Mexico Weekly Flash

Next week…

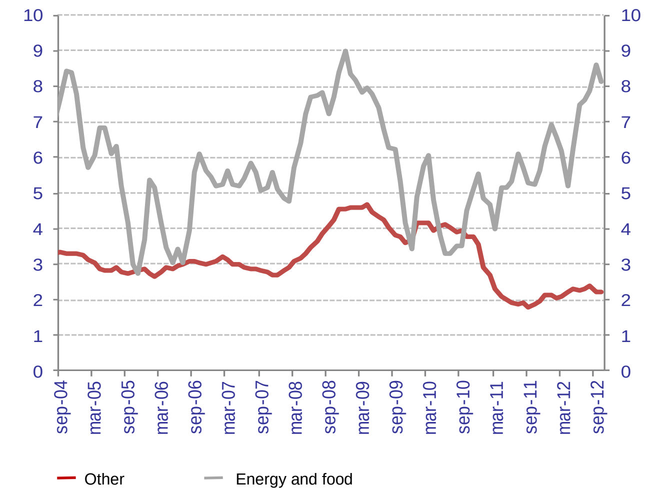
- ### Inflation will continue to decline, although some of its risks remain

On Friday we will learn the inflation figures for November, which we estimate will be around 0.75% m/m, with an annual rate of 4.25% y/y. This will consolidate the decline from the high of 4.77% in September. Although the figure for the first half of the month was slightly above that expected by the market (0.79% q/q against the 0.75% consensus), we consider that in general November was a month of moderate inflationary pressure. This is thanks to three factors: an unexpected fall in fruit and vegetable prices in the first half of the month; a slight reduction in livestock prices; and a somewhat lower than expected rise in energy prices. In addition, core inflation continued to fall to 3.5% in the first half of the month, after hitting a high for the year in August of 3.7%. *(Continued on page 2).*

- ### Increased demand across the MBond curve in response to the Banxico statement

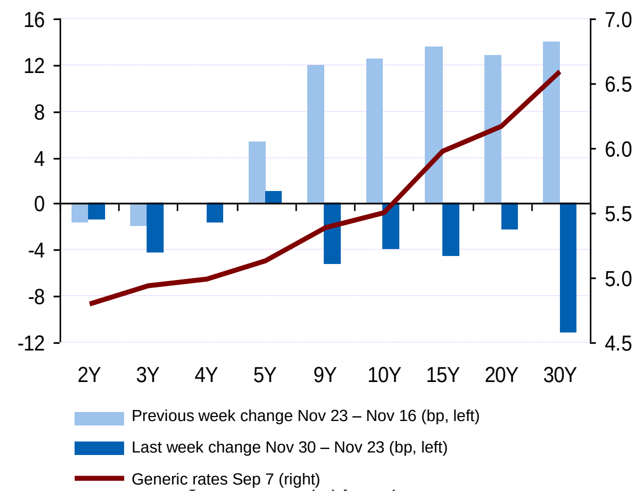
In reaction to the Banxico statement, there was market demand across the whole MBond curve, causing it to fall 8 bps on average. It is clear that after a week with a slew of corporate debt issues, Banxico's more dovish tone was a major trigger for the local curve. Our butterfly strategy remains unchanged. It is supported by strong inflows from abroad to the short part of the curve, a favorable outlook for Mexico (which could consolidate following the announcement by the IMF that it was extending a flexible 2-year credit facility of USD 73 billion for Mexico), and zero risks that suggest a restrictive monetary policy cycle: long in 3Y and 4Y, short in the middle section (10Y). We are pleased with the spreads on the US rates, but only in the short term (2Y and 3Y).

Chart 1
Inflation in food and energy and other goods and services (y/y % change)



Source: BBVA Research with INEGI data

Chart 2
Fixed-interest yield curve (% and bps)



Source: BBVA Research with INEGI data

Calendar: Indicators

Producer confidence indicator for November (December 4)

Forecast: 0.3% m/m, 97.1 points	Consensus: N.A.	Previous: 2.9% m/m, 96.8 points

Consumer confidence indicator for November (December 4)

Forecast: 0.2% m/m, 55.3 points	Consensus: N.A.	Previous: 1.0% m/m, 55.2 points

The performance of producer and consumer confidence indicators for October will be released this week. In October, most complementary business opinion indicators such as the aggregate trend indicator, the manufacturer order indicator and its components were down on the previous month. This contraction was of the order of (-)8.8% in the case of the indicator of domestic demand for business products and (-)4.3% in the case of exports. The expected volume of output was down by 3.7% on the expected figure in September. In contrast, the producer confidence indicator bounced back in October by one percentage point. This difference may be related to the trend for moderation in US manufactures, with a fall in October of 0.9% m/m, one of the biggest in recent months, and which will lead to lower growth in the Mexican manufacturing sector. Consumer confidence showed more optimism (growth of 2.9% m/m in October), but moderated slightly in November, although we expect a slight growth of around 0.2%, supported by the continuous increase in employment.

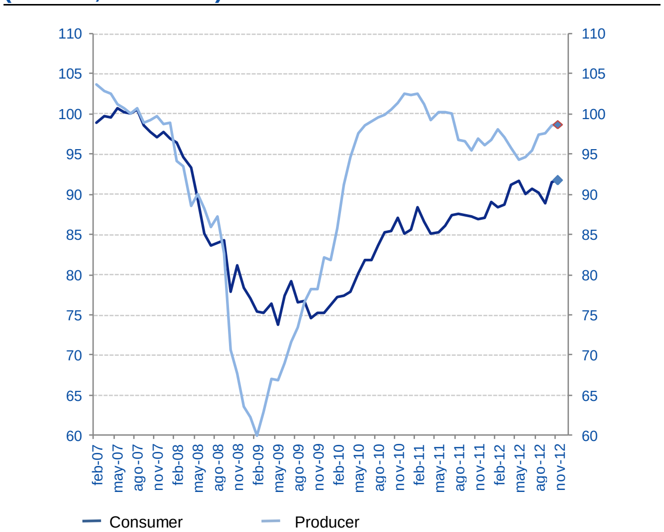
November inflation (December 7)

Forecast: 0.75% m/m, 4.25% y/y	Consensus:	Previous: 0.51% m/m, 4.64% y/y

(Continued from page 1) The recent upturn in inflation was due to specific pressure on food and energy prices, but so far there are no signs that these supply shocks have been passed on to other prices, which are more closely linked to economic activity (see Chart 1). This is because despite the steady economic recovery since 2010, growth has still not been sufficiently strong to generate pressure on prices. Finally, we should highlight that despite the major turnaround in the inflation trend since October some risk factors persist. They include: the slowdown in the production of staple foods, both in Mexico and abroad; the possibility that global uncertainty could lead to a major depreciation of the peso; and the probability that the tariffs set by the public sector increase more than expected in January. We consider that inflation will continue to fall for the rest of the year and will finally remain steady under 4% until the second quarter of 2013.

Chart 3

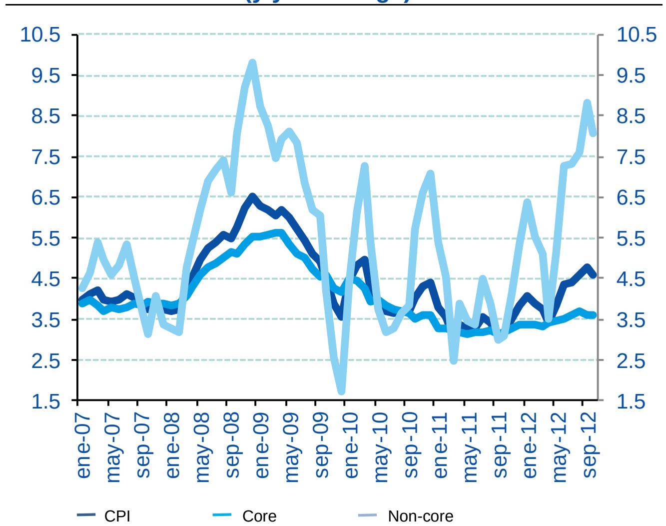
Consumer and producer confidence (Indices, 2007=100)



Source: BBVA Research with INEGI data

Chart 4

Inflation breakdown (y/y % change)



Source: BBVA Research with INEGI data

Technical Analysis

IPC

The week's fall in the IPC share index means it is still in a favorable technical position for the short term (flag), which suggests it will return to levels of 42,7000 points, where the market was trading in October. The high part of this flag is at 42,000 points, where the IPC found resistance during the week, while the base is at 41,500 points. As well as this, other technical events are on the horizon to maintain the positive short-term outlook. The 10-day rolling average ended the week crossing upwards through the 30-day rolling average, while the RSI eased off from overbuying.

Previous recommendation (26/11/12) The level of 41,500 points becomes a support in the short-term. The lack of correlation between IPC and Amx has been evident in recent weeks. The short-term oscillating indicators of the issuer have begun to rebound from very high oversell levels; and still have a lot of upside potential.

Source: BBVA, Bancomer, Bloomberg

MXN

The dollar has not been able to rebound to MXN 13.00 and closed at a low for the week, now very close to an initial support at MXN 12.90. The oscillating indicators are still not showing overselling, so we cannot rule out that this floor will be broken.

Previous Recommendation (26/11/2012): The risk remains of a downward breakthrough in this floor for targets of between MXN 12.90 and MXN 12.70. Any upturn would be limited to between MXN 13.15 and MXN 13.20.

Source: BBVA, Bancomer, Bloomberg

3Y M BOND

3Y M BOND: (yield): A week of marginal movements, still respecting the rolling 30-day average band. We maintain our forecast of resistance at 5.1% and support at 4.9%.

Previous Recommendation (26/11/12). We think it may move to the 5.1% range in the short term.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND

10Y M BOND (yield): The bond remains in the upper part of the lateral channel. The only signal for entering is when it breaks through the 5.6% threshold.

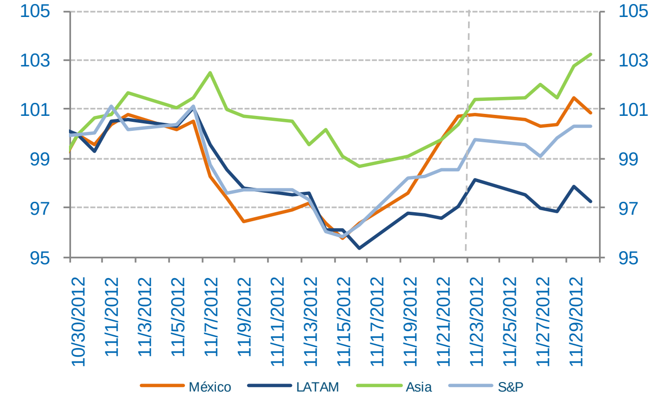
Previous Recommendation (26/11/12). Close to the high part of this channel, we recommend waiting for an upward break to consider a move toward 6%.

Source: BBVA, Bancomer, Bloomberg

Markets

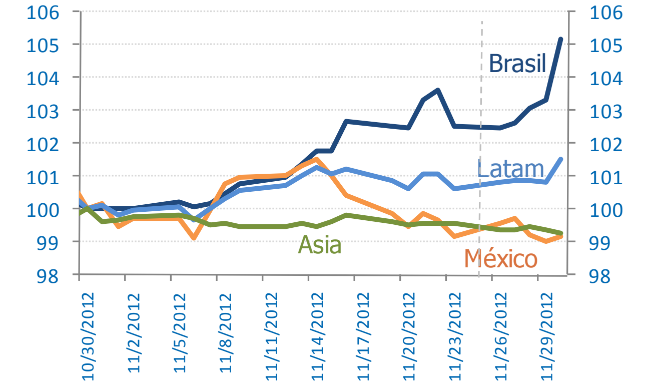
- **Statements by US lawmakers and authorities on negotiations to prevent the "*fiscal cliff*" continue to influence the markets. This week the peso closed with marginal changes after posting levels of above 13 pesos to the dollar mid-week, while the Mexican stock market closed with a slight fall.**

Chart 7
Stock Markets: MSCI indices (October 30, 2012 = 100)



Source: Bloomberg & BBVA Research

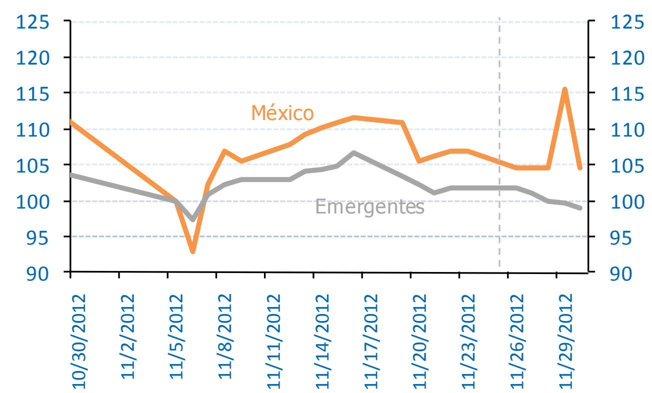
Chart 8
Foreign exchange: dollar exchange rates (October 30, 2012 = 100)



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

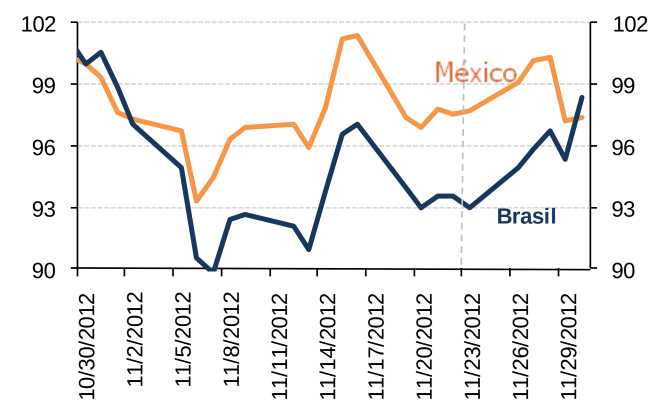
- **Risk aversion increased during the week, influenced by the statements by the US Senate leader about the lack of progress in fiscal negotiations.**

Chart 9
Risk: EMBI+ (October 30, 2012 = 100)



Source: Bloomberg & BBVA Research

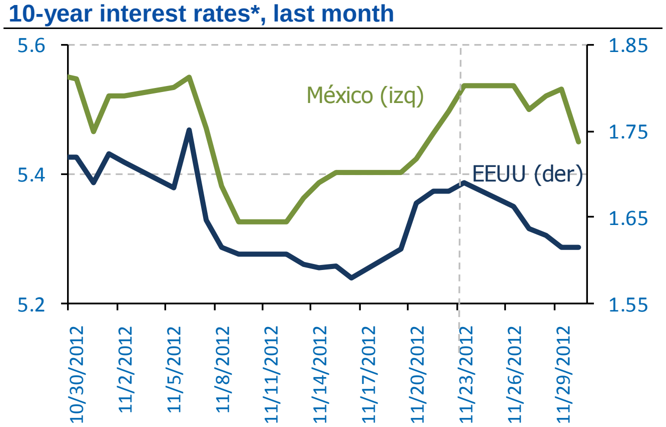
Chart 10
Risk: 5-year CDS (October 30, 2012 = 100)



Source: Bloomberg & BBVA Research

- **Negative correlation between Mexican and US rates in response to growth in risk aversion. The less restrictive statement by Banxico at the end of the week influenced the fall in rates.**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

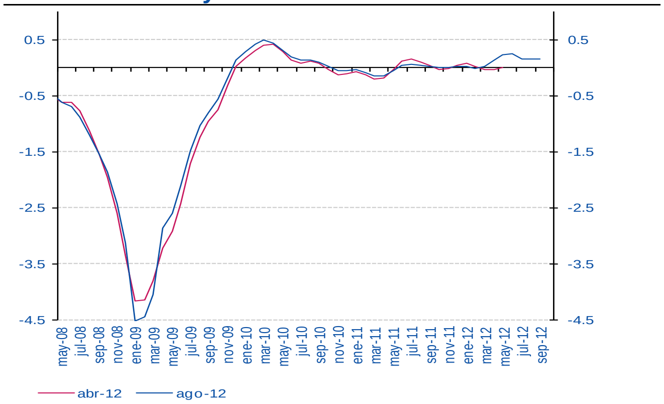
Chart 12
Carry-trade Mexico index (%)

Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

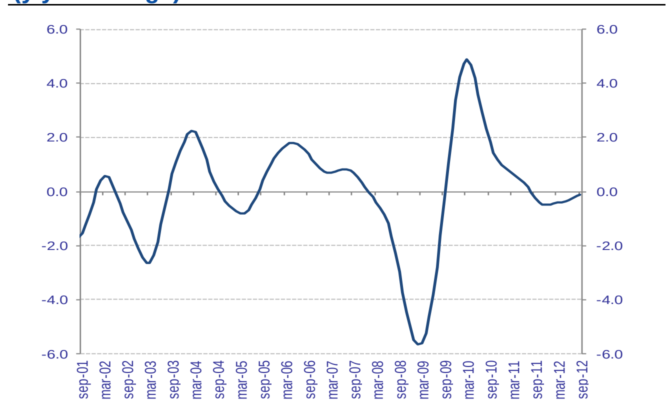
- **Output slowed in the third quarter; timely indicators from the last quarter suggest this trend will continue with a soft slowdown**

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.

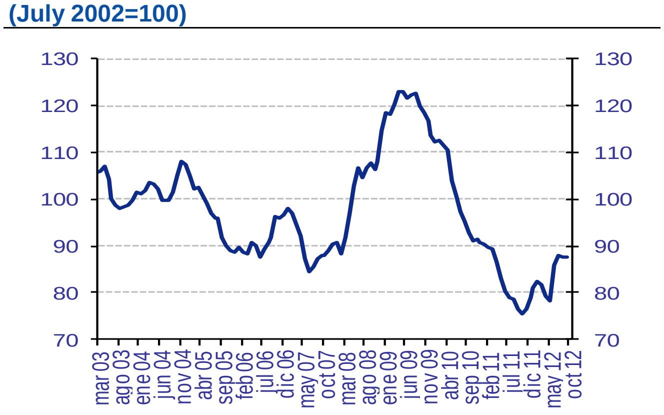
Chart 14
Advance Indicator of Activity, trend (y/y % change)



Source: INEGI

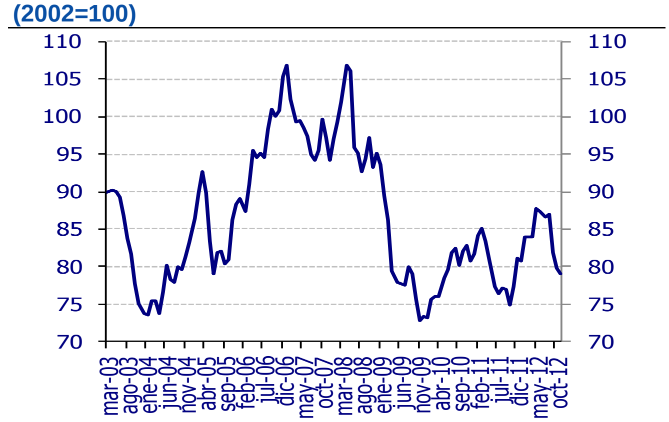
- **Both output and inflation have moderated recently.**

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.

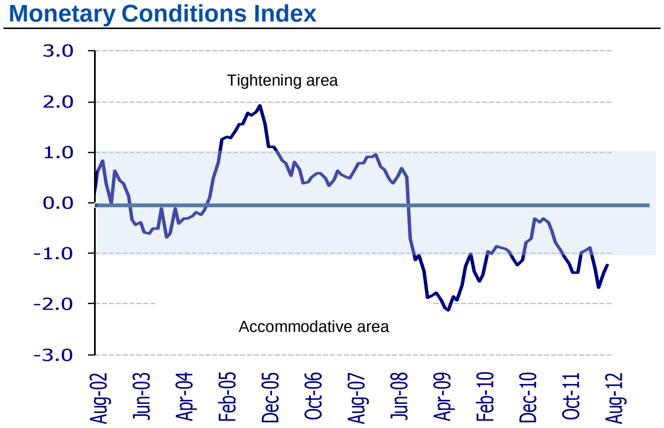
Chart 16
Activity Surprise Index (2002=100)



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.

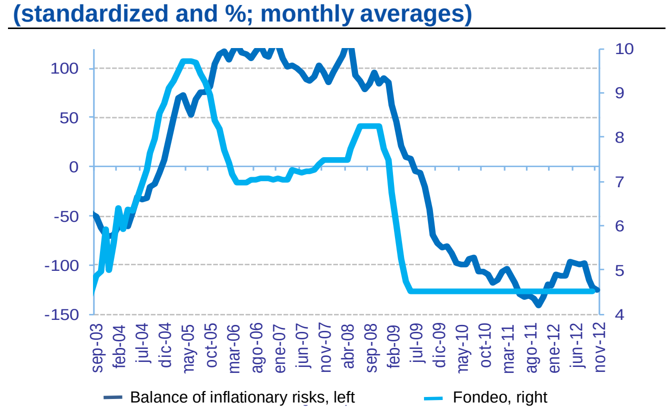
- **Monetary conditions slightly reduced their looseness after the currency gains.**

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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