Mexico Weekly Flash

Next week…

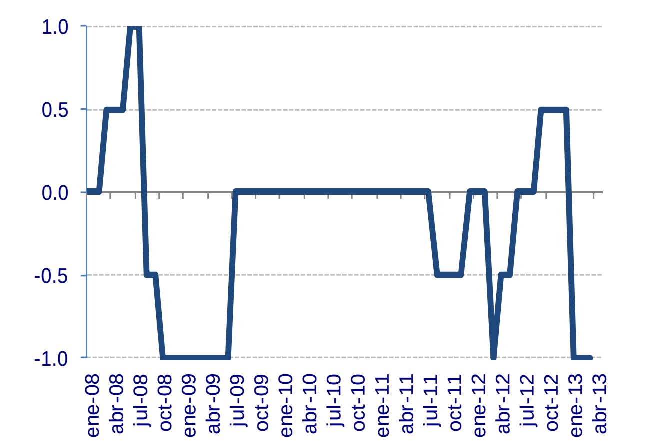
- ### Banxico minutes: first majority decision?

Next Friday, the minutes of the monetary policy meeting held on March 8 will be released. Once the decision to cut the policy rate by 50 basis points was agreed and the relaxed tone of the statement strengthened, the minute should offer us an insight into the board members' arguments in favor of the decision. This comes in an inflation scenario where it may come in around 4% in coming months, as the bank itself recognized in its statement and after the minutes from the previous meeting showed a board member seeing the rate cut as premature given the lack of information to support such a decision. In turn, the details of the argument for agreeing to a cut in order to avoid an unnecessary harshening of monetary conditions and take advantage of the lower fiscal deficit in 2013 will be important. This is because Banxico could signal a greater weight for economic output in its decision making process. Lastly, the minutes will show the level of agreement for the rate cut which will be important given all decisions since meeting minutes have been released were unanimous, in addition to this being the first meeting including the new deputy governor.

- ### Locally, speculation points to Banxico possibly stepping in on the currency market

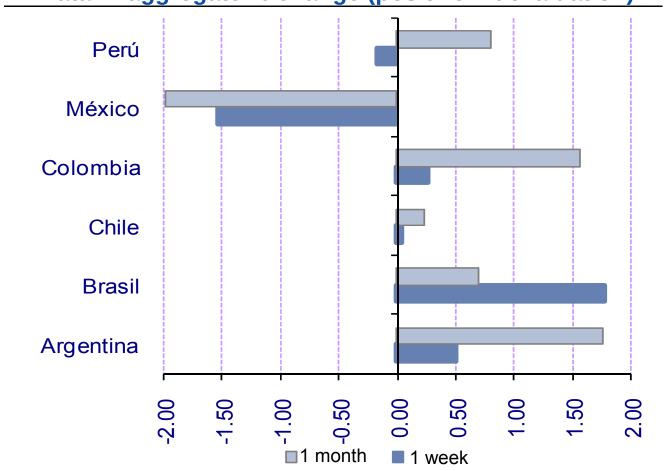
In comparison to previous sessions, the MXN traded within a narrow range above the intraday 12.40 level. The currency continues decoupled from other assets with which it normally sees a major correlation. For example, it has moved in the opposite direction to the EUR since the start of the week and strengthened against the European currency...

Chart 1
Monetary policy communication index*



Source: BBVA Research
*Index based on central bank statements. The index takes a value of 1 (-1) when communication become more restrictive (relaxed) and the likelihood of a rate rise (cut) thus increases.

Chart 2
FX Latam: aggregate % change (positive = devaluation)



Source: BBVA Research and Bloomberg

Calendar: Indicators

Inflation for the first two weeks in March (March 22)

Forecast: 0.30% bi-weekly (3.89% y/y)	Consensus: 0.30% bi-weekly	Previous: 0.49 m/m (3.55% y/y)

Friday 22 sees the release of inflation figures for the first two weeks of March. We expect, as does the central bank, that inflation is set to continue to rise at an annual rate and to come in around 3.9% y/y. This rise in inflation is due firstly to some pressures on non-core inflation, especially agricultural prices where some key products are relatively scarce at present (e.g. green tomatoes), an temporary upturn in egg prices due to the bird flu outbreak and rises in prices for rates set by the public sector. In addition, some situational pressures are likely to materialize for core inflation due to the sub-index rate for other services possibly rising given the upcoming holiday period for Easter week. This may involve price rises in inter-state and air transport, package tourist service and eating out. It is important to highlight that despite the aforementioned elements, core inflation remains favorable thanks to inflation in the goods sector continuing to fall due to the stronger peso, lower global grain prices and the slack in the economy. In this way, the upturn in inflation will continue until April mainly due to pressure on non-core prices and an unfavorable comparison basis with regard to 2012. Nonetheless, after April, inflation will decline and remain under 4% for the rest of year.

Goods and Services Supply and Demand, 4Q12 (March 19)

Forecast: 2.9% y/y	Consensus: 3.1%	Previous: 2.6% y/y

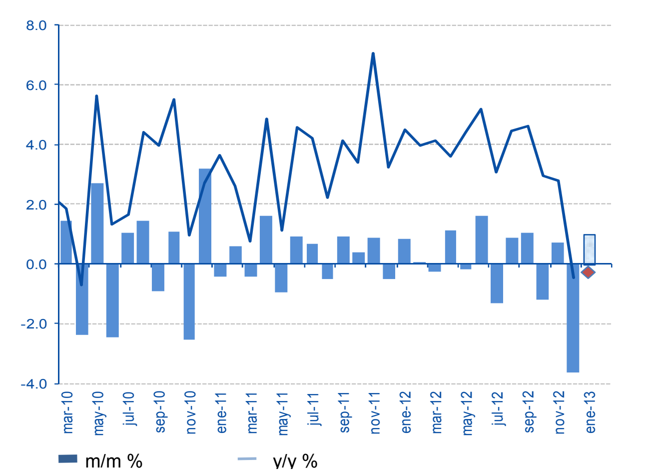
March 19 sees the release of the breakdown for GDP demand for 4Q12. It should be stated that said quarter saw output expand at a rate of 0.8% q/q (3.3% y/y). We forecast annual growth in aggregate demand increasing to 2.9% due to expansion in domestic demand components (private consumption, government consumption and investment) that will add 3.4 points to growth; meanwhile net export contribution will be slightly negative (-0.1 pts). It will be especially important to see the progress in private consumption and investment for the last quarter. We forecast good progress in employment and sustained growth in funding sources for business and households having an impact meaning these components should see 2.2% y/y growth for consumption and 7.6% y/y for investment.

Retail sales indicator in January (March 22)

Forecast: 1.0% m/m (-0.3% y/y)	Consensus: N.A.	Previous: -3.6% m/m (-0.4% y/y)

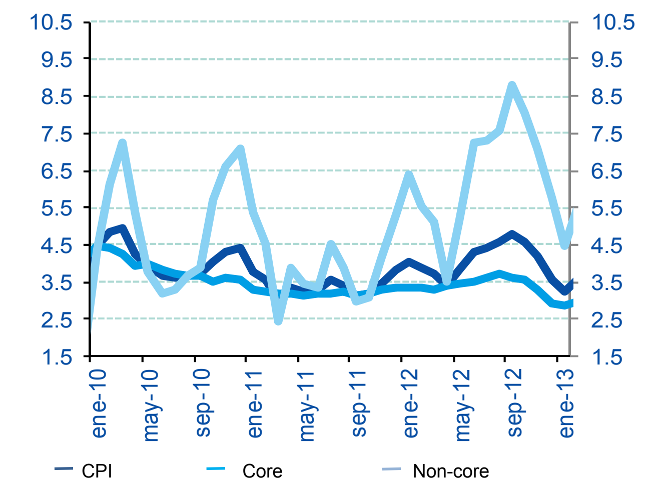
Retail sales in December saw the highest decline in annual terms (corrected for seasonal variation [CSV]) since 2001 (-3.6% y/y) and one of the highest monthly declines (-0.4%). In turn, the ANTAD sales indicator also showed a decline in December (-1.2% m/m). Nevertheless, the decline did not worsen in January (0.0% m/m). Moreover, the services indicator expanded in annual terms at the best rate since 2005 (start of the series) with growth of 10.7% y/y. As a result, we believe retail sales will see an upturn of around 1% m/m.

Chart 3
Retail Sales indicator (% change y/y and m/m)



Source: BBVA Research with INEGI data

Chart 4
Inflation breakdown (y/y change y/y)



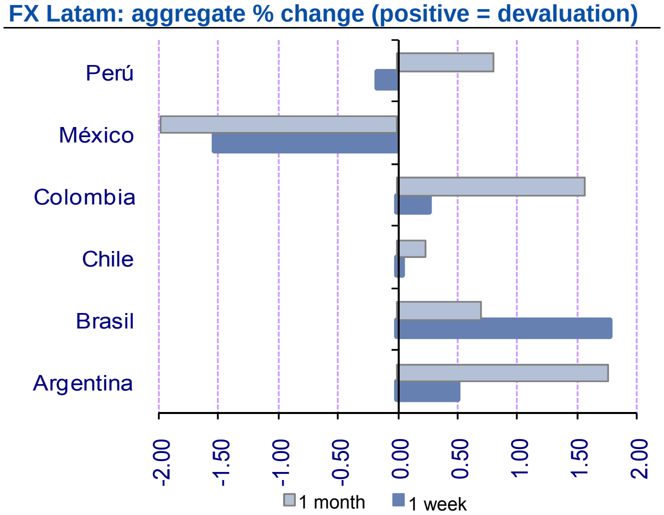
Source: BBVA Research with INEGI data

- **Locally, speculation points to Banxico possibly stepping in on the currency market**

Domestic markets are speculating Banxico could possibly step in on the currency market due to the size and speed of the recent strengthening. BBVA Research has considered this possibility from the last monetary policy decision since the central bank referred specifically to the hardening of monetary conditions. A possible "intervention" could be removing the contingent USD sales mechanism: this implies selling USD400mn at a minimum price (the conditions for the sale are fulfilled whenever the MXN falls over 2% in comparison to the FX from the previous day.

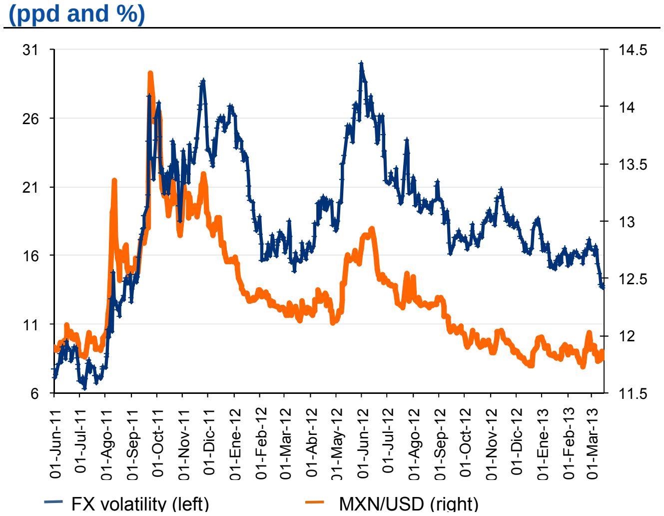
This step would point to Banxico being uncomfortable with the recent strengthening. However, it should be stated that the conditions for this to come into play were only seen 3 times in 2012 (Banxico announced the mechanism in November 2011) meaning the auction would only allow the USDMXN rate to come back strong if market conditions were so aligned. A more revealing signal would be the re-starting of put options auctions for USD40mn (an insignificant amount but one that in the past has provided support to the USDMXN rate), alongside a more interventionist tone (the "perfect storm" again and again). Indeed, when the central bank announced the USD sales mechanism, it canceled the option auctions for dollar sales.

Chart 5
FX Latam: aggregate % change (positive = devaluation)



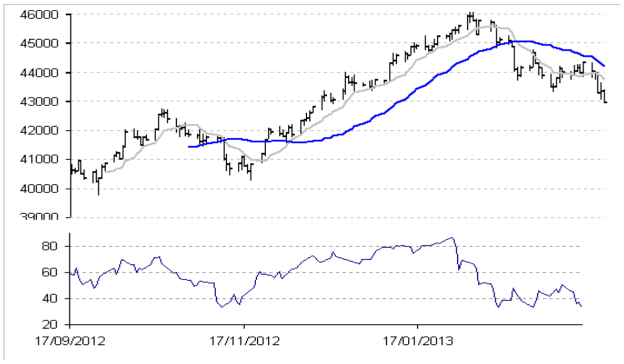
Source: BBVA Research and Bloomberg

Chart 6
Mexico: MXN/USD and implied 1-month volatility (ppd and %)



Source: BBVA Research and Bloomberg

IPC



Source: BBVA, Bancomer, Bloomberg

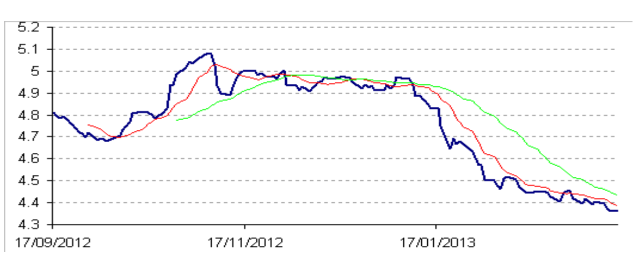
The decline of Amx led the IPC to fall below the first floor level, coming in under 43,500pts. This opened the door for a move toward the next support levels set at 42,700pts and 42,000pts. We see the second as a stronger floor since it is the low section of the upward channel where the market has traded since October 2011. In addition, the IPC's 200-day rolling average trades at 41,850pts, given the technical level more strength. Previous Rec. (3/11/13): 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.

MXN

Source: BBVA, Bancomer, Bloomberg

Major decline over the week causing a break through the 12-month lows of MXN12.55. A floor seems to have been hit at MXN12.40, although any bounce would bump at MXN12.55. If it breaks MXN12.40, the next floor is between the MXN12.20 and MXN12.15 range. Previous Rec. (3/4/13): Coming in below the 30-day rolling average and therefore with a view to a return to the MXN12.60/12.55 level

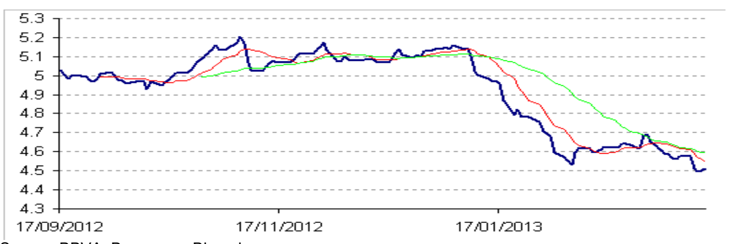
3Y M BOND



Source: BBVA, Bancomer, Bloomberg

3Y M BOND (yield): It continues to trade with a downward trend with an RSI at high over-selling at 29pts. Major resistance at the 30-day rolling average at 4.44%. Previous Rec. (3/4/13). 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.

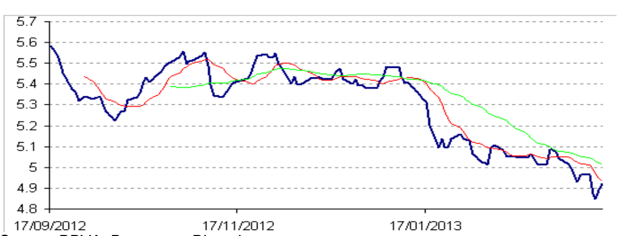
5Y M BOND



Source: BBVA, Bancomer, Bloomberg

5Y M BOND (yield): A timid bounce at the end of the week. We can only consider a major upward signal when it breaks the 30-day rolling average at 4.6%. Previous Rec.: First recommendation

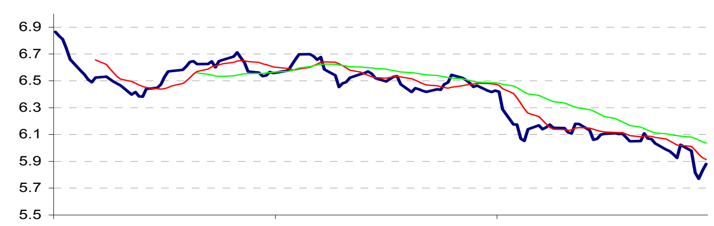
10Y M BOND



Source: BBVA, Bancomer, Bloomberg

10Y M BOND (yield): A bounce has started but it continues to below 10 and 30-day rolling averages. We can only consider a trend change when it hits above 5.02%. Previous Rec. (3/4/13). Any bounce could encounter resistance between 5-5.1%. Until it breaks this level, the trend remains downward (floors at 4.9-4.8%.

30Y M BOND



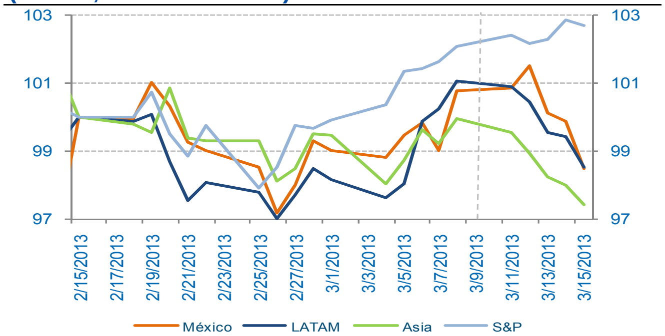
Source: BBVA, Bancomer, Bloomberg

30Y M BOND (yield): The bond has bounced toward the 10-day rolling average level. It will have to exceed 6.04% before a stronger upswing can be considered. Previous Rec.: First recommendation

Markets, activity and inflation

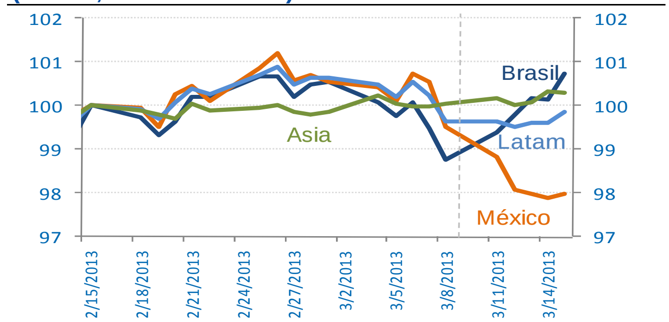
- **The Mexican stock market falls after the government presented its telecommunications reform proposal impacting the share prices of companies in the sector that represent over 20 per cent of the IPC. The peso saw a major strengthening toward levels not seen since 2011. This was influenced by the change in outlook from stable to positive in the sovereign risk rating.**

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



Source: Bloomberg & BBVA Research

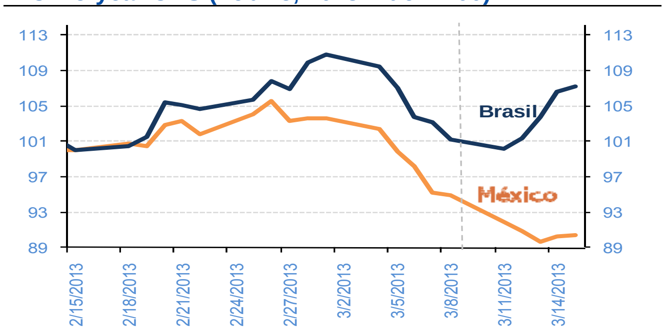
Chart 8
Foreign exchange: dollar exchange rates (Feb 15, 2013 index=100)



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.

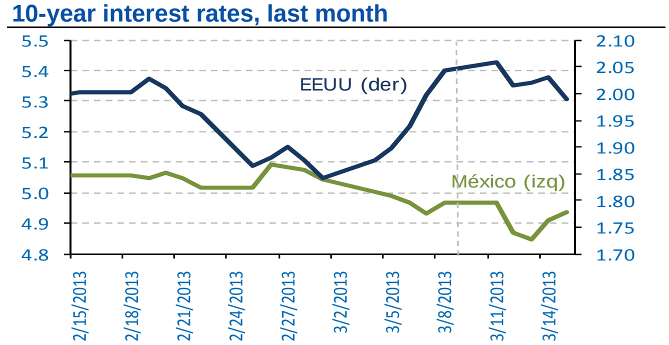
- **Lower risk aversion for Mexican assets in the light of optimism surrounding the possible reforms and better-than-expected retail sales and industrial output figures in the US. After the 50bp cut in the lending rate, long-term rates in Mexico fell mid-week to then rise due to lower-than-expected consumer confidence figures from the US.**

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



Source: Bloomberg & BBVA Research

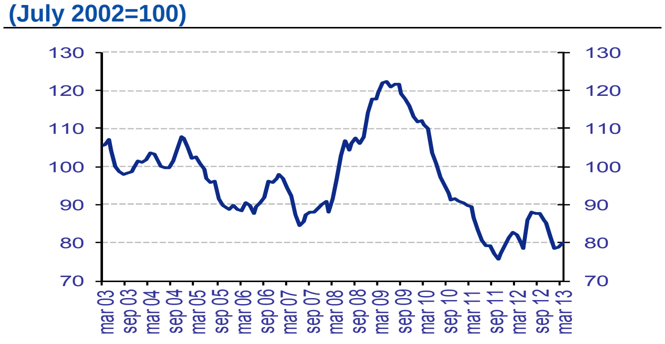
Chart 10
10-year interest rates, last month



Source: Bloomberg & BBVA Research

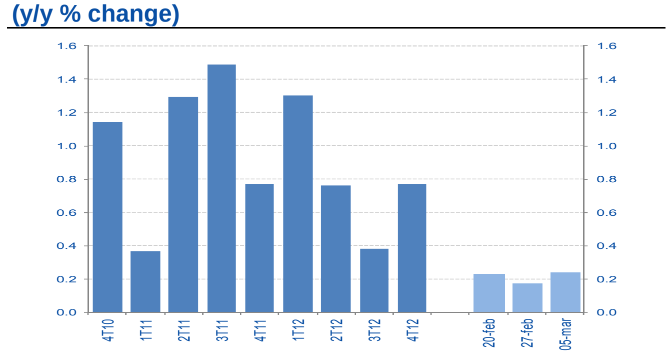
- **Recent situation indicators for economic output point to the start of 2013 continuing to see a slowdown in output. The BBVA MICA model points to annual growth of 2.5% or slightly lower. Inflation has started a temporary upturn and is expected to hit its high in April, falling after this mid-year.**

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

Claudia Ceja
claudia.ceja@bbva.com

Cecilia Posadas
c.posadas@bbva.com

Alejandro Fuentes Pérez
a.fuentes@bbva.com

Octavio Gutiérrez Engelmann
o.gutierrez3@bbva.com

+Ociel Hernández
ociel.hernandez@bbva.com

Pedro Uriz Borrás
pedro.uriz2@bbva.com

Iván Martínez
ivan.martinez.2@bbva.com

Rodrigo Ortega
r.ortega@bbva.com

Arnoldo López Marmolejo
arnoldo.lopez@bbva.com

BBVA | RESEARCH | Av. Universidad 1200, Col. Xoco, Mexico 03339 D.F. | researchmexico@bbva.bancomer.com | www.bbvaresearch.com

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