Mexico Weekly Flash

Next week…

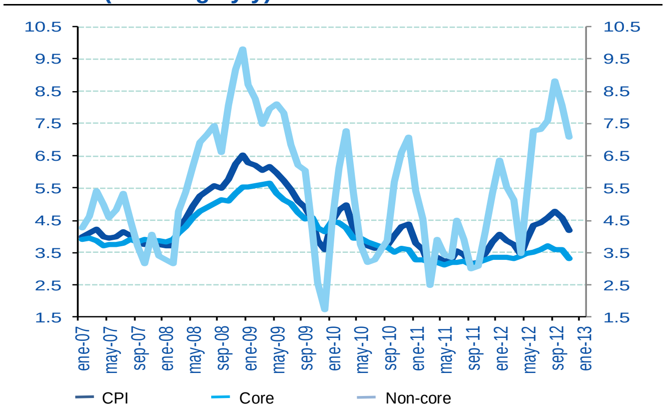
- **The last inflation figures to be released this year will be in line with Banxico forecasts of around 4.0% for the year.**

  Next Friday sees the release of inflation figures for the first two weeks of December. The figures are set to show inflation remaining near 4.0%, in line with Banxico forecasts from the last Quarterly Inflation Report. We estimate core inflation in December seeing a slight upswing year-on-year with continued food price pressures due to global grain markets, the high exchange rate impacting the price of other goods and, this month, seasonal increases in tourist service prices. In addition, lower reductions in telephone prices than those seen in previous bi-weekly figures are likely. In turn, non-core inflation will continue to benefit from declines in fruit and vegetable prices that should partially offset increases in the prices of some livestock products such as beef products and eggs, and higher increases in fuel prices. Although inflation is set to end the year in line with central bank forecasts, attention will need to focus in early 2013 on possible pressures hindering inflation from fully falling within the range of variability; this is due to risks such as a weaker peso, unexpected rises in commodity prices or possible higher-than-expected rises in rates set by regional governments.

- **Uncertainty returns to markets**

  Markets reacted to the FOMC monetary policy message over the week (more quantitative easing and new policy guidelines), increasing uncertainty surrounding the fiscal cliff, the Greek debt repo program, the unlocking of resources required by the Greek economy, and EU agreements on joint banking supervision. The fiscal cliff especially continues to set the level of risk appetite and weaken optimism on other fronts. In this scenario, the MXN continued to fluctuate between 12.87 and 12.68, ending the week with a gain of 0.66% (higher than that seen in other Latin American economies) pointing to a certain optimism among investors. Nonetheless, fronts remain open at year-end meaning we remain cautious (especially for the US). This could place pressure on markets with corrections in long futures positions in the MXN. Nevertheless, our forecast for 2013 remains positive.

Chart 1
Inflation (% change y/y)



Source: BBVA Research with INEGI data

Calendar: Indicators

Inflation for the first two weeks in December (December 22)

Forecast: 0.55% bi-weekly, 4.04% y/y	Consensus: N.A.	Previous: -0.68% m/m, 3.3% y/y

Commercial establishments in October (December 19)

Forecast: 0.0% m/m, 4.4% y/y	Consensus: N.A.	Previous: 1.0% m/m, (4.5% y/y)

Service revenues in October (December 19)

Forecast: -0.5% m/m, 3.6% y/y	Consensus: N.A.	Previous: 0.1% m/m, (2.3% y/y)

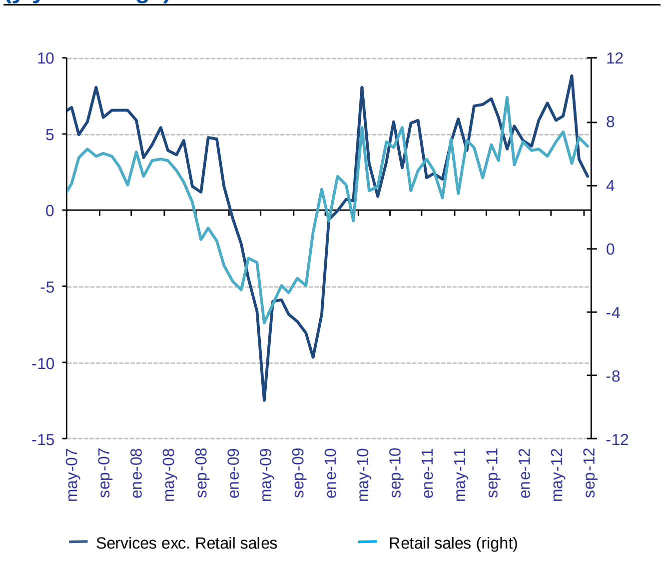
Open Unemployment Rate (December 21)

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

Domestic demand indicators are set to be released this week. The aggregate services index and the retail sales indicator will provide better information on consumer spending in 4Q12 after the good performance seen in 3Q12 of 1% q/q (2% y/y). We forecast retail sales remaining unchanged from the previous month with a slight contraction in services not being ruled out. It should be stated that manufacturing saw a major contraction in October, dropping (-)0.9% m/m. This has a strong link to the clearer slowdown in foreign demand. This slowdown will also affect other areas, likely through lower job creation rates. Although key indicators such as employment in the formal private sector and in other sectors continue to see good growth, they contrast with income in real terms for workers meaning wages saw a lower growth rate than at the start of the year.

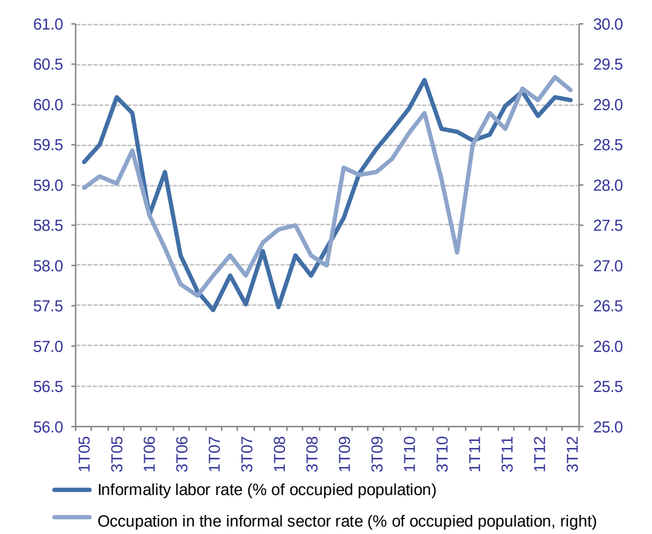
In this vein, this week also sees the release of occupation and employment figures for November. It should be remembered that the open unemployment rate has showed major downward resistance and sits slightly below 5% (4.8% in August to October). Occupation indicators will provide more information on performance here, as well as additional employment indicators such as underemployment which came in at 8.7% of workers in the stated period. With regard to job indicators, it should be recalled that the INEGI recently released the Informal Employment Rate (TIL) in line with International Labor Organization (ILO) guidelines. This indicator includes those in the informal sector (29.2% of workers) and those lacking protection who work outside the informal sector - this group of workers is vulnerable as they work outside legislation covering their jobs, either because their economic unit is not registered or because the worker is not registered. Adding both these groups together shows that in 3Q12 29.3 million people, i.e. 60.1% of those in jobs, work informally. This includes unprotected workers in agriculture, domestic service, personal micro-businesses and even low-level workers who although working for formal economic units, do so in ways so as to avoid registration with social security.

Chart 3
Retail sales and services indicator (y/y % change)



Source: BBVA Research with INEGI data

Chart 4
Informality rates: informal sector and vulnerable workers



Source: BBVA Research with INEGI data

Technical Analysis

IPC

Source: BBVA, Bancomer, Bloomberg

The IPC hit a high of 43,373pts over the week, very close to the 43,500pts resistance level. This move led to the RSI hitting levels of 73pts, signaling high over-buying for a short-term move. We believe this adjustment that started at the end of the week could continue over coming days for the support levels at 42,500pts (10-day rolling average and previous resistance) and 41,800pts (30-day rolling average). Given the over-buying, we believe the IPC is highly likely to seek out the second support level before returning to an attractive technical position.

Previous Rec. (12/10/12): If the IPC is able to break this level and hit a new all-time-high, we could consider a short-term target of 43,500pts.

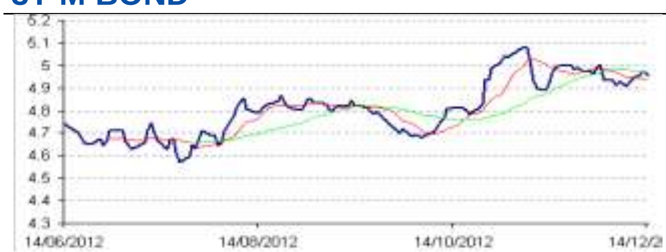
MXN

Source: BBVA, Bancomer, Bloomberg

The dollar found a floor at MXN12.70 and started a slight bounce. The 1st resistance level could be the MXN12.89 zone, followed by MXN12.95 where the 10- and 30-day rolling averages sit.

Previous Rec. (12/10/12): With the RSI already in the over-selling zone, we believe it could respect the MXN12.80 level.

3Y M BOND

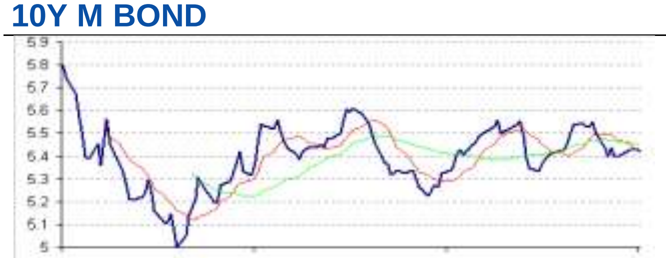


Source: BBVA, Bancomer, Bloomberg

3Y M BOND (yield): The bond bounced over the week and respected the 4.9% floor. We recommend a target of 5.1% as long as it shows no downward break.

Previous Rec. (12/10/12). We recommend holding positions while this floor remains unbroken, awaiting a bounce toward 5.1%.

10Y M BOND



Source: BBVA, Bancomer, Bloomberg

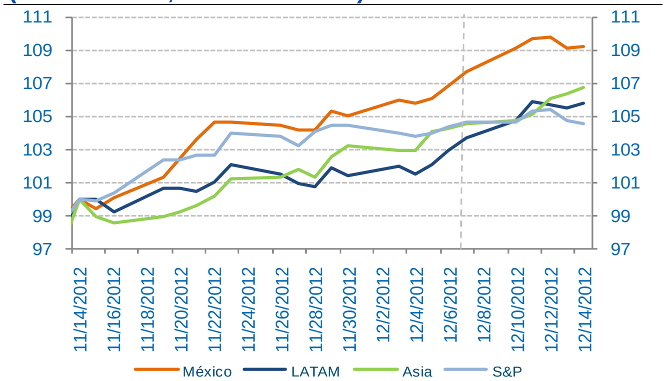
10Y M BOND: (yield): The bond remained below the 10- and 30-day rolling averages. It did not set off an entry signal.

Previous Rec. (12/3/12). Positions again to be taken when it hits 5.35%.

Markets

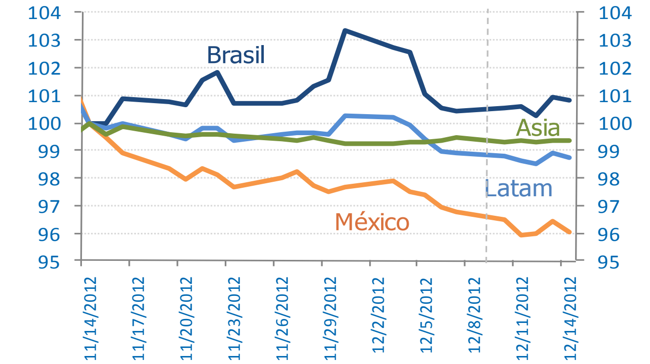
- **The lack of fiscal agreement in the US loomed over better-than-expected manufacturing output data and initial unemployment benefits claims leading to losses on stock markets at the end of the week. The peso ended the week up slightly.**

Chart 7
Stock Markets: MSCI indices (November 14, 2012 index=100)



Source: Bloomberg & BBVA Research

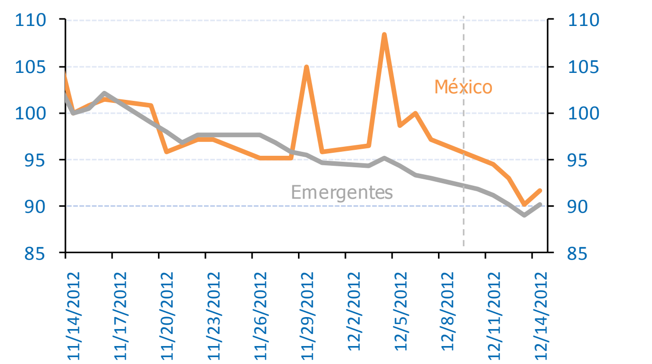
Chart 8
Foreign exchange: dollar exchange rates (November 14, 2012 index=100)



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

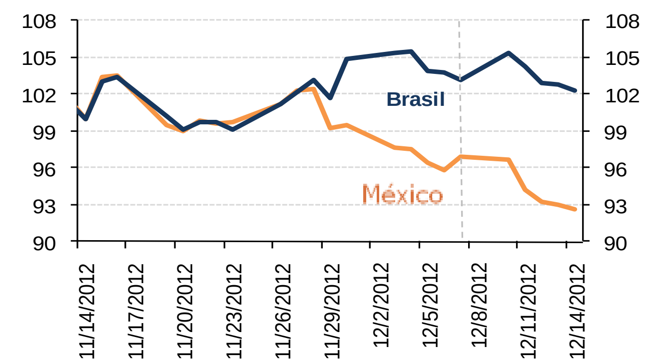
- **Slight fall in global risk aversion over the week. Stock markets remained focused on talks in the US to avoid the so-called "fiscal cliff".**

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



Source: Bloomberg & BBVA Research

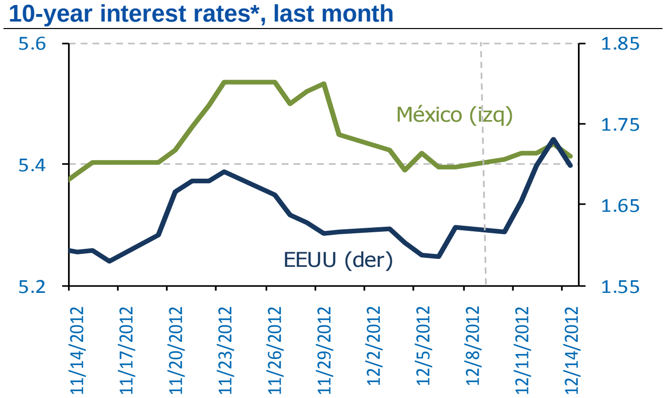
Chart 10
Risk: 5-year CDS (November 14 index=100)



Source: Bloomberg & BBVA Research

- **Increase in rates in the US after better-than-expected economic reports. The trend reversed after increased fiscal concerns in the US. Rates in Mexico rise slightly over the week.**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

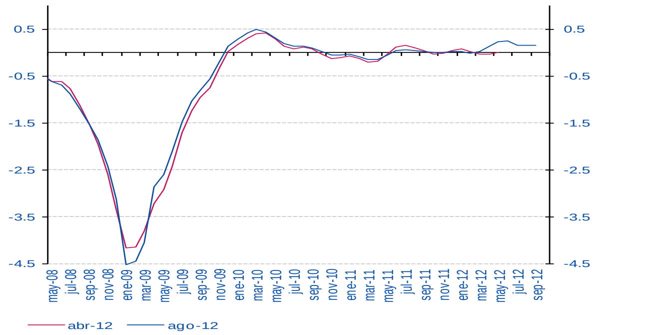
Chart 12
Carry-trade Mexico index (%)

Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

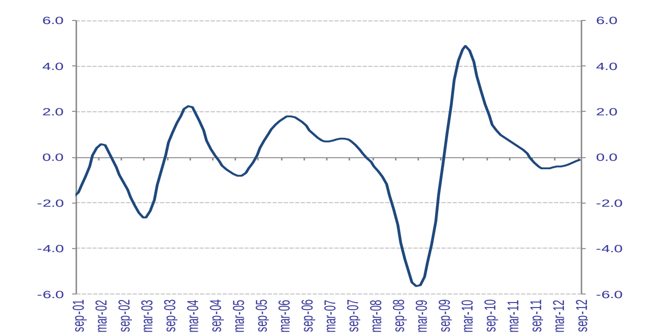
- **Output slowed in the third quarter; timely indicators from the last quarter suggest this trend will continue with a soft slowdown**

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.

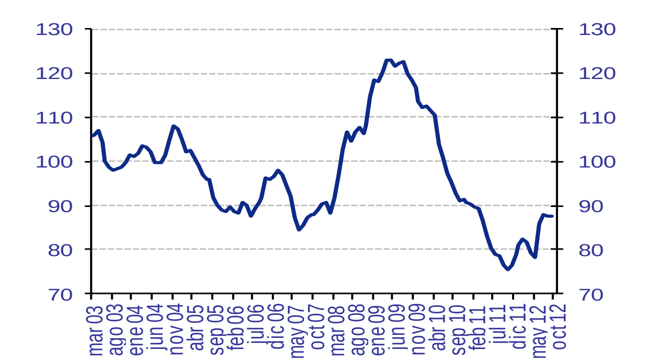
Chart 14
Advance Indicator of Activity, trend (y/y % change)



Source: INEGI

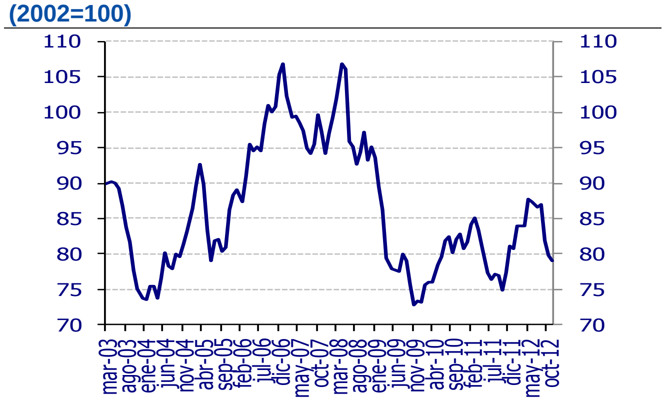
- **Both output and inflation have moderated recently.**

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.

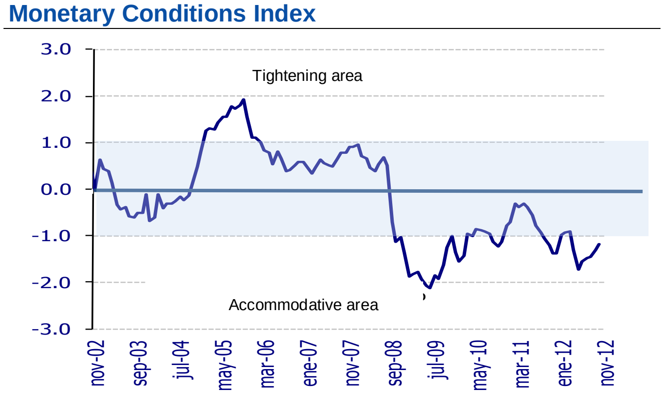
Chart 16
Activity Surprise Index (2002=100)



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.

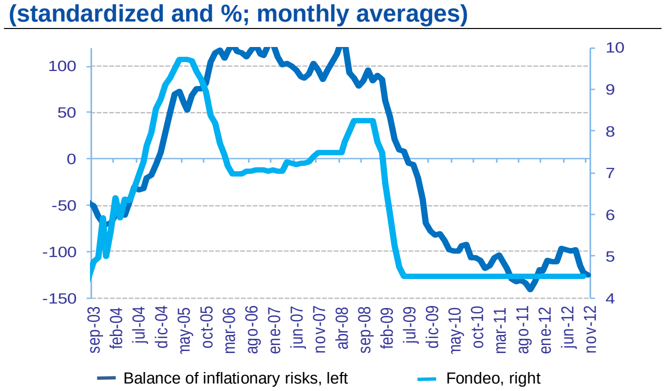
- **Monetary conditions slightly reduced their looseness after the currency gains.**

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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