# Mexico Weekly Flash

## Next week…

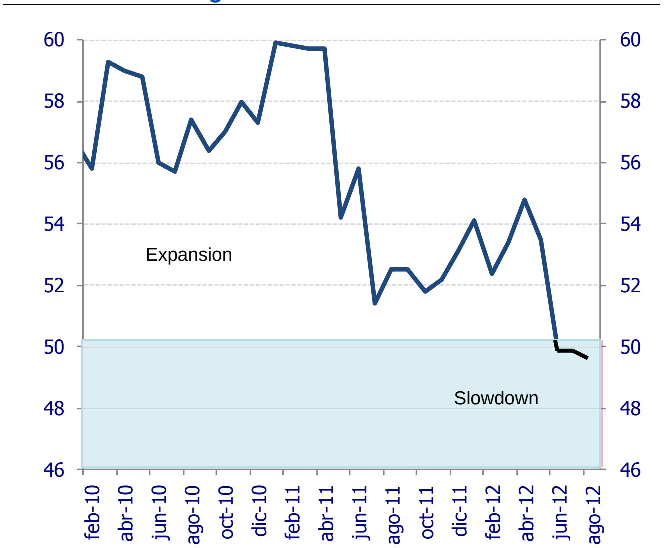
- **Data linked to domestic output take on importance in a week overseas context**

In light of recent data showing a slowdown in the US, eyes will need to be on domestic output data such as retail sales and employment set to be released next week. Faced with US output and jobs weakness, the Federal Open Market Committee at the Federal Reserve lowered its growth outlook for 2012 from between 1.9 and 2.4% to between 1.7 and 2.0%, implemented a new round of QE with the purchase of mortgage backed securities (MBS) and anticipated that the current federal interest rate would possibly be guaranteed through mid-2015. These new stimulus measures are expected to improve the US jobs market which would support foreign demand with Mexico. In turn, a more relaxed US monetary policy, alongside inflation expected to return below 4% due to expected supply shocks easing, lead us to believe the monetary policy rate in Mexico could remain unchanged for a prolonged period.

### Greater appetite in the face of Fed measures and European resolutions

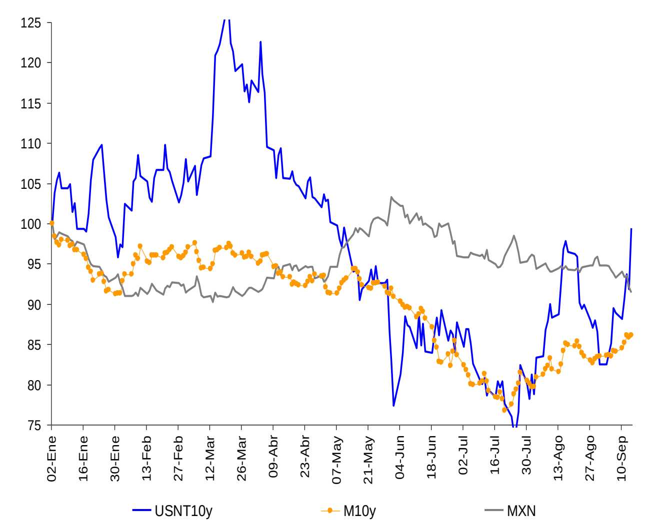
Markets reacted to the Fed's meeting, Germany ratifying the ESM and an initial banking union plan with higher risk appetite. The MXN closed up nearly 2% at the end of the week and we believe this bias could carry on as the market continues to focus on liquidity factors. In terms of fixed income, the MBonds curve rose in line with US T-bill performance and the outlook for ongoing foreign inflows into the domestic curve continues.

Chart 1
**ISM Manufacturing Index**




Source: BBVA Research and Bloomberg

Chart 2
**US and Mexico Bonds and USDMXN performance (Generic 10-year rates, % and ppd)**




Source: BBVA Research and Bloomberg

# Calendar: Indicators

## Retail Sales in July (September 20)

| Forecast: 0.3% m/m (5.3% y/y) | Consensus: N.A. | Previous: 1.8% m/m (5.2% y/y) |
|---|---|---|

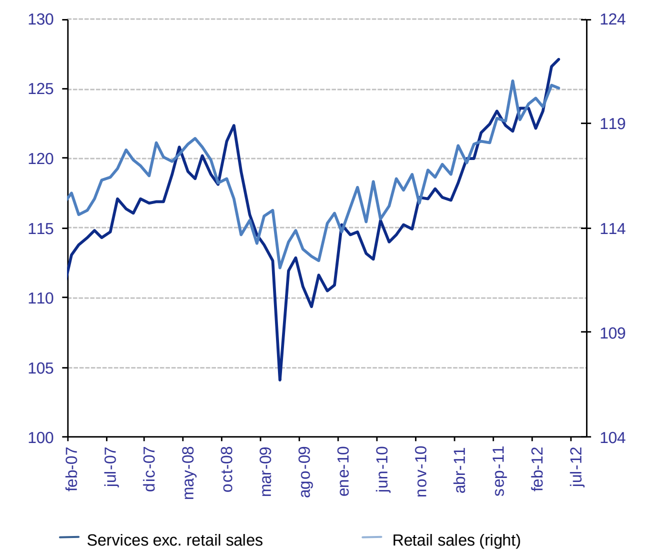
This week sees the publication of retail sales performance and service sector revenue in June. We believe that with the performance in formal private employment where good job creation rates continue to be seen, as well as consumer and confidence survey indicators, things point to July possibly having continued to see growth in these two indicators, albeit at a slightly lower rate than in the previous month. It should be stated that private consumption in the second quarter of the year continued to see strong growth rates (0.4% q/q, 3.6% y/y), although slightly lower than in the first three months of the year (0.8% q/q, 4.2% y/y). We estimate sales and services indicators will point to growth in domestic demand in the third quarter, albeit maintaining a slower outline.

## Occupation and employment in August (September 21)

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

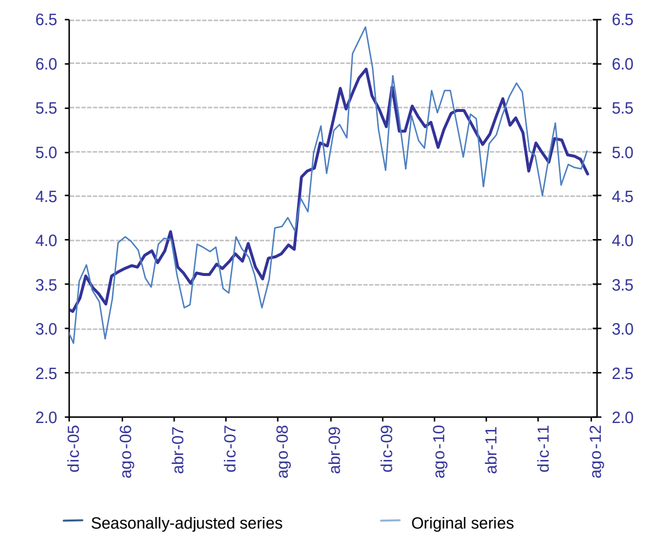
The jobless rate has showed downward resistance since the start of the recovery in 2009. In August, we estimate the jobless total to have come in at 4.8% of the EAP, equating to around 2.4 million people. Knowing the performance of related indicators such as the under-employed rate will also be important, which in the second quarter of the year sat at 8.9% of those in employment, i.e. 4.3 million people.

Chart 3
**Retail Sales and Services Indicator (2003 Index=100, seasonally-adjusted series)**




Source: BBVA Research with INEGI data

Chart 4
**Unemployment Rate (% of EAP)**




Source: BBVA Research with INEGI data

## Strengthening bias in the MXN may continue in coming days

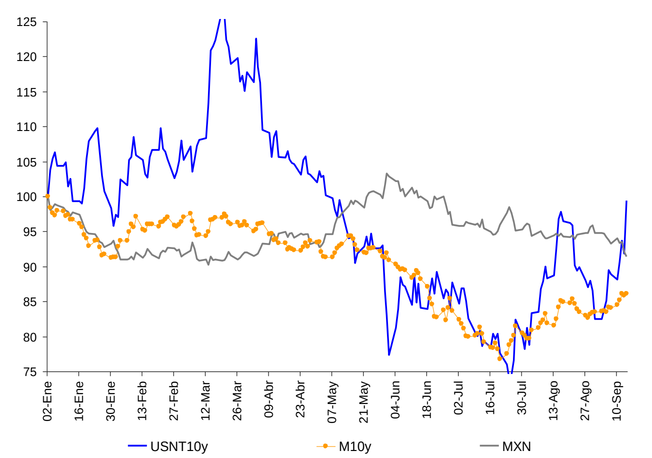
Markets revolved around the Federal Reserve meeting and the EMU hosting two important events last week. In the case of the FOMC, the decision to go ahead with QE3, as well as extending policy guidance to 2015, led to a revaluation of most risk assets, in turn seen strongly in the MXN. In the EMU, Germany ratifying the ESM and the presentation of an initial banking union plan also favored risk appetite on markets.

In this way, the MXN closed up nearly 2% at the end of the week and we believe this bias could carry on as the market continues to focus on liquidity factors and prior to key events in Europe (such as the October summit). Looking forward, sustained MXN strength will depend on if these actions are seen as effective for the US economic cycle and if it starts to show signs of a slowdown.

## The MBonds curve rises in line with the US curve

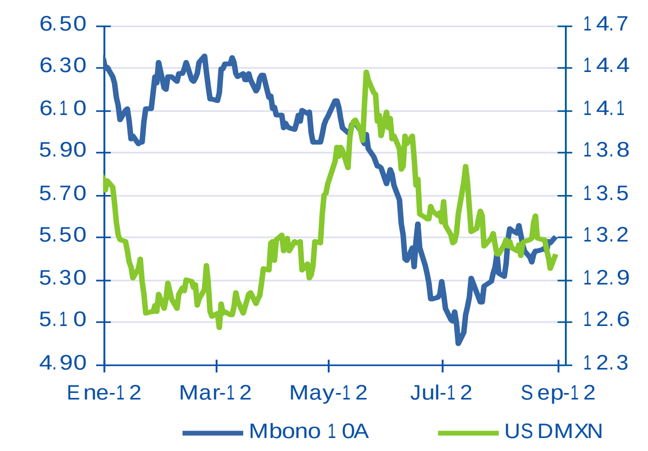
In terms of fixed income, the MBonds curve rose in line with US T-bill performance. Risk appetite has been behind the lower demand for safe assets. We believe the extended guidance, the continuation of Operation Twist and the message on the economy's status will lead the market to factor in a slack scenario for longer and of higher interventions. The Fed's stance leads us to maintain a favorable outlook for domestic fixed income assets. As we mentioned, the likelihood of a rise in Mexico's credit rating, but especially of favorable perspectives for Mexico compared to other economies, will continue to be an important factor for global investors when adjusting their portfolios. We continue to believe that the space for gains is limited, especially if equities substitute fixed income due to excess liquidity. Nonetheless, the Fed's stance was highly convincing regarding the upward limits on long-term rates. This scenario continues to support ongoing foreign inflows into the domestic curve and we would expect positioning in the long sections to shore up, being an in-demand sector and which, in our opinion, will continue to be so in coming months. The short section are and will continue to be a defensive sector which foreigners will not abandon. In this way, we remain outside directional positions and repeat out tacit "Butterfly" strategy (long in the short and long section of the curve, short in the medium tranche).

Chart 5
**US and Mexico Bonds Performance (Generic 10-year rates, % and ppd)**




Source: BBVA Research and Bloomberg

Chart 6
**USDMXN vs. 10-year MBond (ppd and %)**




Source: BBVA Research and Bloomberg

# Technical Analysis

## IPC


We believe this still has room for maneuver. It ended the week breaking up through the 30-day rolling average meaning the door is open for a return to the all-time highs at 41,500pts. The 10-day rolling average is about to go above the 30-day and the RSI has not hit over-buying readings. Triple-A issuers such as Amx, Femsa and Walmex have upward room. All this leads us to remain optimistic in the short-term while it trades above the 40,260pts floor.

Previous Rec. (9/10/12): 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.

Source: BBVA, Bancomer, Bloomberg

## MXN


The dollar broke 2 major floors over the week, passing MXN13.00 and then MXN12.85. We are still seeing a downward move to the MXN12.60/12.50 zone, although the RSI is very near over-selling. Any bounce would be limited to the MXN12.85 resistance.

Previous Rec. (9/10/12). Stop loss below MXN13.00 since the next floor would be at MXN12.85.

Source: BBVA, Bancomer, Bloomberg

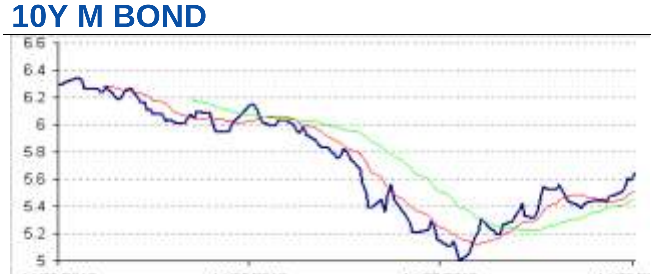
## 3Y M BOND


3Y M BOND (yield): It continued to trade sticking to the 30-day rolling average. Our floor now sits at 4.88% and we recommend maintaining while it continues to trade above this level. Targets at 4.9% and 5%.

Previous Rec. (9/10/12). 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%.

Source: BBVA, Bancomer, Bloomberg

## 10Y M BOND




10Y M BOND (yield): Bounce from 30-day rolling average and passing the previous high. We recommend maintaining toward 5.8% as initial resistance and 6% as the next. Floor at 5.4%.

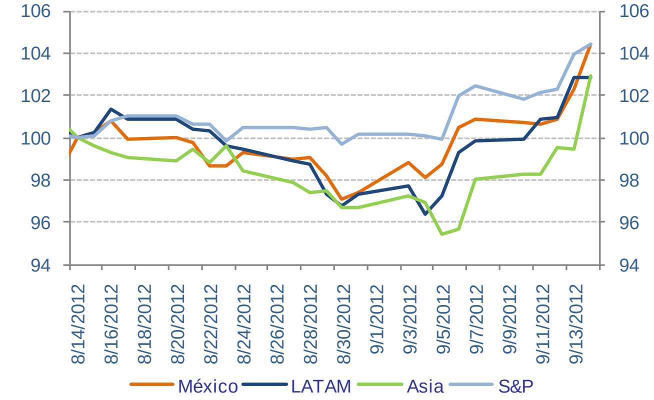
Previous Rec. (9/10/12). Maintaining positions while no break downward through the 5.3% zone.

Source: BBVA, Bancomer, Bloomberg

# Markets

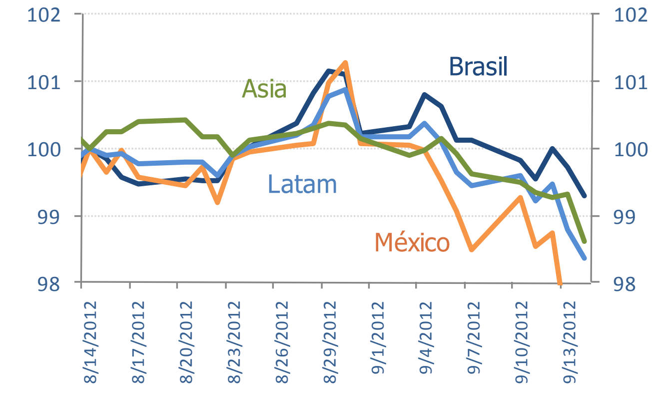
- **The Federal Reserve's announcement of a new security purchase program valued at 40 billion dollars a month and the extension of the monetary pause until at least mid-2015 led to a fall in global risk aversion contributing to stronger currencies from emerging nations and gains on stock markets.**

Chart 7
**Stock Markets: MSCI Indices (August 14, 2012 index=100)**




Source: Bloomberg & BBVA Research

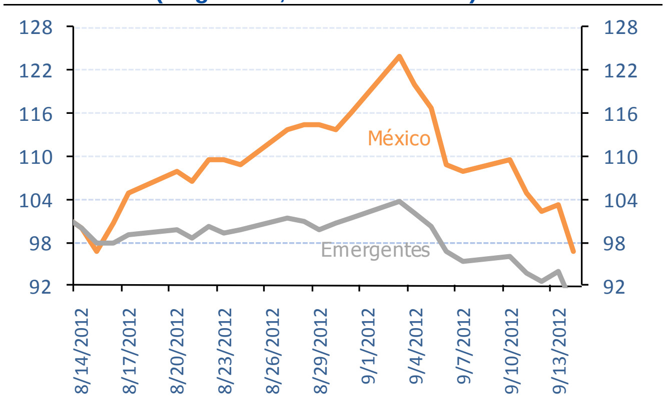
Chart 8
**Foreign exchange: dollar exchange rates (August 14, 2012 index=100)**




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

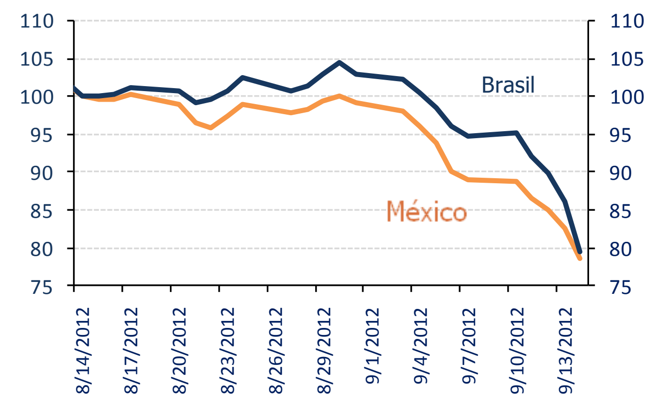
- **Fall in risk aversion after the Federal Reserve's statement**

Chart 9
**Risk: EMBI+ (August 14, 2012 index=100)**




Source: Bloomberg & BBVA Research

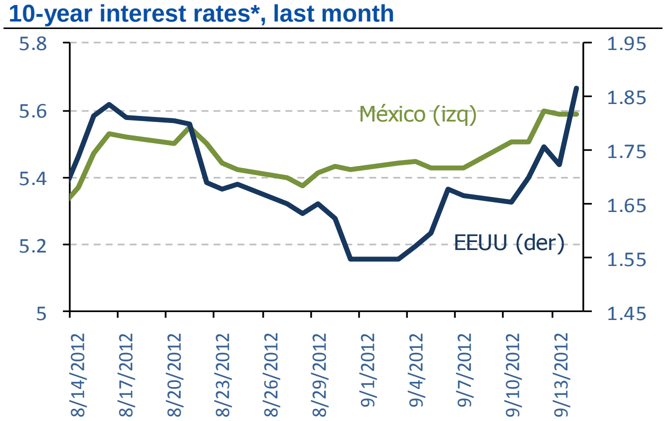
Chart 10
**Risk: 5 year CDS (August 14, 2012 index=100)**




Source: Bloomberg & BBVA Research

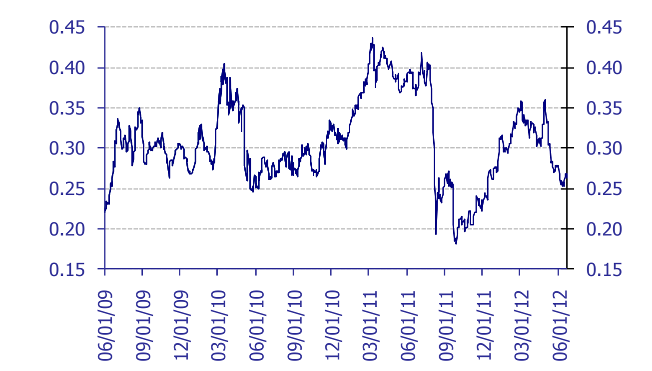
- **Increase in rates in the USA in light of lower risk aversion. Rates in Mexico also see an increase over the week.**

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




Source: Bloomberg & BBVA Research

Chart 12
**Carry-trade Mexico index (%)**

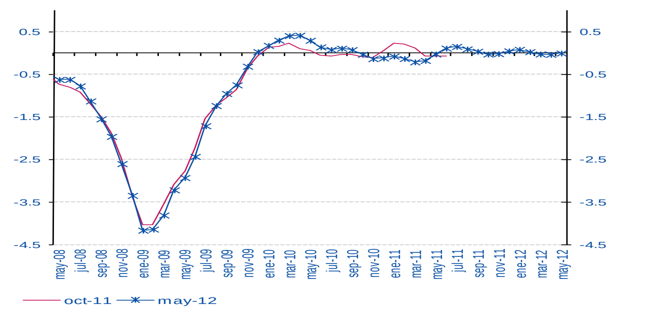


Source: BBVA Research with data from Bloomberg

# Activity, inflation, monetary conditions

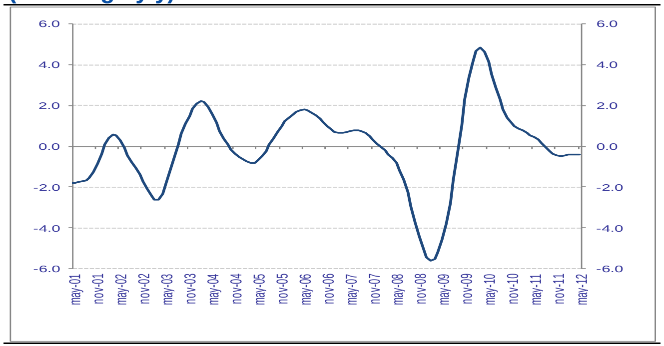
- **Output holds positive albeit moderate performance, situation indicators point to 3Q12 with quarterly rates above 0.5%.**

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.

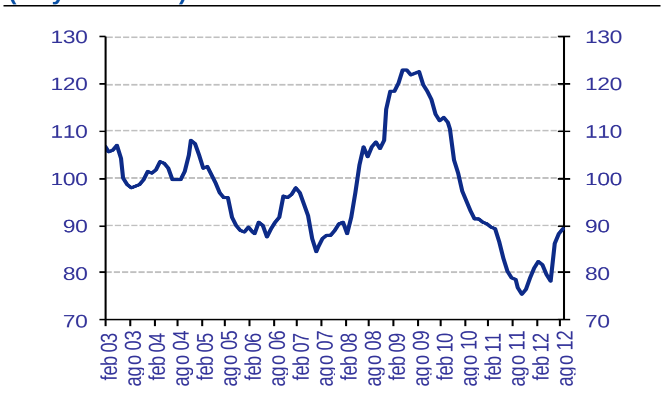
Chart 14
**Advance Indicator of Activity, trend (% change y/y)**



Source: INEGI

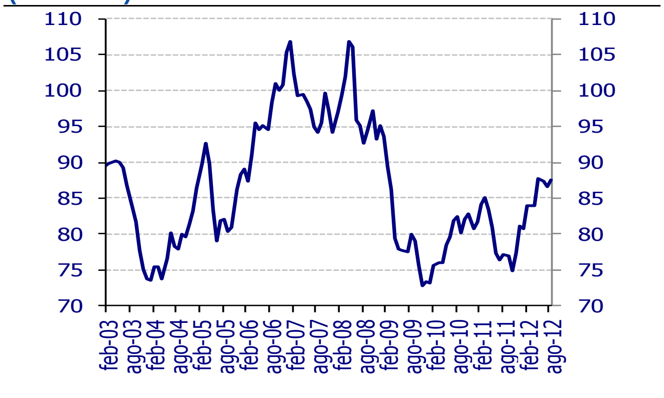
- **Recently we have seen upward surprises in inflation and output.**

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.

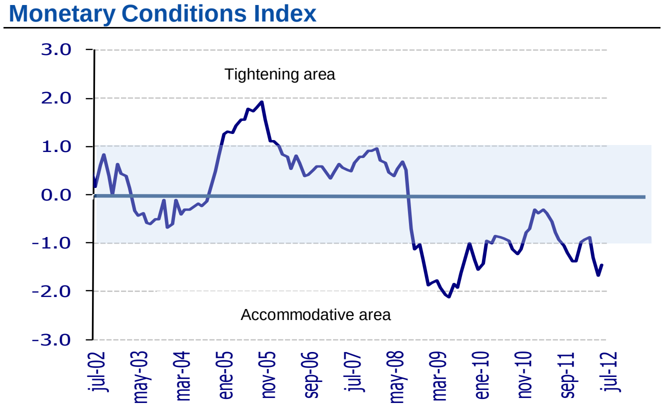
Chart 16
**Activity Surprise Index (2002=100)**



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.

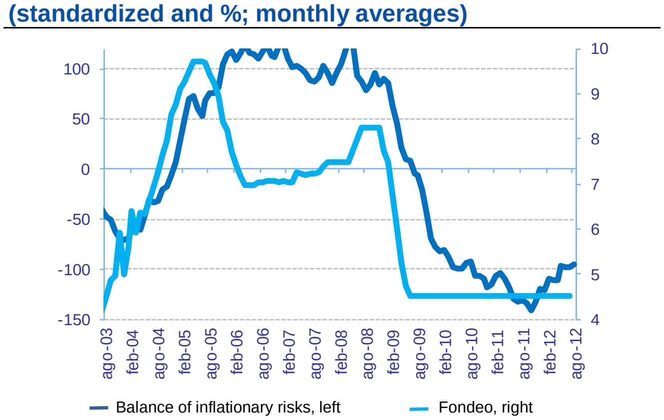
- **Monetary Conditions relax after higher inflation.**

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 and weighted index (of inflation and economic growth) based on economic indicators of economic activity and inflation. A rise in the IBR signals greater weight of inflationary risks over those of growth and, therefore, more likelihood of monetary restriction

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