

Mexico Weekly Flash

Next week...

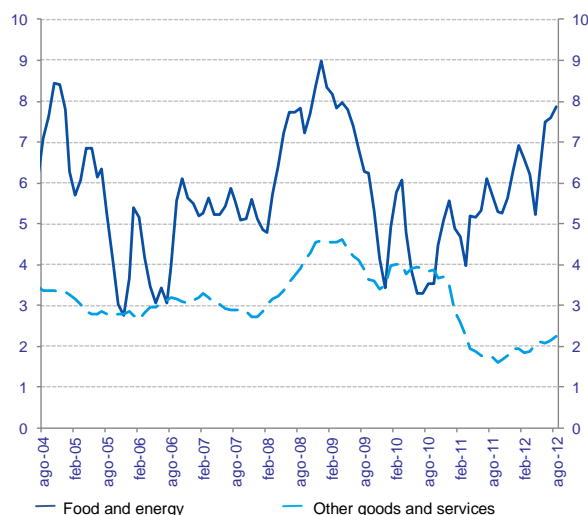
- Output data will provide more information on the economy's growth rate**

Industrial output and GDP breakdown will contribute to an assessment of the economic activity situation allowing continued assessment of the risk balance for output and inflation. This in a context where central banks in developed nations seem to be more inclined to undertake measures to boost financial markets and reduce risks surrounding growth. In Mexico, the monetary rate is expected to remain unchanged despite the recent upturn in inflation now at 4.5%. This is due to the fact that the upswing in inflation continues to be deemed temporary with no demand pressures being seen to date. Nonetheless, as the central bank has stated, focus will need to be on supply shocks not having knock-on effects or influencing expectations.

The situation favors a limited upward yield curve with the currency still seeing a margin to strengthen

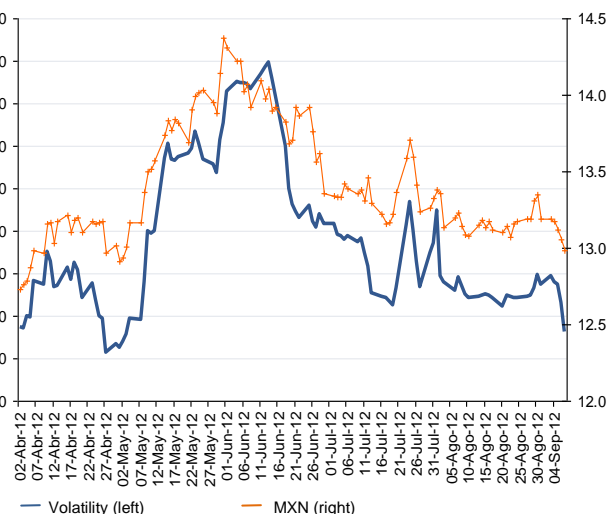
The domestic yield curve should remain contained upward and mainly see a flattening-out between the long and medium section. The above is due to a highly liquid context, weak global economic growth, strong economic output in Mexico compared to advanced and emerging economies, and higher albeit manageable inflation in the short-term. Despite the MXN tending to respond less to local factors than to those from overseas, we believe the less "soft" statement on Friday will be favorable. While global risks remain, there will be a margin for a stronger MXN.

Chart 1
Food and energy and other goods and services inflation (% change y/y)



Source: BBVA Research and INEGI

Chart 2
MXN and Implied Volatility (USDMX and %)



Source: BBVA Research with Chicago Mercantile Exchange

Calendar: Indicators

Industrial Output in July (September 11)

Forecast: 0.6% m/m (4.3% y/y)	Consensus: N.A.	Previous: 1.3% m/m (4.2% y/y)
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This week sees the release of industrial output in July, as well as contributions from demand to the quarterly GDP change released a few weeks ago of 0.9%.

With regard to industrial output, we believe this will have continued to see growth albeit at a slower rate than the previous month; the positive surprise of industrial performance last June (1.3% m/m) should be recalled, led by the good performance in the manufacturing sector. For July, one of the main manufacturing branches, the automotive industry, continued to see growth although at a slower rate than in the past. The construction industry will, in turn, continue to positively contribute to growth in the secondary sector having seen 1.5% m/m growth in the previous month. In short, we expect industry to see continued growth, benefitting from foreign demand. Nonetheless, signs of a slowdown in coming months remain, as evidenced by producer confidence indicators and those such as the US ISM trend indicator.

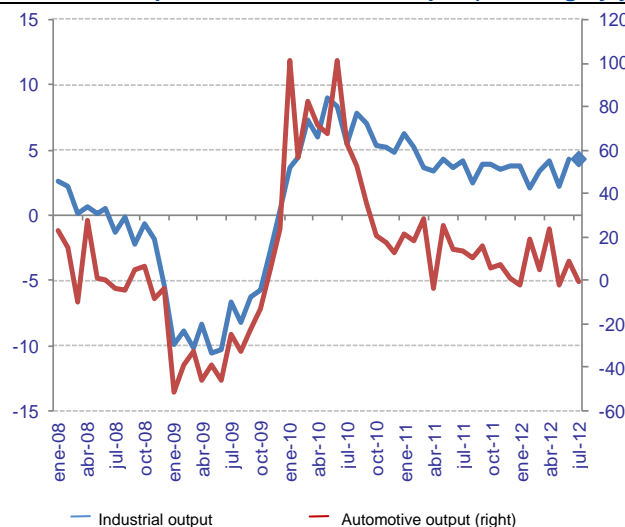
GDP 2Q12 demand (September 14)

Forecast: 1.1% q/q (5.3% y/y)	Consensus: N.A.	Previous: 2.1% q/q (5.4% y/y)
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In GDP contributions on the demand side from 2Q12 released a few months ago of 0.9%, we estimate the contribution from private demand will have continued to be very important, specifically private consumption where quarterly expansion remained around 1% in the last three months. In turn, capital formation stood out last quarter with 4.6%, largely thanks to increased private investment. Nevertheless, it should be stated that the stock change component saw the biggest decline since 2003. Finally, we believe the export component may continue to provide a major contribution to growth, albeit at a slower rate than in the previous quarter. .

Chart 3

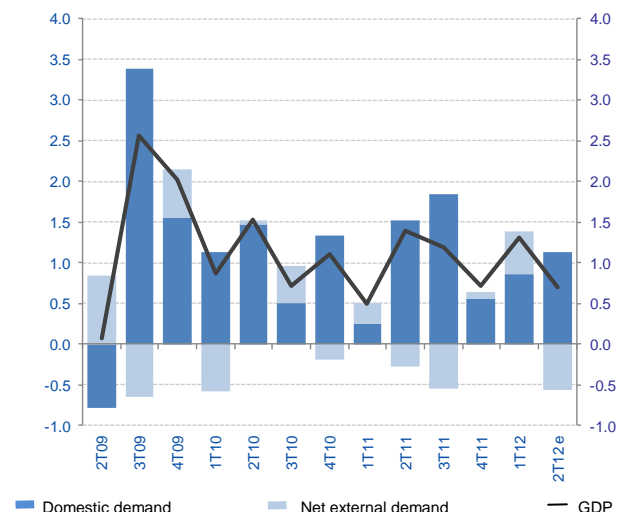
Industrial Output and Automotive Output (% change y/y)



Source: BBVA Research with INEGI data

Chart 4

GDP and contribution (% change q/q)



Source: BBVA Research with INEGI data

We remain long in the long part compared to the medium section

Despite an accommodating stance at the ECB and Fed possibly leading to yield rises, the global context of low rates will sure last longer (we do not expect the Fed to take monetary policy actions leading to an upward yield trend). As a result, the domestic curve should remain contained upward and mainly see a flattening-out between the long and medium section.

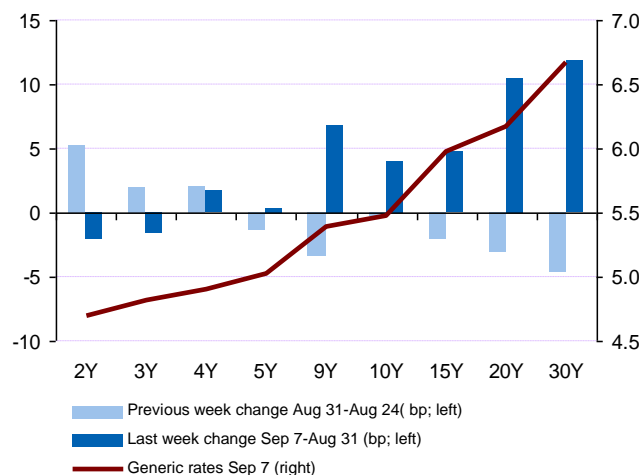
The bottom line is everything being down to a highly liquid context, weak global economic growth, strong economic output in Mexico compared to advanced and emerging economies, a fiscal context free from cyclical risks and higher albeit manageable inflation in the short-term. We continue to recommend extreme strategies (long M2042), short (M2022) and long (M2015). We also confirm our forecast for the 10Y/30Y slope moving toward 90bp. This strategy has provided good results thanks to good foreign investor appetite in the long terms recently and the equally defensive stance of domestic and foreign investors in the face of the gradual decline in the economic context. We remain long in the Udibonos curve (3 with entry at 1.25%).

MXN set to maintain positive bias

Despite the MXN tending to respond less to local factors than to those from overseas, we believe the *dovish* statement on Friday will be favorable. The fact that global conditions point to low interest rates for some time and continued (and even increased) abundant liquidity, as well as Banxico's stance, favor the attractive *carry* remaining and, therefore, capital inflows remaining positive. In turn, risk premiums have started to moderate due to recent ECB measures meaning the euphoria could continue in the short-term.

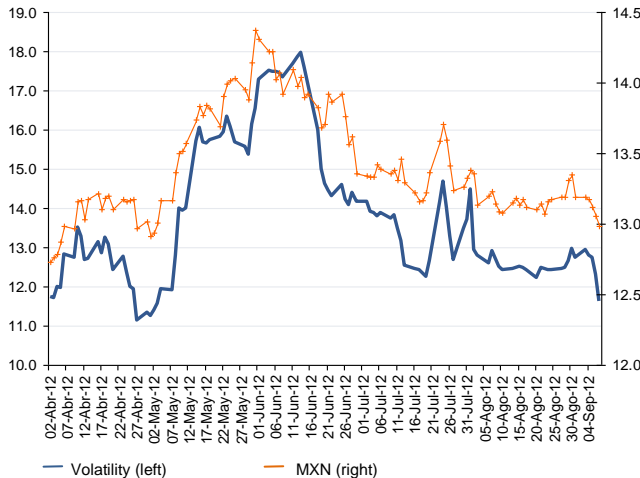
We continue to see some risk linked to the "fiscal cliff" and elections in the US and the EMU summit. However, if these event pass without anything new and the MXN maintains its attractive value, there will be a margin for more strengthening in the currency.

Chart 5
Yield curve
(Fixed rate, generic % and bp)



Source: BBVA Research and Bloomberg

Chart 6
MXN and Implied Volatility
(USDMX and %)



Source: BBVA Research and Bloomberg

Technical Analysis

IPC



Source: BBVA, Bancomer, Bloomberg

The level providing a floor for the market was the 100-day rolling average, avoiding a fall to 38,500pts to the 200-day rolling average. In this way, we believe an initial upward move toward the 40,500pts level could take place without any problem. If the market is able to maintain the bounce and break through this level, we could be seeing a major signal since it would mean a return of the IPC trading above the 30-day rolling average. This would leave the path clear to a return to the all-time-high of 41,500pts. The new support is at 39,380pts (100-day rolling average).

Previous Rec. (9/3/12). Breaking this support downwards would be important in the short-term since it would set the next floor in the 38,500pts zone where the 200-day rolling average sits.

MXN



Source: BBVA, Bancomer, Bloomberg

After the failed attempt to upturn the 200-day rolling average, the dollar maintained a clear downward trend. Already in the MXN13.00 range, we could consider an initial floor to take long positions aiming to a bounce toward MXN13.30. Stop loss below MXN13.00 since the next floor would be at MXN12.85.

Previous Rec. (9/3/12). We only recommend taking long positions if it manages to close above the 200-day rolling average (MXN13.35) looking to hit MXN13.75.

3Y M BOND

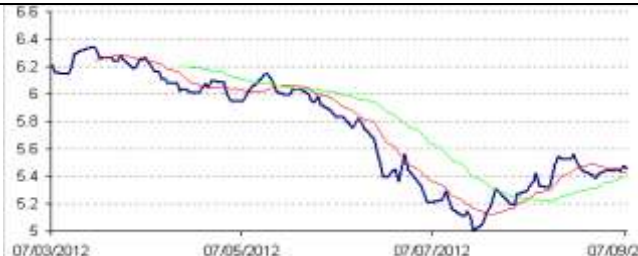


Source: BBVA, Bancomer, Bloomberg

3Y M BOND (yield): Ends the week at the support right on the 30-day rolling average. We would only recommend closing positions if it breaks down through 4.75% since it may return to 4.6%. Upward targets at 4.85% and 5%.

Previous Rec. (9/3/12). Major support at 4.75%; if it manages to break through 4.85% it could maintain the move toward levels near 5%.

10Y M BOND



Source: BBVA, Bancomer, Bloomberg

10Y M BOND (yield): Maintaining positions while no break down through the 5.3% zone. Resistances at 5.6% and then 5.8%.

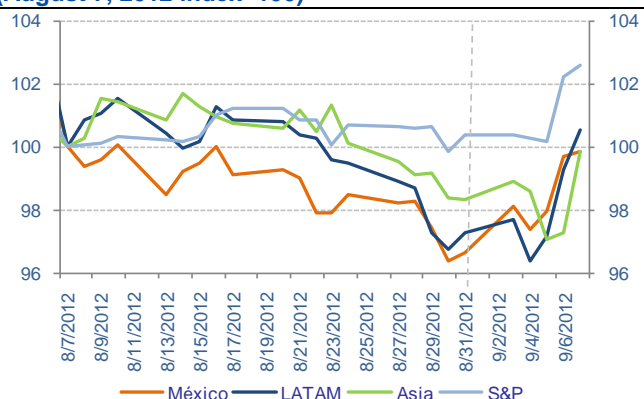
Previous Rec. (9/3/12). Floor at 5.3% and initial resistance at 5.6%. Above this level, it could test the 5.6/5.8% zone.

Markets

- The announcement of a new sovereign bond purchase program at the ECB with restrictions leads to a fall in global risk aversion which strengthens currencies in emerging nations and leads to gains on stock markets. At the end of the week, US jobs figures coming in below expectations increased expectations of more monetary stimulus from the FED.

Chart 7

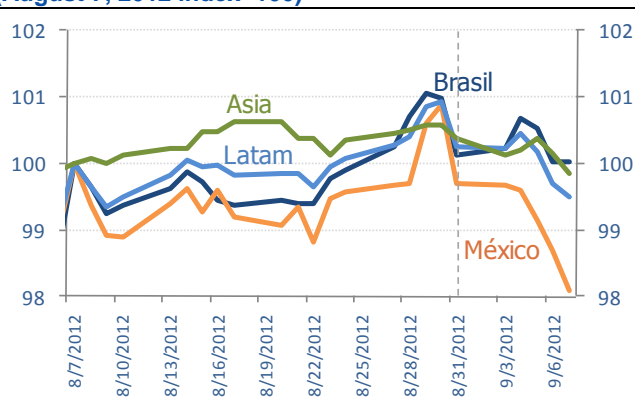
Stock Markets: MSCI Indices
(August 7, 2012 index=100)



Source: Bloomberg & BBVA Research

Chart 8

Foreign exchange: dollar exchange rates
(August 7, 2012 index=100)

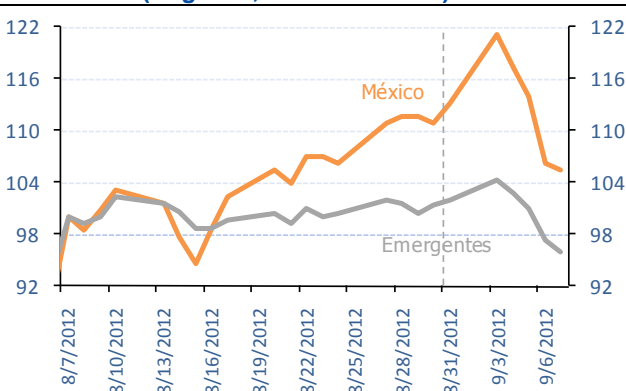


Source: Bloomberg and BBVA Research Note: LATAM includes Argentina, Brazil, Chile, Colombia and Peru. Asia includes the Philippines, South Korea, Taiwan, Singapore, Indonesia and Thailand. Non-weighted averages

- Fall in risk aversion after the ECB's statement.

Chart 9

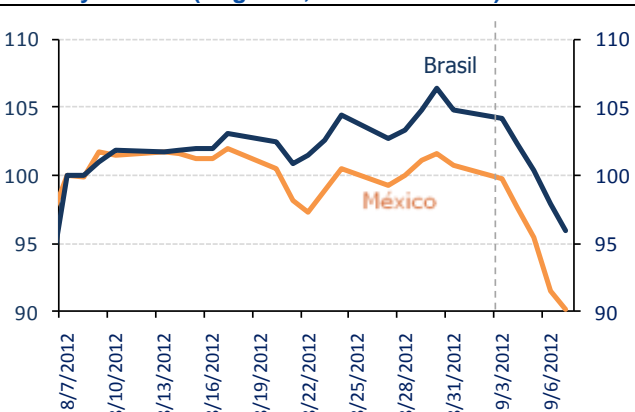
Risk: EMBI+ (August 7, 2012 index=100)



Source: Bloomberg & BBVA Research

Chart 10

Risk: 5 year CDS (August 7, 2012 index=100)

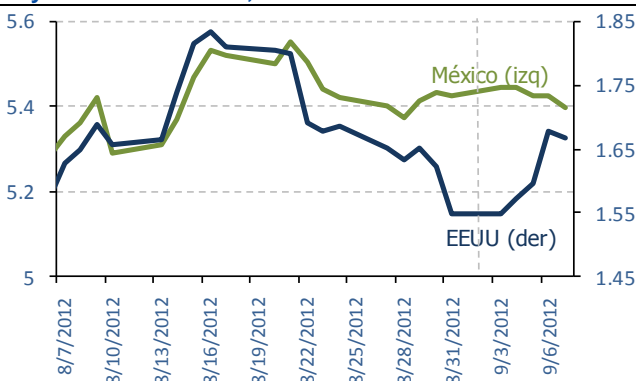


Source: Bloomberg & BBVA Research

- Increase in rates in the USA in light of lower risk aversion. Rates in Mexico record marginal changes over the week.

Chart 11

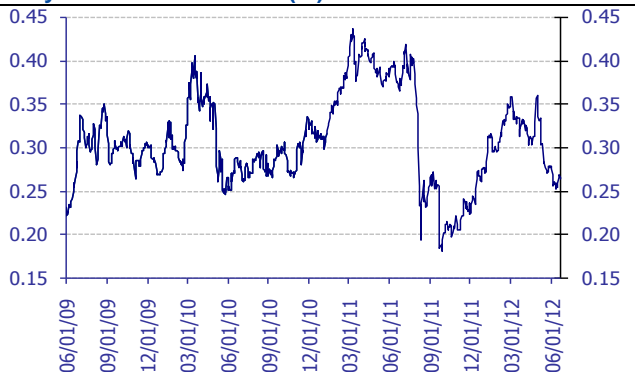
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12

Carry-trade Mexico index (%)



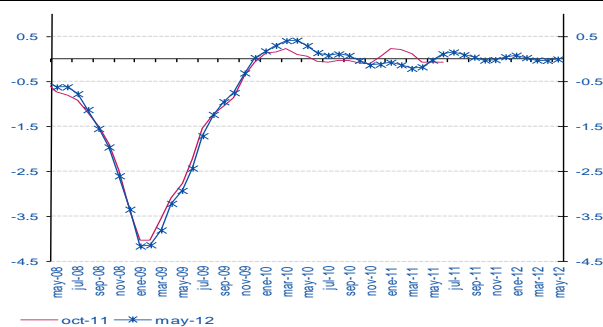
Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

- Output holds positive albeit moderate performance, situation indicators point to 3Q12 with quarterly rates above 0.5%.

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.

- Recently we have seen upward surprises in inflation and output.

Chart 15

Inflation Surprise Index (July 2002=100)

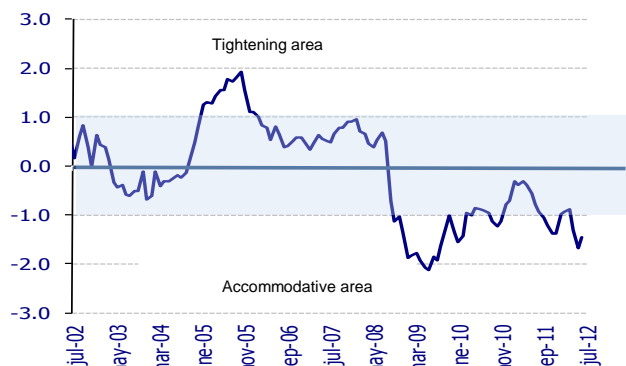


Source: BBVA Research with data from Banxico from the monthly surveys on the expectations of economic specialists in the private sector.

- Monetary Conditions relax after higher inflation.

Chart 17

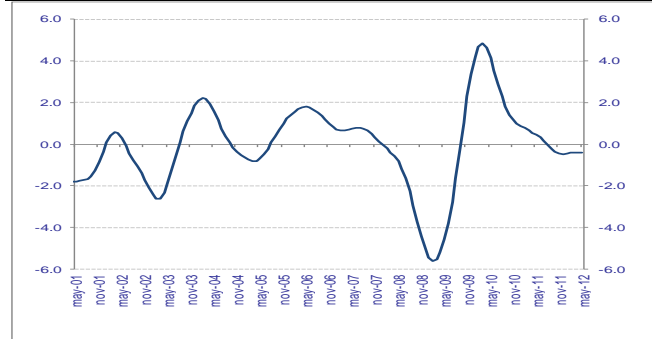
Monetary Conditions Index



Source: BBVA Research

Chart 14

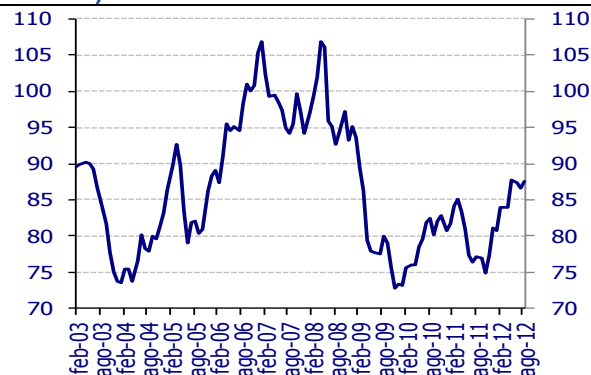
Advance Indicator of Activity, trend (% change y/y)



Source: INEGI

Chart 16

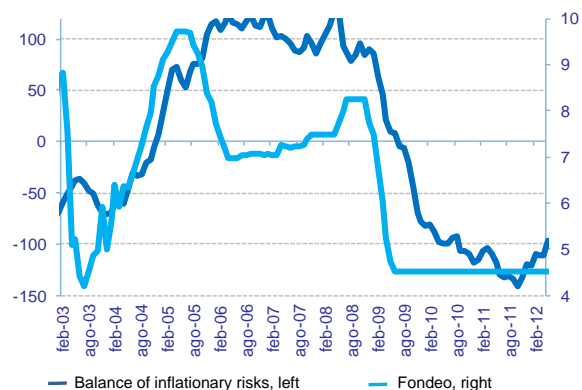
Activity Surprise Index (2002=100)



Source: BBVA Research with data from Bloomberg. Difference between recorded data and the Bloomberg consensus for seven activity variables in Mexico. Standardized index. Rises (falls): positive (negative) surprises.

Chart 18

Balance of Inflationary Risks* and Lending Rate (standardized and %; monthly averages)



Source: BBVA Research. * Standardized and weighted index (of inflation and economic growth) based on economic indicators of economic activity and inflation. A rise in the index points to a greater weight of inflationary risks over growth risks and thus a greater possibility of monetary restriction

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