Mexico Weekly Flash

Next week…

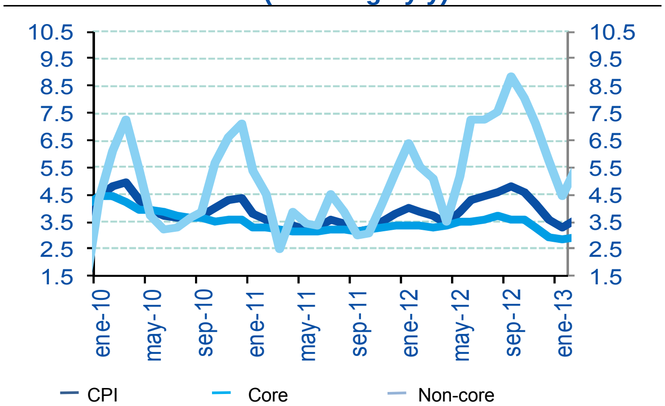
- **Banxico is set to release its economic outlook in the inflation report and highly important figures for assessing the cycle such as industrial output and inflation will be coming out**

Next week will present us with the central bank's outlook for output and inflation this year. The current Banxico forecast is for both GDP and inflation to come in between 3% and 4% this year. A review of these forecasts takes on major importance in a scenario where markets have seen a new policy rate cut as a possibility and heard different statements about it. In addition, figures linked to the cycle will be released, specifically automotive and industrial output for March, which will help fill out information for assessing GDP performance in Q1. Finally, inflation is forecast to come in at 4.7% in April, the high for the year. This is due to recent supply shocks seen on agriculture and livestock markets and the major upswing seen in rates set by local governments in the year-to-date. Nonetheless, core inflation will again come in slightly below 3%, supported by the ongoing slack in the economy, the stronger peso and lower global grain prices. In light of this, we believe inflation will start to come down in May and likely end the year below 4%. The year-end level will depend on how quickly supply shocks and the intensity in mobile telephony offers ease off in the last quarter.

- **ECB and US employment figures drive risk appetite...**

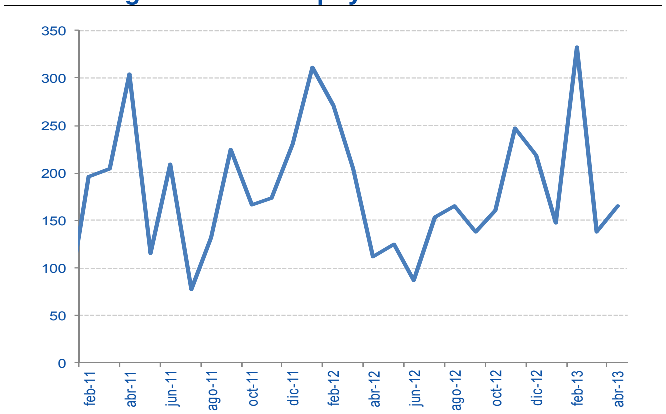
Several factors acted as driving forces for financial markets this week. Market sentiment improved on Thursday thanks to a surprise decline in US unemployment claims and the ECB monetary policy meeting which fulfilled market expectations with a 25bp cut to the policy rate while also signaling the likelihood of a further cut. In this way, the view that global liquidity would remain abundant in the future strengthened and continued to drive risk appetite. US employment figures on Friday showed a surprise bounce (figures for April were lower-than-expected and there were major upward corrections in job creation for the two previous months) and gave an additional push to financial markets that chose to ignore other figures such as the non-manufacturing ISM which fell to 53.1 in April (54 in March). The MXN continued its positive bias and long-term interest rates in Mexico saw additional declines despite the major upswing in the US after the release of job figures. In this way, the MBonds curves seems to be responding to domestic factors such as market expectations of a possible further cut in the lending rate while the peso continues to show a positive difference.

Chart 1
Inflation breakdown (% change y/y)



Source: BBVA Research with INEGI data

Chart 2
US: Change in non-farm payroll



Source: Bloomberg

Calendar: Indicators

April Inflation (May 9)

Forecast: 0.13 m/m 4.72% y/y	Consensus: 0.09% m/m	Previous: 0.73% m/m 4.12% y/y

Gross fixed investment data indicator for February (May 8)

Forecast: 0.9% m/m (2.5% y/y)	Consensus: n/a	Previous: 3.0% m/m (2.2% y/y)

Industrial output, March (May 10)

Forecast: 0.6% m/m (1.8% y/y)	Consensus: n/a	Previous: 0.5% m/m (1.2% y/y)

This week sees the release of key output indicators for the first quarter. Although the figures are fairly behind, investment in February should confirm the slight bounce on the indicator. It should be stated that capital goods imports increased in February by around 7.2% (all figures are corrected for seasonal variation) in dollar terms which will be reflected by higher machinery and equipment investment equivalent to around 6% growth. In turn, the construction industry saw an upswing in March of around 1.9% y/y. We estimate total investment to see a 2.5% y/y increase in February (0.9% m/m).

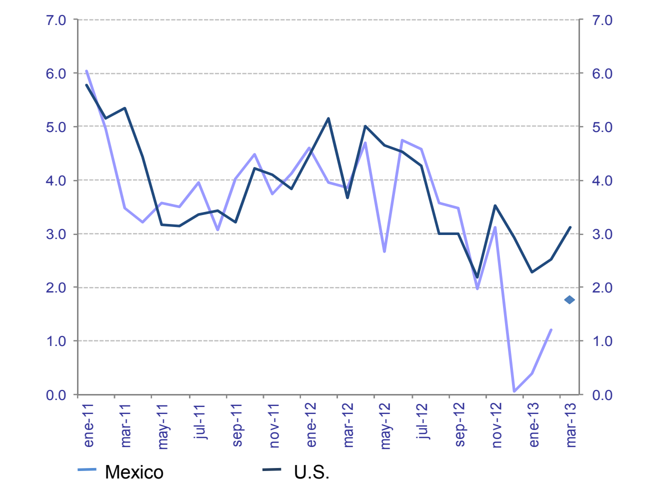
More hard data will come out this week in the guise of industrial output for March. After the major slowdown in December mainly linked to the construction industry, total industrial output has again started a slow but steady path to recovery. It should be highlighted that construction saw a surprise decline of (-)4.1% y/y ([-]3.6% m/m) in December - the biggest decline since July 2010. Indicators such as the US industrial sector and especially manufacturing of both durable and non-durable goods contribute to a forecast for manufacturing having benefitted from the good performance in foreign demand, with growth coming in around 1.8% y/y (0.6% m/m).

Structural Indicators for Occupation and Employment 1Q13(May 10)

Forecast: 5% (unemployment rate)	Consensus: n/a	Previous: 5% (unemployment rate)

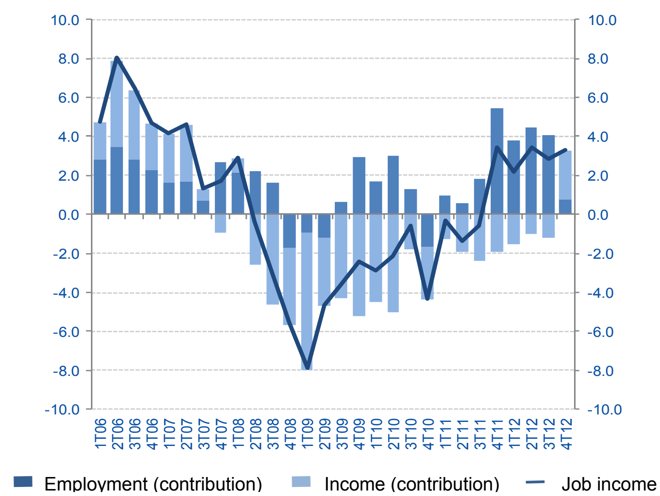
Structural employment indicators for the first quarter will provide a clearer picture of job income at the start of the year. These ENOE indicators are full of information since we will get details on employment created in the first months of the year for the entire labor force. It should be underlined that in 4Q12 the workers who made a greater contribution to the 0.8% increase in employment were those paid up to 3x minimum wage; nevertheless, in terms of annual change, income in real terms saw a slight recovery which led to job income growth (a combination of employment and income) remaining stable at around 3% per year.

Chart 3
Industrial output, US and Mexico (% change y/y)



Source: BBVA Research with INEGI and Bloomberg data

Chart 4
Job Income
(% change y/y and contribution to growth)

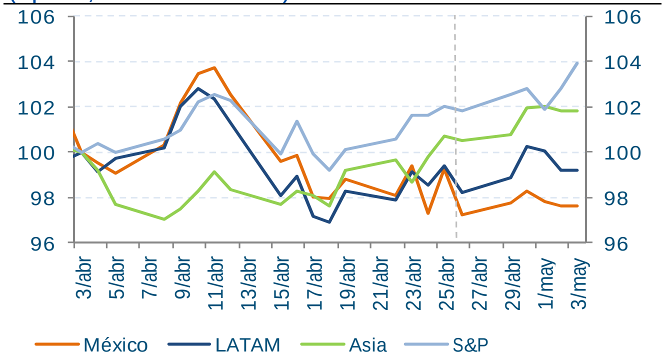


Source: BBVA Research with INEGI data

Markets, activity and inflation

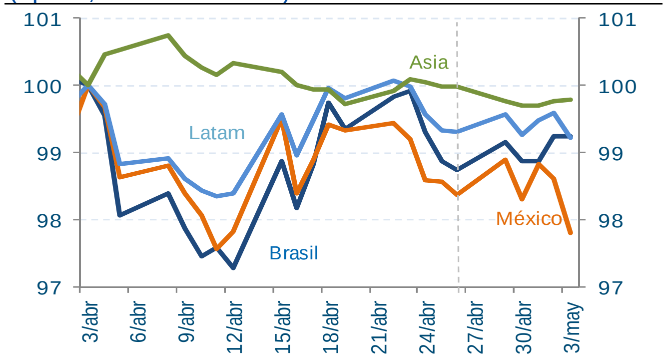
- **Higher-than-expected job creation in the US in April and the major upward revision for the previous two months strengthened markets. Higher risk appetite contributed to a stronger peso at the end of the week meaning it continues to show a positive difference.**

Chart 7
Stock Markets: MSCI indices
(April 3, 2013 index=100)



Source: BBVA Research with data from Bloomberg

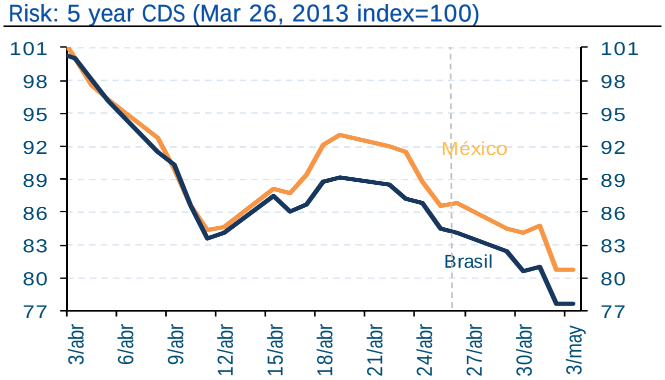
Chart 8
Foreign exchange: dollar exchange rates
(April 3, 2013 index=100)



Source: BBVA Research with Bloomberg data NB: LATAM includes Argentina, Brazil, Chile, Colombia and Peru. Asia includes the Philippines, South Korea, Taiwan, Singapore, Indonesia and Thailand.

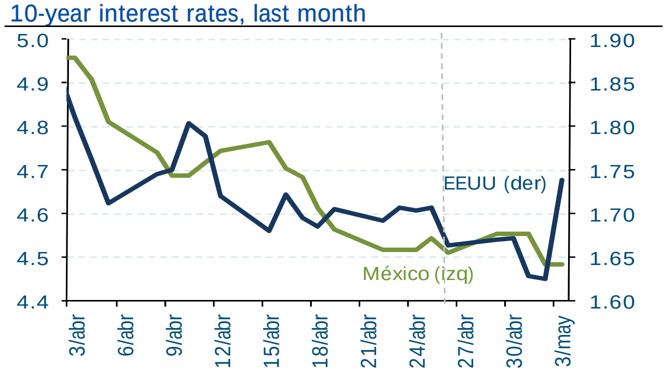
- **After remaining relatively stable over the week, the positive surprise in US job figures for April led to a major upswing in long-term US interest rates at the end of the week. In contrast, rates in Mexico declined with their performance seeming to respond to monetary policy expectations.**

Chart 9
Risk: 5 year CDS (Mar 26, 2013 index=100)



Source: BBVA Research with data from Bloomberg

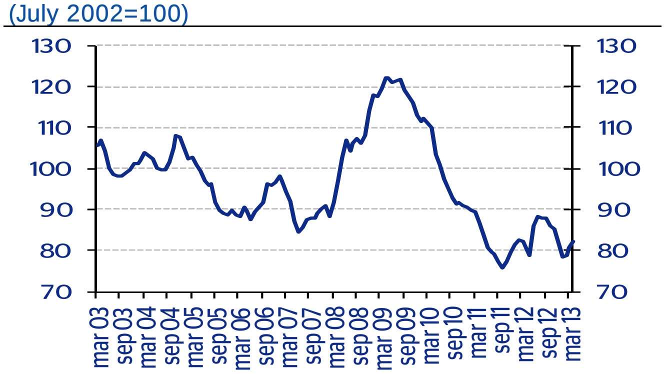
Chart 10
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

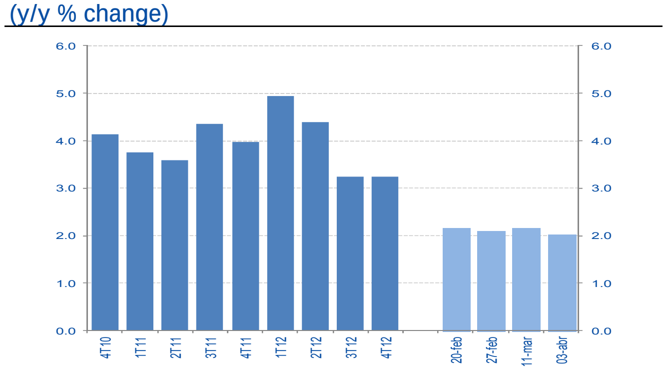
- **Inflation moved up in the first two weeks of March above expectations. Nonetheless, we believe the bounce will be temporary and have hit a high in April.**

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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