Mexico Weekly Flash

Next week…

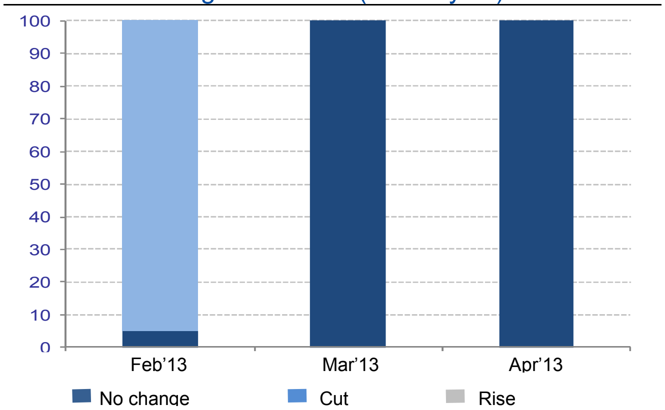
- **Monetary policy rate remains unchanged in the face of higher inflation**

  Next Friday sees Banxico release its monetary policy decision. We expect the rate to remain unchanged based on the following factors. Firstly, annual inflation has increased to 4.25% since the last monetary policy meeting. Although this increase is seen as temporary and core inflation sits around 3.0%, these levels lead us to believe that inflation will remain above-target for 3 months or more and end the year at 3.8%, still far from hitting the 3.0% target. Secondly, recent economic output figures point to a slowdown which is expected to reverse in the second half of the year. Manufacturing exports and automotive output show signs of weakness while industrial output figures for the US remain positive. This could point to the slowdown reversing in coming months - a forecast the central bank governor agreed with during his speech to the senate. In turn, with regard to the statement, we will need to watch for news on a stronger currency and the possible unnecessary toughening of monetary conditions, especially in the face of market expectations of a possible intervention in the currency market in an ongoing global liquidity scenario.

- **Concerns surrounding growth lead to declines in commodities prices and a pause in higher emerging currency rates although the interest rate rally continues**

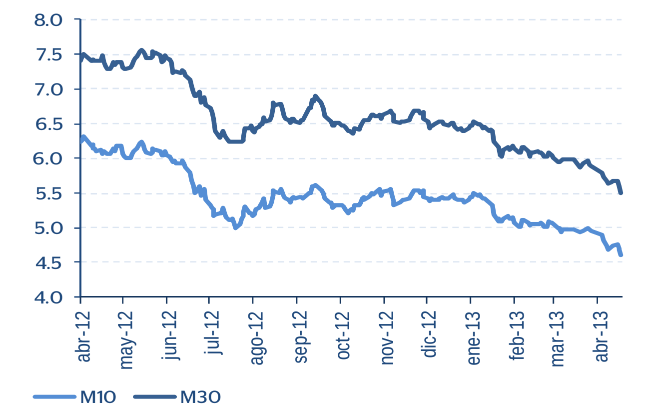
  Concerns surrounding global growth re-emerged this week. Concerns surrounding the strength and sustainability of global growth reappeared over the last week after the release of Chinese growth figures for 1Q13 (lower-than-expected at 7.9% y/y) and mixed data from the US. Regional indicators for industrial output in April in this economy (below expectations) point to a driving factor for growth in 1Q13 possibly seeing its positive contribution drop in 2Q13. This re-emergence of concerns is behind the decline in commodities prices this week and impacted the volatility in emerging currency rates. Nonetheless, demand for risk assets continues to be linked to monetary expansion and higher global liquidity. A sign of this is the continued increase in prices on fixed-income markets.

Chart 1
Expectations of next movement in the monetary policy rate in the coming six months (% analysts)



Source: BBVA Research with data from the Financial Market Analysts' Survey

Chart 2
Interest rates: M10 and M30



Source: BBVA Research with data from Bloomberg

Calendar: Indicators

Retail sales (April 22)

Forecast: 0.3% m/m (1.1% y/y)	Consensus: n/a	Previous: 2.1% m/m (0.9% y/y)

IGAE (April 25)

Forecast: 0.1% m/m (2.0% y/y)	Consensus: n/a	Previous: 0.2% m/m (2.3% y/y)

Two indicators set to provide greater information on how domestic demand stood in February are set for release this week: the IGAE and retail sales. In both instances, it should be stated that as 2012 was a leap year, there will be a negative base effect for these indicators, as seen in the industrial output figures (-1.2% y/y original series, 1.2% CSV in February) meaning the adjusted series should be looked at.

In both cases, we believe that as with manufacturing, the slowdown will continue to be seen in slightly positive growth rates in comparison to the previous month. With regard to retail sales, forecasts point to February seeing growth of around 0.3% m/m (1.1% y/y), bearing in mind growth in wages at the start of the year boosted by real income and formal employment. In turn, IGAE performance is set for release on Wednesday 25. With the industrial output figures (0.5% m/m), we forecast services slowing from 0.4% m/m in January to 0.2% in February. This would mean the Global Indicator seeing 0.1% m/m growth which, in annual terms equates to 2.0%.

Inflation for the first two weeks of April (April 24)

Forecast: -0.12% bi-weekly 4.69% y/y	Consensus: n/a	Previous: 0.73% m/m 4.25% y/y March

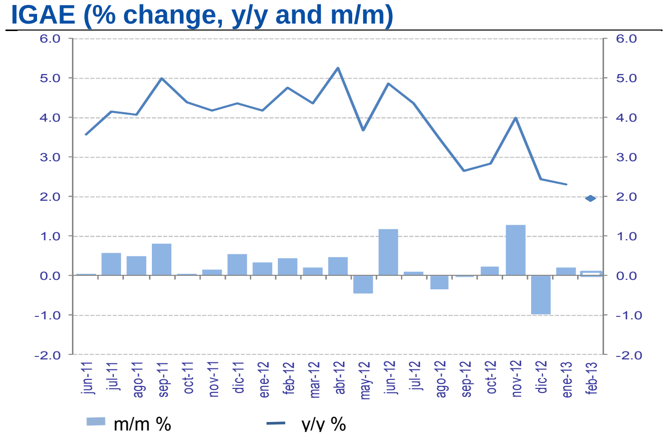
Next week sees the release of inflation figures for the first half of the month. These figures are very important as they are the first to be published with updated weighting for results from the 2010 ENIGH household survey. This update sees several methodology improvements that better reflect Mexican consumption. An example of this is electricity use where the calculation now is based on bills and not just on survey responses. It is also important to update the weighting periodically to reflect increased service consumption such as fixed line telephony that has gained weighting in the basket of goods. Finally, we should highlight that the weighting of core inflation increases in comparison to non-core. This means more stable prices continue to gain importance with a stronger ratio in the economic cycle. Our forecast (calculated with the preliminary weighting) is for inflation to decline -0.12% bi-weekly meaning the annual rate continues to increase, coming in at around 4.7% y/y. We estimate core inflation to increase 0.05% bi-weekly, meaning it continues to be around 3.0% y/y. In this sense, the bounce in inflation is due to shocks in the non-core component, especially in agricultural and livestock products impacted by the bird flu outbreak and the lemon harvest as well as the higher public transport prices in Mexico City this month. Moreover, the lower weighting for energy prices means that despite the drop in prices due to summer rates coming into force, the monthly decline in non-core inflation could be modest. Although inflation will remain around 4.0% y/y for the second month in a row, we believe it will drop from May onwards to come in around 3.85% in December.

Chart 3
Previous inflation weighting and new preliminary levels (% of basket of goods)

	Actual Weights (ENIGH 2008)	Preliminary Weights (ENIGH 2008)	Difference 2010-2008
CPI	100.00	100.00	0.00
Core	76.74	78.82	2.08
Merchandise	34.52	35.01	0.49
Processed food	14.82	14.72	-0.10
Rest of Merchandise	19.70	20.29	0.59
Services	42.22	43.81	1.59
Housing	18.74	19.8	1.06
Other Services	18.36	18.8	0.44
Education	5.13	5.21	0.08
Non-core	23.26	21.18	-2.08
Agricultural and livestock	8.47	8.17	-0.30
Agricultural	3.66	3.26	-0.40
Livestock	4.82	4.91	0.09
Energy and tariffs set by local governments	14.78	13.01	-1.77
Energy	9.51	7.93	-1.58
Tariffs set by local governments	5.28	5.08	-0.20

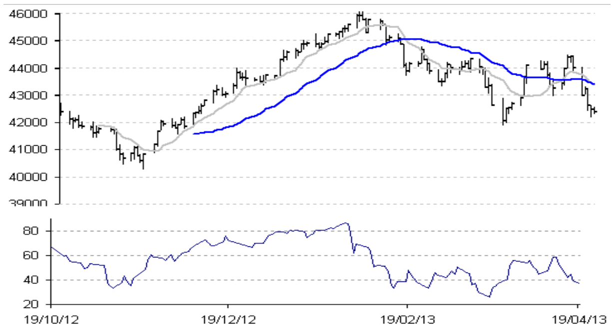
Source: INEGI, weights 2010 are preliminary and could change on publishing day

Chart 4
IGAE (% change, y/y and m/m)



Source: BBVA Research with INEGI data

IPC



Source: BBVA, Bancomer, Bloomberg

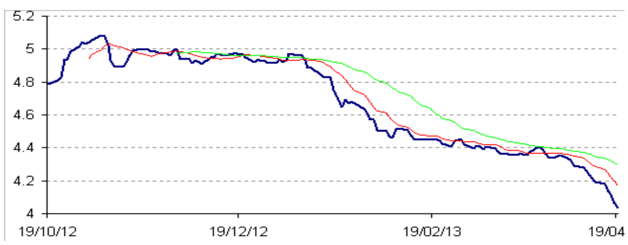
Thanks to the weekly decline, the IPC again hit a major support level at the 200-day rolling average (42,355pts). Unlike previously where the market hit the 200-day rolling average, the RSI is still not at the over-selling zone, trading at 38pts. The minimum value on this oscillating indicator in the recent bounce hit 27pts. This means it is apparent that the market could still seek out the 42,000pts level in the short-term. We believe that this return to the floor represents a new entry opportunity for the short-term although exit levels are set below 42,000pts. In the event of a bounce, the first resistance level the IPC could hit is at 43,300pts where the 10- and 30-day rolling averages trade. **Previous Rec.** (4/15/13): Despite not managing to end the week above this level, the upward signal continues while it trades above the 30-day rolling average at 43,619pts.

MXN

Source: BBVA, Bancomer, Bloomberg

The dollar bounced over the week and found resistance at the 30-day rolling average. We believe it could start a consolidation move with support at MXN12.00 and resistances at MXN12.29 at the same 30-day rolling average. **Previous Rec.** (4/15/13): We believe it has reached the buy level with targets at MXN12.20 and MXN12.38 on the 10- and 30-day rolling averages.

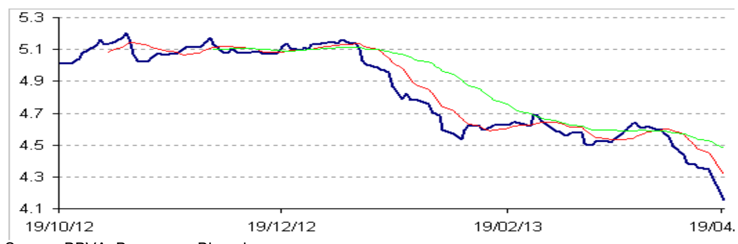
3Y M BOND



Source: BBVA, Bancomer, Bloomberg

3Y M BOND (yield): The 3Y bond maintained its downward move. It could find support at the 4% psychological level. High over-selling with resistances at 4.2% and 4.3%. We can only be on the look out for a technical bounce. The RSI at 9pts indicates this bond having the highest likelihood of starting a bounce before the others. **Previous Rec.** (4/15/13). The RSI being at a very high over-selling level (17pts) leads us to consider a bounce, albeit limited to 4.28% and 4,35%.

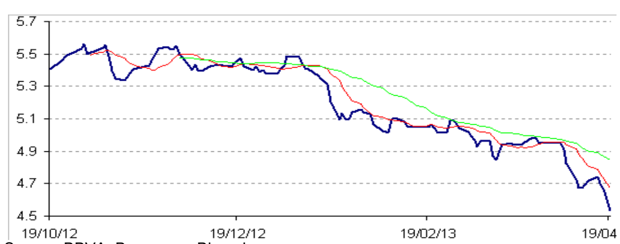
5Y M BOND



Source: BBVA, Bancomer, Bloomberg

5Y M BOND (yield): The 5Y bond is trading with an RSI at 23pts with resistances at 4.3% and 4.5%. High over-selling could cause a short-term bounce. **Previous Rec.** (4/8/13): The RSI at 22pts points to a bounce albeit without a trend change. Resistance at 4.47% and 4.54%.

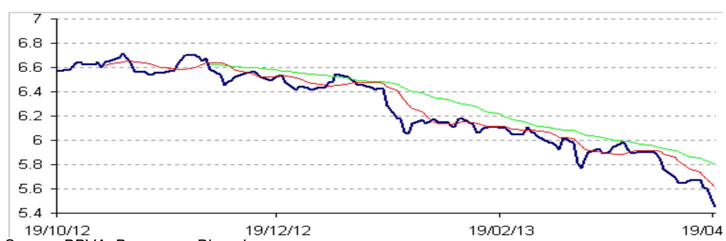
10Y M BOND



Source: BBVA, Bancomer, Bloomberg

10Y M BOND (yield): The 10Y bond is approaching the 4.5% psychological level. Possible bounces toward 4.7% and 4.8%. **Previous Rec.** (4/15/13). We can therefore only consider technical bounces toward these levels.

30Y M BOND



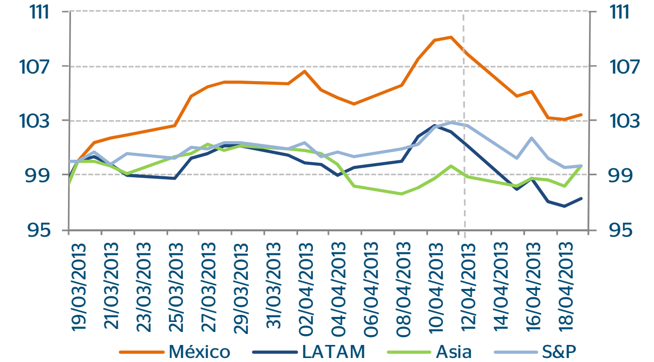
Source: BBVA, Bancomer, Bloomberg

30Y M BOND: (yield): The 30Y bond continues to trade below the 10- and 30-day rolling averages. If the over-selling indicated by an RSI at 18pts causes a bounce, it would hit resistances at 5.6% and 5.9%. **Previous Rec.** (4/15/13). Only breaking this level would mean a trend change. RSI at over-selling level at 26pts.

Markets, activity and inflation

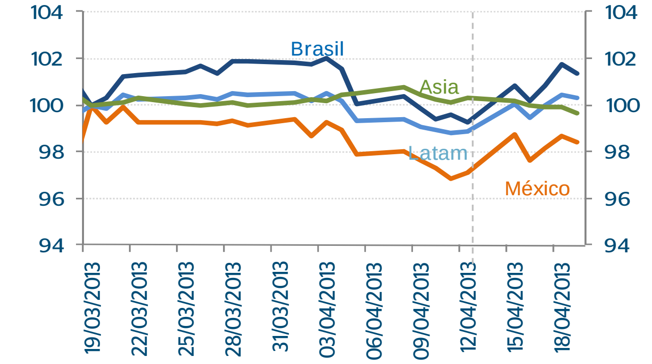
- **Figures of lower-than-expected growth in China and weak construction data and car sales in Europe led to losses on stock markets and weaker currencies. The Mexican stock market was especially impacted by the major decline in the housing sector.**

Chart 7
Stock Markets: MSCI indices (Mar 19, 2013 index = 100)



Source: Bloomberg & BBVA Research

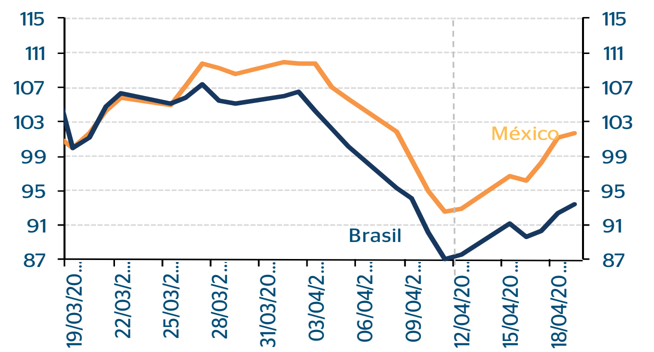
Chart 8
Foreign exchange: dollar exchange rates (Mar 19, 2013 index = 100)



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.

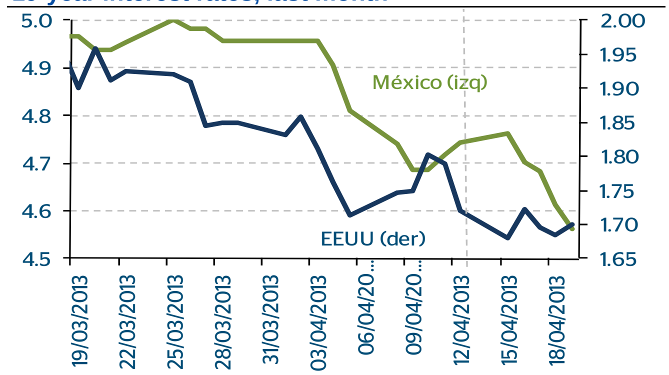
- **Upturn in global risk in light of lower-than-expected macroeconomic data that led to higher demand for low-risk assets. Rates in Mexico declined over the week in line with the drop in US Treasury bonds**

Chart 9
Risk: 5 year CDS (Mar 19, 2013 index=100)



Source: Bloomberg & BBVA Research

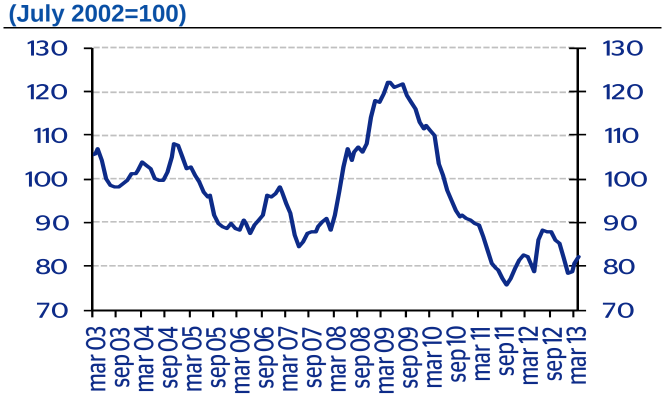
Chart 10
19-year interest rates, last month



Source: Bloomberg & BBVA Research

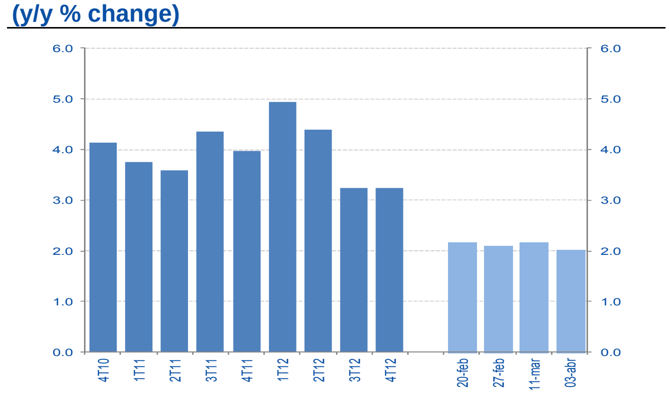
- **Inflation bounced back in the first half of March above the expected level. However, we consider that the upturn will be temporary and reach its high in April, after which it will moderate mid-way through the year.**

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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