

Mexico Weekly Flash

Next week...

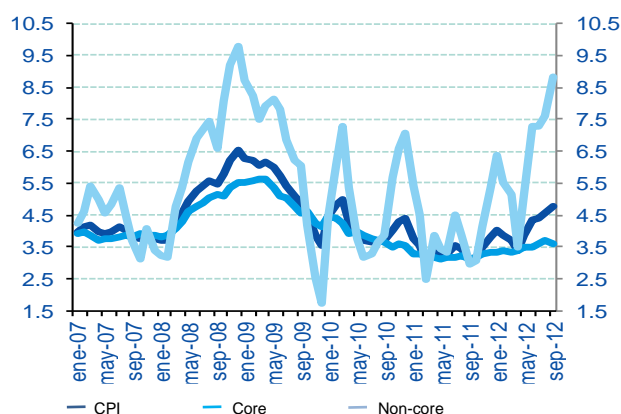
- **Banxico set to release its inflation report setting out its forecasts in a scenario with above-target inflation for over 4 months.**

The Bank of Mexico will publish its quarterly inflation report on November 7. It will be important to focus on the inflation forecasts and assessment the central bank makes of the knock-on effects of the recent inflation upswing. With recent higher prices leading to headline inflation of 4.7% y/y in September and ongoing supply shocks, inflation forecasts are likely to move slightly higher for next year. Despite these forecasts being shown in fan charts, their spread and trend point to the central bank outlook. With regard to knock-on effects, we need to focus on possible reasoning on price pressures due to salary rises and the possible effects of inflation remaining above 4.0% for a prolonged period. This becomes especially important after the last monetary policy decision statement where the central bank took a more restrictive tone.

- **Caution on markets despite surprise higher figures in economic indicators**

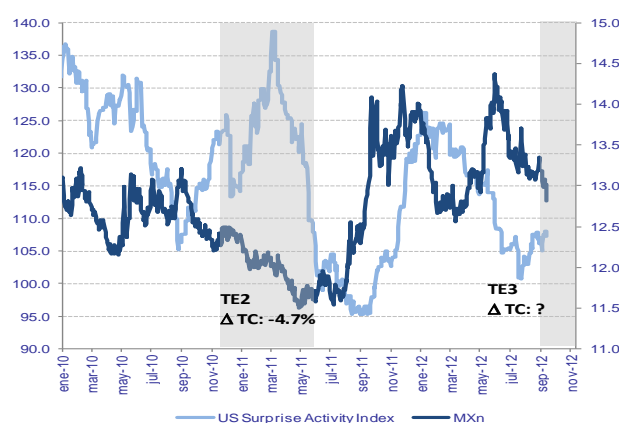
Although on balance, the flow of economic data and corporate reports were above forecasts on a global level in a week where, in addition to news from the EMU being neutral, markets maintained a certain bias for risk aversion. The MXN remained above the 13.0 level while the MBonds curve moved up, a move more marked in medium maturities on the curve (e.g. the 10Y/2Y curve flattened around 5bp). This, in our opinion, shows a market remaining cautious before the US elections and, especially, the fiscal debate toward the end of the year. Given the potential impact on the US economy being high, investors prefer to remain without directional positions in risk assets. In this way, we believe the trend should continue to be consolidation with a negative bias. Toward the end of next week, focus will be on events in European, with the ministers meeting likely to be brought forward to November 8.

Chart 1
Inflation Breakdown (% change y/y)



Source: BBVA Research with INEGI data

Chart 2
Surprise index for US output and peso dollar (Index and pesos per dollar)



Source: BBVA Research and Bloomberg

Calendar: Indicators

October Inflation (October 24)

Forecast: 0.57% m/m (4.67% y/y)	Consensus: 0.55% (4.64%)	Previous: -0.44% m/m, (4.77% y/y)
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Inflation for October will be released next week. We estimate it should start to come down after hitting 4.8% in September. This decrease in consumer prices is due to pressure linked to the outbreak of bird flu starting to decline, a lower seasonal increase in electricity rates thanks to the new CFE billing plan and a slight decline in prices for some agricultural products. We estimate non-core inflation to increase 0.24% m/m, meaning our estimate remains very near 3.6% y/y. Although the result for October is set to be relatively positive due to inflation starting to ease, we believe the intensity of supply shocks having hit will lead to inflation remaining above 4% for a few more months, ending the year around 4%. In addition, we cannot rule out new pressures from the livestock subindex whether due to higher fruit and vegetable prices or higher livestock product prices given the high global grain prices.

Consumer Confidence in October (November 5)

Forecast: -0.1% m/m (0.5% y/y)	Consensus: N.A.	Previous: -1.5% m/m, (1.5% y/y)
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Producer Confidence in October (November 5)

Forecast: -0.1% m/m (1.9% y/y)	Consensus: N.A.	Previous: -0.1% m/m, (0.9% y/y)
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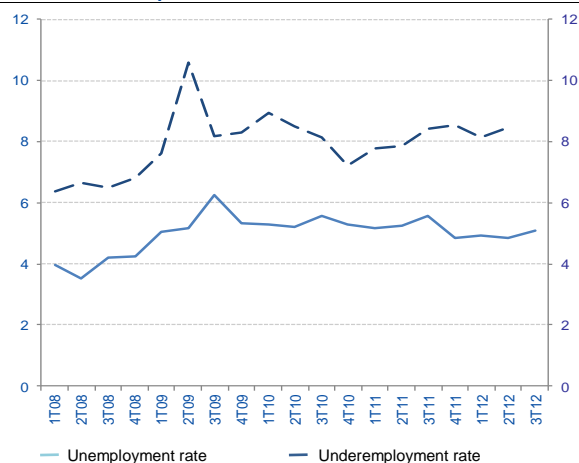
Unemployment Rate in 3Q12 (November 8)

Forecast: 5.1% of EAP	Consensus: N.A.	Previous: 4.8%
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The performance in producer and consumer confidence indicators for October will be released this week. Although growth continued to be good in recent months, domestic demand, supply, manufacturing output and construction indicators clearly point to a slower economy in the third quarter; confidence indicators will be the first outlook data for the fourth quarter and we expect said slowdown to have continued. Up to September, manufacturers' outlook worsened on whether it is a good time to invest, with 42% of those surveyed replying positively, in contrast to 44% a month earlier. In this way, the IMEF indicator (manufacturing producers) highlights a major decline in September, from 53.8% on average in the three previous months to 50 points in September, in line with the decline in industrial output and manufacturing export indicators. In turn, the consumer confidence indicator showed contractions in September across all sub-components. The subindex linked to the possibility of acquiring a durable good stands out, seeing a contraction for the second month in a row and being in line with the expected decline in private consumer spending.

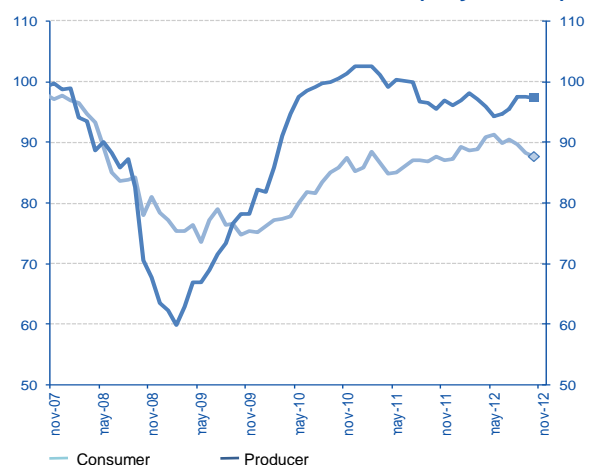
Details on the job market in the third quarter will also be important this week. It should be stated that the unemployment rate, as well as supplementary indicators such as underemployment and employment in critical conditions, have remained high since the start of the recovery. The performance in wages in real terms will be especially important, having been negative in yearly-change terms since 2008.

Chart 3
Unemployment and underemployment rate (as % of the EAP)



Source: BBVA Research with INEGI figures

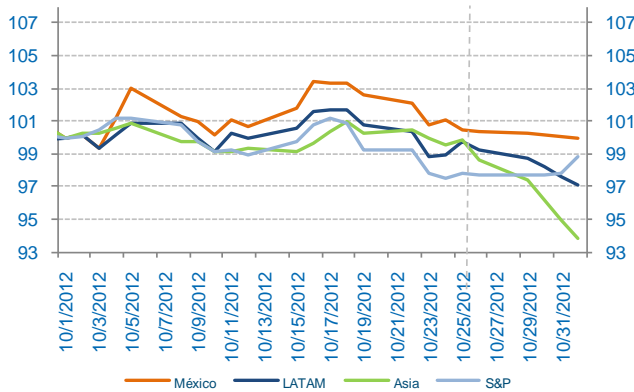
Chart 4
Confidence: Consumer and Producer (July 07=100)



Markets

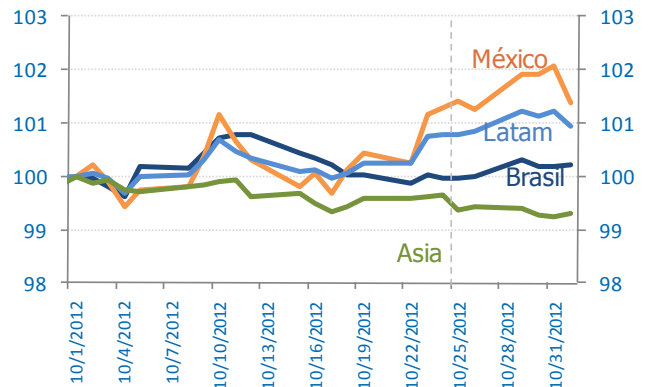
- Despite corporate reports being in line with expectations, caution prevailed in the face of uncertainty surrounding conditions in the US and Europe. Above-forecast US jobs figures strengthened the peso at the end of the week.

Chart 7
Stock Markets: MSCI Indices
 (October 01, 2012 index=100)



Source: Bloomberg & BBVA Research

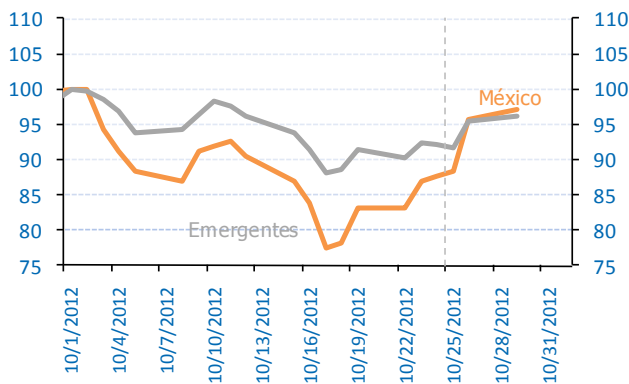
Chart 8
Foreign exchange: dollar exchange rates
 (October 01, 2012 index=100)



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

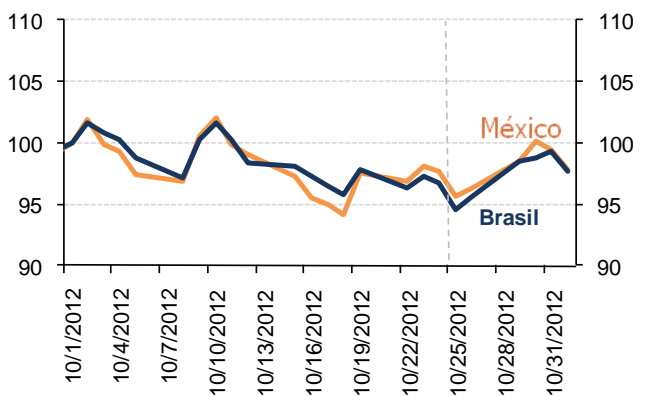
- Risk aversion remains reflecting caution before the US elections and uncertainty surrounding the fiscal debate in the US Congress toward the end of the year

Chart 9
Risk: EMBI+ (October 01, 2012 index=100)



Source: Bloomberg & BBVA Research

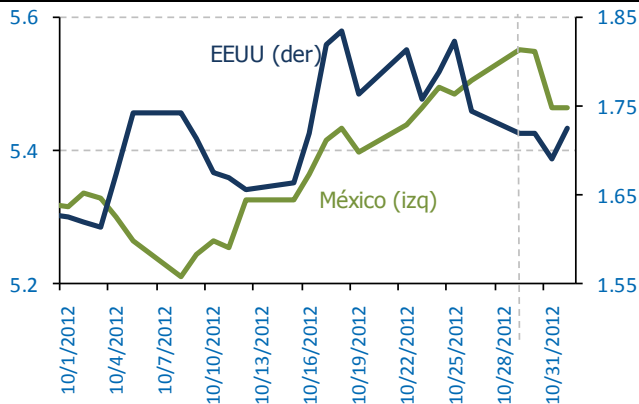
Chart 10
Risk: 5-year CDS (October 01, 2012 index=100)



Source: Bloomberg & BBVA Research

- Fall in US rates due to persistent risk aversion and uncertainty surrounding the election there.

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

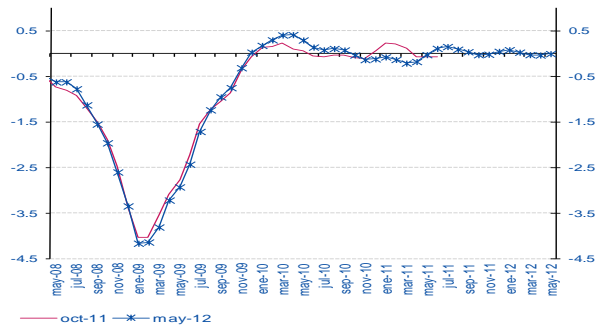


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

- Output holds positive albeit moderate performance, situation indicators point to 3Q12 with quarterly rates above 0.5%.

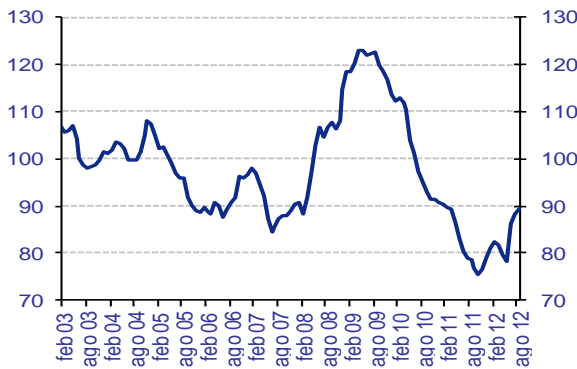
Chart 13
BBVA Research Synthetic Activity Indicator for the Mexican economy



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.

- Recently we have seen upward surprises in inflation and output.

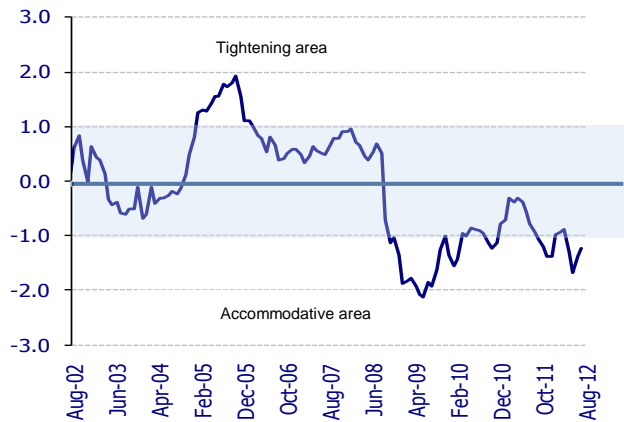
Chart 15
Inflation Surprise Index (July 2002=100)



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

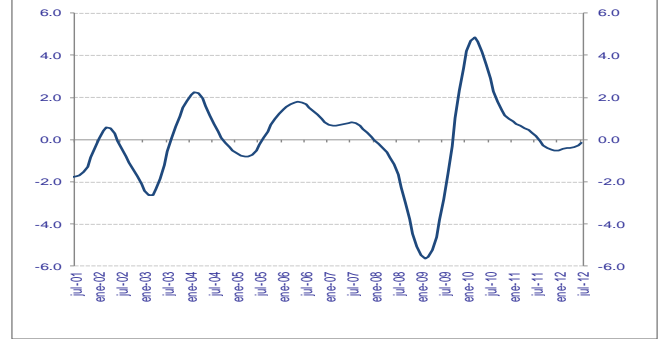
- Monetary conditions slightly reduced their looseness after currency appreciation.

Chart 17
Monetary Conditions Index



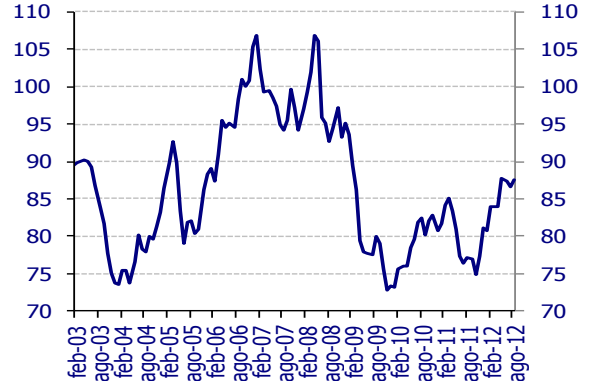
Source: BBVA Research

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



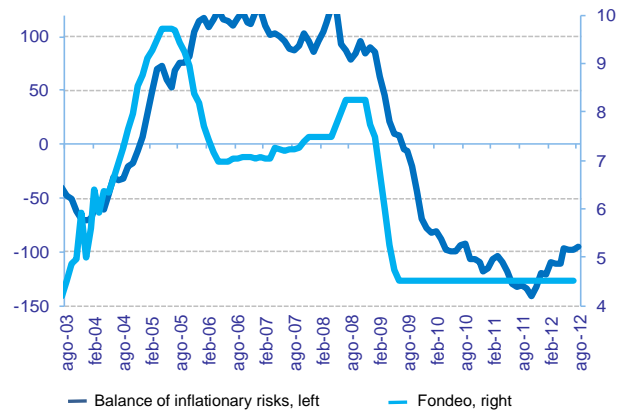
Source: INEGI

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.

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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