Mexico Weekly Flash

Next week…

- **INEGI is set to release industrial output figures for September and GDP for the third quarter which we believe will match signs of a slowdown.**

Industrial output and GDP figures will be released in a slowdown scenario for foreign demand. For example, the Bank of Mexico inflation report for July-September 2012 underlined the continued slowdown in the global economy, already being seen in the domestic economy. The central bank estimates that growth for 2012 will come in between 3.5% and 4.0%, with expected US growth falling from 2.3% at the start of the year to 2.1% at present. BBVA Research's outlook for Mexican growth this year remains at 3.7% with a slight upward bias helped by the better-than-expected figures for job creation in the formal sector. Third quarter GDP and industrial output figures are expected to confirm a slowdown and will help map its extent.

- **Monetary and cyclical driving factors dominate markets**

Quarterly inflation report, October inflation and minutes on the last Banxico monetary policy decision were released. In short, all had an affect on reducing any upward risk in the short-term lending rate. Specifically, the Banxico Board increased the number of risks to watch over and highlighted that if there were a rate rise, it would be purely "preventive" (i.e. a minimal rise and not a period of monetary restriction). This should affect the flattening out on the nominal curve, mainly in the long part

Table 1
Inflation Breakdown (% change y/y)

	1Q12 Report		2Q12 Report		3Q12 Report	
	2012	2013	2012	2013	2012	2013
Growth US (annual %)*	2.3	2.5	2.2	2.1	2.1	2.0
Growth Mexico (annual %)	(3.25-4.25)	(3.0-4.0)	(3.25-4.25)	(3.0-4.0)	(3.5-4.0)	(3.0-4.0)
Employment (thousands of workers at IMSS)	(540-640)	(500-600)	(540-640)	(500-600)	(600-700)	(500-600)
Current Account (% of GDP)	1.0	1.3	0.9	1.4	0.4	1.6
Memorandum:						
BBVA Research GDP forecast (annual %)	3.7	3.0	3.7	3.0	3.7	3.0
*Consensus of Blue Chip survey						

Source: BBVA Research with Banxico data

Calendar: Indicators

Industrial Output in September (Monday, November 12)

Forecast: 1% m/m (3.7% y/y)	Consensus: 0.4% m/m	Previous:	-0.8% m/m, (3.8% y/y)

GDP in 3Q12 (Friday, November 16)

Forecast: 0.8% q/q (3.7% y/y)	Consensus: 0.7% q/q	Previous:	0.9% q/q (4.1% y/y)

Industrial output figures in September will come out before full indicators on economic activity in the third quarter of the year. Industrial output performance in September will be released on Monday 12. Key related indicators point to output seeing a slight bounce in September, in contrast to August. On the one hand, US output went from average monthly growth of (-)0.4% in July and August to 0.4% in September, in line the ISM index (among manufacturers) wend from 49.7 in July and August to 51.6 points in September and October. On the other, domestic automotive output improved in September, from an average of (-)3.2% in the previous two months to 4% in September. In this way, we believe output will have seen an upswing in September of around 1% m/m, after averaging (-)0.1% in the two previous months. Manufacturing growth and, in particular, in key sectors such as transport equipment will be behind said improvement, in addition to the construction industry having continued its expansion at a rate even above total output, as witnessed by the higher job growth in the sector.

Friday 16 sees the release of GDP figures for the third quarter, we estimate, based on available indicators, that it will have seen continued expansion although likely at a lower quarterly rate than in the second quarter. A lower contribution will have been seen particularly in manufacturing while the tertiary sector will have continued to contribute most to growth. For the year as a whole, we continue to expect GDP growth of around 3.7%.

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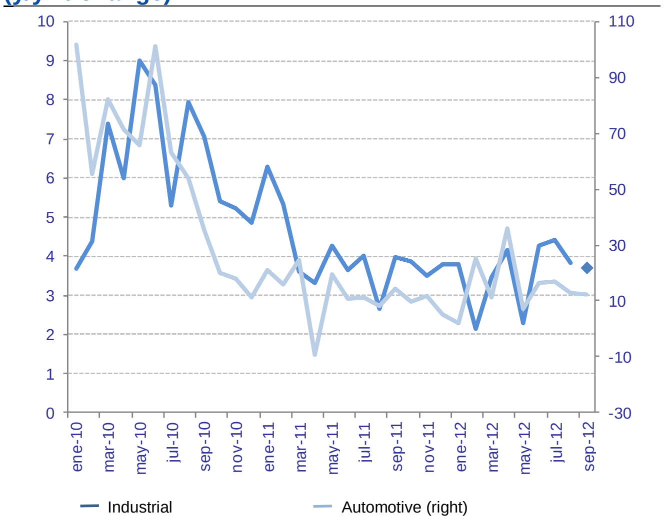
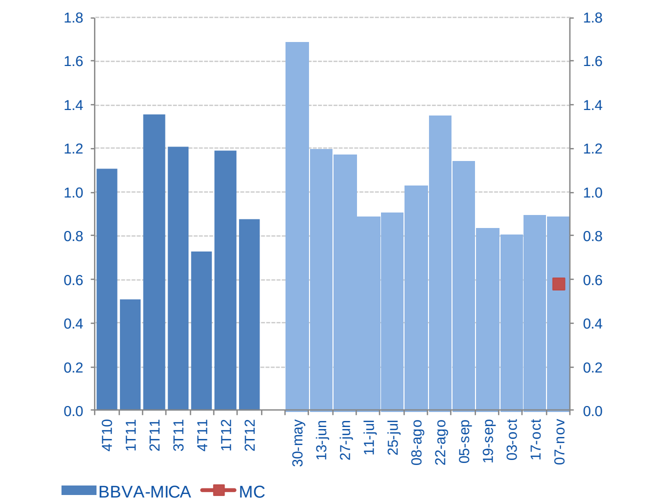
Chart 3
Industrial and Automotive Output (y/y % change)



Source: BBVA Research with INEGI and AMIA figures

Chart 4
Mexico GDP: BBVA-MICA indicator % change q/q



Source: BBVA Research

- **Monetary and cyclical driving factors dominate interest rate and MXN markets over the week.**

The quarterly inflation report, October inflation and minutes on the last Banxico monetary policy decision were released during the week. In short, all had an affect on reducing any upward risk in the short-term lending rate: on the one hand, inflation was below expectations due to the partial dilution of supply shocks that had put pressure on inflation recently. On the other, the Board increased the number of risks to watch, including the closing of the output gap and wage increases. In turn, it highlighted that the aim of a possible rate rise would be merely "preventive". This could mean that, if a rise comes, it would be minimal and not mean a period of monetary restriction. This should affect the flattening out in the nominal curve, mainly in the long part, faced with a context where no cyclical rate rise is expected - in the worst case scenario, it would only be a preventive rise.

After both the positive inflation figure for October and the greater balance risk clarity at Banxico were digested by the market, the correlation of domestic and US rate again increased, seeing a major decline in the curve level (on average over 14bp). The risks in Europe and lack of clarity around the so-called fiscal cliff (fiscal adjustment in the US) will continue to limit the directional upswings in domestic rates. While Banxico maintains its hard discourse, the flattening will dominate. With regard to the MXN, two factors affect its weakness: on the one hand, and despite the good economic data in the US this week, uncertainty is increasing around the negative effect of the US fiscal adjustment. On the other, risks in Europe continue to affect the MXN via hedging and high exposure to the volatility of other emerging currencies (known as high beta). Since domestic bonds continue to be attractive, we have not doubt that many investors are hedging their long Mbonds position in a context where futures on the speculative market are at highs for the peso.

Technical Analysis

IPC

The weekly decline puts the IPC under 41,500pts, breaking the 30-day rolling average and a level it has worked hard to break up through. In addition, the 10-day rolling average crossed down through the 30-day rolling average. This break sets the next floor levels at 40,500 and 40,000pts. The first of these supports was tested in the last session of the week where the market kick started a bounce. For this upswing to again set the market at a favorable short-term position, it has to go beyond 41,500pts. The doji candlestick with which the IPC ended the week suggest a major bounce. Nonetheless, it has to combine with a positive candlestick to complete the upswing pattern

Previous Rec. (11/5/12): It should be stated that a downward break through 41,400pts would point to a move beyond simple profit-taking and open the door to a return to the 40,500pts zone, or even 40,000pts

Source: BBVA, Bancomer, Bloomberg

MXN

The dollar high its highest level in the last two months over the week. Once above MXN13.10, expectations are maintained to seek out the MXN13.30/13.40 zone. MXN13.00 continues to be our major support. It practically hit the 1st resistance in the Friday session.

Previous Rec. (11/5/2012): The entry signal came after breaking up through this level and remains valid while the dollar fails to come in again below MXN13.00.

Source: BBVA, Bancomer, Bloomberg

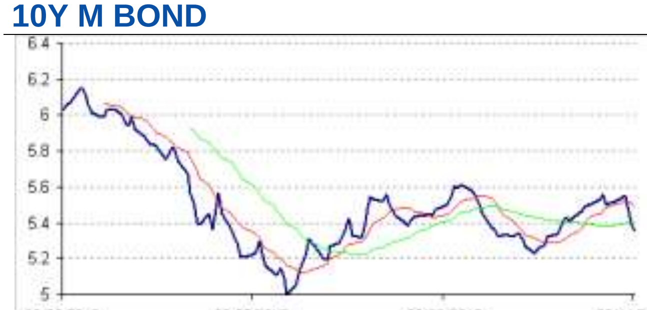
3Y M BOND

3Y M BOND (yield): The bond followed over-purchasing readings on the RSI and had a major weekly adjustment, returning to the 30-day rolling average zone. The 4.85% level should provide support to attempt an upswing.

Previous Rec. (11/5/12). With the RSI at 77pts and a major opening-up between the bond and its 30-day rolling average, we believe the upswing could halt at this level and return to 4.85%.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND



10 Y M BOND (yield): The bond came in below the 30-day rolling average opening the door to a return to the previous minimum at 5.25% levels.

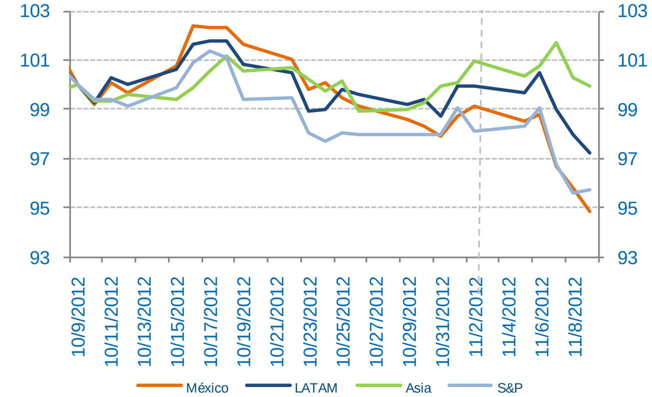
Previous Rec. (11/5/12). We still see some upward move in this bond, seeking out the 5.6% level.

Source: BBVA, Bancomer, Bloomberg

Markets

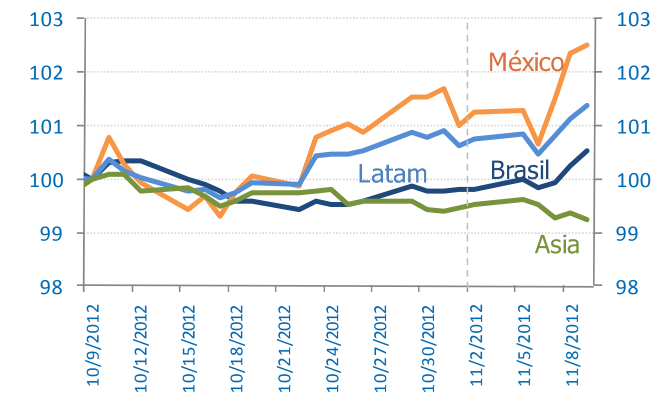
- **After the elections, the configuration of political forces in the US congress revives the uncertainty around fiscal negotiations. This influenced losses on stock markets and weaker currencies toward the end of the week.**

Chart 7
Stock Markets: MSCI Indices (October 09, 2012 index=100)



Source: Bloomberg & BBVA Research

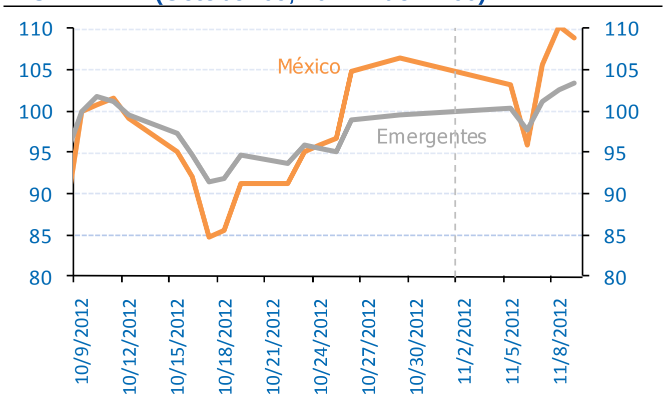
Chart 8
Foreign exchange: dollar exchange rates (October 09, 2012 index=100)



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

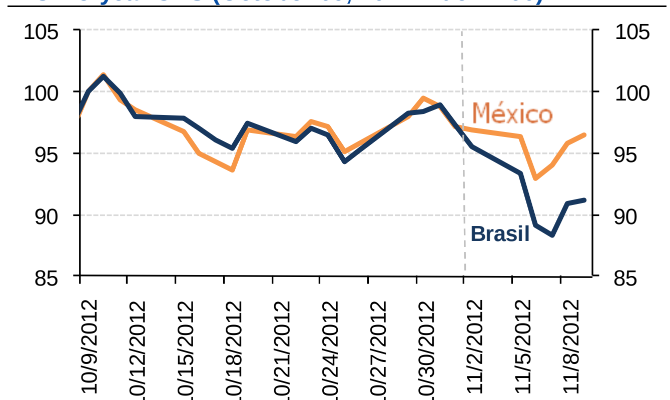
- **Risk aversion increased in the face of the risks from the so-called "Fiscal Cliff" in the US and doubts surrounding compliance with the bailout terms in Greece**

Chart 9
Risk: EMBI+ (October 09, 2012 index=100)



Source: Bloomberg & BBVA Research

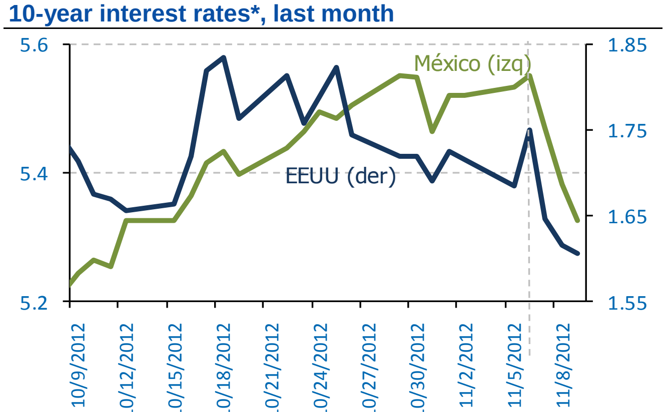
Chart 10
Risk: 5-year CDS (October 09, 2012 index=100)



Source: Bloomberg & BBVA Research

- **Fall in US interest rates in light higher global risk aversion. Rates in Mexico fall after lower inflation figures and more clarity regarding the risk balance at Banxico.**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

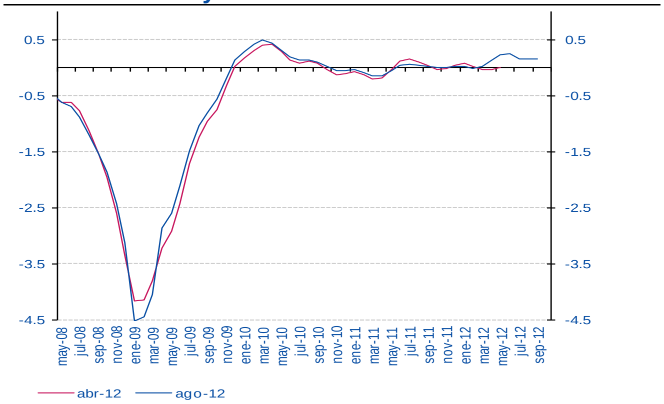
Chart 12
Carry-trade Mexico index (%)

Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

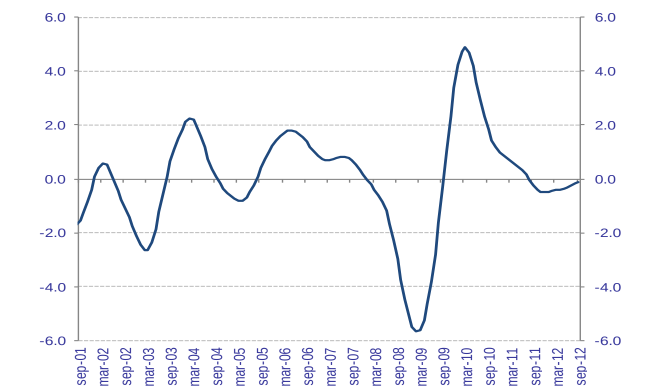
- **Output holds positive albeit moderate performance, situation indicators point to 3Q12 with quarterly rates near 0.8%**

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.

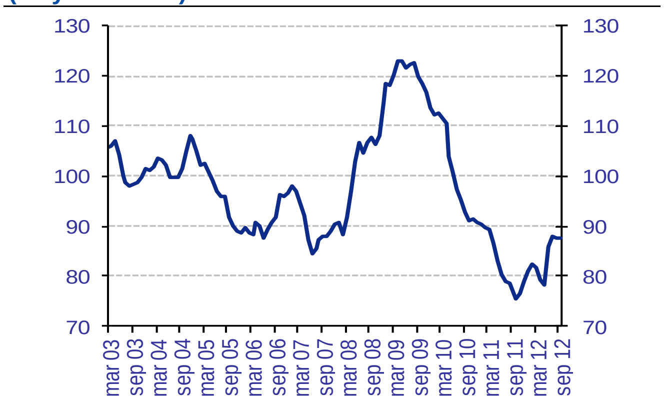
Chart 14
Advance Indicator of Activity, trend (% change y/y)



Source: INEGI

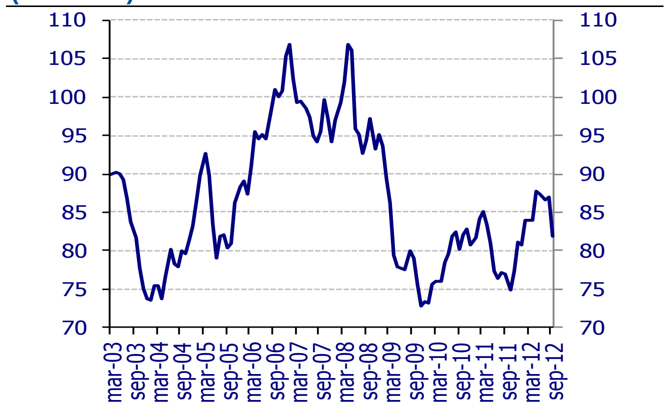
- **It has recently seen a slight downward bias while inflation has stopped seeing upward surprises.**

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.

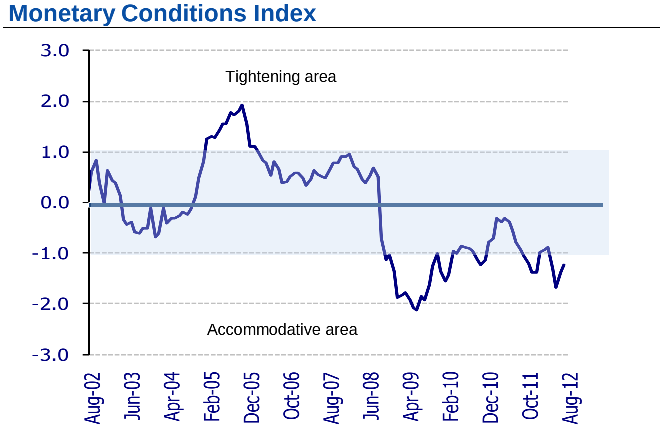
Chart 16
Activity Surprise Index (2002=100)



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.

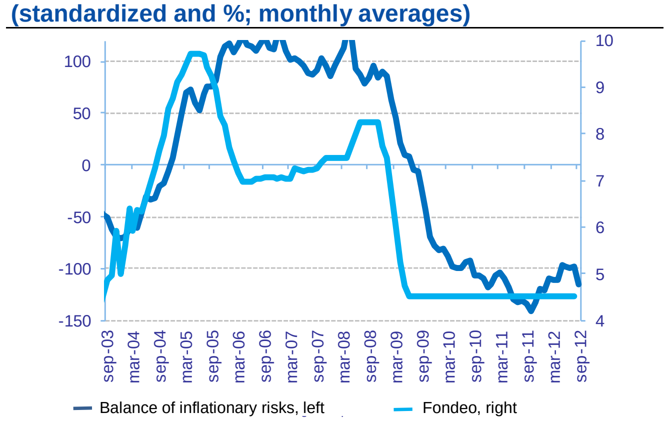
- **Monetary conditions slightly reduced their looseness after currency appreciation.**

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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