

Mexico

Weekly Watch

October 1, 2010

The week to come

Economic Analysis

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Mexico, a glimpse at the third quarter

Next week we will be wrapping up the quarter for relevant indicators, such as formal employment, manufacturing expectations and inflation. In terms of employment, sustained month-to-month growth near 0.3% has been observed, slightly below that of the first half of the year, a support for the performance of domestic spending (or, rather, the support in the face of braking of the stagnation of work revenue). As regards the indications given by the IMEF, the strong performance of the most recent export data could lead to a surprising change in an overall scenario of deceleration of activity. Thus, in 3Q10, GDP will significantly slow in annual terms and fall slightly in the quarterly rate. And, regarding inflation in September, it will confirm that the lowest rate of the year (3.7%) was registered in 3Q10, with a forecasted limited increase (4.2%) in 4Q10.

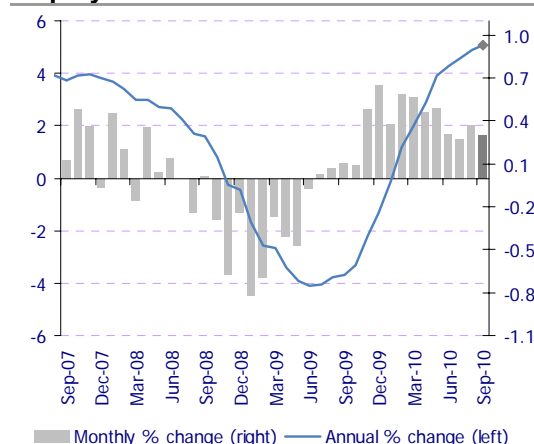
The varying approaches of the central banks are weighing on their currencies...

The Fed and the Bank of England appear to be more willing to relaunch their “quantitative easing” policy (QE2), while the ECB is underway in a gradual process of eliminating exceptional measures. In this context, the effective euro exchange rate has gone back to April 2010 levels. Could this be the ECB’s comfort level? Regarding the cycle, we have not observed any solid reason for a change in the bias of the monetary policy. Economic data from the euro zone suggested that the recovery is maintained in Q3, though it is far from the impressive quarterly GDP growth seen in the previous quarter. Furthermore, data released in the US this week has been somewhat disappointing: consumer confidence fell significantly in September; ISM manufacturing dropped from 56.3 to 54.4 in the same month. All eyes will be on the employment data next week.

...such that speculation over the monetary measures in the US implied a slight increase in the appetite for assets in Mexico

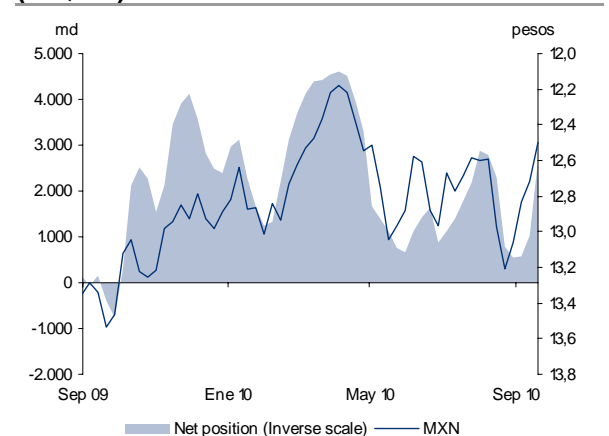
As speculation over US monetary actions continues, we expect the peso to keep fluctuating between 12.5 and 12.65 ppp. We should point out the weekly increase in the long positions in pesos in CME, the greatest since October 2009, as well as the slight increase in volatility. As for long-term bonds, the situation caused a continuation of the rally for 10-year terms. Over the coming days we expect to see a scenario with lateral movements in these bonds. For equity, we expect that the start of the reporting period will function as an element of support.

Chart 1
Mexico, formal private-sector employment



Source: BBVA Research and INEGI

Chart 2
MXN: Long Non-Trading Positions in CME (US\$mn)



Source: BBVA Research with Bloomberg data

Economic Analysis

Calendar: Indicators

September Inflation

Thursday, October 7: 0.53% mom (3.7% yoy) Consensus: 0.59% mom Previous: 0.22% mom (3.68% yoy)

For September, we expect a slight increase in overall inflation, after a lower-than-expected first two weeks. Core inflation will rise 0.37% mom, the equivalent of 3.61% yoy. This good performance of core inflation is primarily due to the weakness of internal demand and exchange stability, and the favorable performance of prices for education and food is the cornerstone of the component's slowdown in September. While the favorable performance we expect for inflation is not free of risks, like a potential reversal of the favorable cycle of agricultural products and, possible supply shocks under the other services heading resulting from the situation of Mexico's aeronautical industry, the risk balance is equilibrated. Therefore, we maintain our prediction for the year to close around 4.6%.

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The dynamics of foreign demand contribute by supporting employment and the manufacturing IMEF indicator in September

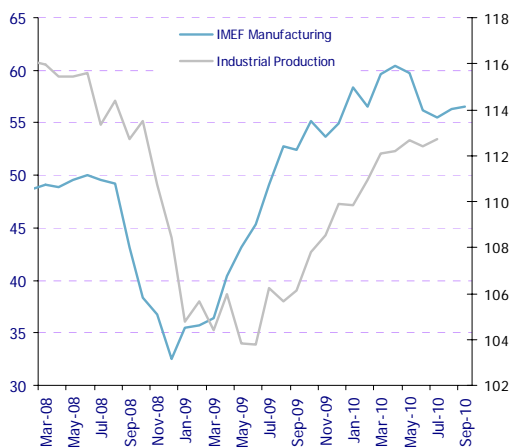
Employment: throughout the week: 0.3% mom (5.1% yoy), Consensus: N/A. mom Previous: 0.4% mom (4.9% yoy)

IMEF: Monday, October 4: 56.6 pts Consensus: NA Previous: 56.3 pts

Formal private-sector employment will continue to slow towards the halfway point of the third quarter. Specifically, we estimate a monthly variation of around 0.3% (5.1% yoy), the equivalent of nearly 536 thousand formal jobs more than in the last month of 2009. Though employment attached to the IMSS is recovering consistently, the other component of the wage bill, the primary determining factor of private consumption and, with that, domestic demand, are maintained at low levels and even negative rates of yearly change.

The IMEF indicator will continue well over 50 points but with a trend towards moderation. This is accompanied by the industrial dynamic and is closely linked to the export sector. Keep in mind that manufacturing exports have maintained their growth of nearly 25% yoy in the last quarter and enjoy a strong dynamic in monthly terms as well. We calculate that the IMEF indicator will be situated at 56.6 points, which will imply a half-point increase as compared to the previous report.

Chart 3
IMEF Manufacturing index and industrial production (2003 index=100 and pts)



Source: BBVA Research with IMEF and INEGI data

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Markets

Possible “quantitative easing” of the Fed of the US implies that the peso fluctuates between 12.5 and 12.65 ppd. The greatest weekly increase since October 2009 was recorded in the long speculative peso position in Chicago

In the event the central banks of the US and UK relaunch their "quantitative easing" policy, the peso remained within a 12.50-12.65 range, which we expect to continue in the short term. There are two positioning elements that justify this: First, September 28 data shows a 157% increase in the long speculative peso position in Chicago, the greatest weekly increase since mid October 2009. Thus, the position is again at the levels reached in mid August (US\$2.6mm), and though it is far from the maximums reached in April (US\$4.6mm) the movement appeared with a displacement of the peso to the 12.20 zone. Second, the implied volatility registered a weekly increase of 0.2 vegas (the weekly increase of the VIX was 3.6%), but is still below the average for the last 6 months (11.1% vs. 14.3%).

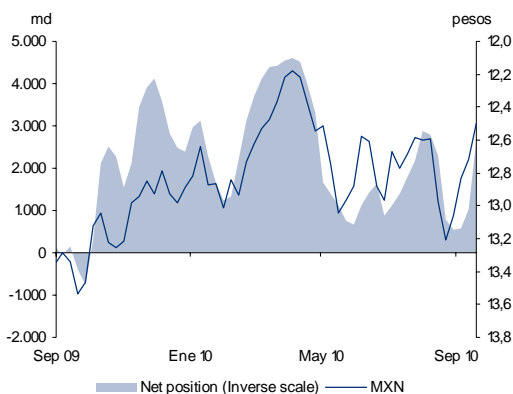
Profit-taking in the international debt curves correct the rally recorded throughout the week.

On Friday, the flattening of the curve recorded in the week reversed almost completely. They increased by 10 and 12 bp in 10 and 20 years, respectively. This adverse adjustment in the volatility of the Bonds gave rise to a greater appetite for long positions on the curve *Swap*. In general, the international debt markets resented the profit-taking driven by the publication of positive economic data in Asia, and a decreased appetite by *Treasuries* on behalf of investors in this region, who have, until now, lead the *bullish* aspect of the curves. The context of the level and slope of the domestic curve has not changed; we expect the curve to continue to register lateral movements with a resistance at levels of 6.3% for the 10-year and support at 6.0%.

Capital market in Mexico with better performance than in developed countries, but with greater weakness in Latam. Results season in Mexico as support

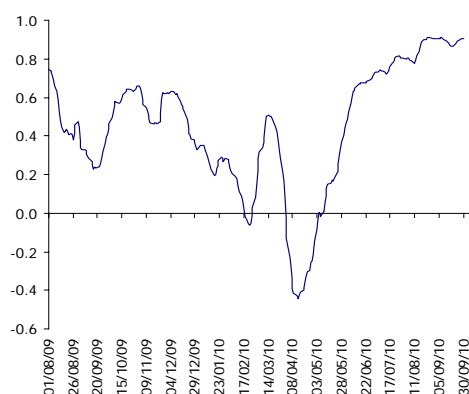
The region has continued to differentiate itself positively among the global stock exchanges; though Mexico has exceeded the indices of developed countries, its performance has been weak in the region. As regards the weeks to come, and having concluded the quarter, the focus will be on the results period. We expect the reports to be a support element; nevertheless, we expect modest results in year-on-year terms for the third quarter due to its elevated basis for comparison. For Mexico, we expect the growth rates of 5.4% in sales, 7.0% in EBTIDA and 7.3% in net profit; while for the US, the consensus expects 9.15% in sales and 23.3% in EPS, with ALCOA being the most relevant report on Thursday of this week.

Chart 4
MXN: Long Non-Trading Positions in CME (US\$mn)



Source: BBVA Research with Bloomberg data

Chart 5
Rolling correlation between Mexican and US 10-year Bonds (mp 2 months)



Source: BBVA Research with Bloomberg data

Technical Analysis

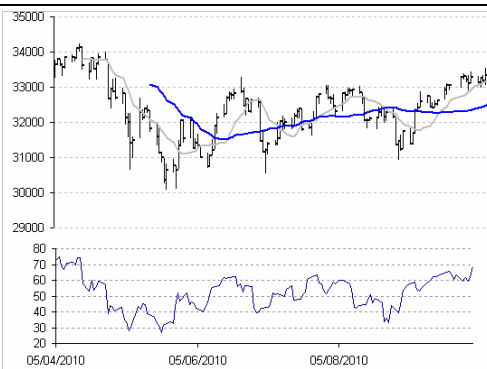
Market Analysis Equity

Technical Analysis

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CPI

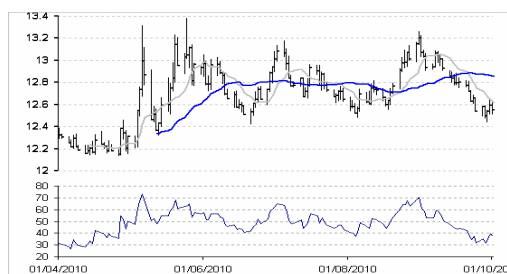


Source: BBVA Bancomer, Bloomberg

CPI: The CPI closes the week with a significant upward movement that breaks the lateral formation of the previous sessions and that keeps our perspective for a return to the 34,000/34,200pts zone current. The 33,400 pts level is once again a short-term support.

Previous record: After this break, the next objective short-term level is at the 34,000/34,200 pts zone, a positive prospect maintained as long as it continues to operate above the aforementioned support.

MXN

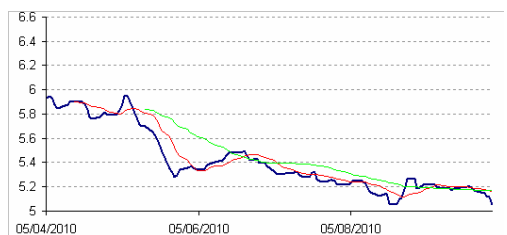


Source: BBVA Bancomer, Bloomberg

MXN: Respect for the P\$12.50 support level during the week, attempting a rebound. This has not had the forces needed to be placed above the moving 10-day average, which maintains the latent risk of breaking P\$12.50 in search of the following steps in P\$12.37 and \$12.20.

Previous record: The next support is at P\$12.50, where the most recent rebound occurred.

3-YEAR M BOND

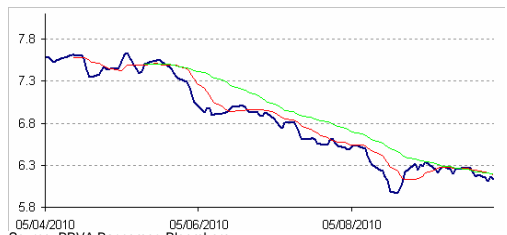


Source: BBVA Bancomer, Bloomberg

3-YEAR M BOND: (yield): The downward trend is resumed, with a return to the 5.10 zone. The failed attempt to upturn the 10- and 30-day moving averages maintain the negative trend in the short term.

Previous record: There is still a chance of returning to 5.10.

10-YEAR M BOND



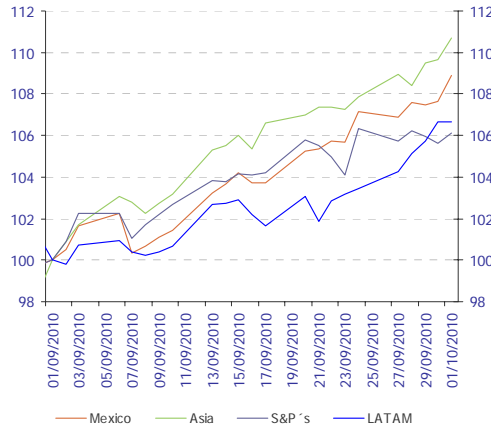
Source: BBVA Research with Bloomberg data

10-YEAR M BOND (performance): It remains below the 10-day and 30-day moving averages, which keeps the negative trend and risk of returning to the 6.0 zone current.

Previous record: 10 YEAR M BOND: (performance): Continues to be below rolling averages of 10 and 30 days, with a possibility of returning to 6.0.

Markets

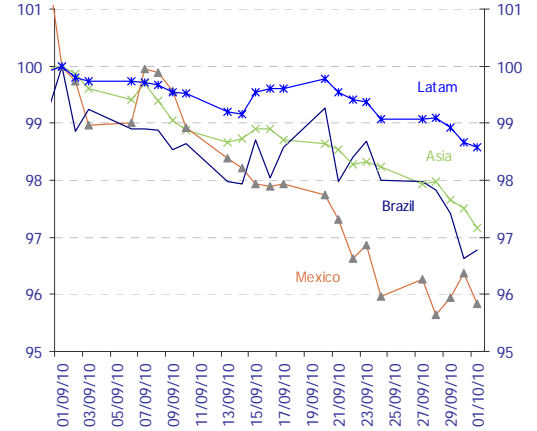
Chart 6
Stock Market: MSCI indexes (September 1, 2010 index = 100)



The positive differentiation of the peso with respect to other emerging currencies intensifies.

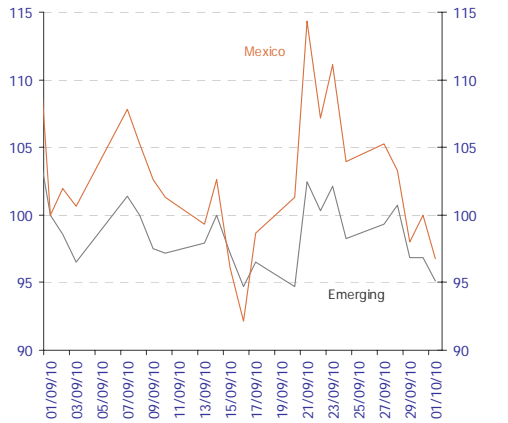
Source: Bloomberg and BBVA Research

Chart 7
Foreign exchange: dollar exchange rates (September 1, 2010 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.

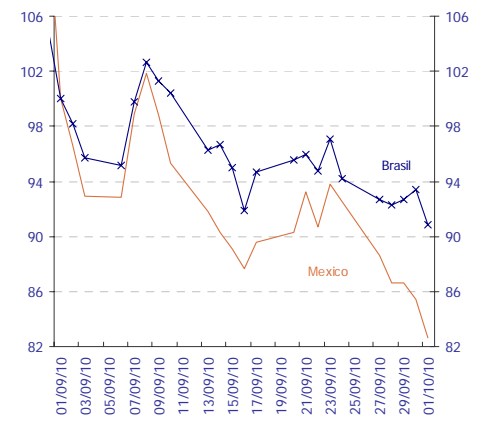
Chart 8
Risk: EMBI+ (September 1, 2010 index = 100)



The Mexico country risk drops more than other emerging countries.

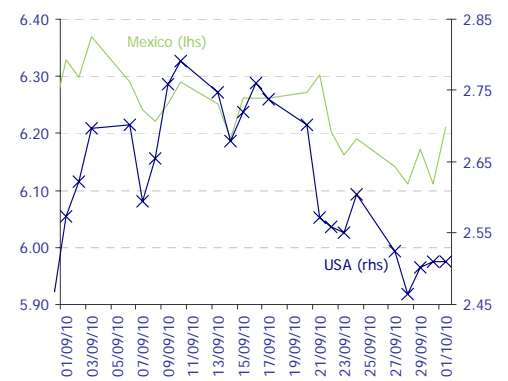
Source: Bloomberg and BBVA Research.

Chart 9
Risk: 5-year CDS (September 1, 2010 index = 100)



Source: Bloomberg and BBVA Research.

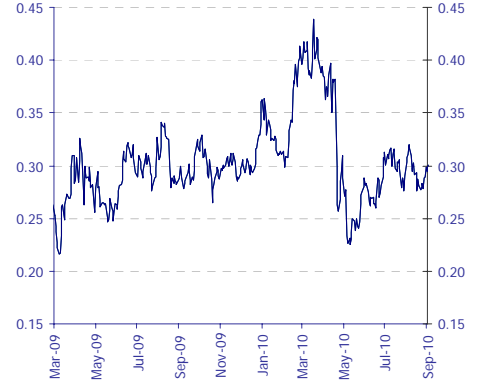
Chart 10
10-year interest rates*, last month



The rally continues in the long part of the curve with a rebound at the closing of the week.

Source: Bloomberg and BBVA Research

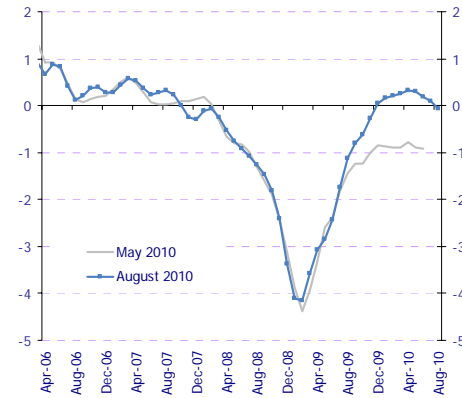
Chart 11
Mexico carry-trade index (%)



Source: Bloomberg and BBVA Research

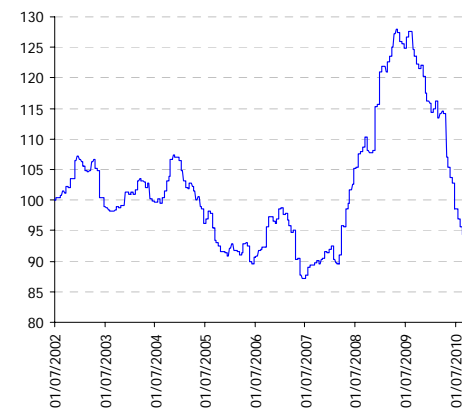
Economic activity, inflation, monetary conditions

Chart 12
Economic Cycle Indicator (standardized)



Source: BBVA Research with data from INEGI, AMIA and BEA. The weighted sum of 21 different indicators of economic activity, spending and expectations based on trend series.

Chart 14
Index of Inflationary Surprises (July 2002=100)



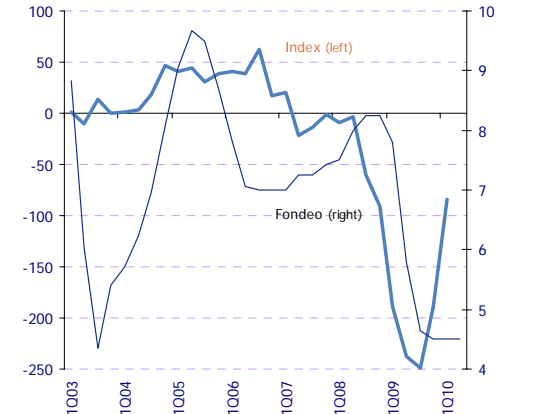
Source: BBVA Research, with data from Banxico on the monthly surveys of expectations of specialists in the private-sector economy.

Chart 16
Index of monetary conditions



Source: BBVA Research

Chart 13
Indicator of inflationary demand pressures and bank lending rates (standardized index & %)



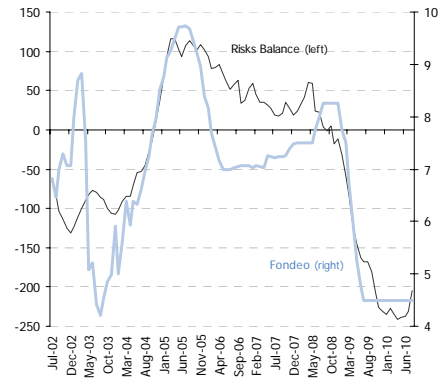
Source: BBVA Research and Banxico

Chart 15
Index of Economic Activity Surprises (2002=100)



Source: BBVA Research with Bloomberg data. Difference between the registered data and the Bloomberg consensus for seven variables of economic activity in Mexico. Standardized index. Rises (falls): positive (negative) surprises.

Chart 17
Balance of Inflationary Risks* and Lending Rates (standardized and %; monthly averages)



Source: BBVA Research. * Standardized and weighted index (between inflation and economic growth); it uses economic indicators of economic activity and inflation. A rise in the IBR points to a greater weight of inflationary risks compared to growth and thus a greater possibility of monetary restriction.

The Mexican economy is in better shape than a few months ago, but the monthly rate of recovery appears to be slowing.

Compared with the consensus, inflationary surprises are still downward

Monetary conditions are accommodative. No rush to raise monetary rates; no need to lower them

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