Mexico Weekly Flash

Next week…

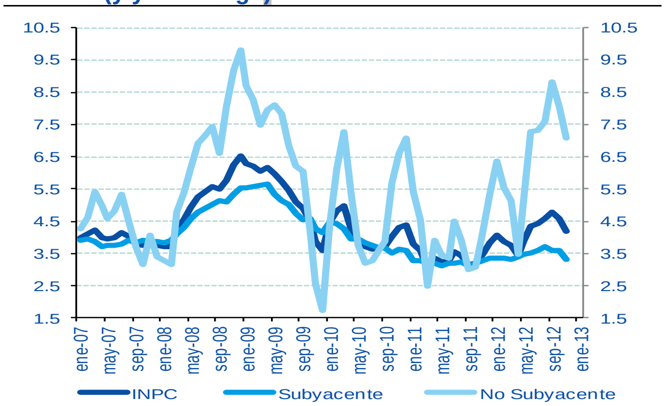
- **Inflation to end the year within the Banxico variability range.**

The inflation figures for December will be released on Wednesday. They will show that inflation was within the Central Bank's variability range. Between June and November 2012 inflation stood at above 4%. This was the result of various supply shocks mainly affecting food and energy prices. Among these shocks was an outbreak of bird flu, high cereal prices resulting from the drought in North America, high oil prices and the continuing weakness of the peso throughout the year. However, inflation fell steadily in the last quarter as a result of the weakening negative effects of these shocks and easing of prices in the service sector, where telecommunications prices (in particular cell phones) fell sharply. Core inflation actually closed below 3% thanks to these positive figures from services. Although at the start of this year it is still not possible to rule out upward risks in inflation derived from rises in agricultural prices and greater than expected increases in local public tariffs (e.g. the credit on the tax on car ownership) or further increases in cereal prices on a global scale, we consider that inflation will remain relatively in check. This will partly be the result of favorable statistical effects for much of the year, but basically because the economy is still not recovering with sufficient force for demand to impact prices, so if there are no extraordinary shocks inflation will remain within Banxico's variability range throughout the year.

- **Financial markets react positively in the wake of the legislative agreement in the U.S. to avoid the fiscal cliff and favorable employment figures**

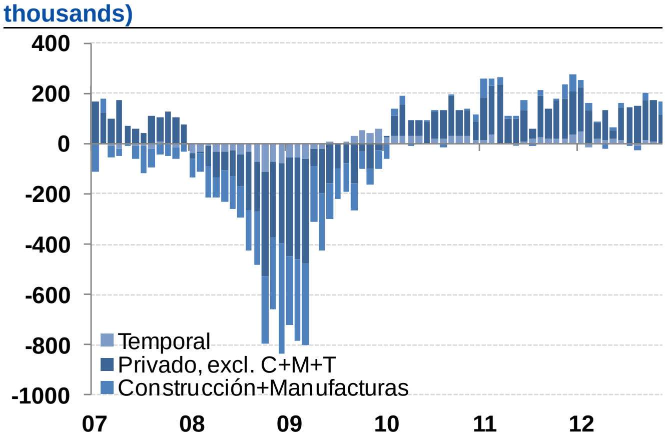
The commitment reached in Congress has, among other measures, increased some taxes on the highest incomes and postponed automatic spending cuts for two months. The reform is expected to increase tax revenues by 600 billion dollars over the next 10 years. In addition, economic data continue favorable. The December employment figures suggest that job creation continues, and that the manufacturing and housing sectors are still improving. The financial markets have responded favorably to the US economy's positive news.

Chart 1
Inflation (y/y % change)



Source: BBVA Research with INEGI data

Chart 2
US private-sector employment (monthly change in thousands)



Source: BBVA Research with Haver data

Calendar: Indicators

December inflation (January 9)

Forecast: 0.2% m/m, 3.54% y/y	Consensus: N.A.	Previous:	-0.68% m/m, 4.2% y/y

Consumer confidence in December (January 8)

Forecast: 97.4 pts, 0.5% m/m	Consensus: N.A.	Previous:	97.0 pts, 0.1% m/m

Producer confidence in December (January 8)

Forecast: 56.2 pts, 0.5% m/m	Consensus: N.A.	Previous:	55.9 pts, 0.8% m/m

Gross fixed investment, October (January 10)

Forecast: 1.1% m/m, 8.5% y/y	Consensus: N.A.	Previous:	1.1% m/m, 5.6% y/y

October IGAE (January 10)

Forecast: -0.5% m/m, 2.3% y/y	Consensus: N.A.	Previous:	0.0% m/m, 2.8% y/y

Industrial output, November (January 11)

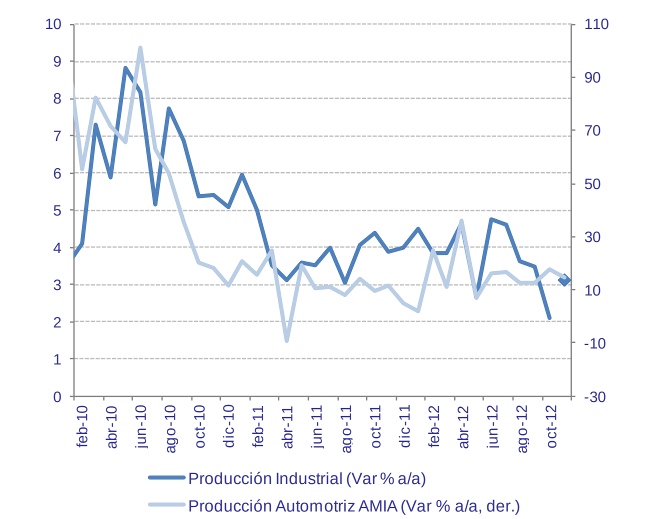
Forecast: 1.1% m/m, 3.1% y/y	Consensus: N.A.	Previous:	-0.9% m/m, 2.1% y/y

This week sees the publication of various very important indicators that will outline the position of economic activity in the last quarter of 2012. We estimate that the economy will have closed the year positively, though maintaining its moderate dynamics, in line with the trend in the export sector, which is largely linked to the US manufacturing sector. It should be recalled that the quarter began with a fall in industrial output. This was affected by the fall in manufacturing output and the construction sector. At the start of the quarter the US manufacturing sector had one of the worst falls in the year, partly related to the effects of Hurricane Sandy, which affected production in some key industrial zones in the country. Mexican automotive production increased by 0.2% in October, well below average growth to September, which stood at 1.5%.

These disappointing figures will have been offset in November, when we forecast a growth in the manufacturing sector of 1.1%. Automotive production and sales in the domestic market offer some signs that manufacturing industry has recovered ground. Automotive production as a whole in November was up 1.4% m/m, while manufacturers showed their improved opinions in practically all the trend indicators of output in November, particularly those related to domestic demand for capital goods (down 9% m/m in October, up 9.5% m/m in November), although opinions on expected foreign demand also improved (down 3.5% October, up 1.0% November). Similarly, the expected volume of orders and job levels posted one of the biggest rises of the year in the month. In the most timely data for December corresponding to confidence we expect the recovery to continue. Optimism regarding the good performance of key variables in the Mexican economy such as the manufacturing sector and private-sector formal employment should consolidate. This in turn will lead to continued improvement in consumer confidence (estimated at 0.5% m/m in December, 0.1% in November).

Chart 3

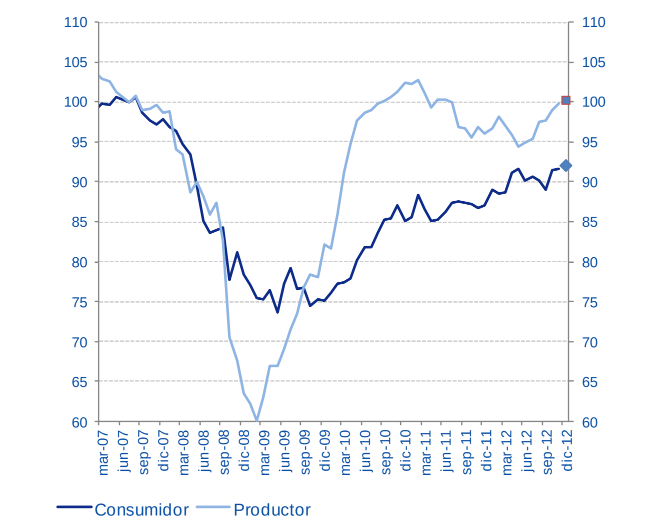
Total industrial output and automotive output (y/y % change)



Source: BBVA Research with data from INEGI and AMIA

Chart 4

Consumer and producer confidence (2007=100)

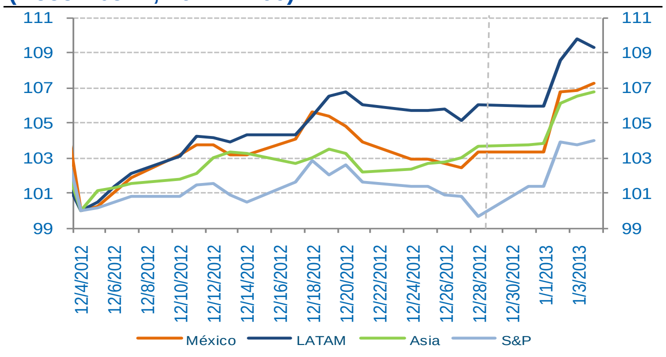


Source: BBVA Research with INEGI data

Markets, activity and inflation

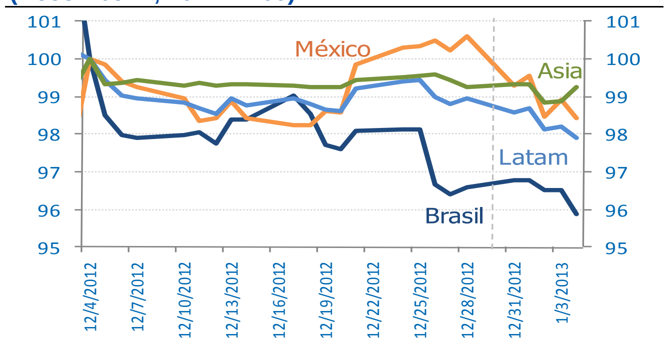
- **Though limited, the fiscal agreement reached in the U.S. generated significant rises in the stock markets and appreciations in LATAM currencies. The mention of a possible withdrawal of monetary stimuli by the FED in the minutes of the December meeting reduced the rate of gains towards the end of the week.**

Chart 7
Stock Markets: MSCI indices (December 4, 2012 = 100)



Source: Bloomberg & BBVA Research

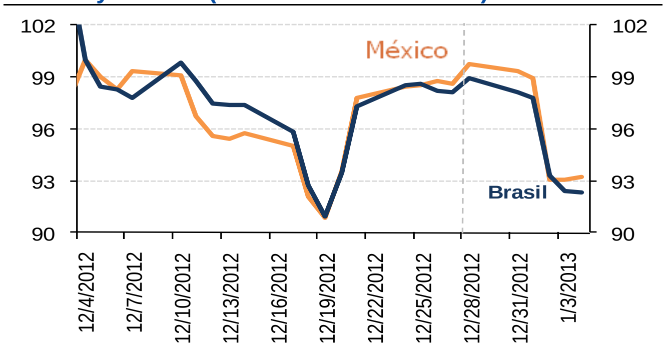
Chart 8
Foreign exchange: dollar exchange rates (December 4, 2012 = 100)



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

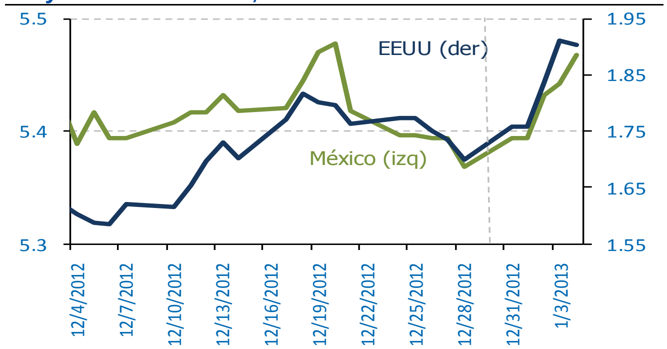
- **Appetite for risk has increased in the wake of the agreement reached in the U.S. that delays for two months the cuts in government spending programmed for the start of this year. Interest rates in the U.S. and Mexico will increase, given the greater demand for risk assets**

Chart 9
Risk: 5-year CDS (December 4 2012 = 100)



Source: Bloomberg & BBVA Research

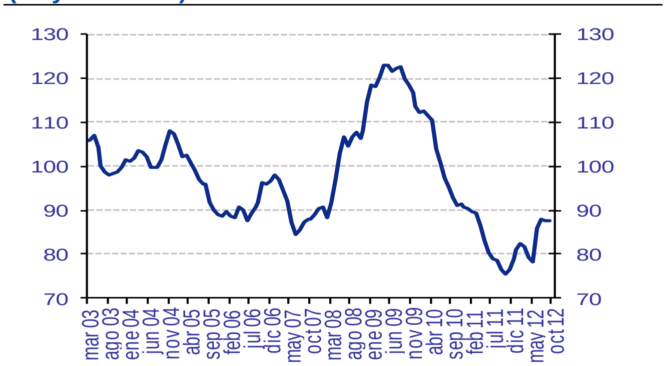
Chart 10
10-year interest rates, last month



Source: Bloomberg & BBVA Research

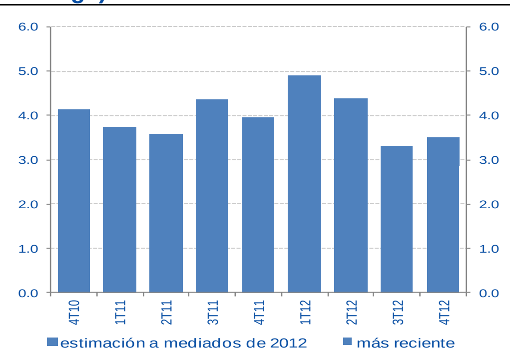
- **Increase in interest rates in the U.S. after better-than-expected economic reports. The trend reversed after increased fiscal concerns in the U.S. Rates in Mexico rise slightly over the week.**

Chart 11
Inflation Surprise Index (July 2002=100)



Source: Bloomberg & BBVA Research

Chart 12
Observed and estimated GDP (q/q % change)



Source: BBVA Research with data from Bloomberg

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