BBVA Research

Mexico

Weekly Watch

March 25, 2011

Economic Analysis

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Next week…

Economic output in January and clues as to what will come with public finance information. Downward surprise in inflation

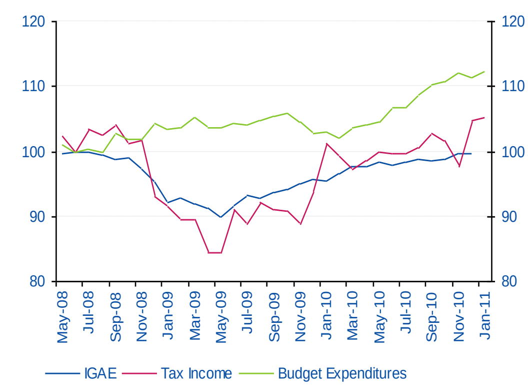
The coming week starts with hard output data for the beginning of the year. The January IGAE index will provide important information on whether the services sector speeded up at the start of the year as was true for industry (especially manufacturers). Although this could be a situation upturn, available information to date regarding demand factors performance toward the end of last year point to foreign demand slowing above forecasts. This created an output moderation trend seen in public finance indicators and tax receipts whose performance for the second month of the year will be released this week.

As for prices, there was a surprise downward move this week. Inflation in the first two weeks of March was 0.05% q/q taking annual inflation over the period to 3.09%. The lower rate is due, among other reasons, to the fall in different agricultural product prices and ownership collection in some cities. The good core inflation performance should also be underlined, coming in at 3.31% for the year despite the increase in corn tortilla prices. We will need to see inflation data for the second two weeks of March to confirm this good performance.

Despite persisting global uncertainty, the appetite for risk continued leading to an appreciation in the MXN over the week and the debt market with some volatility, albeit with a flattening out trend.

In spite of global events increasing risk (the conflict in Libya and the crisis in Portugal), the MXN closed the week 0.66% higher. Nonetheless, uncertainty remains and, if it flares up again, we may well see technical corrections for the currency. Strategies on the debt market were aimed towards reducing curves: these came under heavy pressure at the start of the week, hitting attractive levels for long positions on 5-, 10-year bonds and longer sections. The balance of risks suggests May could be the best time to take positions on flattening out with rate increases

Chart 1
Public Finance and Output Indicators, Real seasonally-adjusted (Jun08 = 100)



Source: BBVA Research and INEGI

Chart 2
MXN and VIX (ppd)

Source: BBVA Research and Bloomberg

Economic Analysis

Calendar: Indicators

Public Finances in February

Wednesday, March 30

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This week sees the publication of the public finance indicators for February. The performance will be important both as an output sign, an indicator of public sector demand and to assess the sector's financial situation. Although with a positive performance in comparison with the same period last year, tax receipts tended to see a slowdown mainly linked to lower revenue from VAT. This, in turn, could be linked to a slowdown in private consumption at the start of the year. Further, it will be important to see the performance of current and capital expenditure indicators which, in turn, are linked to public sector demand – a major factor in domestic demand. In this sense, it should be stated that although capital expenditure stood out in recent months above current expenditure, the weight of the former (around 18% of budgetary spending) limits its contribution. Lastly, we will also see the performance of public sector finances which, in terms of trend and given income and expenditure, are in the red since 2009.

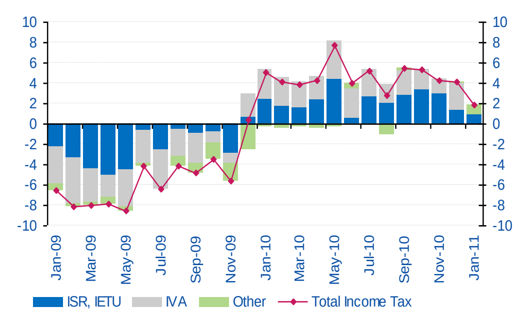
IGAE in January

Monday March 28

0.56% m/m (4.9% y/y), previous (0.07% m/m 4.1% y/y)

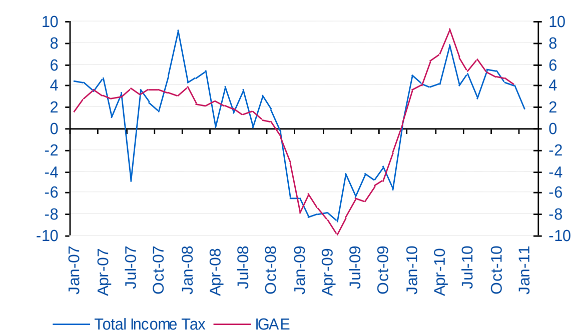
Taking into account the positive surprise in industrial output last January (1.4% m/m), the IGAE is likely to show some upswing in service sector evolution with those linked to foreign demand possibly having a good performance. In all, we should expect a slowing trend in comparison with the same period last year.

Chart 2
Tax Receipts (real y/y % change, seasonally-adjusted and contributions)



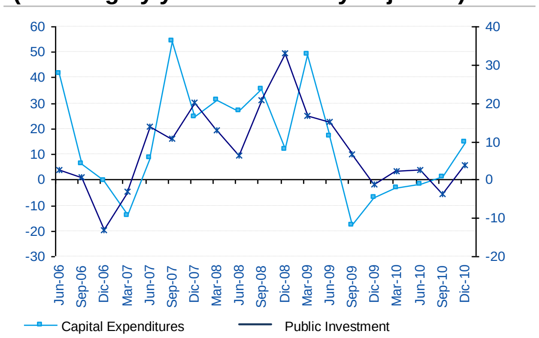
Source: BBVA Research, and SHCP, seasonal adjustment obtained with Tramo-Seats

Chart 3
IGAE and Tax Receipts (y/y % change, seasonally-adjusted)



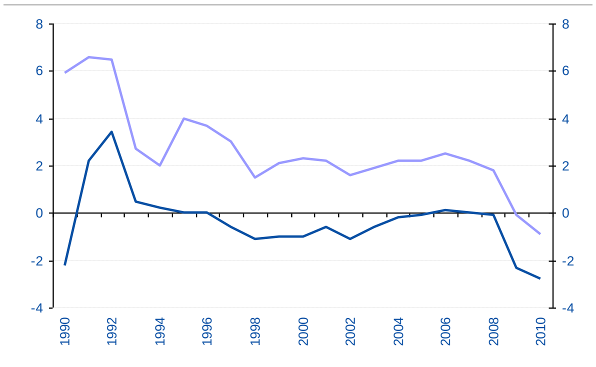
Source: BBVA Research, INEGI and SHCP, seasonal adjustment obtained with Tramo-Seats

Chart 4
Public Investment and Capital Expenditure (% change y/y and seasonally-adjusted)



Source: BBVA Research, and SCHP, AR: seasonal adjustment obtained with Tramo-Seats

Chart 5
S Financial Situation of Public Sector (% GDP)



Source: BBVA Research, and SHCP, trend obtained with Tramo-Seats

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Markets

Despite continuing global uncertainty, the appetite for risk on markets continues…

The risks due to the Japanese nuclear crisis dissipated somewhat, but several risk factors arose last week on global markets: the persistent geopolitical tension in Libya and greater uncertainty regarding the fiscal situation in European periphery nations (the crisis in Portugal with the rejection of the austerity measures and the resignation of Prime Minister). Despite this scenario, the appetite for risk remained high.

…leading to volatility on the Mexican debt market, with a flattening out trend (the debt curve ended with practically no level changes)…

Strategies were aimed as a curve reduction. This performance comes in a scenario of no directional moves: curves came under strong pressure at the start of the week, attaining attractive levels for long positions on 5- and 10-year bonds and longer sections. However, these were partially diluted with a quick profit-taking at the end of the week. The balance of risks suggests May could be the best time to take positions in aggressive flattening out with higher rates (Bear Flattener) between belly (5- and 10-year bonds) and short terms, as well as between the long and short part.

In addition, an extraordinary 182 and 350 day Cetes auction for monetary regulation was seen with the aim of removing excess market liquidity (large amounts of MXN 37.5 billion for each year).

…and the MXN closing the week 0.66% higher although technical corrections are not ruled out.

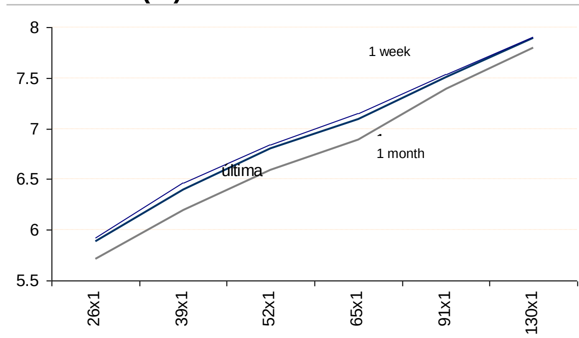
The currency showed a high correlation level with the EUR, the same seen on Friday (which was also positive for stock markets) when a slight gains correction in the European currency was seen in the face of risks linked to Portugal.

It is important to underline the latent risk factors linked to the EU, commodity prices and geopolitical conflicts. If these fall back, we may well see technical corrections for the currency. Taking into account the relative strength of the MXN recently and forecasts for a return of the global economic cycle as the focal point, we recommend any return to the 12.07 zone to take long positions on the MXN.

Chart 5
MXN and VIX (ppd)

Source: BBVA Research and Bloomberg

Chart 6
IRS Curve (%)



Source: BBVA Research with data from Bloomberg

Technical Analysis

Mexico City, March 18, 2011

Market Analysis
Equities

Technical Analysis

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CPI Stock Market Index

Source: BBVA, Bancomer, Bloomberg

CPI: the weekly CPI bounce is important since, after several failed attempts, it finally comes in above the 30-day rolling average. In turn, it ends the week above the negative trend line under which it has stayed for almost three months. The rise came about with 3 consecutive positive closes, a technical course considered to be a positive sign, especially when it comes after a steep fall. Only a return to below 36,500 points would be of concern, coming in below the 10-day rolling average.

Previous rec.: With the majority of issuers heavily weighted in the oversell zone, we should begin to see a reaction by the CPI, to return at least to the high part of the channel, around 36,500 points.

MXN

Source: BBVA, Bancomer, Bloomberg

MXN: remaining around the P$11.95 level all week, ending with a slight upswing in the last session. The momentum oscillating indicators are still not at high oversell levels; therefore, we would not be considering a short-term bounce. Significant resistance comes in at P$12.043 and only breaking this level would lead us to consider a return to P$12.20.

Previous rec.: We believe that it will again go to the support zone of P$11.95.

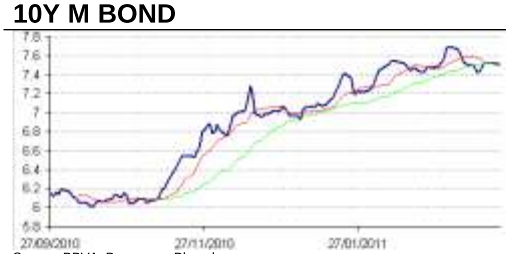
3Y M BOND

Source: BBVA, Bancomer, Bloomberg

3Y M BOND (yield): Return to previous maximum of (6.1%) where it may see resistance. The sign to consider a trend change would only come about with a downward break in the 30-day rolling average (5.95%)

Previous rec.: For now the upward trend continues, with a rebound foreseen around the 6.2% level. Support levels at 5.9% and 5.75%.

10Y M BOND



Source: BBVA, Bancomer, Bloomberg

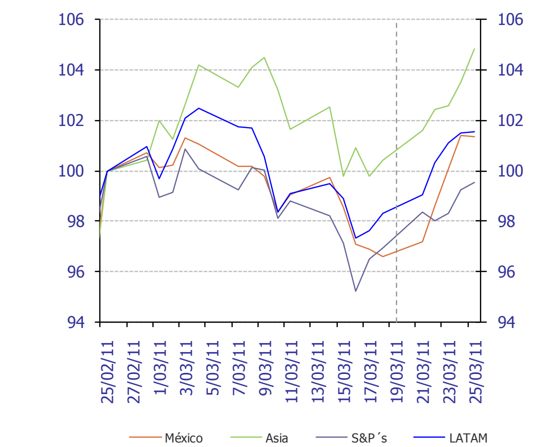
10-YEAR M BOND: (yield): It looks like the upward trend is losing ground since the 10-day rolling average came in below the 30-day average. An adjustment may be starting.

Previous Rec.: Major support at 7.4%. Should this level be broken downward, the short term tendency would change, with support levels at 7.2% and 7%.

Markets

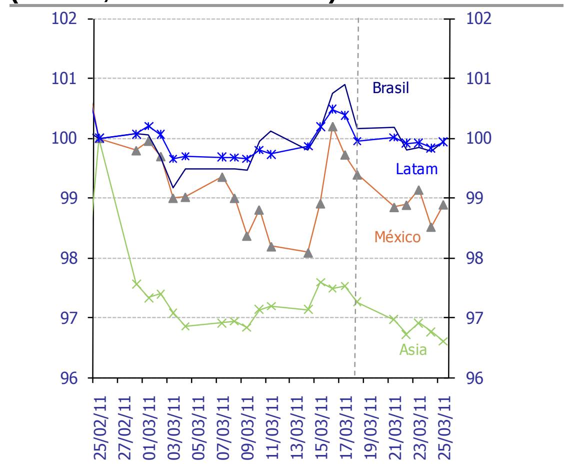
Upswing over the week on stock markets linked to investor appetite for risks despite global risk factors. The peso marginally depreciates on the last day, but sees week-on-week appreciation.

Chart 5
Stock Market: MSCI indices (Feb 25, 2011 index = 100)



Source: Bloomberg & BBVA Research

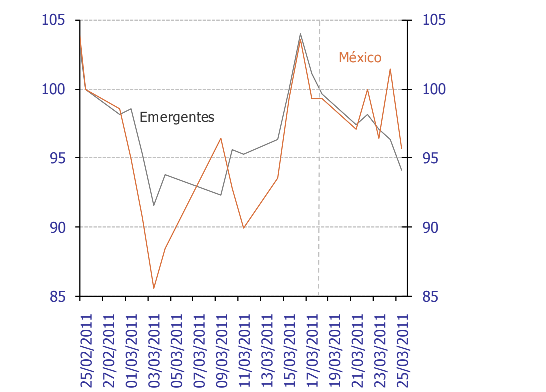
Chart 6
Foreign currencies: dollar exchange rates (Feb 25, 2011 index = 100)



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.

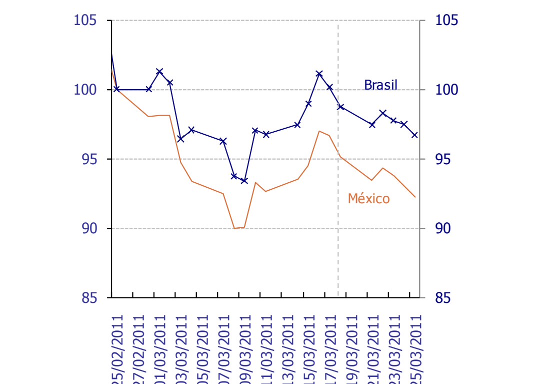
Aversion to risk with no major changes in the face of investor caution at the meeting of European finance authorities and events in the Middle East

Chart 7
Risk: EMBI+ (Feb 25, 2011 index = 100)



Source: Bloomberg and BBVA Research.

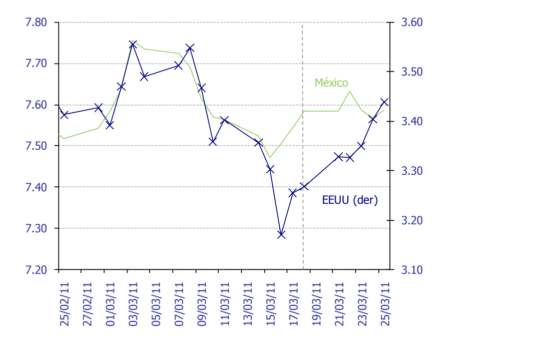
Chart 8
Risk: 5-year CDS (Feb 25, 2011 index =100)



Source: Bloomberg and BBVA Research.

Upswing in US rates influenced by higher growth prospects generated by statements from the FED FOMC members. Rates in Mexico saw a marginal fall at week-end due to profit-taking.

Chart 9
10-year interest rates*, last month



Source: Bloomberg and BBVA Research

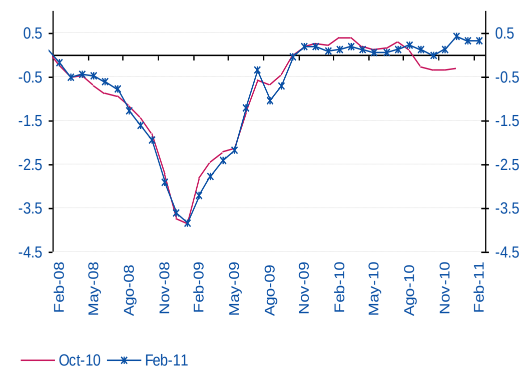
Chart 10
Carry-trade Mexico index (%)

Source: Bloomberg and BBVA Research

Activity, inflation, monetary conditions

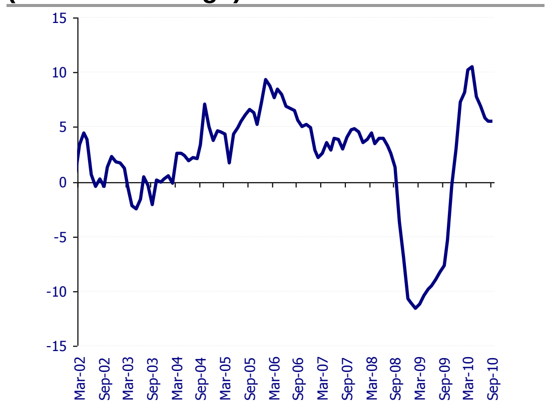
Economic activity in Mexico has improved as a result of foreign demand while domestic demand is recovery at a slower pace.

Chart 11
BBVA Research Synthetic Activity Indicator for the Mexican economy



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

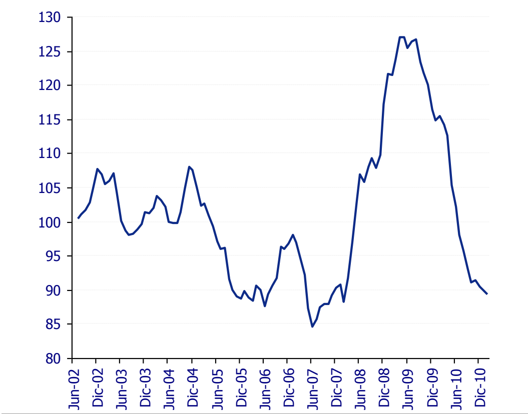
Chart 12
Advance Indicator of Activity (% annual change)



Source: INEGI

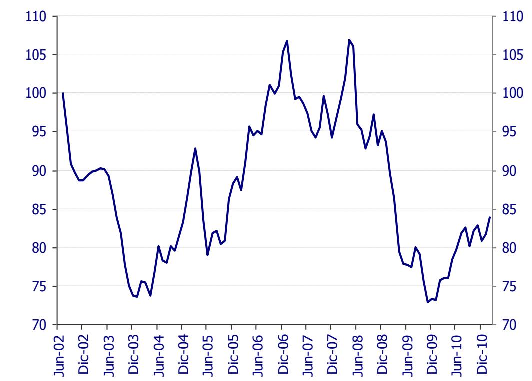
Inflation surprises fell throughout most of 2010, while activity surprises were slightly upward.

Chart 13
Inflation Surprise 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.

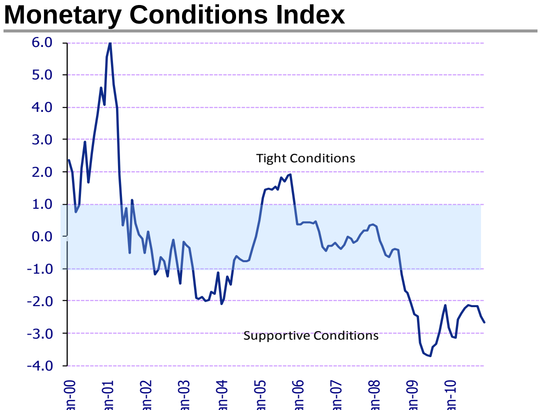
Chart 14
Activity Surprise Index
(2002=100)



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.

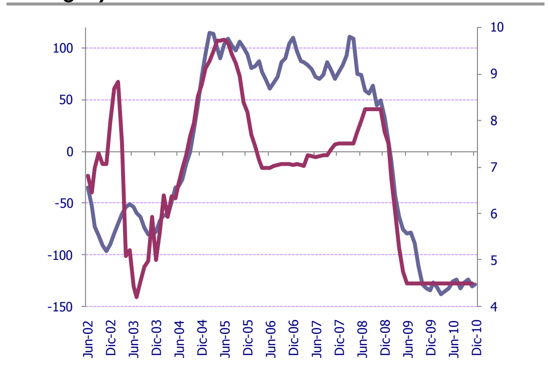
The monetary conditions in which the economy is moving continue to be helpful, although with a slight deterioration in the balance of inflationary risks.

Chart 15
Monetary Conditions Index



Source: BBVA Research

Chart 16
Balance of Inflationary Risks* and Lending Rate **(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

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