Economic Analysis and
Customer and Markets
Strategy
March 8, 2013

Mexico Weekly Flash

Next week…

- **Industrial output figures for January could confirm economic slowdown**

Industrial Output in January (March 12)

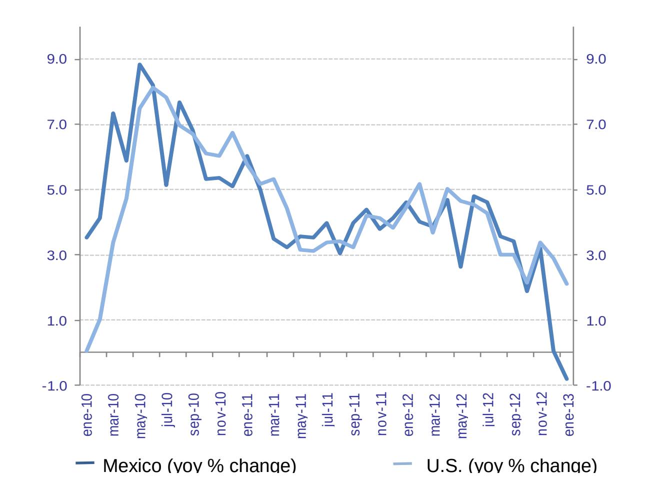
Forecast: 0.0% m/m (0.8% y/y, csv)	Consensus: 0.5% m/m	Previous: -2.1% m/m (0.0% y/y csv)

Industrial output for January is set to maintain the same pace as in December. It should be stated that manufacturing saw a surprise fall-back in the last month of the year, contracting (-)2.1% m/m, the biggest decline since June 2009. In that month, the decline was due to all four integral components dropping and most manufacturing branches reporting poor figures with a particularly poor month in construction. For January, automotive output figures saw a 6% bounce in comparison to the previous month (around 13,000 units more than in January). US manufacturing declined however in January (-)0.1% m/m although it should be highlighted that figures for durable goods were particularly bad (-)2.0% m/m. This could have had particular impact on industrial sectors linked to exports for these types of goods. Alongside producer confidence indicators that showed a general trend for lower optimism in terms of expected orders, domestic and foreign demand for goods, etc. these factors point to January possibly maintaining the output rate from December, confirming signs of a slowdown in output in coming months.

- **Profit-taking on the curve after monetary statement while MXN supports remain**

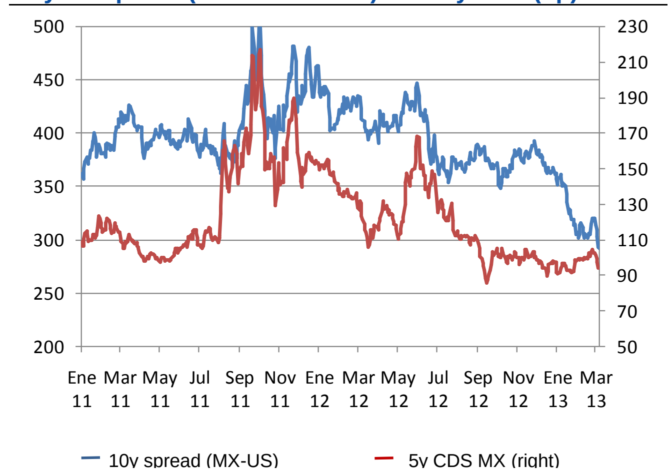
Fixed-income investors took profits after the cut to the lending rate and with the weak episode in Treasuries. We continue to believe there is margin for gains, especially in at the short and long end of the curve. In turn, global liquidity is a key factor for the MXN which we believe will continue and even increase.

Chart 1
Industrial output (% change y/y, csv)



Source: BBVA Research. CSV: corrected for seasonal variation

Chart 2
10-year Spread (Mexico less US) and 5-y CDS (bp)



Source: BBVA Research and Bloomberg

- ## Profit-taking on the curve after monetary statement

Fixed-income securities market investors took profits after Banxico decided to cut the lending rate and with the weak episode in Treasuries after a series of economic readings with upward surprises in the US. Nonetheless, we believe there is still margin for gains, especially in the short and long sections. Firstly, the curve is already partially discounting the cut so there was room for weakening if Banxico actually carried it out. Secondly, Banxico stated that the cut was not the start of a cut cycle but even so, the bias continues to accommodating looking forward. Lastly, we are at least sure that Banxico will not raise the policy rate in the long-term meaning the value of domestic curves will continue to be appealing.

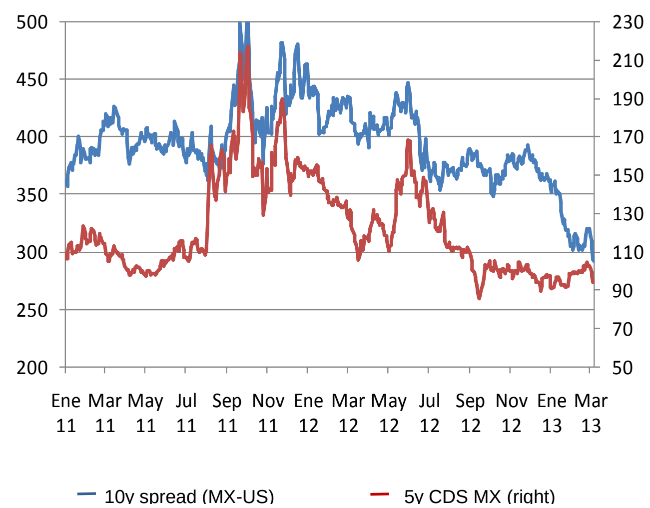
In addition, we are optimistic regarding economic reforms meaning we cannot rule out improvements in the country's credit rating. In this way, we maintain our strategy of purchases in the long section of the curve and our constructive outlook for the MXN. The spread between the 10-year MBond and the UST with the same maturity could hit 250 toward the end of the year (this being our target).

- ## MXN supports continue

Despite the growth in the USDMXN crossing just after the monetary statement, the exchange rate saw an immediate rise in response to global factors and closed near its weekly lows (12.62 vs. 12.78 high on Friday). The reaction in the MXN was in line with expectations as the lending rate cut has been in the table since January. In spite of the low carry-trade yield, the likelihood of structural reforms in the country and improvements in the sovereign risk will continue to favor the MXN. Furthermore, US job figures provided a positive respite after weeks of uncertainty linked to the US fiscal debate and the political situation in the Eurozone.

Global liquidity is a key factor on global markets and different central banks seem to support an ongoing bias for more monetary easing. This is a crossroads: MXN supports could remain current while Banxico shows some concern for the issue. The already signaled dovish bias will likely increase if the MXN sees a major strengthening. Therefore, given additional easing cannot be ruled out, this will continue to stop the MXN breaking the 12.50 level in the short-term. Nevertheless, we forecast the MXN at 12.25 at the end of 2013 with a clear bias for a wider strengthening margin.

Chart 5
10-year Spread (Mexico less US) and 5-y CDS (bp)



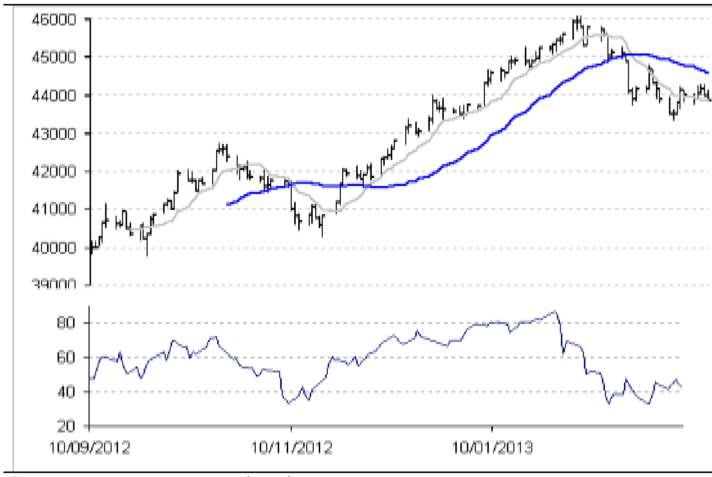
Source: BBVA Research and Bloomberg

Chart 6
USDMXN

Source: BBVA Research and Bloomberg

Technical Analysis

IPC



Despite the positive week in the US, the IPC was unable to copy this move and saw a contrary negative weekly balance. As in recent weeks, it found resistance at the 44,000/44,200pts level with the first support level continuing to be at 43,500pts. With profit-taking in the US, we could see the IPC breaking this floor to seek out the next support levels at 42,700 and 42,000pts. We see this adjustment scenario as more likely but, if this does not materialize, the entry signal on the IPC would start with an upward break through the 30-day rolling average at 44,560pts.

Previous Rec. (3/4/13): For the time being, and thanks to the RSI level, we can only consider a return to these resistances and a trend change could be considered once there is an upward break through the 30-day rolling average

Source: BBVA, Bancomer, Bloomberg

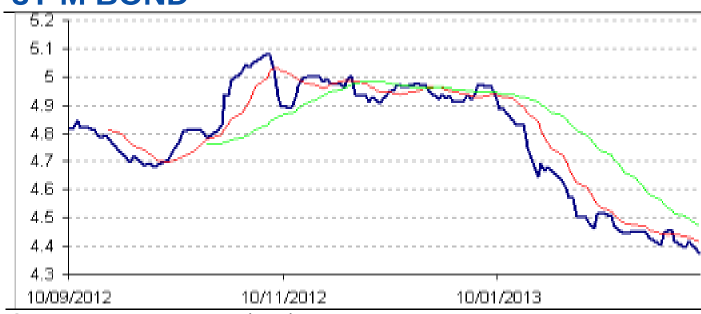
MXN

The dollar again hit resistance at MXN12.80, starting a new adjustment move that ended up below the 30-day rolling average and, therefore, with an outlook for a return to the MXN12.60/12.55 level.

Previous Rec. (3/4/13): Oscillating indicators continue to point to an upturn through MXN13.00 while it remains above MXN12.75. We maintain long positions

Source: BBVA, Bancomer, Bloomberg

3Y M BOND

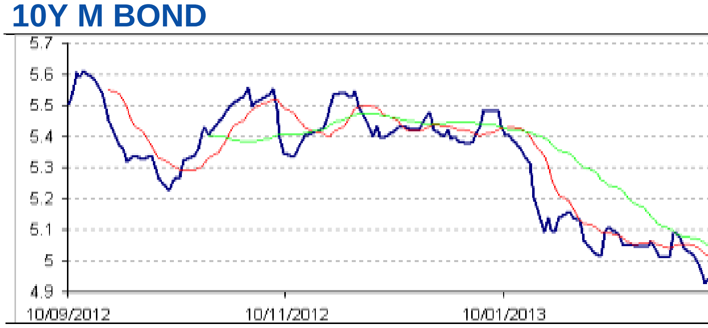


3Y M BOND (yield): Despite over-selling, the bond could not materialize a bounce. Any attempt to discount the decline would find resistance at 4.45% and only breaking this level would lead us to consider a trend change.

Previous Rec. (3/4/13). We continue to consider a move to at least the 30-day rolling average at 4.5%

Source: BBVA, Bancomer, Bloomberg

10Y M BOND



10Y M BOND (yield): The bond broke 5% and is at a record low. Any bounce could encounter resistance between 5% and 5.1%. Until it breaks this level, the trend remains downward. Floors at 4.9 and 4.8%.

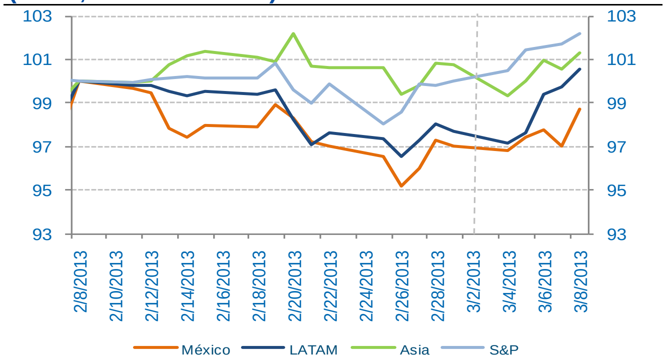
Previous Rec. (3/4/13). We believe we will see an upward move over coming days with resistances at 5.1 and 5.15%

Source: BBVA, Bancomer, Bloomberg

Markets, activity and inflation

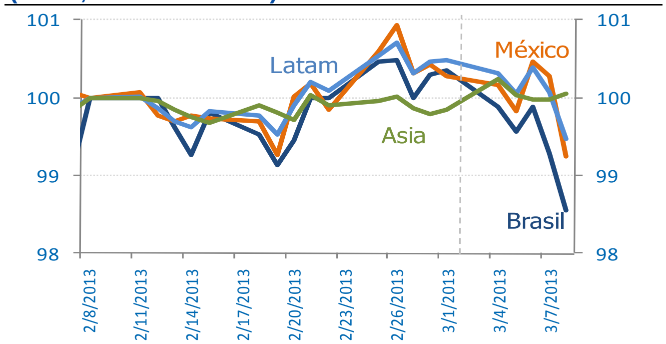
- **Upswing on stock markets and LatAm currency rises at the end of the week influenced by significantly better-than-expected US employment figures than analyst predictions.**

Chart 7
Stock Markets: MSCI indices (Feb 8, 2013 index=100)



Source: Bloomberg & BBVA Research

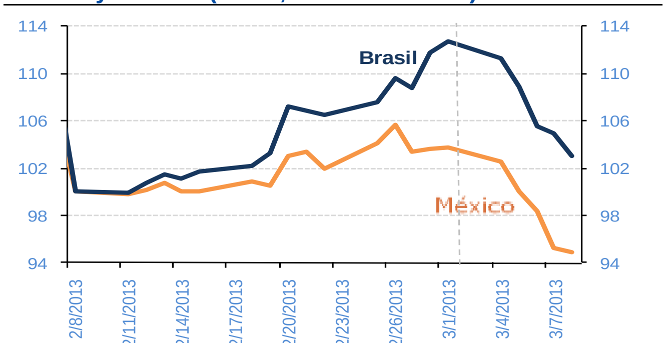
Chart 8
Foreign exchange: dollar exchange rates (Feb 8, 2013 index=100)



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.

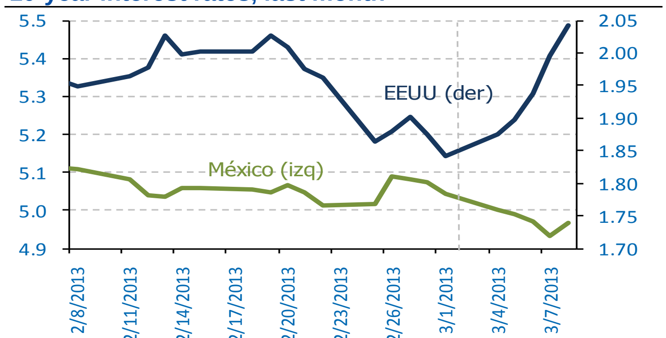
- **Decline in global risk thanks too US job and service sector figures pointing to continued recovery. Thanks to this decline in risk aversion, US rates rose over the week. Rates in Mexico rose at the end of the week with profit-taking after the 50bp cut in the monetary policy rate.**

Chart 9
Risk: 5-year CDS (Feb 8, 2013 index=100)



Source: Bloomberg & BBVA Research

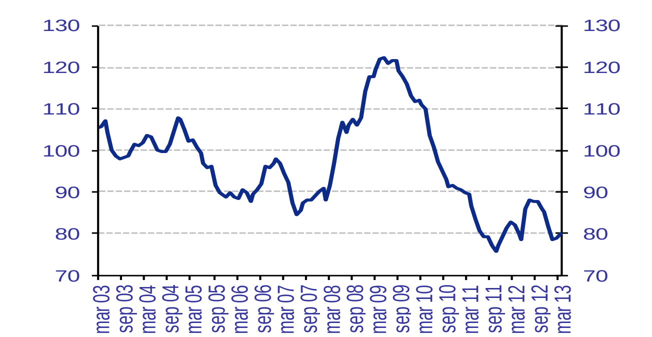
Chart 10
10-year interest rates, last month



Source: Bloomberg & BBVA Research

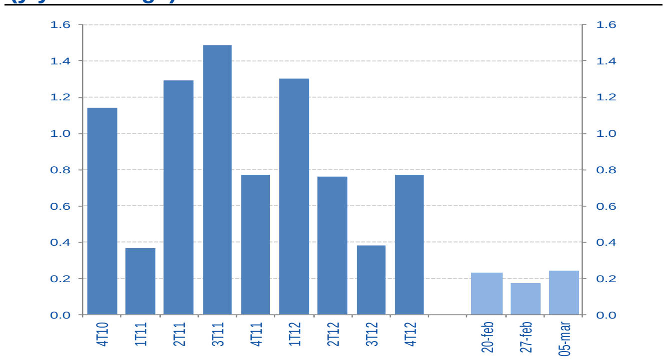
- **Recent situation indicators for economic output point to the start of 2013 continuing to see a slowdown in output. The BBVA MICA model points to annual growth of 2.5% or slightly lower. Inflation has started a temporary upturn and is expected to hit its high in April, falling after this mid-year.**

Chart 11
***Inflation Surprise Index (July 2002=100)**



Source: Bloomberg and BBVA Research
*This measures the deviations in inflation in comparison to market-forecast figures, adjusting for inflation volatility. When it trends down, this implies a lower-than-expected inflationary surprise. When it trends up, this indicates a higher-than-expected inflationary surprise.

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



Source: BBVA Research with data from Bloomberg

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