Economic Analysis and Customer and Markets Strategy
October 5, 2012

Mexico Weekly Flash

Next week…

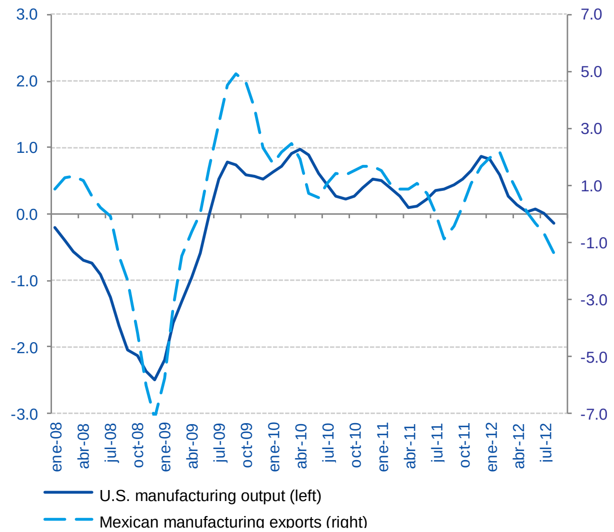
- **Industrial output will make a difference to see if the US slowdown is affecting Mexico**

  Next week sees the release of industrial output for August. This information will provide more insight into the effect the slowdown in US industrial output (-1.2% m/m in August) had on output in Mexico. It should be stated that said slowdown seems to be linked to a fall in manufacturing exports in Mexico of around 4.9% in August. In the face of this, we believe the level of Mexican industrial output should remain unchanged from July, hitting an annual rate of 5.2%. This slowdown in manufacturing is in line with our economic outlook where we maintain our 3.7% growth forecast for this year.

- **MXN breaks 12.7 level with the chance of extending gains**

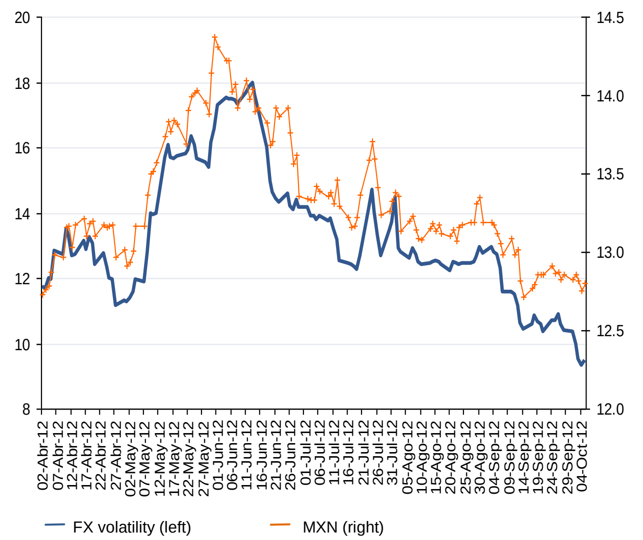
  The MXN strengthened around 0.6% last week after hitting allow of 12.66 thanks to positive surprises in US indicators and risk appetite in the face of high liquidity. Next week events in Europe (Ecofin meeting, banking supervision and Troika meeting) will be the focus. The corporate reporting season is set to begin this week which could have an effect on markets.

Chart 1
Mexican manufacturing exports and US manufacturing output (% m/m, trend)



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 August (October 12) seasonally adjusted series

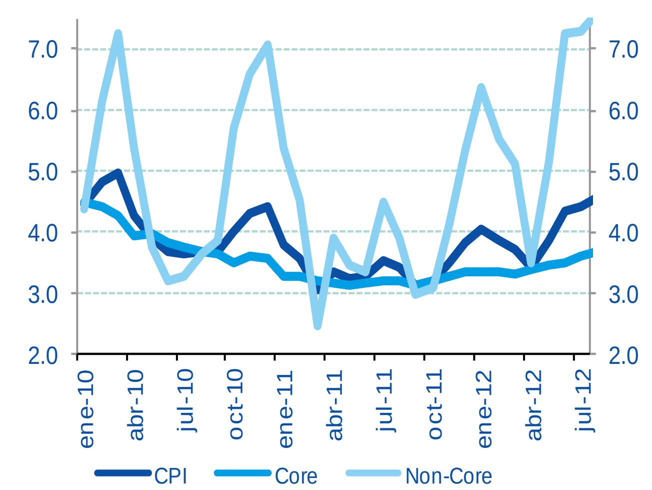
Forecast: 0.0% m/m (5.2% y/y)	Consensus: 0.2% m/m	Previous: 2.2% m/m (4.43% y/y)

September Inflation (October 9)

Forecast: 0.45% m/m (4.78% y/y)	Consensus: 0.45% m/m	Previous: -0.30% m/m, (3.7% y/y)

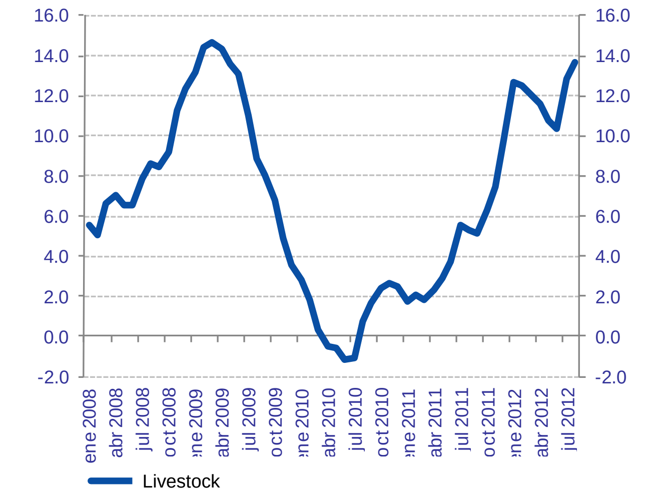
Next week sees the release of September inflation figures saw a downward surprise in the first two weeks thanks to good performance in the core component and energy prices, particularly gas. We forecast a 0.48% m/m increase for the CPI and 0.19% m/m for core inflation meaning non-core prices are set to contribute more keenly to the upswing. We believe inflation will hit its annual high in September (4.78%) although some price pressures for livestock products could bring upward surprises due to the effects of the bird flu outbreak in Jalisco being more persistent than anticipated and global grain prices remaining very high. We see inflation in the fourth quarter falling considerably thanks to favorable statistics in comparison to 2011, the recent strengthening in the peso and the ongoing slack in the economy. We think inflation is set to come in around 4.0% at the end of the year although our forecast does have an upward bias since the appearance of new supply shocks cannot be ruled out that lead to inflation falling below expectations at the end of the year.

Chart 3
Inflation Breakdown (% change y/y)



Source: BBVA Research with INEGI data

Chart 4
Inflation for livestock products (% change y/y)



Source: BBVA Research with INEGI data

• The MXN breaks the 12.7 level thanks to positive surprises in the US.

Over the week, the MXN strengthened around 0.6%, after hitting a low of 12.66. The series of positive surprises in US indicators (particularly the ISM and NFP), in addition to Federal Reserve minutes reiterating high liquidity for a prolonged period had a positive effect on the risk appetite among global investors. The scenario points to possible further gains in coming days with the calendar of economic data less charged in the near future and key events in the EMU taking place toward the middle of the month. In this way, room for strengthening toward 12.60 remains. Risk continues to focus on when Spain will ask for a bailout and the effect this would have on its credit rating. In addition, the risk of closing positions on the CME remains (with net contracts at all-time highs). In this way, we maintain the range expectation and make the most of moves toward the support to take long USDMXN positions.

Along this line, interest rates on the Mbond and TIIE market fell over the week. On average, Mbond curve yields fell 7bp, with the longer tranches seeing the highest demand. Global risk premiums stabilizing and slow economic growth is the ideal combination for long maturity demand thriving. In turn, in addition to the construction context in Mexico, President Calderón announced deep water oil finds with estimated reserves of 125 million barrels. According to the statement, it is the most important find for many years.

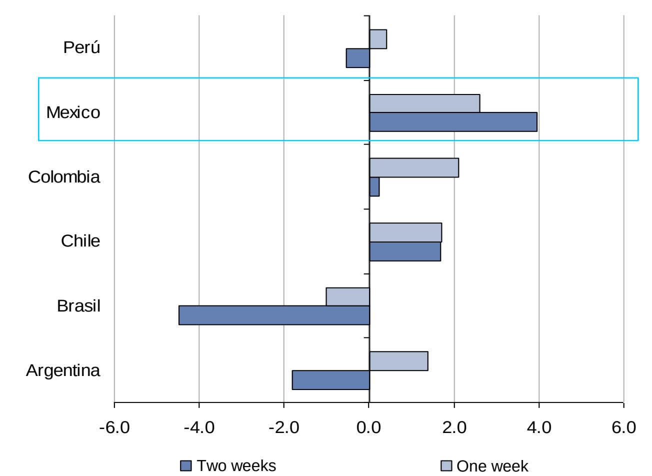
• Minister and banking supervision meeting now in market spotlight

The European Finance Ministers meeting to deal with sovereign issues (October 8 and 9) and the EU Parliament will discuss banking supervision proposals (October 10). The Ministers of Finance and Central Banks will meet with the IMF to discuss, among other things, global outlook. Lastly, markets will remain focused on a possible issue of Credit Enhancers from European rescue funds (EFSF / ESM) for initial losses in sovereign debt.

• Corporate reporting season in the U.S.

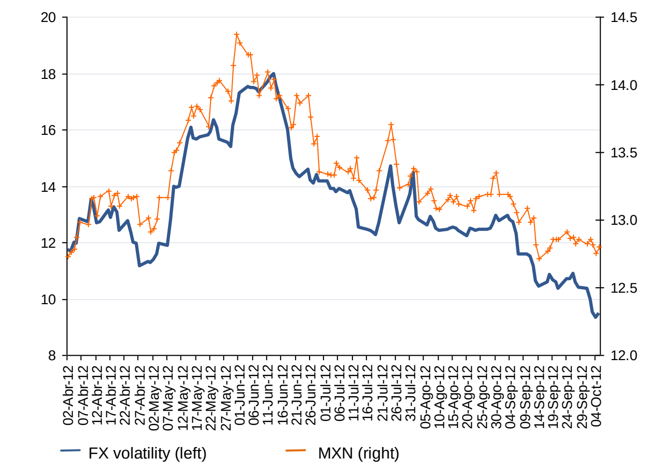
Furthermore, the corporate reporting season will be starting in the US with Alcoa (Tuesday) and financial institutions JP Morgan and Wells Fargo (Friday). We remind readers that the consensus forecast a 1% fall in revenue and -2% in EPS. In turn, revenues in Mexico are expected to see around 14% growth with EBITDA increasing by 8.2%.

Chart 5
Stock Market Yields in LatAm (% change of main index)



Source: BBVA Research and Bloomberg

Chart 6
MXN and Implied Volatility (USDMX and %)



Source: BBVA Research and Bloomberg

Technical Analysis

IPC

The weekly market balance meant the IPC hit a new all-time high, breaking the 41,500pts resistance level. By trading at levels never hit before, we could set a new target projecting the points from the last bounce level (40,000pts) to 41,500pts, giving a new short-term target of 43,000pts. This level matches the high section of the upward channel the market has traded in since August 2011 for over a year already. The market benefitted from the AAA issuer bounce over the week. Given the lag we could still be seeing at Amx and Walmex and the recent upward break through at Femsa, we believe these issuers are set to continue to be the main engine for short-term IPC trading.

Previous Rec. (10/01/12): It did not manage to go above the 41,000pts barrier in recent week but we believe it could have the necessary momentum this time to break through this level and seek out the 41,500pts zone.

Source: BBVA, Bancomer, Bloomberg

MXN

After several lateral sessions, the dollar started an adjustment taking it to the initial support at MXN12.70. This was the point of the last dollar bounce. Nonetheless, we could see this floor being broken and it testing a next support toward MXN12.55/12.60, the minimum range of the year.

Previous Rec. (10/01/12). The dollar remained in the short-term downward channel and only an upward break through MXN13.00 would mark a trend change.

Source: BBVA, Bancomer, Bloomberg

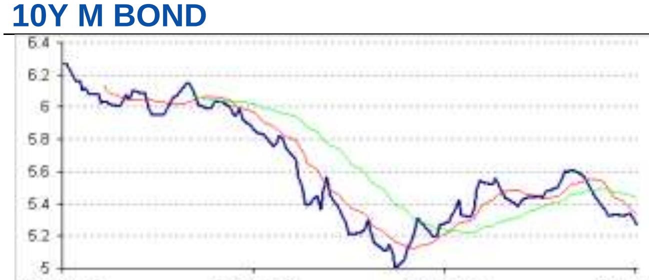
3Y M BOND

3Y M BOND (yield): The bond could not materialize a bounce from the 4.7% floor. The next floor would sit toward the 4.6%-4.55% range. The trend change would be marked by the upward break of 4.8%.

Previous Rec. (10/01/12). If it breaks down through 4.7%, the next floor is at 4.55%.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND



10Y M BOND: (yield): The bond maintained its downward move after the negative intersection of the 10- and 30-day rolling averages. Floors at 5.2% and then toward 5%. Only if it bounces above 5.5% could we consider a trend change.

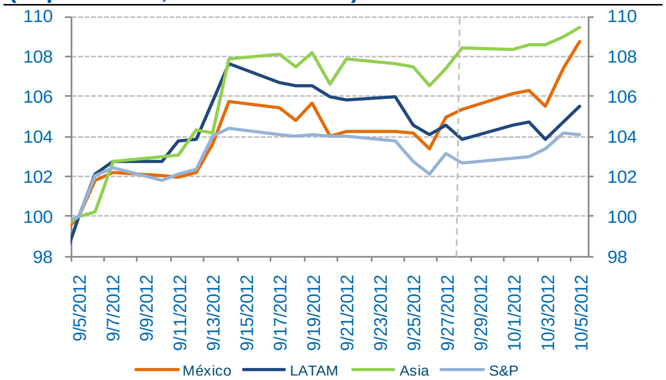
Previous Rec. (10/01/12). The 10-day rolling average crossed down through the 30-day meaning we could expect weakness. Floor at 5.2%

Source: BBVA, Bancomer, Bloomberg

Markets

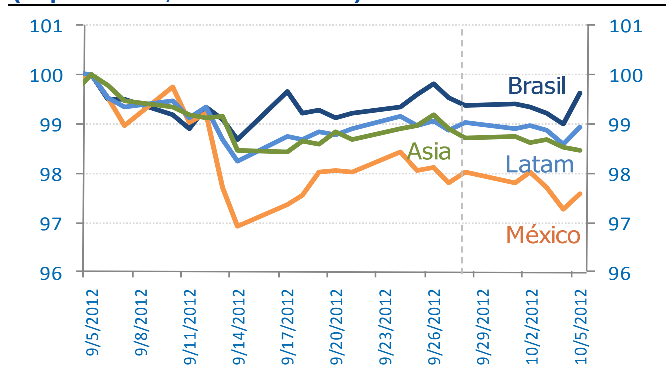
- **Upswing on stock markets and emerging currency rises over the week after better-than-expected US employment and manufacturing figures. The peso fell on the last day of the week after the postponement of Spain asking for a bailout dominated over US non-farm payroll figures which were in line with expectations.**

Chart 7
Stock Markets: MSCI Indices (September 5, 2012 index=100)



Source: Bloomberg & BBVA Research

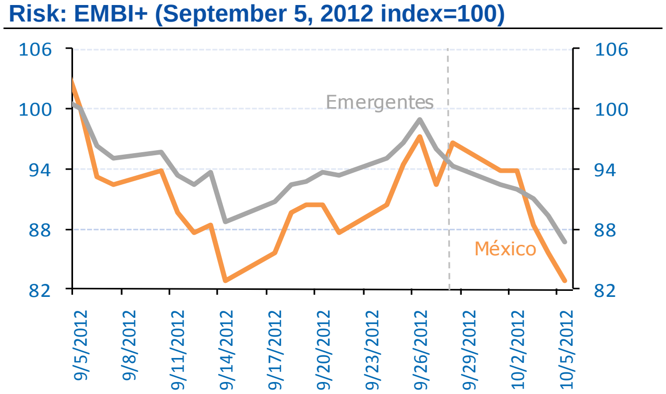
Chart 8
Foreign exchange: dollar exchange rates (September 5, 2012 index=100)



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

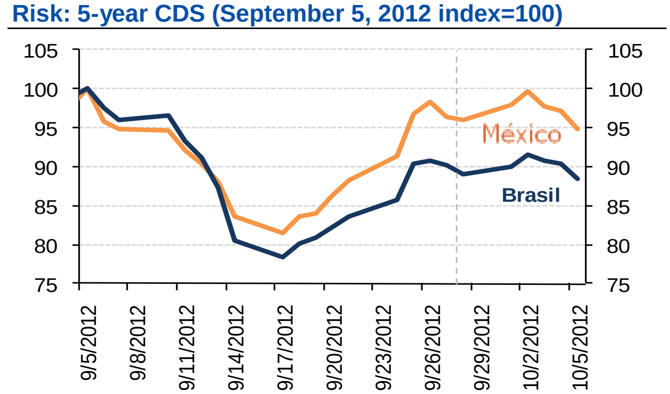
- **Slight upswing in risk aversion midweek due to the Spanish authorities denying rumors that it could ask for a bailout in coming days. US jobs figures ease risk aversion at the end of the week.**

Chart 9
Risk: EMBI+ (September 5, 2012 index=100)



Source: Bloomberg & BBVA Research

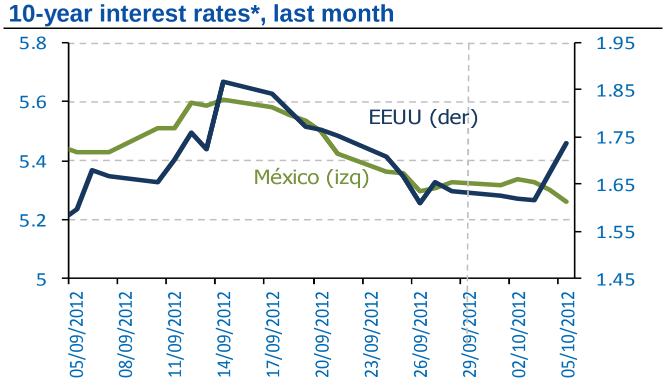
Chart 10
Risk: 5-year CDS (September 5, 2012 index=100)



Source: Bloomberg & BBVA Research

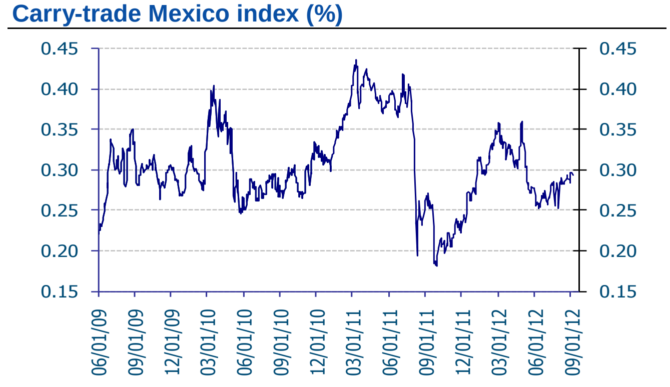
- **Increase in rates in the US in light of better-than-expected economic data. Mexican rates fall on final day after maintaining high correlation with US rates.**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

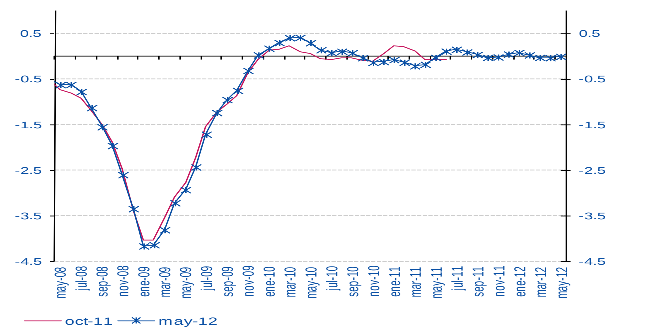


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

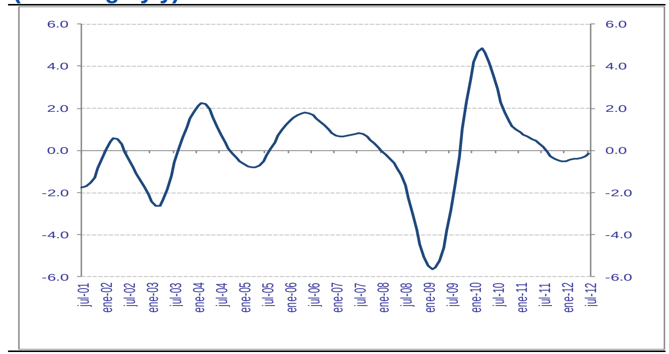
- **Output holds positive albeit moderate performance, situation indicators point to 3Q12 with quarterly rates above 0.5%.**

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.

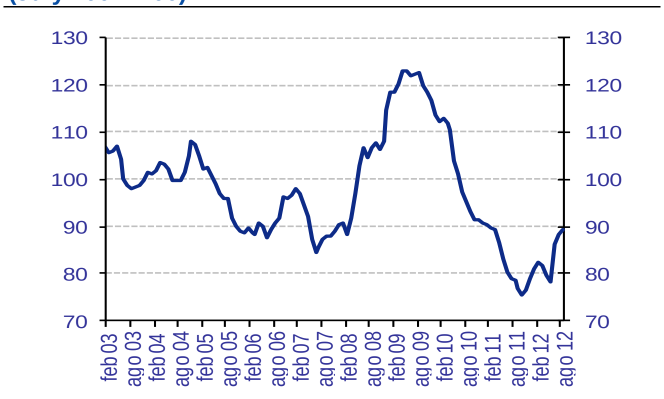
Chart 14
Advance Indicator of Activity, trend (% change y/y)



Source: INEGI

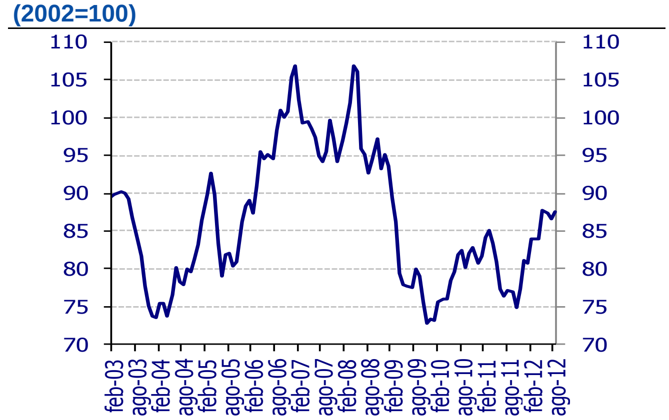
- **Recently we have seen upward surprises in inflation and output.**

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.

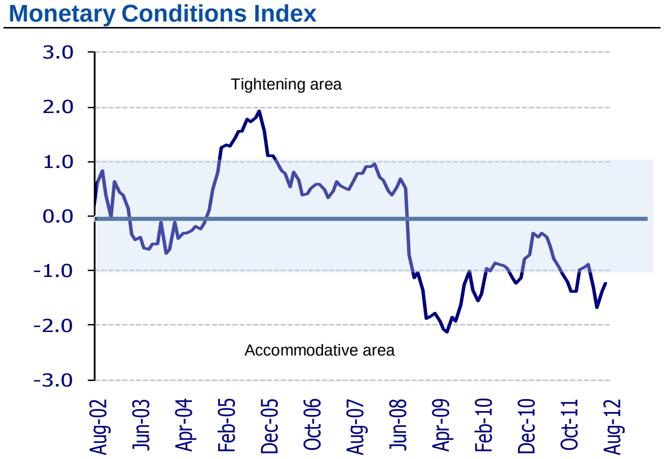
Chart 16
Activity Surprise Index (2002=100)



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.

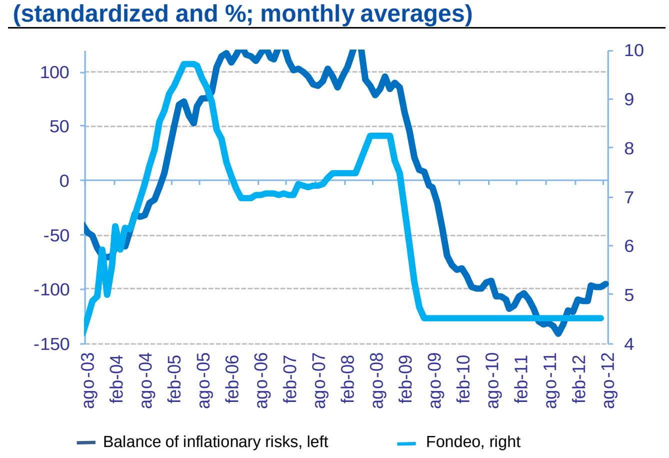
- **Monetary conditions slightly reduced their looseness after currency appreciation.**

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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