Weekly Watch

Mexico

January 13, 2012

Economic Analysis

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Market Analysis

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Next week...

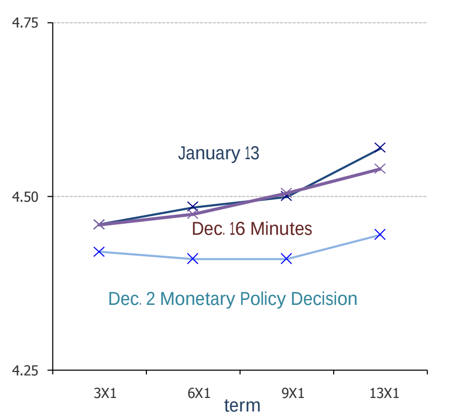
Bank of Mexico to maintain monetary policy pause

The release on Banxico's decision next Friday, January 20 is expected to send a more neutral message in line with the minutes from the last meeting in December with moderate growth and inflation figures coming in above forecasts in December. The latter figures strengthens a change to neutral in the inflation risk balance and supports the stance of some Board members who have repeatedly set out the upward inflation risks. It should be pointed out that the increase in prices over the first two weeks of January will show a decline thanks to lower telephone rates. However, this does not change the upward outlook for the year based on forecasts for high commodity prices and higher prices in imported goods. We see these variables having a temporary effect on prices which will gradually dissipate due to the lack of demand pressure.

Appetite for risk over the week reverses after a downgrade in European credit ratings is announced

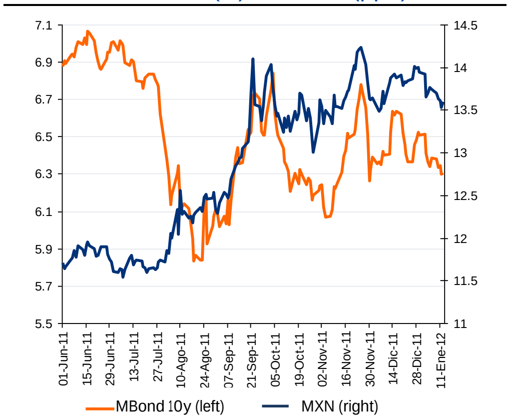
Investors continued to have an appetite for risk in light of an expected improvement in the US economic cycle and higher liquidity on global markets. In this sense, most G10 and EM currencies strengthened against the USD (the MXN gained 1%). These moves saw a partial reversal at the end of the week due to news that S&P had cut France's credit rating. Long-term bond in Mexico correlated with MXN parity.

Chart 1
Funding Rate implied in the IRS swap curve



Source: BBVA Research and Valmer

Chart 2
Mexico: 10Y MBond (%) and MXN (ppd)



Source: BBVA Research and Bloomberg on Friday

Calendar: Indicators

Economic Analysis

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Unemployment Rate (Thursday, January 19)

Forecast: 5.0% Consensus: N.A. Previous: 5.2%

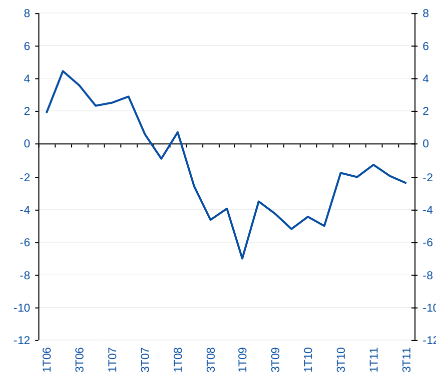
This week sees the release of December figures for the job market: Economically Active Population (EAP), Unemployment and Under-employment Rate. We forecast the unemployment to have ended 2011 around 5% of the EAP, i.e. around 2.48 million people. This indicator remains at relatively high levels in comparison to those seen prior to the 2008-2009 crisis (2008 average: 4% vs. 5.2% between January and November 2011) despite the sustained recovery in output in Mexico since mid-2009. Increased employment is not enough to cover the rise in economically active population.

Another sign of the slower recovery in the job market is the performance of the under-employment rate which includes workers who need and are available to work more hours than they do. The rate in 3Q11 came in at 9% of those in work and with a growing trend over the year. This shows the availability of work resources on the marker to meet growth in demand.

In short, employment performance is not hampering income from the job market but rather it is an increase in income per hour which in real terms has continually fallen over recent years. From 1Q05 to 3Q11, income per hour reported by the ENOE has fallen 8.3% in real terms. Employment and income per hour lead to a decline in job income of around 8% in real terms over the same period.

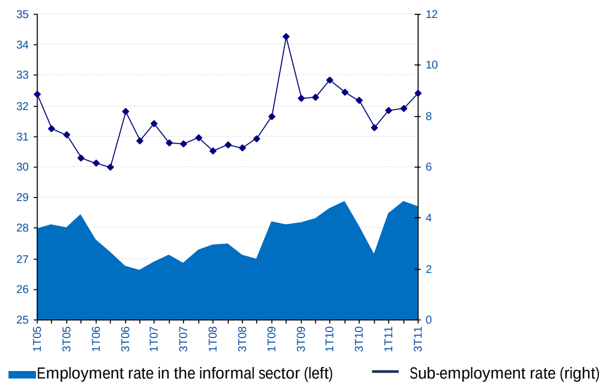
Finally, the ENOE is also set to provide information on the employment percentage in the informal sector which remains relatively stable at around 28% of those in work.

Chart 3
Total Income from Wages (y/y % change)



Source: BBVA Research with INEGI data

Chart 4
Job marker indicators



Source: BBVA Research with INEGI data

Markets

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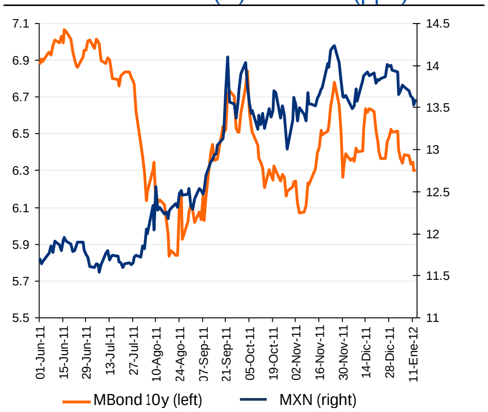
USD again on offer over the second week of the year

Last week, investors continued to have an appetite for risk mainly due to an expected improvement in the US economic cycle as well as higher liquidity on global markets. In this sense, although no recent news has come in on the EFSF or on how peripheral European nations will deal with maturities in the first quarter of the year, sentiment continues to be less negative. Thus, most G10 and EM currencies strengthened against the USD except for the GBP.

The trades reversed at the end of the week in response to news that S&P had downgraded France. However, in the weekly balance, LatAm currencies saw better relative performance. The MXN strengthened around 1% although, as we have been highlighting, the technical support remains at 13.50. We believe the band dynamic will remain in place in the short term.

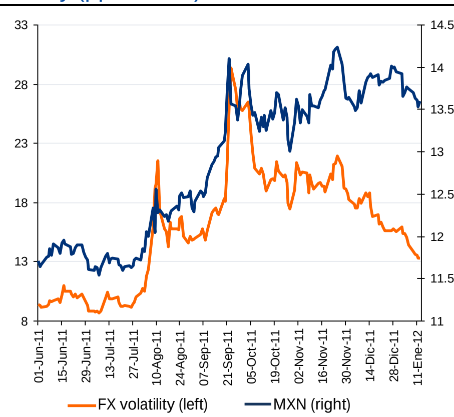
The MBOND and TIIE curve level fell 8bp on average. Initially, investors benefitted in the short tranche. However, the medium and long tranches were in strong demand at the end of the week. As we have been stating, MXN stability was a requirement for the curve to see a major correction.

Chart 5
Mexico: 10Y MBond (%) and MXN (ppd)



Source: BBVA Research and Bloomberg

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



Source: BBVA Research and Bloomberg, information from Friday

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Technical Analysis

IPC Stock Market Index

The IPC kept trading in the upward triangle formation over the week. It has already spent just over 3 months in consolidation. Although the negative day at the end of the week did not allow for an upward break in the formation and purchase signal, we believe that coming sessions may see this break. This sign would be very important given the time the market has taken to consolidate this formation. Although the triangle signal would produce a target of around 40,000pts, we believe 38,700pts would be a more realistic target, 3% above current resistance.

Previous Rec.: The weekly return we saw in AAA issuers may help the market's ability to respect this support and we see a new attempt to produce the purchase signal.

Source: BBVA, Bancomer, Bloomberg

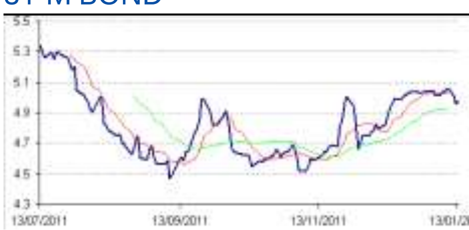
MXN

The dollar has followed a downward path since the start of the year although it still respects the MXN13.50 level. Only a downward breakthrough of this minimum would mark a trend change to negative with a new target at MXN13.00. For the present, any bounce might encounter resistance at MXN13.80 and MXN14.00.

Previous Rec.: This would only change with a downward break through MXN13.50.

Source: BBVA, Bancomer, Bloomberg

3Y M BOND

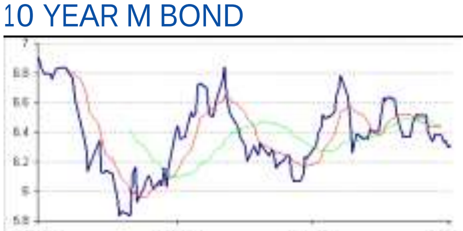


3-YEAR M BOND (yield): After the last upward move, it is finding resistance at the 200-day rolling average (5.1%), returning to the support set by the 30-day rolling average (4.97%). The oscillating indicators a new upward bounce. Only a downward break through the 30-day rolling average would rule out this outlook.

Previous Rec.: We see the move toward 5.114% (where the 30-day rolling average sits and where profit-taking could start) as limited.

Source: BBVA, Bancomer, Bloomberg

10 YEAR M BOND



10Y M BOND (yield): Lack of decision on movement in recent months. The bond trades in a triangle formation and only an upward break to 6.62% would produce a purchase signal. Formation floor at 6.28%.

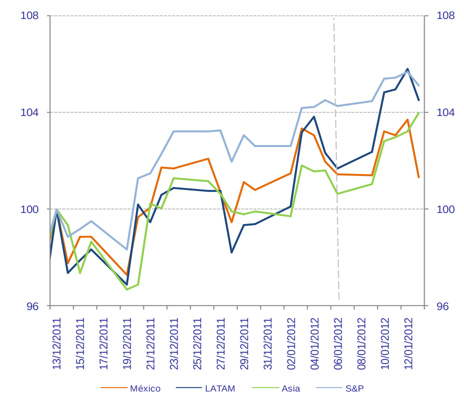
Previous Rec.: A purchase signal would only come about if it breaks up through 6.65%.

Source: BBVA Bancomer, Bloomberg

Markets

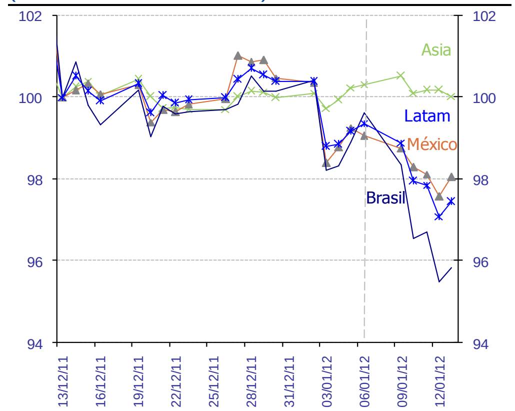
Downgrade for France and other European countries by S&P linked to negotiations between Greece and bank lenders being suspended lead to falls on stock markets and a fall in the peso at the end of the week.

Chart 7
Stock Markets: MSCI Indices (Dec 13, 2011 index = 100)



Source: Bloomberg & BBVA Research

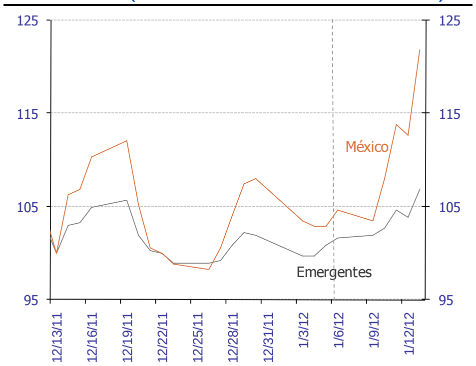
Chart 8
Foreign exchange: dollar exchange rates (Dec 13, 2011 index = 100)



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

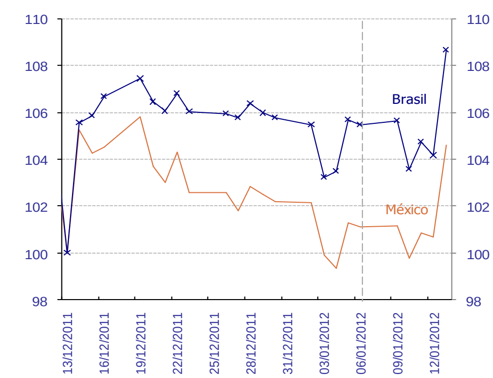
Upswing in risk aversion after events in Europe increase concerns around the debt crisis.

Chart 9
Risk: EMBI+ (December 13, 2011 index=100)



Source: Bloomberg & BBVA Research

Chart 10
Risk: 5-year CDS (Dec 13, 2011 index=100)

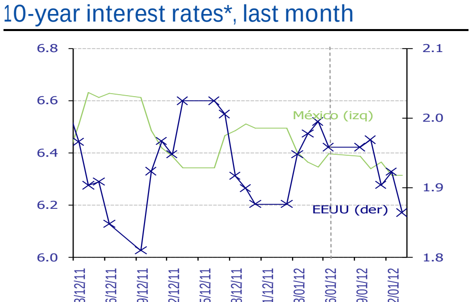


Source: Bloomberg & BBVA Research

Fall in rates in the USA due to increased risk aversion. Rates in Mexico fall over the week due to an expected improvement in the economic cycle

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

Chart 11
10-year interest rates*, last month



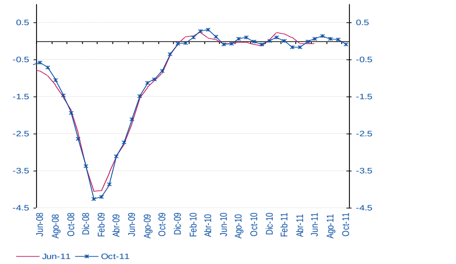
Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

Source: BBVA Research with data from Bloomberg

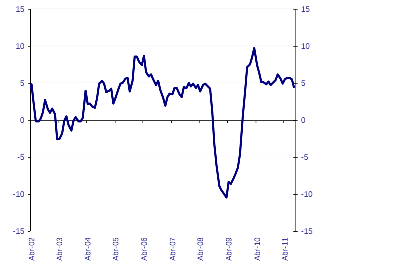
Activity, inflation, monetary conditions

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.

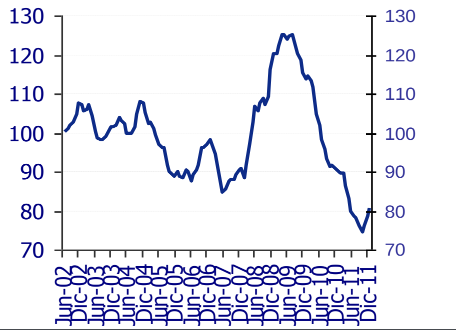
Chart 14
Advance Indicator of Activity (% change y/y)



Source: INEGI

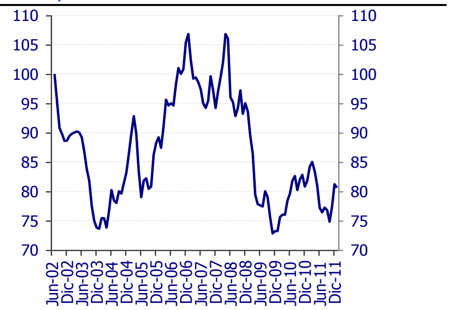
Recent inflationary surprises have been downward, while those concerning economic activity have been mixed.

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.

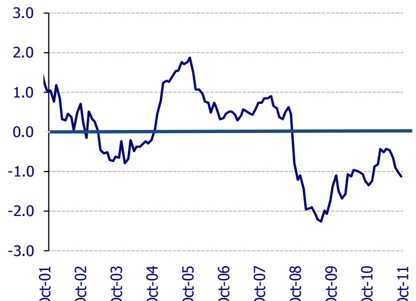
Chart 16
Activity Surprise Index (2002=100)



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.

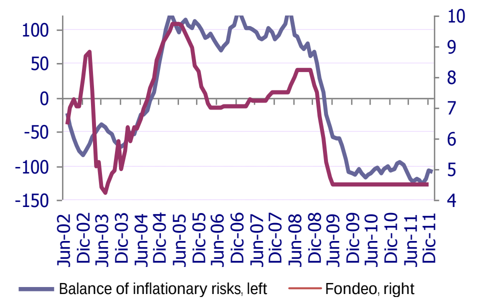
Monetary Conditions relax due to recent exchange rate depreciation

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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