Mexico Weekly Flash

Next week…

- **GDP in 4Q12 set to see a similar growth rate to 3Q meaning the Mexican economy expanded around 4% y/y in 2012**

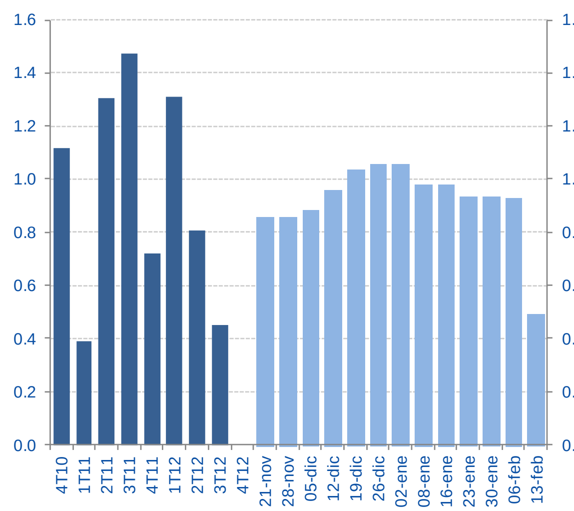
This week will be busy for output indicators for the end of 2012. Firstly, GDP for 4Q output will be released on Monday 18 and we forecast it coming in around 0.5% for the quarter (3.1% annual) making average growth for the year of 3.9%. The MICA-BBVA model including output and financial situation data saw a major drop for the quarterly GDP forecast after the release of industrial output figures for December showed a surprise decline linked to a drop in manufacturing output in the automotive and metals industries as well as a contraction in the construction industry.

Indicators for 1Q13 are still in short supply: confidence (producer and consumer), automotive production (Source: AMIA) and US industrial output. Although indicators are mixed, the slowdown in output looks likely to continue. The performance in US manufacturing points to this (-)0.1% m/m affected by lower manufacturer demand especially for durable goods - an item impacting domestic manufacturing. In turn, the general trend is for a drop in both producer and consumer forecasts. With regard to domestic automotive production, the decline in December was likely a temporary one since there was a major upturn in January: from (-)9.5% m/m to 6% m/m in January (8.3% at annual rate, seasonally-adjusted).

- **Impact of potential Banxico cut on local assets**

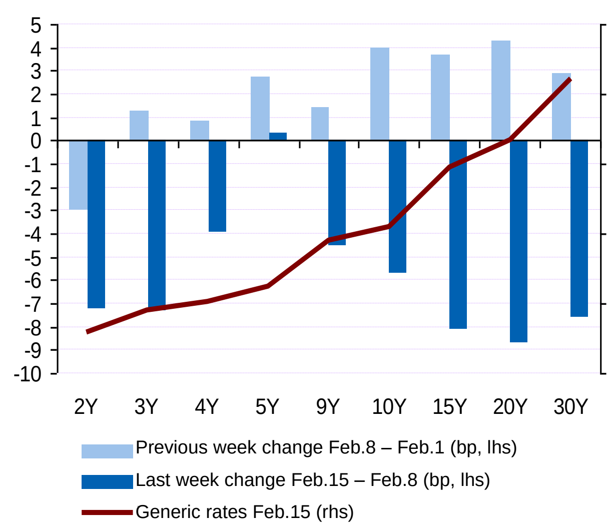
The short sections are already discounting a 25bp-50bp cut. Banxico will undoubtedly maintain the new rate level for a prolonged period. The central bank's position and current constructive domestic context should continue to favor a flattening-out in the long section compared to the middle toward 80bp. In turn, a rate cut should limit the short-term MXN appreciation margin to 12.60.

Chart 1
MICA-BBVA Indicator, GDP estimate q/q for 4Q12



Source: BBVA Research with INEGI, STPS and Bloomberg data

Chart 2
Mexico: MBond Curve (% and bp, generic)



Source: BBVA Research and Bloomberg

Calendar: Indicators

GDP in 4Q12 (February 18)

Forecast: 0.5% q/q (3.1% y/y)	Consensus: 0.6% q/q (3.3% y/y)	Previous: -0.5% q/q (3.3% y/y)

Unemployment Rate in January (February 22)

Forecast: 5% of EAP, SA	Consensus: N.A.	Previous: 5.0%

IGAE in December (February 18)

Forecast: -1.5% m/m, 2.3% y/y	Consensus: N.A.	Previous: 1.1% m/m, 4.2% y/y

The December IGAE will be important for seeing the level of slowdown in services at the end of the year. With a major decline in industrial output linked to manufacturing and construction already known, most services linked to manufacturing are set to feel the knock-on effect of this contraction. On the demand side, retail sales in December are also set to see lower growth and could, in our opinion, even see a slight contraction despite the positive jobs performance (0.4% m/m in December) partially offset by the almost zero change in wages in real terms at the end of the year.

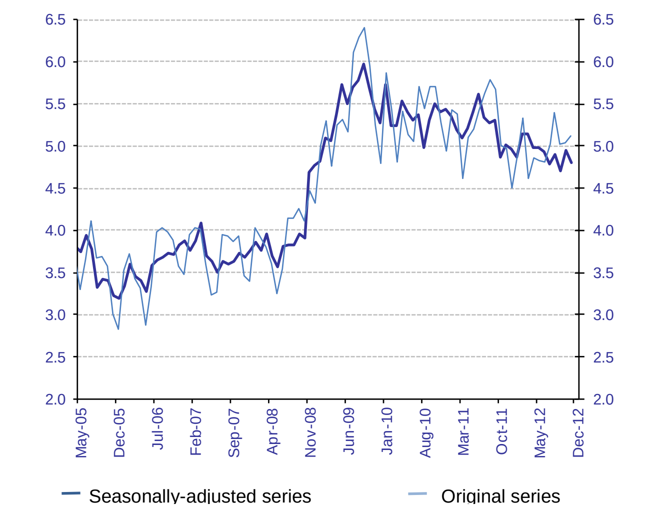
Although the Mexican unemployment rate is one of the lowest in Latin America (5% of EAP), it has showed major downward resistance after the crisis. Other job indicators will provide valuable data on the slack in the job market such as the underemployment rate (around 8%) and employment in critical conditions (around 12% of the EAP)

Inflation 1st two weeks of February (February 22)

Forecast: 0.2% bi-weekly, 3.4% y/y	Consensus: 0.2% bi-weekly	Previous: -0.4% m/m, 3.25% y/y

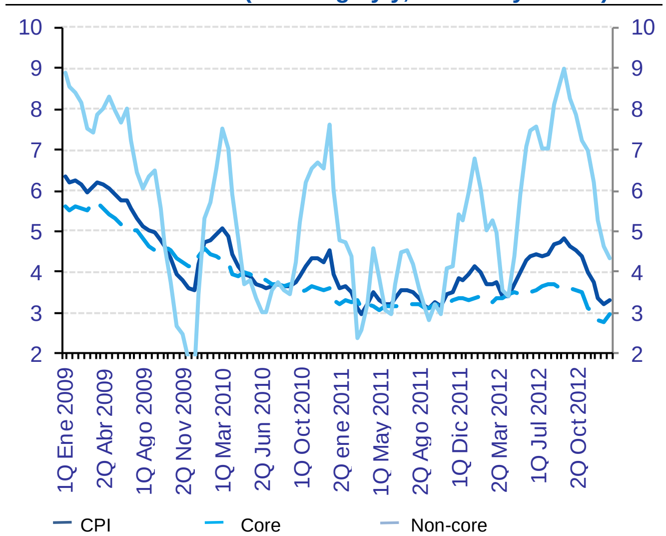
Inflation for the first two weeks in February is set for release on Friday 22. We forecast inflation seeing a slight upturn in annual terms for the first time in 4 months, increasing from 3.25% in January to 3.44%. We see this slight upturn being due to headline inflation increasing 0.2% bi-weekly thanks to factors including the end of the sale season which helped non-food prices and tourist services in January, as well as some price pressure in agricultural and energy prices and rates set by local governments. In short, much of this upturn is due to an unfavorable base effect which should cause a slight rise in inflation between February and April. Despite this, we believe inflation is mainly under control and although it will rise in coming months, this increase will be temporary meaning it is set to stay under 4% for the year as a whole.

Chart 3
Unemployment Rate % of EAP



Source: BBVA Research with INEGI data

Chart 4
Inflation breakdown (% change y/y, bi-weekly series)



Source: BBVA Research with INEGI data

Impact of potential Banxico cut on local assets

Although short sections are already discounting a 25bp-50bp cut, we maintain our strategy of receiving 13x1 from the TIIE curve with a target at 4.5% (entry level at 4.9%). This opened up in expectation of a more *dovish* Banxico stance and an inflation-economic context that would loosen the short section.

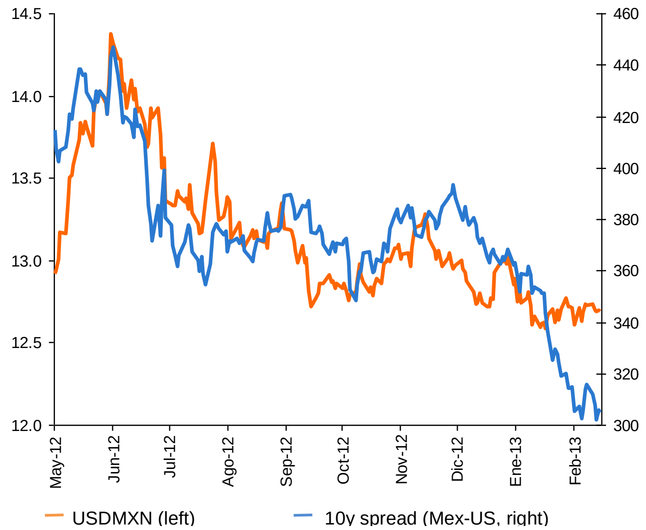
Banxico will undoubtedly maintain the new rate level for a prolonged period. Therefore, there will be room to use the long sections instead of the belly (which is now very expensive). The central bank's position and constructive domestic context should continue to favor a flattening-out in the long section compared to the middle toward 80bp.

A brief negative reaction is to be expected since Banxico's decision and the imminent debate surrounding the fiscal cliff in the US would be seen as signals for closing some long positions in the MXN at almost historical peaks. It should be stated that Banxico's decisions would represent an intention to reduce inflows onto the domestic fixed income securities market although the time to do this would be right given the context in Mexico is set to continue to be constructive.

A rate cut should limit the short-term MXN appreciation margin to 12.60

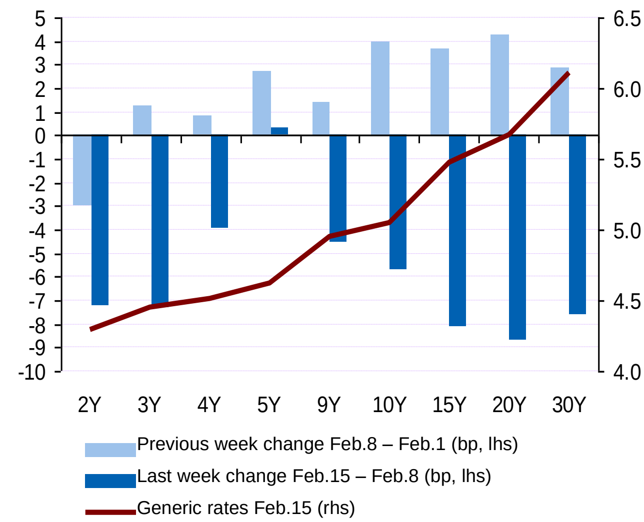
In turn, a rate cut should limit the short-term MXN appreciation margin to 12.60. We expect the MXN to see demand at levels near 12.85 since even if there were a 50bp cut and given global liquidity levels, the *carry* would remain attractive. It should be remembered that central banks in other countries remain concerned about their exchange rates (in contrast to the more conservative stance at Banxico) and reforms continue to be likely toward the second half of the year.

Chart 5
Mexico: 10-year rate spread and USDMXN (generic bp and ppd)



Source: BBVA Research and Bloomberg

Chart 6
Mexico: MBond Curve (% and bp; generic)



Source: BBVA Research and Bloomberg

IPC

The market has shifted 1,815pts (-4%) from the high of 46,000pts at the end of January to a low of 43,700pts, very near the 43,500pts level we have signaled as an initial short-term support and which corresponds to the 38.2% drop in the Fibonacci model. Meanwhile, the RSI hit 33pts, very near the over-selling zone. We believe this decline has put the market at attractive levels to start taking some short-term positions. Given the volatility the remaining two weeks of quarterly reports could generate, we cannot rule out the market hitting below the 43,500pts floor level. Nonetheless, we see the next floor at 42,700pts (50% drop in the Fibonacci model), just 2% below current levels.

Previous Rec. (2/11/13): Now at 53pts, the RSI still has room to move downward and we do not recommend an entry as yet. We continue to see the floor level at 43,500pts

Source: BBVA, Bancomer, Bloomberg

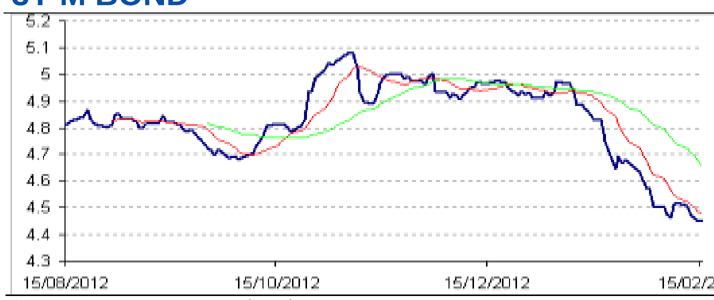
MXN

The dollar continues to trade in the MXN12.55/12.80 range. Although it traded in the upper band of this range, it was unable to break through the resistance level. It ended the week slightly below the 30-day rolling average, indicating a possible return to MXN12.55.

Previous Rec. (2/11(13): Looking at a lack of over-buying on oscillating indicators and the 10-day rolling average about to go above the 30-day rolling average.

Source: BBVA, Bancomer, Bloomberg

3Y M BOND

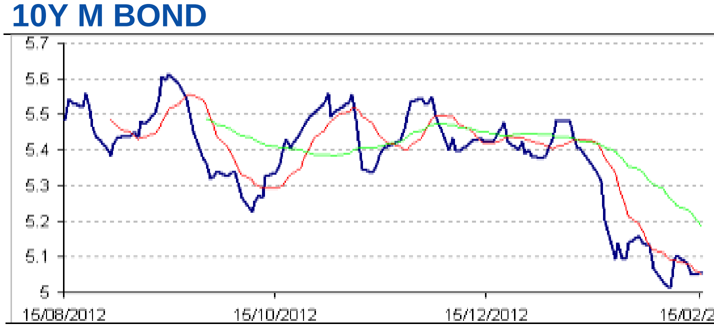


3Y M BOND (yield): The bond continued downward. The over-selling and opening up of averages points to an upturn toward 4.6%.

Previous Rec. (2/11/13). The opening up of the 10- and 30-day averages points to a move up and would be confirmed if it breaks 4.55% with a 2nd resistance at 4.75%.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND



10 Y M BOND: (performance): The bond fell back over the week but continues to trade above the 10-day rolling average. Given the spread at this level with the 30-day average, we continue to assume an upturn, now toward 5.2%.

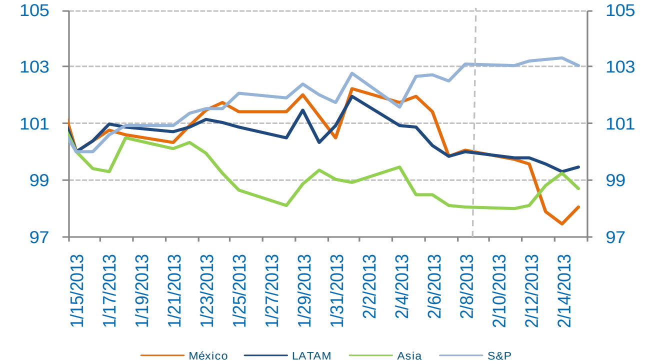
Previous Rec. (2/4/12). We believe it could continue this upturn toward 5.25% where the 30-day rolling average sits.

Source: BBVA, Bancomer, Bloomberg

Markets, activity and inflation

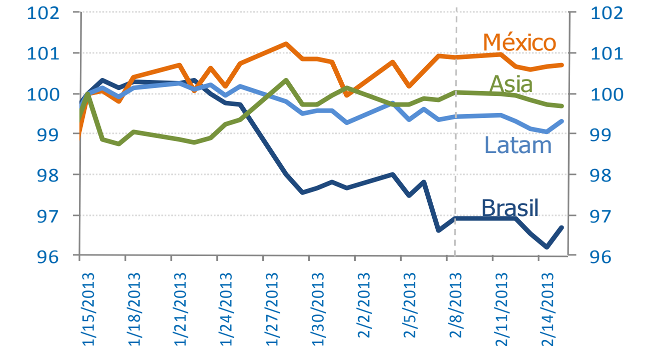
- **Losses on the Mexican stock market over the week due to the decline in homebuilders in the face of skepticism surrounding the National Housing Program of the new government and the major drop in América Móvil after lower-than-expected revenue in the fourth quarter. The peso rose slightly mid-week thanks to better-than-expected industrial output figures for the Eurozone.**

Chart 7
Stock Markets: MSCI indices (January 15, 2013 index=100)



Source: Bloomberg & BBVA Research

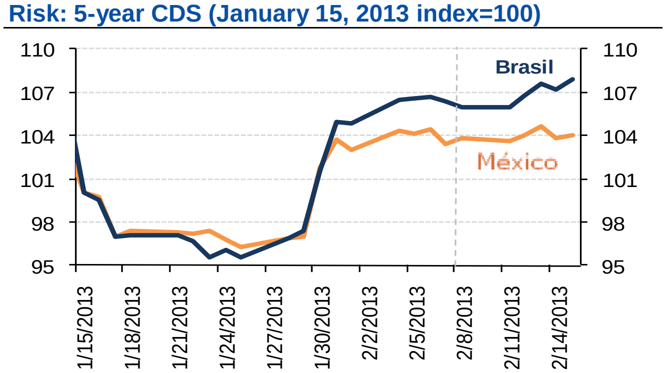
Chart 8
Foreign exchange: dollar exchange rates (January 15, 2013 index=100)



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

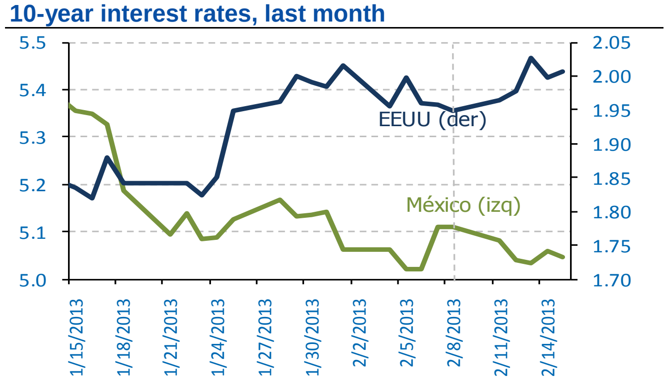
- **Rates in Mexico decouple from the rise in US Treasury rates and fall due to the confirmed accommodating tone at Banxico. This could lead to a cut in the lending rate in the next three months.**

Chart 9
Risk: 5-year CDS (January 15, 2013 index=100)



Source: Bloomberg & BBVA Research

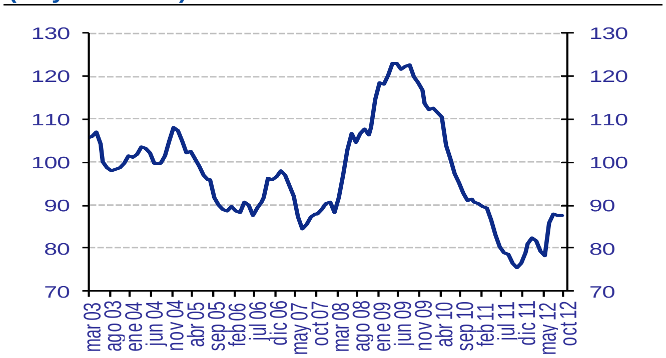
Chart 10
10-year interest rates, last month



Source: Bloomberg & BBVA Research

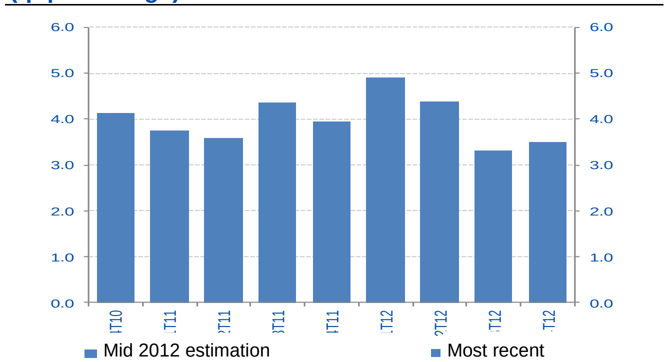
- **Recent situation indicators for economic output point to the last quarter having seen good growth meaning an annual average for 2012 slightly above 3.7%. In the meantime, inflation fell, coming in under 4% in December.**

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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