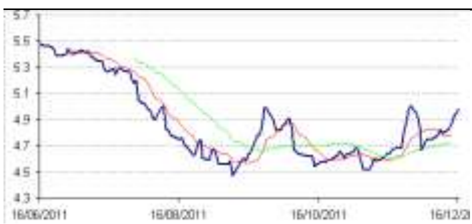
## MXN

The dollar again bounced over the week to come in above the 10- and 30-day rolling averages, again nearing the MXN14.00 level. Good support at MXN13.70 where the 10- and 30-day rolling averages converge, as well as the lower part of the short-term upward channel. At this time, the technical setting is upward while the aforementioned support continues to be respected.

Previous Rec.: 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.

Source: BBVA, Bancomer, Bloomberg

## 3Y M BOND

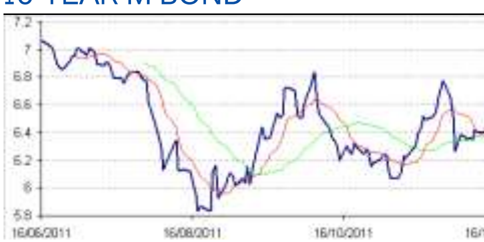


3 Y M BOND: (yield): Maintaining its bounce move and hitting resistance at 5%. We could see a new adjustment toward 4.7%. If it breaks 5%, the next ceiling would be 5.3%.

Previous Rec.: We believe this movement may find resistance around 5%. Floor at 4.7%.

Source: BBVA, Bancomer, Bloomberg

## 10 YEAR M BOND



10Y M BOND (yield): Upturn from 30-day moving average. Still not hitting resistance at 6.8%. We believe it could hit that level and stop the upward move.

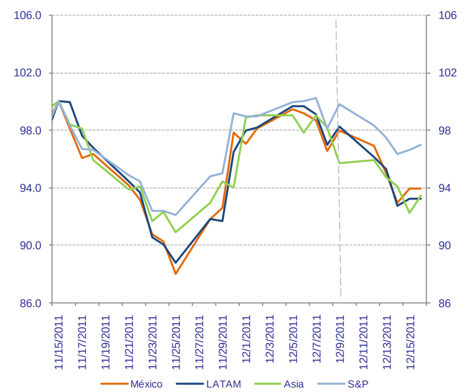
Previous Rec.: May maintain toward an initial resistance at 6.5% and then at 6.8%. Important to watch the 6.3% floor.

Source: BBVA Bancomer, Bloomberg

# Markets

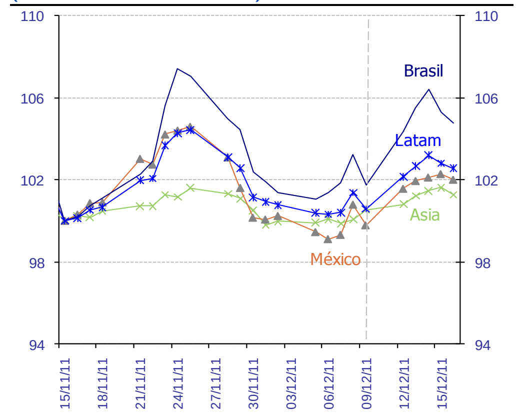
Falls on stock markets over the week after lack of final agreements to resolve the European debt crisis and no clear signals on more monetary easing at the FED. LatAm currencies fall due to global risk.

Chart 7
Stock Markets: MSCI Indices (Nov 15, 2011 index=100)




Source: Bloomberg & BBVA Research

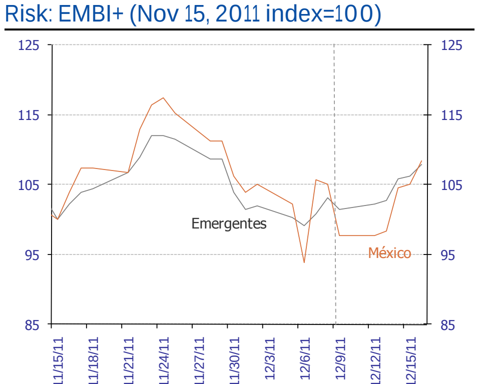
Chart 8
Foreign exchange: dollar exchange rates (Nov 15, 2011 index=100)




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

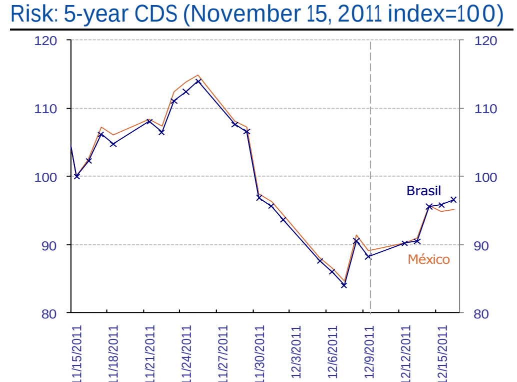
Increase in risk aversion over the week influenced by higher tightening of interbank lending conditions in Europe.

Chart 9
Risk: EMBI+ (Nov 15, 2011 index=100)




Source: Bloomberg & BBVA Research

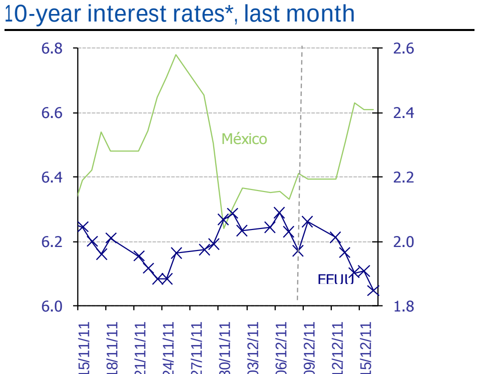
Chart 10
Risk: 5-year CDS (November 15, 2011 index=100)




Source: Bloomberg & BBVA Research

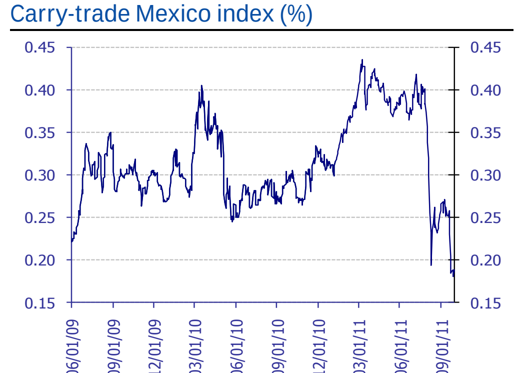
Fall in rates in the USA due to increased risk aversion. Rates in Mexico rose due to Banxico monetary policy minutes showing a neutral position.

Chart 11
10-year interest rates*, last month




Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

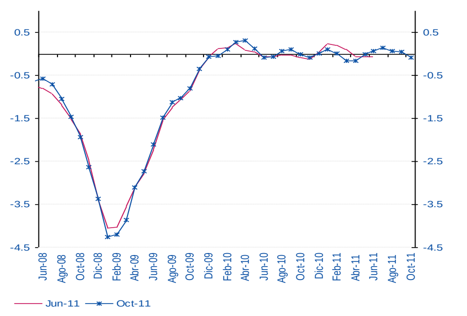


Source: BBVA Research with data from Bloomberg

# Activity, inflation, monetary conditions

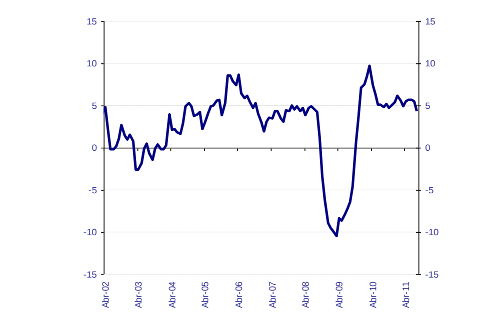
Output holds positive performance, situation indicators point to 3Q11 with quarterly rates around 1%

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.

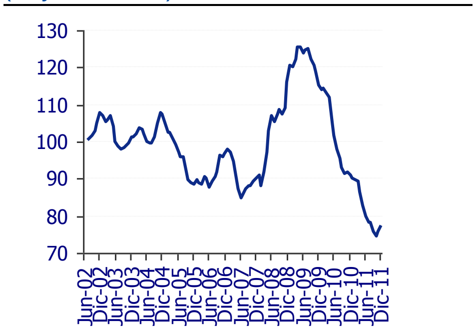
Chart 14
Advance Indicator of Activity (% change y/y)



Source: INEGI

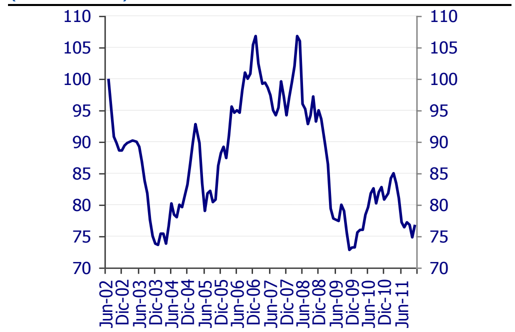
Recent inflationary surprises have been downward, while those concerning economic activity have been mixed.

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.

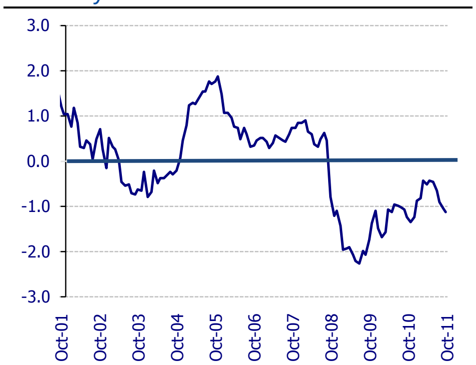
Chart 16
Activity Surprise Index (2002=100)



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.

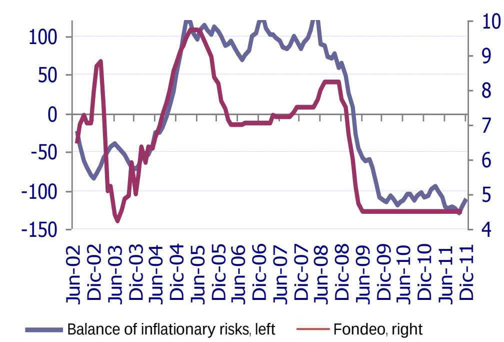
Monetary Conditions relax due to recent exchange rate depreciation

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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