Mexico Weekly Flash

Next week…

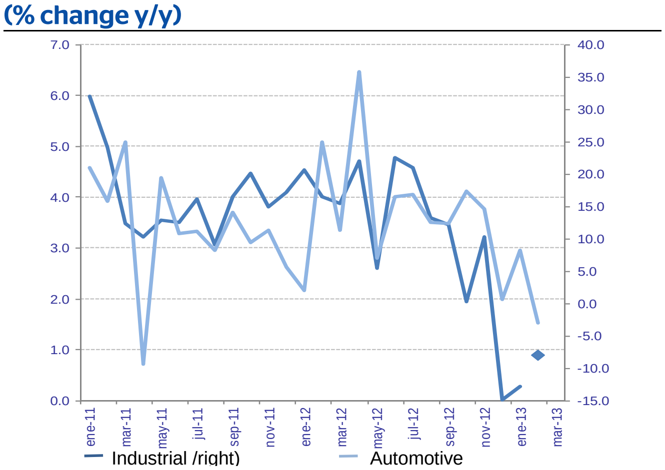
- **Output indicators set to provide information on size of slowdown in first quarter of the year**

Industrial output for February is set for release this week. Manufacturing performance in February could match what was seen in a key branch - automotive production. According to AMIA, production expanded around 0.1% m/m in February (-3.0 y/y). In turn, producer confidence indicators as well as the IMEF indicator point to a marginal slowdown in February compared to January: producer confidence fell (-)0.3% in February (-0.8% in March). Meanwhile, the IMEF manufacturing producers indicator fell back by (-)0.4% in February. It should be stated that out of the selection of confidence indicators and manufacturing orders, manufacturing orders for February are a positive highlight, especially those linked to domestic demand for business products. Moreover, construction industry performance will be key this month having shown two months of declines in annual terms.

- **Weak US economic data and the announcement of a dramatic expansion in monetary policy by the BoJ are behind a global decline in interest rates**

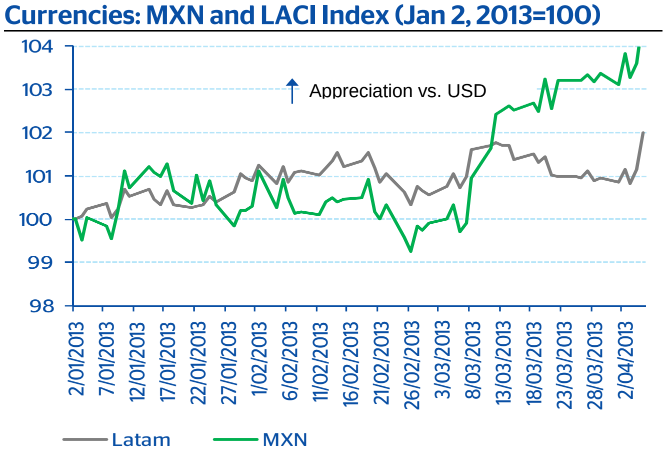
Weak US economic data this week (with negative surprises in the ISM manufacturing index, the ISM services index and job creation in March) and the Bank of Japan's (BoJ) decision to expand its asset purchase program beyond market expectations led to a global *rally* in interest rates. The figures from this week, with losses on stock markets and major declines in interest rates, point to markets expecting the increase in global liquidity due to the BoJ's higher asset purchases to drive global demand for bonds. In turn, concerns over the situation in Europe continue in the background, as suggested by the decline in credit default swaps. In a scenario of higher global liquidity expectations and no upswing in risk aversion, emerging market currencies strengthened over the week. The MXN was no exception, strengthening and hitting the 12.17 ppd level.

Chart 1
Industrial Output and Automotive Output (% change y/y)



Source: BBVA Research with INEGI data

Chart 2
Currencies: MXN and LACI Index (Jan 2, 2013=100)



Source: BBVA Research with data from Bloomberg

Calendar: Indicators

Investment in January (April 8)

Forecast: 2.1% m/m (1.0% y/y)	Consensus: n/a	Previous: -3.9% m/m (-0.5% y/y)

Industrial Output for February (April 11)

Forecast: 0.5 m/m (0.9% y/y)	Consensus: 0.8% m/m	Previous: 1.1 m/m (0.3% y/y)

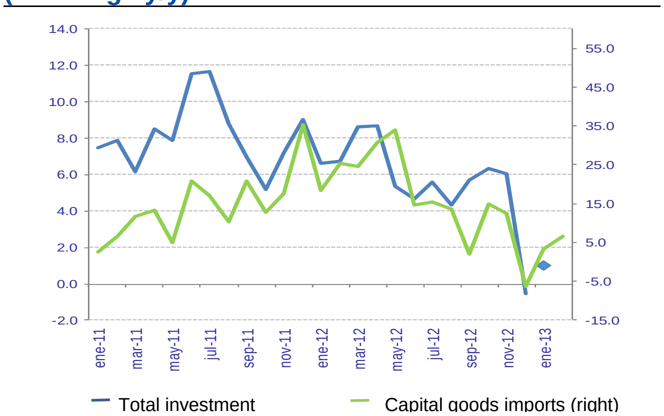
Investment in January is set to be released this week. We forecast growth of around 1.0% y/y, the change in January for capital goods imports in pesos increased to 3.3% y/y. Nonetheless, the trend toward a slowdown in the indicator should be recalled, involving a decline from variations of around 6.0% from September to November to (-)0.5% y/y in December due to lower investment in construction as well as imported machinery and equipment.

March Inflation (April 9)

Forecast: 0.67% m/m 4.19% y/y	Consensus: 0.68% m/m	Previous: 0.49% m/m, February

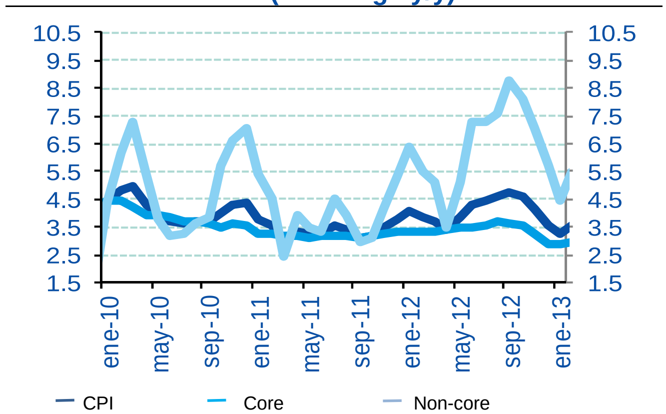
Inflation saw a surprise upswing in the first two weeks of March from 3.6% y/y in the second half of February to 4.1%. This increase is due to different pressures on the non-core sub-index. Behind these pressures are supply shocks on agricultural markets such as lemons due to the HLB outbreak in Colima or eggs and chickens affected by a new outbreak of bird flu mainly hitting Guanajuato state this time around. In addition, energy prices and some local government set prices have also seen pressures this year. In turn, core inflation remains at low levels despite seeing an upswing from 2.97% y/y in the second half of February to 3.06% y/y. This favorable performance, after remaining above 4% since April 2011, is thanks to goods prices seeming to stabilize since last February under the 4% threshold due to the stronger peso, stability in grain prices and the continuing slack in the economy. Service prices continue to move up after hitting a minimum of 1.15% in December, coming in at 2.4% in the first half of March thanks to mobile telephony prices seeing major increases in the first two months of the year due to the end of the winter season offers and, to a lesser extent, the holiday situation in March causing an upswing in tourist prices. We estimate that inflation will rise 0.67% m/m and come in around 4.2% y/y. Inflation will continue to rise until at least April. Nevertheless, low core inflation points to the upswing being due to supply shocks which will not create knock-on effects. This means inflation should decline steeply in the third quarter to end the year below 4.0%.

Chart 3
Investment and Capital Goods Imports (% change y/y)



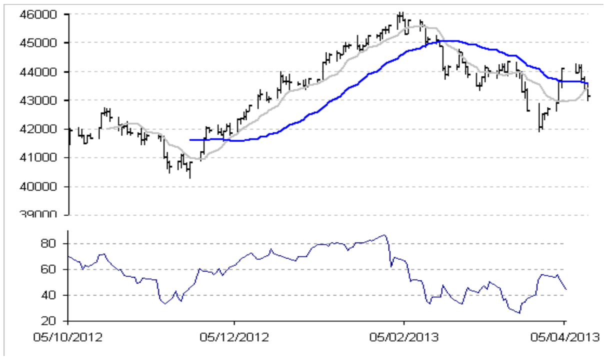
Source: BBVA Research with INEGI data

Chart 4
Inflation breakdown (% change y/y)



Source: BBVA Research with INEGI data

IPC



Source: BBVA, Bancomer, Bloomberg

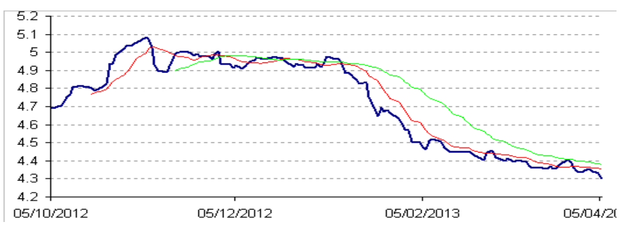
The weekly change again places the IPC below the 10- and 30-day rolling averages and opens the door to a return to the short-term support level (42,000pts). We could see the following scenarios at this level: i) the IPC starts to bounce from the floor, marking a short-term double bottoming-out seeking a higher upswing than recently or ii) the IPC breaks down through 42,000pts, hitting a new low and strengthening the negative short-term trend to seek out the 40,500pts level. Since we saw no over-buying levels during the last bounce, we believe the most the first scenario is the most likely and therefore recommend, with a return to the support level, increasing short-term exposure. Previous Rec. (3/25/13): The RSI of the IPC stood at 26 points, indicating a short-term overselling.

MXN

Source: BBVA, Bancomer, Bloomberg

The dollar continued its major short-term downward trend. The upswing attempts remained below the 10-day rolling average. We think the MXN12.20/12.15 level could in the end provide short-term support. Previous Rec. (3/25/13): After this breakthrough, the next support is at the MXN 12.20/12.15 level.

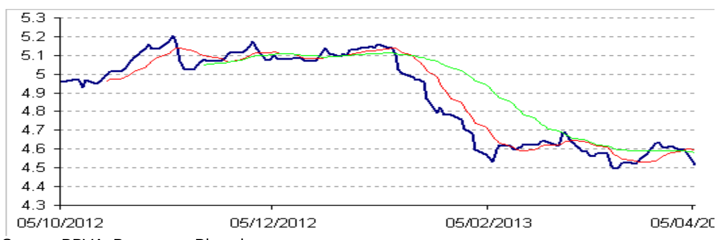
3Y M BOND



Source: BBVA, Bancomer, Bloomberg

The 3-year bond failed to hit above the 10- and 30-day rolling averages. The RSI at 28pts signals high over-selling. Major resistance at 4.39%. Breaking this level would mean a trend change. Previous Rec. (3/25/13). No break of any major resistance since it continues to trade below 10 and 30-day rolling averages

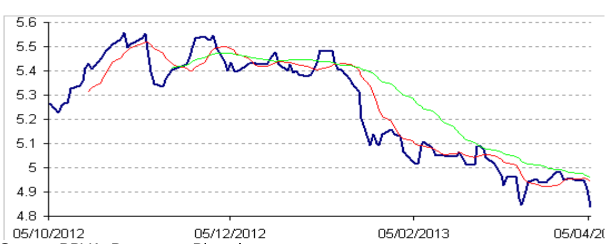
5Y M BOND



Source: BBVA, Bancomer, Bloomberg

The 5-year bond was unable to break through the 4.6% resistance level. It has hit below the 30-day rolling average, testing the level where it bounced. We believe it may respect the 4.5% support level. Previous Rec. (3/25(13): Important signal if it breaks through 4.6% to hit at least 4.7%.

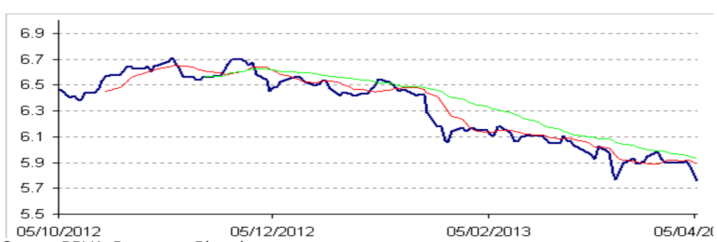
10Y M BOND



Source: BBVA, Bancomer, Bloomberg

The 10-year bond continued to trade below the 10- and 30-day rolling averages. It is important it does not break down through 4.85%. The resistance level to set a trend change stands at 5%. The RSI at 29pts signals high over-selling. Previous Rec. (3/25/13). It already trades above the 10-day rolling average, pointing to a break of the 30-day

30Y M BOND



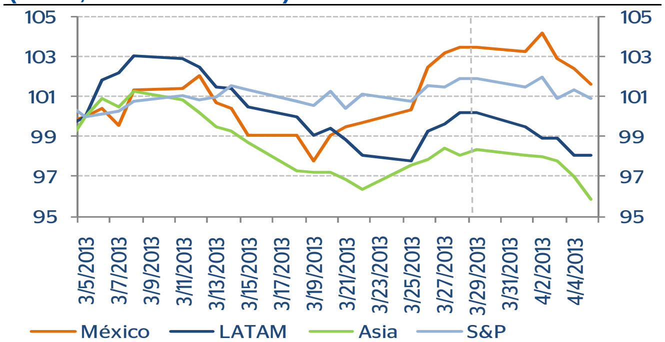
Source: BBVA, Bancomer, Bloomberg

The 30-year bond has a major resistance level at 5.9%. As long as it fails to break up through this level, there is no trend change. Previous Rec. (3/25/13). Pointing to a break of the resistance level at the 6% 30-day rolling average.

Markets, activity and inflation

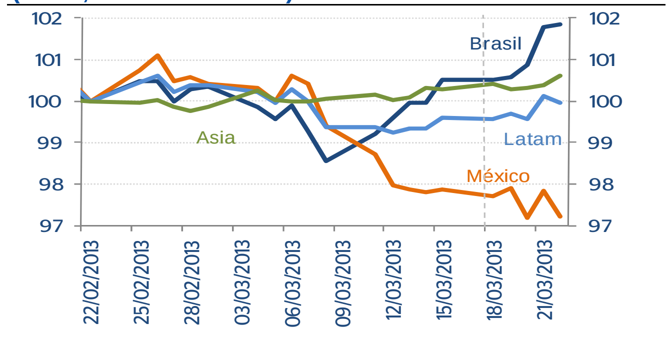
- **Figures significantly below expectations for US employment anticipate monetary stimulus packages continuing for longer and had an impact in a volatile session for the currency market ending with the peso strengthening by 1.09%. In turn, the stock market saw losses in light of a flight toward quality on markets.**

Chart 7
Stock Markets: MSCI indices (Mar 5, 2013 index = 100)



Source: Bloomberg & BBVA Research

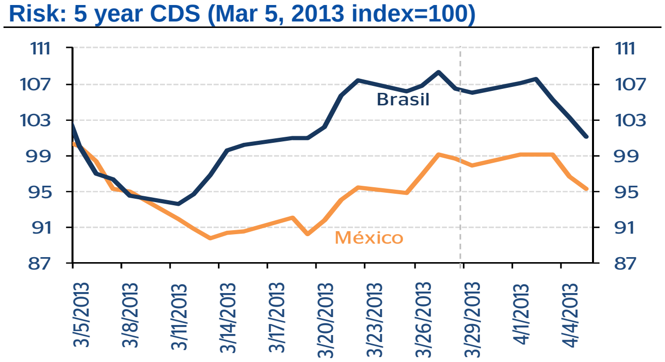
Chart 8
Foreign exchange: dollar exchange rates (Mar 5, 2013 index = 100)



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.

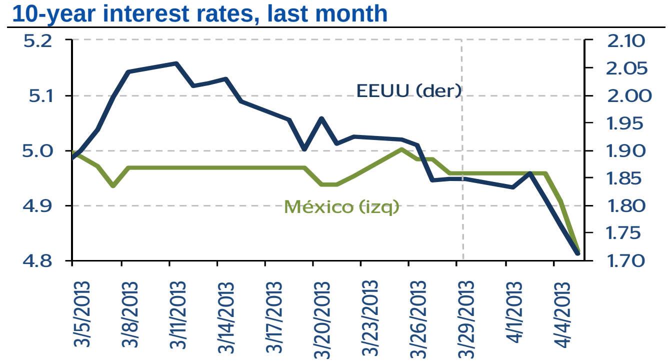
- **Fall in U.S. interest rates in light of a flight toward quality after employment figures came in below expectations. Rates in Mexico maintained their correlation with T-bills while in terms of sovereign credit risk there was a weekly decline after Japan announced its monetary stimulus.**

Chart 9
Risk: 5 year CDS (Mar 5, 2013 index=100)



Source: Bloomberg & BBVA Research

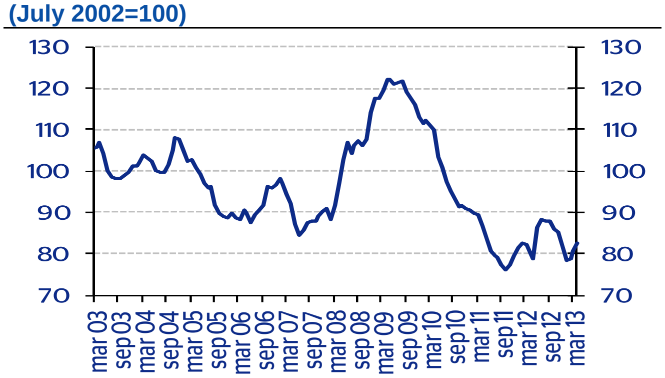
Chart 10
10-year interest rates, last month



Source: Bloomberg & BBVA Research

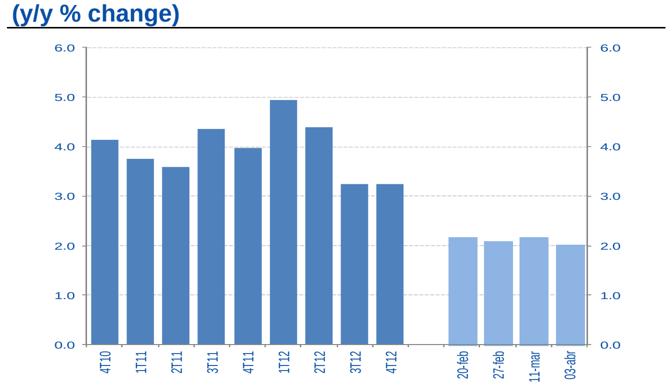
- **Inflation bounced back in the first half of March above the expected level. However, we consider that the upturn will be temporary and reach its high in April, after which it will moderate mid-way through the year.**

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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