Mexico

Weekly Watch

18 February 2011

Economic Analysis

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Next week…

GDP for the close of 2010 will have grown at the same rate as the previous quarter

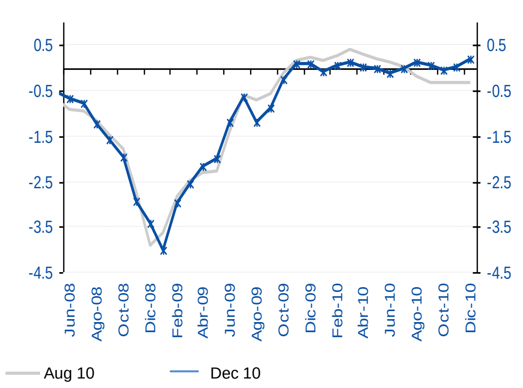
We shall receive news this week of the evolution of GDP during the last quarter of 2010. Known data indicate that over the last months of the year activity interrupted the slowdown of the previous quarter as a result of an improvement of external demand and its recovery domestically. Therefore, the monthly variation in manufacturing went from 0% in the 3rd quarter of to 1.3% in the 4th, with recoveries both in sectors more linked to external demand and in those with greater dependence on the domestic market. Indeed, variables related to household spending such as employment or consumer confidence evolved favorably in the period. On the other hand, demand figures in the construction and mining sector continue to be slightly unfavorable, as well as, to a certain extent, those related to investment. In all, we estimate that GDP will have grown 0.6% in 4Q10 (3.6% year-on-year), which would imply an average annual growth of 5.2%.

On the other hand, inflation over the first two weeks of February will be again affected by a favorable base effect, reaching 3.6%, compared to 3.8% in January. The falling trend will continue in March, but we will need to be attentive to the possible impact of the Sinaloa corn harvests losses. All in all, supply side surprise, relative price changes without implications on monetary policy.

Economic data in the USA positive for assets markets

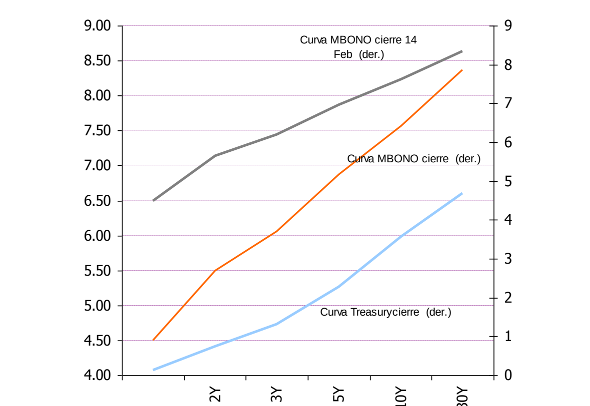
The rates rally seen last week was mainly caused by the easing of the Treasury Bonds curve as well as the slightly dovish monetary policy tone of certain members of the Federal Reserve. We consider that the local debt curve in Mexico is still very steep where the short sections are in the selling zone. For its part, the MXN closed on Friday without changes after having moved between 12.0 and 12.15 during the week. Parity will continue to be affected by US data, and bad news from that region could send it to 12.15.

Chart 3
BBVA Synthetic Activity Indicator of activity for the Mexican economy



Source: Banxico

Chart 2
Yield Curve (%)



Source: BBVA Research with Banxico data

Economic Analysis

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Calendar: Indicators

GDP 4Q10, IGAE in December

Monday 21 February

GDP: 0.6% q/q, 3.6% y/y SA (previous: 0.7% q/q, 5.3% y/y SA) 2010 Estimate: 5.2%

IGAE: 0.8% m/m, 4.7% y/y, SA (previous 0.7% m/m, 4.7% y/y)

In addition to the upturn over recent months resulting from the foreign cycle, two additional factors will have been the stability in statistics linked to domestic demand and the upturn in manufacturing sectors linked to the domestic market. It should be remembered that formal private employment grew at an accelerating rate all year and particularly over the last half of the year.

Inflation

Thursday 24 February

0.21% over two weeks (3.64% y/y); (Previous: 0.49% m/m, 3.78 y/y) Consensus (0.17% over two weeks)

On Thursday, inflation figures for the first two weeks of February will be released: we forecast a figure of 0.21%, a rise mainly caused by processed foods. Core inflation will increase 0.1% over two weeks, less than in previous two-week periods, mainly as a result of rises in the prices of tortillas and tobacco. It is important to monitor the possibility of a greater impact than so far observed of international grain price rises on consumer prices. With regard to non-core inflation, the risk is in agricultural and fishing prices due to the possible impact of recent adverse climate in Sinaloa, one of the main agricultural regions of the country. We reiterate our expectation of a fall in annual inflation during 1Q11, however, the degree of this fall may be limited if grain price increases in international markets and/or agricultural losses suffered nationally continue.

Balance of payments 2010

Friday 25 February

Current Account Balance (-0.8% of GDP in 2010, previous: 0.6% of GDP in 2009)

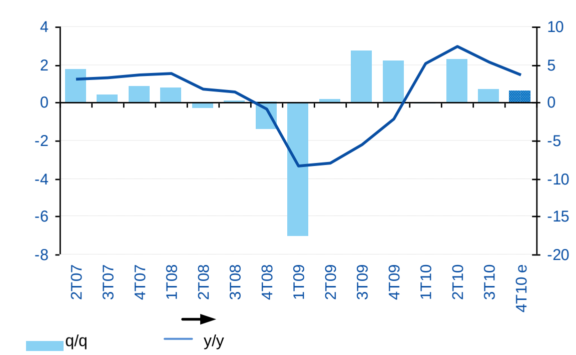
We will be informed next week of the Balance of Payments for 2010 as a whole. We estimate that the balance at the end of the year will negative and amount to 0.8% of GDP, due to the small trade deficit of the country during the year, which amounted to US$3.121 million. This result is linked to persisting asymmetries in the country's recovery. The foreign sector has experienced a much more dynamic recovery, as shown by the fact that the import of intermediate goods has grown considerably more than that of consumer goods or capital. The lower current account deficit generates neither financing difficulties nor very pronounced growth in domestic demand.

Table 1
Estimated inflation by component (% y/y and m/m change)

	Peso	Monthly change (%)				Annual change (%)		
	(%)	Average 2003-2009	Dic-10	Ene-11	Feb-11	Dic-10	Ene-11	Feb-11
CPI-Mx	**100.0**	**0.31**	**0.50**	**0.49**	**0.33**	**4.40**	**3.78**	**3.53**
Core-Mx	*74.8*	*0.42*	0.43	0.46	*0.35*	3.58	3.27	*3.21*
Goods	37.0	0.43	0.48	0.73	0.45	3.82	3.60	3.63
Food products	14.7	0.50	1.08	1.41	0.61	4.35	4.51	4.71
Other Goods	22.4	0.39	-0.02	0.20	0.34	3.38	2.88	2.78
Services	37.7	0.41	0.39	0.23	0.26	3.36	3.00	2.86
Rent	17.9	0.48	0.17	0.23	0.25	2.64	2.34	2.16
Education	5.2	0.35	0.00	0.31	0.26	4.64	4.62	4.61
Other serv.	14.7	0.37	0.74	0.21	0.28	3.58	3.06	2.91
Non Core-Mx	*25.2*	*-0.06*	0.70	0.57	*0.29*	7.09	5.39	*4.54*
Farm products	8.1	-0.63	1.41	-0.27	-0.24	6.96	4.03	2.85
Fruits//Vegetables	3.3	-2.93	2.64	-0.82	-0.81	14.00	7.50	4.80
Meat//Eggs	4.8	0.94	0.55	0.18	0.20	2.46	1.77	1.63
Public managed	17.2	0.29	0.25	0.98	0.59	7.16	6.15	5.46
Energy	7.8	0.00	0.25	0.92	0.46	6.44	6.12	5.77
Controled prices	9.4	0.78	0.25	1.11	0.74	8.39	6.20	4.90
					Monthly Revision			*Monthly Revision*

Source: BBVA Research and Banxico

Chart 4
Mexico: GDP (% q/q and y/y change)



Source: BBVA Research and Banxico

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Markets

The curve rate diminishes during the week with a backdrop of reduced volatility in international markets: short terms in selling zone.

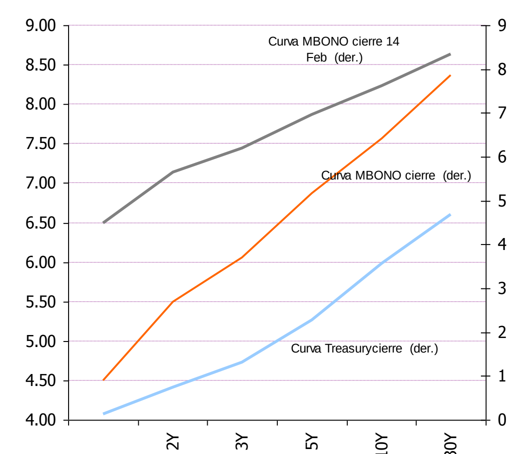
The rates rally seen last week was mainly due to the easing of the Treasury Bonds curve. Three factors dominated this scene: a) greater appetite for debt instruments due to Middle East developments; b) reports without significant surprises and with mixed results; c) the slightly dovish tone of members of both the Federal Reserve and the Bank of England. The local curve experimented strong falls in the short and medium terms.

In our opinion, the curve is still exaggeratedly steep given the monetary context and current inflation. In the future the latter will continue to show significant relevance in the evolution of the curve, in both downward and upward corrections. We estimate that the short sections of the curve are in the selling zone, given that the middle term monetary context has not changed. We continue to support the idea of implementing "*Butterfly*" strategies, which are conservative but more immune to volatile rates environment and even more so given the uncertainty of the remaining stretch. The steepness of the local debt market continues to point to these strategies.

The MXN closed on Friday without changes after having moved between 12.0 and 12.15 during the week. Parity will continue to be sensitive to US economic data

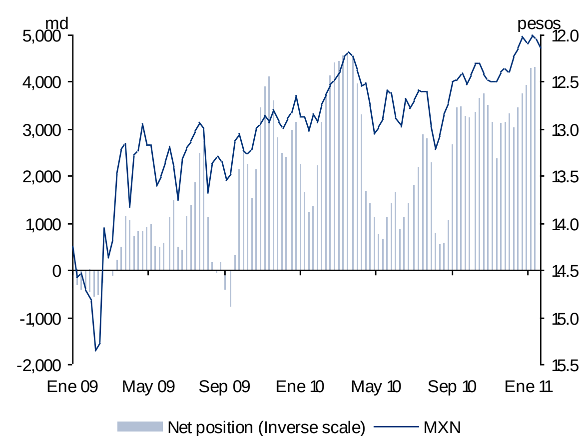
Although the short position of the USD in a seven-currency basket (GBP, CHF, EUR, AUD, CAD, JPY, MXN) in the CME dropped by USD2.9 billion, the long position of the MXN increased by USD178 million. The aforementioned was in spite of the 0.9% decrease in the value of the MXN during the reference period. However, the currency continues without breaking the support zone of 11.98 and the risks of positions closings are starting to increase. Therefore, any negative surprise from the US this week could lead to a new correction in the 12.15 zone, where we recommend long MXN positions to take advantage of range movements with 12.0 as the target.

Chart 5
Yield Curve (%)



Source: BBVA Research with Banxico data

Chart 6
Non-commercial positions in MXN (US$ million)



Source: BBVA Research with data from Bloomberg

Mexico City, 18 February 2011

Market Analysis

Equities

Technical Analysis

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Technical Analysis

CPI Stock Market Index

Source: BBVA, Bancomer, Bloomberg

Consumer Price Index: the weekly gain made it possible for the CPI to return once again to the 30-day rolling average and to the high limit of the negative short term range within which it has fluctuated throughout the year. The double dip from which the market is recovering (36,600pts) may cause the upward breakthrough of these levels, especially when the CPI continues to lag by -9.3% when compared to the US so far in the year. Some technical CPI oscillators such as the RSI or MACD suggest that the rebound could extend. A breakthrough of 38,000, together with the exit from the market of the short term negative range would send a clear upward message for the coming weeks with a new objective at 39,000pts.

Previous recommendation: We recommend taking positions and taking advantage of this pull-back, and increasing them if the trend changes.

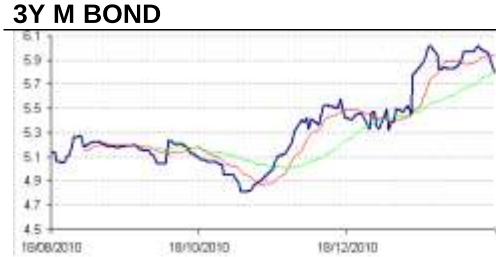
MXN

Source: BBVA, Bancomer, Bloomberg

MXN: returns to the support zone between P$11.95 and P$12.00, again situating itself below the 10 and 30 day rolling averages. Oscillators are not over-sold and maintain their downward tendency.

Previous recommendation: The downtrend remains, and we can expect a return to the floor level between P$11.95 and P$12.00.

3Y M BOND

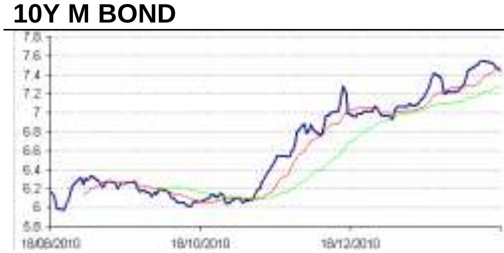


S
ource: BBVA, Bancomer, Bloomberg

3Y M BOND (yield): Correction toward 30-day rolling average (5.8%). The MACD indicates that this correction can be extended to the next support of 5.6%.

Previous recommendation: We believe that the upturn may end at the earlier maximum of 6%, with support at 5.7%.

10Y M BOND



Source: BBVA, Bancomer, Bloomberg

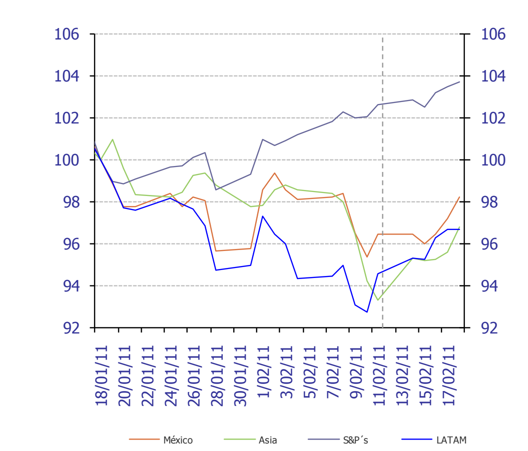
10-YEAR M BOND: (yield): Closes this week below the 10-day rolling average and could move toward the 30-day rolling average (7.3%) should short-term rolling averages expand.

Previous recommendation: We see a possible return to 7.1% before the resistance is broken.

Markets

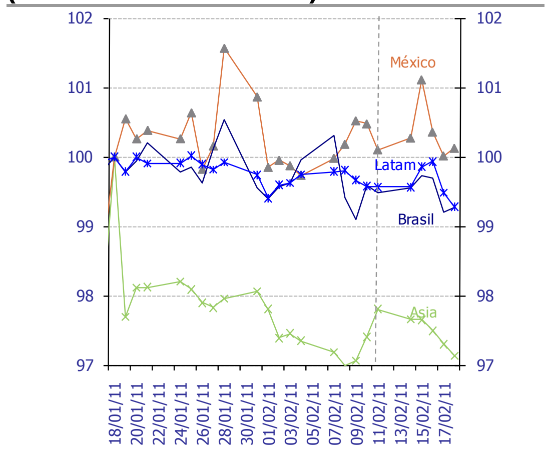
Rise in stock markets and appreciation of peso from mid-week due to better-than-expected data in the manufacturing, real estate, and corporate sectors in the US, in addition to the Federal Reserve's growth expectations

Chart 5
Stock markets: MSCI indices (Jan 18 2011 index = 100)



Source: Bloomberg & BBVA Research

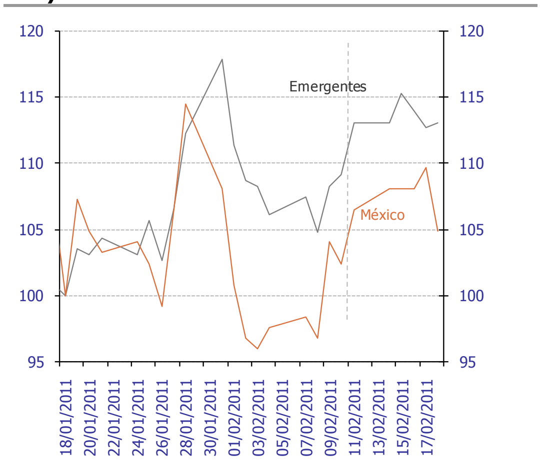
Chart 6
Foreign exchange: Dollar Exchange Rates (Jan 18 2011 index =100)



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. Non-weighted averages.

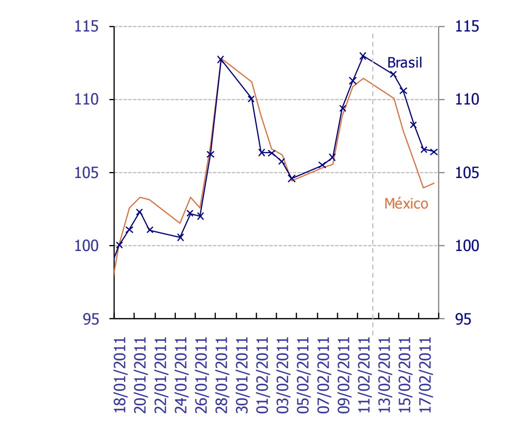
Drop in risk aversion at the end of the week due mainly to data supporting expectations of greater growth

Chart 7
Risk: EMBI+ (January 18 2011 index = 100)



Source: Bloomberg and BBVA Research.

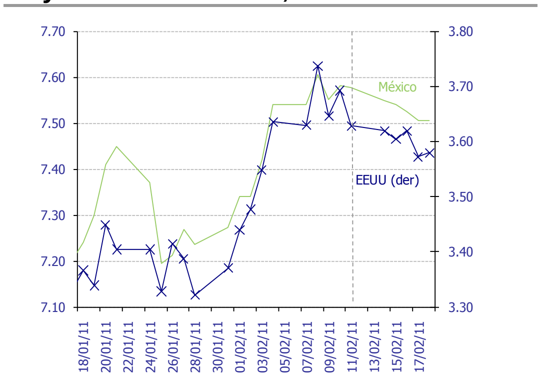
Chart 8
Risk: 5-year CDS (January 18 2011 index =100)



Source: Bloomberg and BBVA Research.

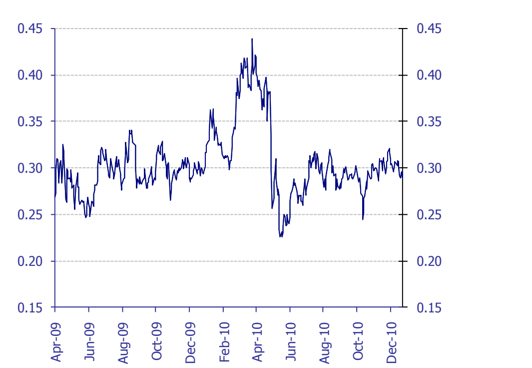
Drop in US rates due to greater demand resulting from new geo-political risks in the Middle East. Rates in Mexico move in line

Chart 9
10-year interest rates*, last month



Source: Bloomberg and BBVA Research

Chart 10
Carry-trade Mexico index (%)

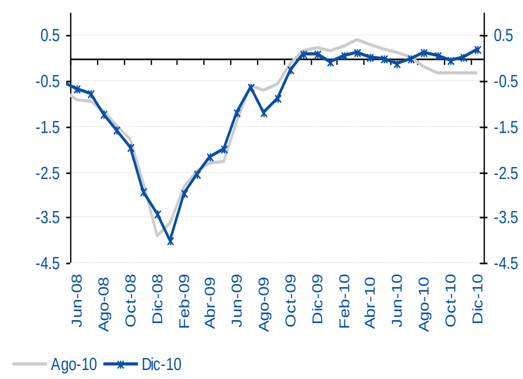


Source: Bloomberg and BBVA Research

Activity, inflation, monetary conditions

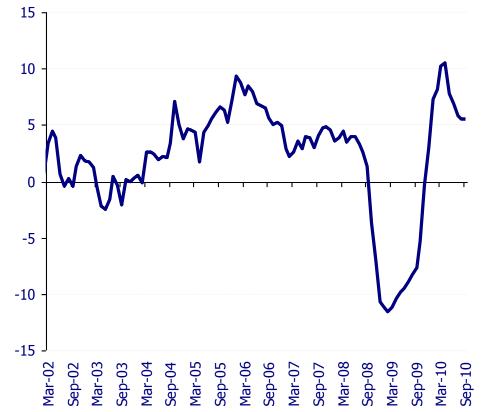
Economic activity in Mexico has improved, but the speed of recovery appears to have moderated

Chart 11
BBVA Synthetic Activity Indicator of activity for the Mexican economy



Source: BBVA Research with data from INEGI, AMIA and BEA
Weighted sum of 21 different activity indicators, expenditure and expectations, based on trend series.

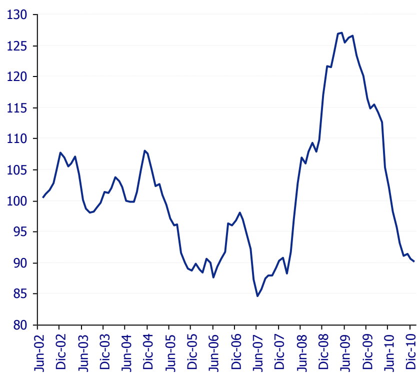
Chart 12
Advance Indicator of Activity (% variation y/y change)



Source: INEGI

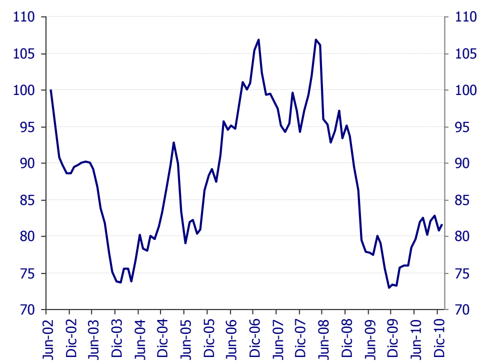
Inflation surprises fell throughout most of 2010, while activity surprises were moderate.

Chart 13
Inflation Surprises Index
(July 2002=100)



Source: BBVA Research with data from Banxico from the monthly surveys on the expectations of economic specialists in the private sector.

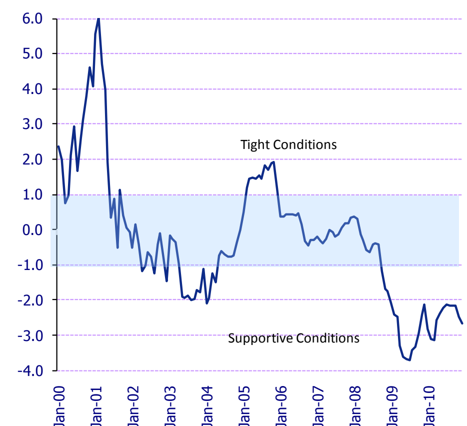
Chart 14
Activity Surprise Index
(2002=100)



Source: BBVA Research with data from Bloomberg. Difference between recorded data and the Bloomberg consensus for seven activity variables in Mexico. Standardized index. Rises (falls): positive (negative) surprises.

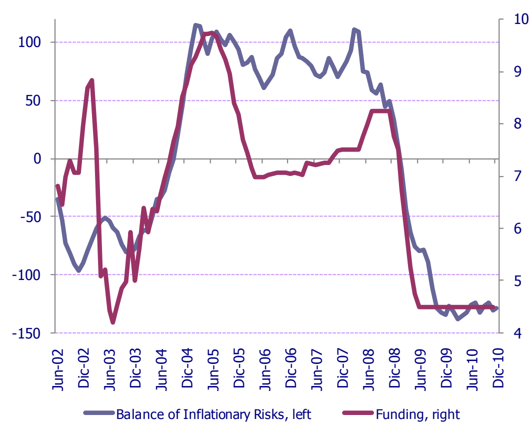
The monetary conditions in which the economy is moving are accommodative. No upward movements are therefore expected to the reference rate in the short term

Chart 15
Monetary Conditions Index



Source: BBVA Research

Chart 16
Balance of Inflationary Risks* and Funding (standardized and %; monthly averages)



Source: BBVA Research. *Standardized, weighted index (between inflation and economic growth); uses economic indicators for activity and inflation. A rise in the IBR signals greater weight of inflationary risk over those of growth and, therefore, more likelihood of monetary restriction

IMPORTANT DISCLOSURES

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