

Weekly Watch

Mexico

Next week...

January 6, 2012

Economic Analysis

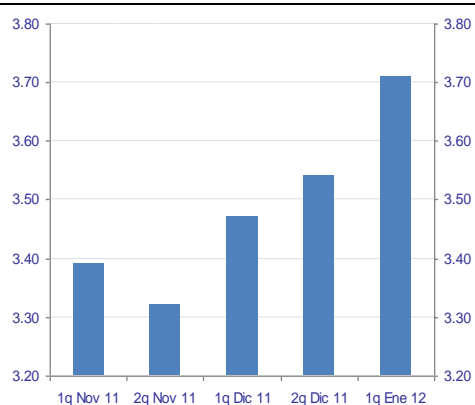
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Output and price data from the last months of 2011 will contribute to specify forecasts and risks for the first months of 2012

Inflation in the second two weeks of December will make a difference to see if inflation is speeding up. Analysts believe inflation in December will come in at 3.7%, a higher-than-expected figure than in November (chart 1). Nonetheless, the inflationary balance for the year is positive since the core component should come in around 3.3% and headline inflation will remain within the central bank's target range. In turn, industrial output for November will provide further information on the economy's good status. These two variables will provide important information on forecasts and risks for the Mexican economy in the coming months. Recent above-expectations output and employment data from the US lead us to believe that output in Mexico could remain on its favorable path.

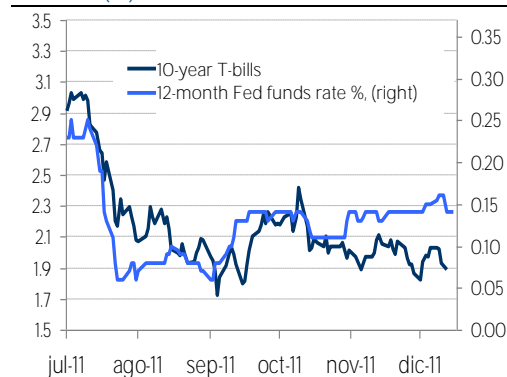
Further, the Fed has continued to improve its communication strategy. This week it announced it will publish forecasts on the target interest rate for Fed funds as part of its economic forecast summary, a long-term level and the period of the first rise in the target rise given its forecasts on future economic conditions. The forecast on the Fed fund rate has been very important for the performance of the interest rate for Treasury securities (chart 2). The announced measure aims to increase transparency around Federal Open Market Committee forecasts (FOMC) and reduce uncertainty on financial markets.

Chart 1
Annual inflation forecast December 2011 by date



Source: Financial Market Analysts' Forecast Survey - Banamex.

Chart 2
10-year T-bills and 12-month Fed funds rate forecast (%)



Source: BBVA Research

Calendar: Indicators

Inflation for December (Monday, January 9)

Forecast:	Consensus:	Previous:
0.71% (3.7% y/y)	0.72%	1.1% m/m (3.48% y/y)

Inflation for end of 2011 will be released on Monday, January 9. We forecast it will come in at 3.7% due to the growth seen in the last 3 months for different prices in the non-core component such as electricity prices, livestock products and to a lesser degree, agricultural prices. The yearly inflationary balance is positive since the core component will end around 3.3%, slightly above the end of 2010, and shows that despite the different external shocks such as the high commodity prices and the financial crisis which has had a major effect on the exchange rate, core prices in Mexico did not increase. Despite this, the balance of inflationary risks has gone from benign to, in the best scenario, neutral. This is the result of the reigning uncertainty surrounding a solution to the European crisis and the economic situation in the US which has led to a lower peso, high commodity prices on international markets and the potential effects that specific domestic supply shocks would have, such as that seen on the corn market. These elements could cause temporary swings in short-term inflation although fundamental factors are expected to continue to act as anchors, such as salaries which are seeing slow growth, and avoid demand pressures on prices.

Industrial Output in November (Wednesday, January 11)

Forecast:	Consensus:	Previous:
0.3% (3.0% y/y)	N/A	-0.5% m/m (3.3% y/y)

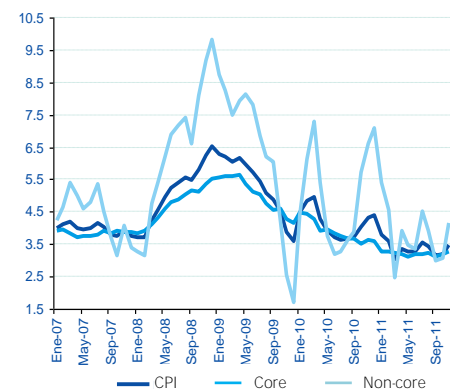
Industrial output data for November, to be released this Wednesday, may provide more information on the good performance of the economy, supported by the good economic performance in the US. It should be stated that industrial output in Mexico has seen almost continuous growth over the last 7 months, specifically in November, with nearly 80% of domestic automotive production being sent overseas and seeing 0.4% growth over the previous month. In this sense, producer confidence indicators for November also point to some improvement in sentiment (the confidence indicator for November saw 1.2% growth after five months of continuous declines). Taking the pulse of the construction industry will be especially important as an indicator of domestic demand.

Economic Analysis

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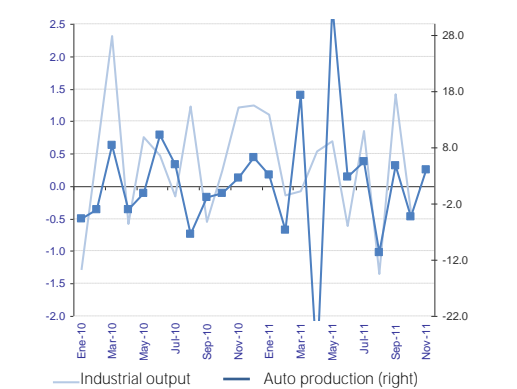
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Chart 3
Annual inflation and components (m/m % change)



Source: BBVA Research with INEGI data

Chart 4
Industrial Output and Automotive Industry (% change m/m)

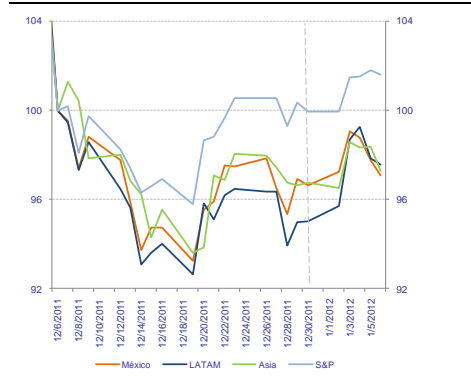


Source: BBVA Research with AMIA and INEGI data

Markets

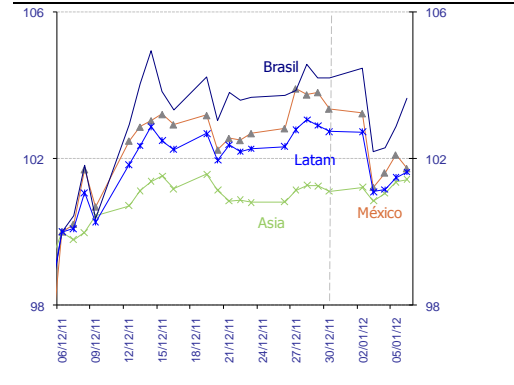
Rises on stock markets influenced by US manufacturing and jobs data coming in above expectations. However, they fell toward the end of the week due to lower-than-consensus German manufacturing output data. Over-riding upward movement in the peso.

Chart 5
Stock Markets: MSCI Indices
(Dec 6, 2011 index = 100)



Source: Bloomberg & BBVA Research

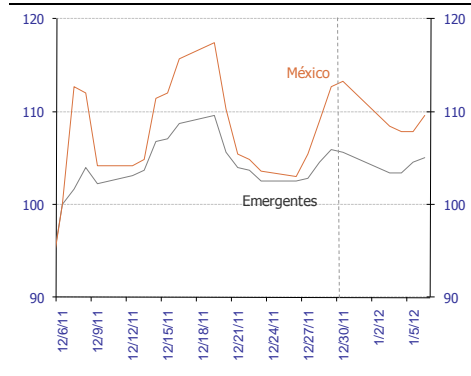
Chart 6
Foreign exchange: dollar exchange rates
(Dec 6, 2011 index = 100)



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

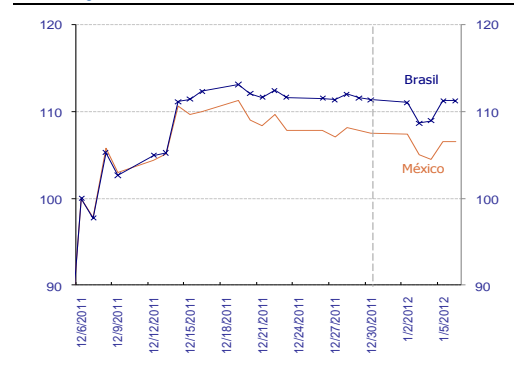
Slight fall in risk aversion over the week

Chart 7
Risk: EMBI+ (December 6, 2011 index=100)



Source: Bloomberg & BBVA Research

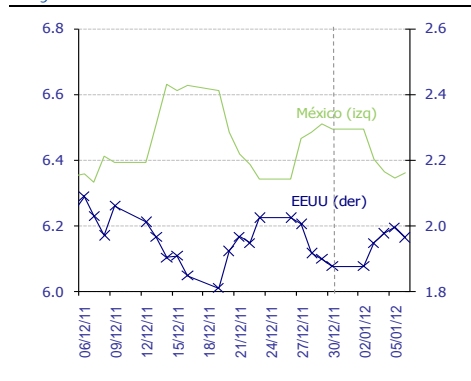
Chart 8
Risk: 5-year CDS (Dec 6, 2011 index=100)



Source: Bloomberg & BBVA Research

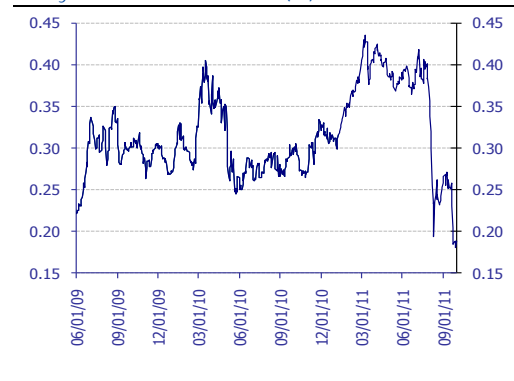
Increase in Mexico and US interest rates thanks to optimism from higher-than-expected US figures

Chart 9
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 10
Carry-trade Mexico index (%)



Source: BBVA Research with data from Bloomberg

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