BBVA Research

Mexico

Weekly Watch

April 1, 2011

Next week…

Economic Analysis

J. Julián Cubero
juan.cubero@bbva.bancomer.com

Cecilia Posadas
c.posadas@bbva.bancomer.com

Market Analysis

Macro LatAm Strategy
Chief Strategist
Octavio Gutiérrez Engelmann
o.gutierrez3@bbva.bancomer.com

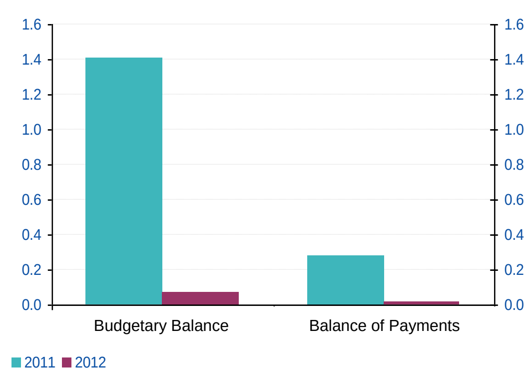
Increased oil prices positive for Mexico…if it does not develop further

Events in the Middle East have sent oil prices higher to three-year maximums, with the outlook being for them to remains high over the coming months. In this sense, we have increased the average forecast Brent price by 15% in 2011 at BBVA Research, from 92 to 106 dollars a barrel. An assessment of the direct effect would mainly come on two fronts: through higher public sector oil revenue and the effects on the balance of payments through higher value oil exports and imports. Based on these restrictive considerations, the effect would be positive in both scenarios for both 2011 and 2012, leading to a lower public and foreign deficit (see attached chart). This leaves aside the effect of increased public spending through investments and neither means changes in oil production but, above all, does not take into account the possible negative impact on demand from oil importing nations such as the US. As we consider US performance will be maintained, with near 3% growth in 2011 (2.8% in 2010), positive effects will take precedence over negative ones for Mexico in the current relatively high oil price scenario.

Financial markets in Mexico point to a new monetary context and reflect more favorable global cyclical news.

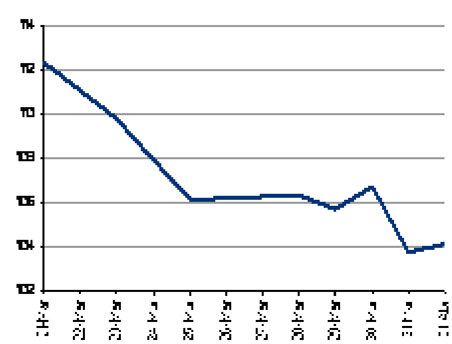
The main determining factor to the evolution of international markets continues to be the expected removal of monetary stimulus in the US and the Euro region, leading to interest rate differential outlooks. US labor data and different statements by Fed and European Central Bank members contributed to these outlooks, with signs of a balance of risks with a bias towards inflation. In this sense, the MXN appreciated 1.3% over the week and broke its resistance levels (11.9 ppd). The correlation between yield curves in the US and Mexico for fixed income had been concentrated on medium and long-term sections in the last month, but as the start of a restrictive monetary cycle can be seen, short-terms will increase this correlation and medium and long-term lose it.

Chart 1
Mexico, direct effect of forecast for higher oil prices in 2011 (% GDP)



Source: BBVA Research

Chart 2
Slope of 30/10 year US T-Bills (bp, 2011)



Source: BBVA Research and Bloomberg

Economic Analysis

Pedro Uriz Borrás
pedro.uriz2@bbva.bancomer.com

Cecilia Posadas
c.posadas@bbva.bancomer.com

Calendar: Indicators

March 2011 inflation

Thu, Apr 7, 2011

Forecast: 0.3% m/m (3.16% y/y) CPI 0.38% Core, Consensus: (0.28% m/m) Previous (0.38% m/m 3.57% y/y Feb.)

Next week sees the release of inflation numbers for March which, given the surprise downward move in the first fortnight, should be considerably under the 0.4% we had forecast after February's numbers came in. The surprise in the first fortnight of March was due to two non-core factors: public prices (influenced by the reduced holding payments in different cities) and agricultural prices. As for public prices, we highlighted the good performance at the start of the year over the last two months and forecast that, if this remained the case, they would support contained inflation. In turn, agricultural prices do not seem to show many price effects after the frost seen in Sinaloa in February. In this way, the deviation with regards to forecast performance at the start of the year seems to be less; however said effects could still come through. The only upward pressure source in the first fortnight in March came from processed food prices which seem to feeling the effects of high global grain prices. The performance of these prices over the coming fortnights needs to be watched since it is still not clear whether the highest spikes have been reached. Despite the prevailing uncertainty on different markets and for different factors, we believe March's result will support our view that inflation will close in the Banxico variability range in 2011 (3% +/- 1%).

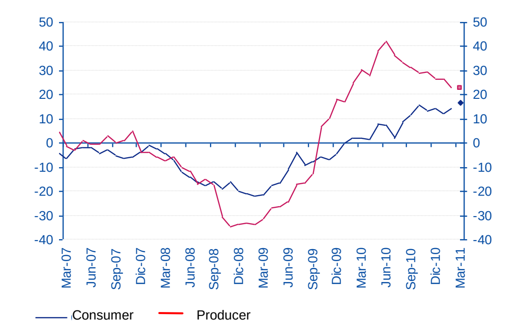
Confidence and formal employment in March

Producer Monday, April 4: 0.1% m/m, 22.7% y/y. (previous: 1.4% m/m, 22.6% y/y)
Consumer Tuesday, April 5: 1.5% m/m, 16.5% y/y. (previous: 1.6% m/m, 14.4% y/y)
Employment in the week: 0.3 m/m, 4.7 y/y. (previous: 0.4% m/m, 4.9% y/y)

This week sees the release of important economic output indicator for March, the first two (confidence) for their timeliness and the third (formal employment) for being a hugely important cyclical pointer. We believe that good employment performance (0.4% average increase over the last 21 months) will help strengthen consumer confidence, where we will see a notable move forward in sub-indices such as the possibility of purchasing durable goods. In turn, as mentioned on previous occasions, although real salary performance has limited consumer recovery, for the second half of the year the salary component contribution to disposable income is likes to start to come in positive in annual comparative terms which should, in turn, have a positive effect on private consumption.

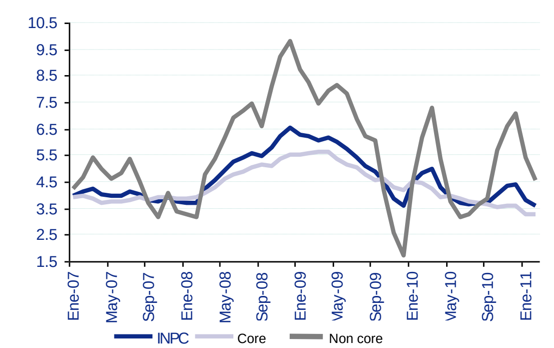
Further, with regard to producer confidence, we are likely to see moderate growth and a maintained downward trend in annual terms, remaining dependent on the evolution of foreign demand through non-oil exports.

Chart 2
Confidence: consumer and producer (y/y%)



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

Chart 3
Inflation breakdown (% change y/y)



Source: BBVA Research with Banxico data

Market Analysis

Macro Latam Strategy
Chief Strategist
Octavio Gutiérrez Engelmann
o.gutierrez3@bbva.bancomer.com
+5255 5621 9245

Fixed Income Analysis
Mexico/Brazil
Chief Strategist
Ociel Hernández
o.hernandez@bbva.bancomer.com
+5255 5621 9616

Liliana Solis
liliana.solis@bbva.bancomer.com
+5255 5621 9877

FX Mexico // Brazil
Claudia Ceja
claudia.ceja@bbva.bancomer.com
+5255 5621 9715

Technical Analysis
Alejandro Fuentes
a.fuentes@bbva.bancomer.com
+52 55 5621 9975

Markets

The MXN broke its 11.9 ppd support level due to favorable international cyclical signs and monetary policy forecasts.

First, the main focus of attention on global markets continued to be related to monetary policy expectations and interest rate differences, where the statements by the Federal Reserve and the European Central Bank resulted in a stronger EUR (even with the persistent uncertainty related to the fiscal situation of the European periphery). Meanwhile, economic data from the U.S. continue to point to a favorable scenario for the economic cycle (especially for employment, published at the end of the week). This has led to an extension of the *rally* in stock market indices.

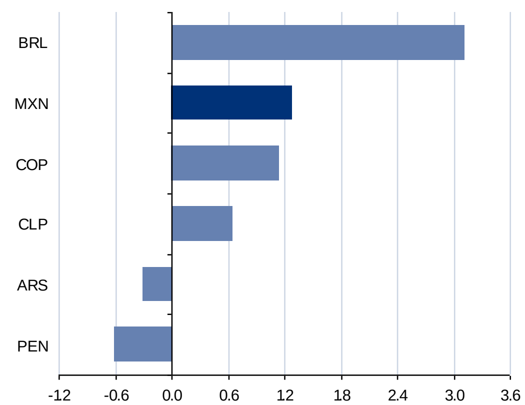
In this sense, the MXN broke its 11.90 support and recorded weekly appreciation of around 1.3%, sustaining its positive slant for the time being. In turn, the long MXN speculative position recorded a slight increase of USD33mn. However, it is important to take into account that this information does not include the currency's movement towards the 11.83 zone; we therefore expect to see a higher increase in this figure on Tuesday.

The debt and swaps curve point to a new monetary scenario

Despite US T-Bill yields closing with no significant changes, volatility increases (mainly on short sections) in line with market forecasts of 100% probability that the Federal Funds rate will go up by 25bp in march 2012 and there will be no major liquidity injections.

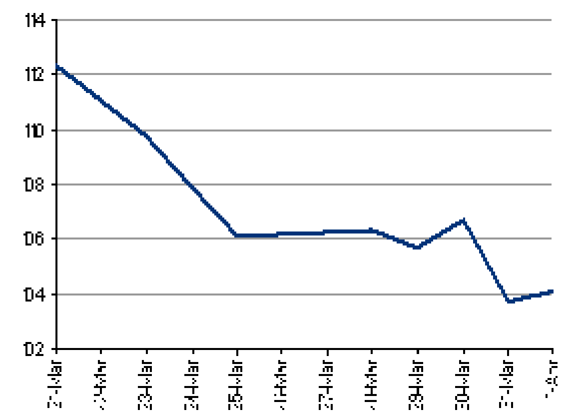
This trend was also seen in the local curve. The correlation between both curves until a month ago had been concentrated on medium and long-term sections but, as the start of a restrictive monetary cycle can be seen, short-terms will increase this correlation and medium and long-term lose it. Monetary positions in both economies are different and the path towards a neutral policy too. This is why the medium and long sections will lose correlation once the restrictive cycle begins.

Chart 5
Weekly changes in LatAm currencies (%)



Source: BBVA Research and Bloomberg

Chart 6
Slope of 30/10 year US T-Bills (bp, 2011)



Source: BBVA Research with data from Bloomberg

Technical Analysis

Mexico City, March 18, 2011

Market Analysis

Equities

Technical Analysis

Alejandro Fuentes Pérez (*)
a.fuentes @bbva.bancomer.com
5255 5621 9705

(*) Writer(s) of the report

CPI Stock Market Index

Source: BBVA, Bancomer, Bloomberg

CPI: This week was important for the CPI from a technical viewpoint since it marked a short-term trend change. The market operated in a negative short-term range for almost three months and finally started the week by breaking the upper limit of this range. At the same time, the upward break of 30 and 50 day rolling averages was confirmed. It closed the week just below 38,000 pts. This could represent short-term resistance if we take into account that, as well as being a psychological level, the market has bounced by almost 2,500 pts in the last two weeks.

Previous rec.: 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.

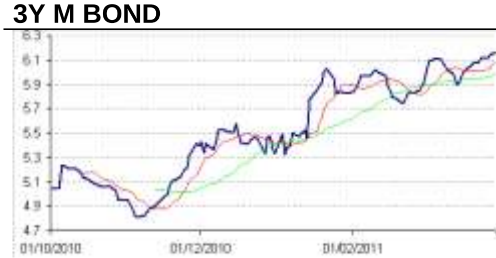
MXN

Source: BBVA, Bancomer, Bloomberg

It continued to operate around the P$11.88 floor level over the week. In the last session it came in below this floor level and opened the possibility of a move towards the P$11.70/11.65 zone corresponding to the lower negative range section on the weekly chart.

Previous rec.: Significant resistance comes in at P$12.043 and only breaking this level would lead us to consider a return to P$12.20.

3Y M BOND

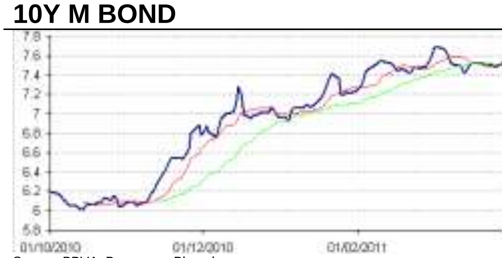


Source: BBVA, Bancomer, Bloomberg

3Y M BOND (yield): The upward trend continues, reaching a new maximum for the year. Resistance at 6.3% and support at 5.97%.

Previous rec.: The sign to consider a trend change would only come about with a downward break in the 30-day rolling average (5.95%)

10Y M BOND



Source: BBVA, Bancomer, Bloomberg

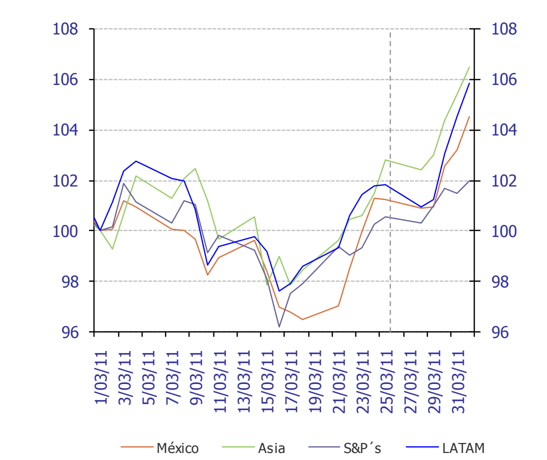
10Y M BOND (yield): No continuance in upward movement and remaining flat over the week. Continues to show signs of adjustment with support at 7.2%.

Previous rec.: The 10-day rolling average came in below the 30-day and may start to see adjustment.

Markets

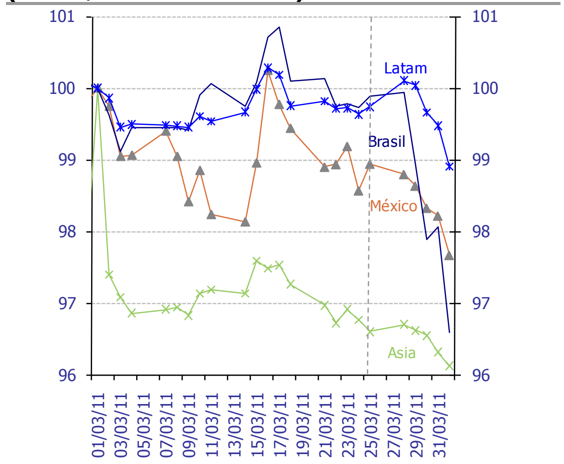
General upturn on stock markets and currency appreciation after better-than-expected US employment data supporting the idea that the economic recovery is continuing.

Chart 5
Stock markets: MSCI indices (Mar 1, 2011 index= 100)



Source: Bloomberg & BBVA Research

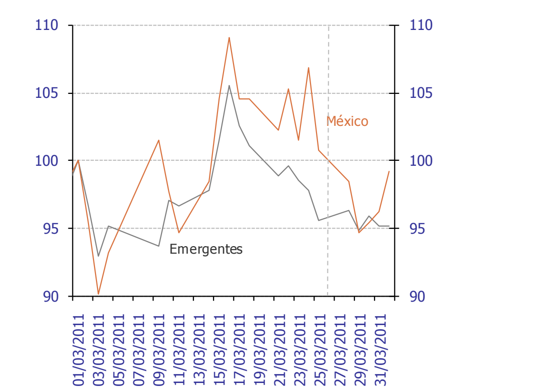
Chart 6
Foreign exchange: Dollar Exchange Rates (Mar 1, 2011 index=100)



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.

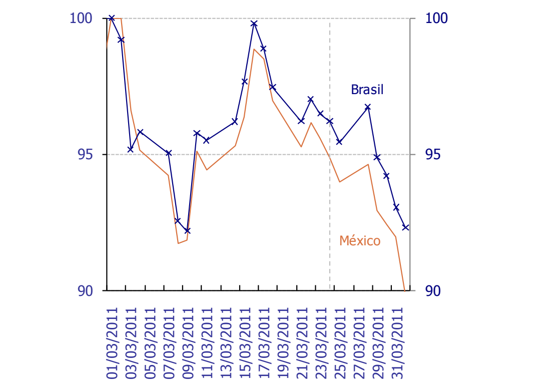
Fall in risk aversion due to US employment data generating optimism on economic recovery, despite risks due to the Middle East.

Chart 7
Risk: EMBI+ (Mar 1, 2011 index = 100)



Source: Bloomberg and BBVA Research.

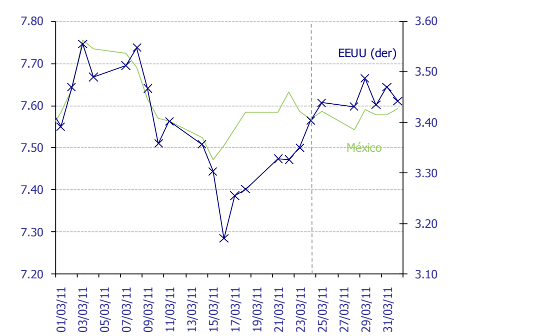
Chart 8
Risk: 5 year CDS (Mar 1, 2011 index=100)



Source: Bloomberg and BBVA Research.

US rates with upward and downward moves over the week after FED statements about a possible reduction in QE2. Rates in Mexico record a slight upswing towards the end of the week.

Chart 9
10-year interest rates*, last month



Source: Bloomberg and BBVA Research

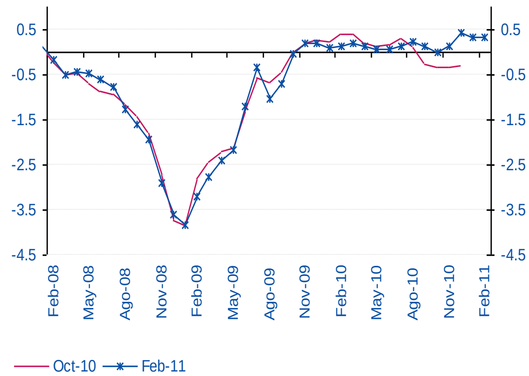
Chart 10
Carry-trade Mexico index (%)

Source: Bloomberg and BBVA Research

Activity, inflation, monetary conditions

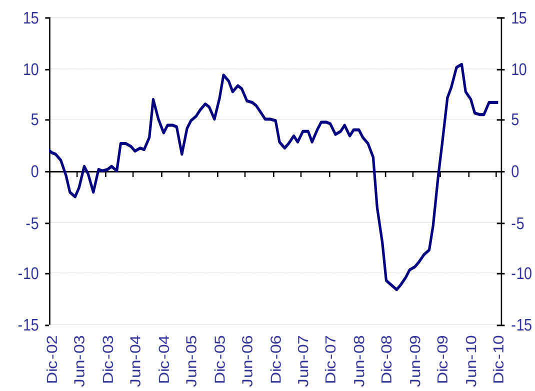
Economic output in Mexico bounced in the last quarter of 2010 and recent data even saw positive surprises.

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.

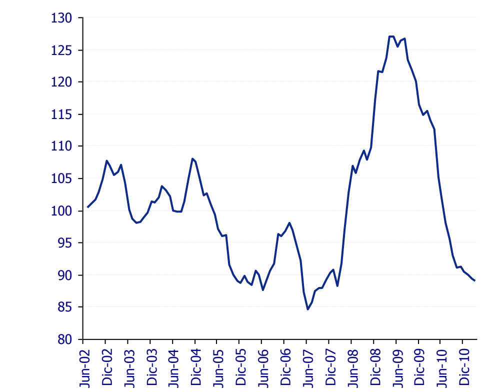
Chart 12
Advance Indicator of Activity (% change y/y)



Source: INEGI

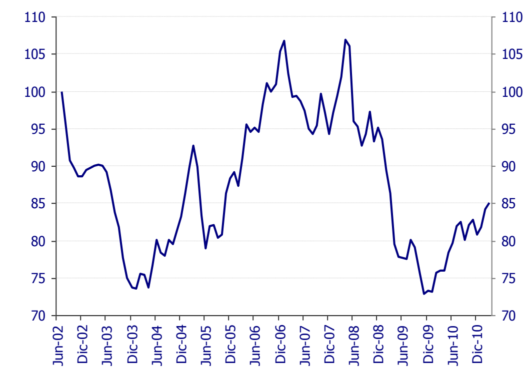
The inflation surprises continued to be slightly downward. While surprises in output were slightly upward

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.

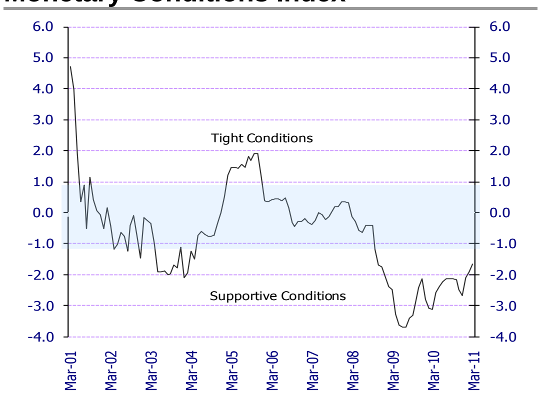
Chart 14
Activity Surprise Index
(2002=100)



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.

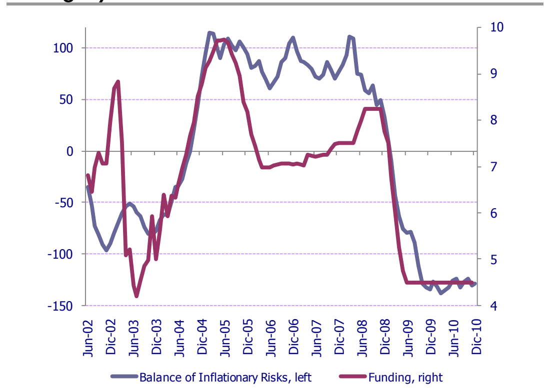
The monetary conditions in which the economy is moving continue to be helpful, although with a slight deterioration in the balance of inflationary risks.

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 risks over those of growth and, therefore, more likelihood of monetary restriction

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