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BBVA Economic Research
Department

Weekly Watch

Mexico

April 15, 2011

Economic Analysis

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Next week...

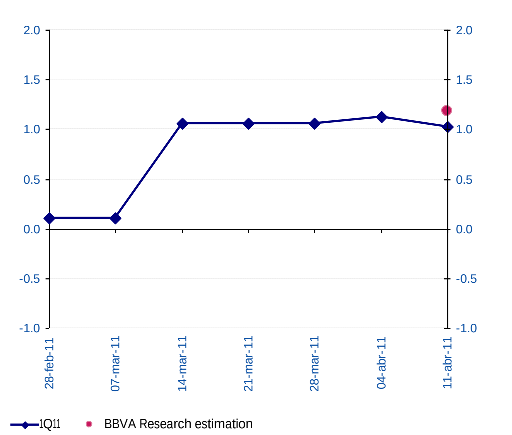
... Attention on inflation data from the 1st two weeks of April

The tone of the Banxico monetary policy release this Friday places special emphasis on inflation data from the first fortnight in April, set to be released on Wednesday 20. There is a relatively high level of uncertainty in analyst forecasts for these data given the combination of two factors 'distorting' specific forecasts: the seasonal effect of Easter week and changes in commodity prices. In our opinion, Banxico will maintain a 'wait and see' attitude until it has pointers as to the final size of the acceleration in prices over the coming months as a baseline for comparison and the pressure on commodities in a sustained output growth scenario. The economy continues to expand for the central bank, which is highly similar to our scenario. In this way, the available situation data to date lead to a forecast of GDP in 1Q11 having expanded near 1.3% q/q in 4Q10, a figure which has improved from the start of the year, as seen in the chart[1]. Therefore, this forecast could have a certain downward bias if the disappointing manufacturing data in February (-0.4% q/q) are repeated in March, taking into account the key role of industry performance in GDP estimates.

Weekly MXN progress and gains in the domestic debt curve dependent on the US

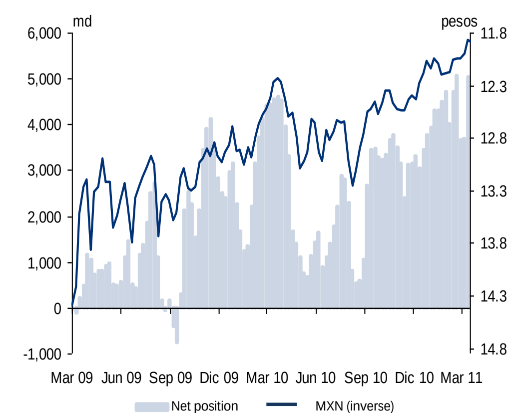
After a depreciating MXN at the start of last week, the cross closed with a 0.5% appreciation and breaks through the 11.7 ppd level. The focus on US monetary policy became important where more "dovish" biases prevailed. In turn, Mexican debt curves saw gains dependent on US curves which acted as a refuge after the continuing sovereign problems in Europe.

Chart 1
Mexico: GDP 1Q11 (% change y/y)



Source: BBVA Research

Chart 2
MXN: Long Non-Trading Positions in CME (US$mn)



Source: BBVA Research and Bloomberg

[1] The evolution over time is collected, as new information is incorporated, on the estimate for 1Q11 GDP quarterly rate in accordance with a dynamic factors model. This model type adds available information at all times from the most important, real and financial situation indicators.

Calendar: Indicators

Inflation 1QApril

Wednesday, April 20

0.08% over two weeks (3.39% y/y); Consensus: 0.02% over two weeks, Previous: (0.19% m/m 3.04% y/y Mar)

Economic Analysis

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Over the first quarter of the year, inflation benefited from a base effect with regard to the same period in 2010 when the new VAT rate came in, monthly upturns in gas prices began and several public prices were unfrozen. In this sense, inflation fell from 4.4% y/y at the end of 2010 to 3.0% in March. However, from April inflation will see major increases since the base effect with regard to 2Q10 will be opposite. We expect inflation to go up 0.14% over April (0.08% in the first two weeks), a rate below the average for recent years due to the fall in electricity prices with the warm season starting in the country. Nevertheless, food price pressures will continue given the persistently high prices on international markets due to less available maize and wheat on a global level. In addition, tourist services prices will see major increases given the coming Easter week. Both these factors will take core inflation up at around 0.3% over the fortnight.

Finally, the high volatility in inflation forecasts for the first two weeks in April should be highlighted as a result of the uncertainty linked to the effects of Easter week and commodity prices. This favors data finally recording an impact on the fixed income market this coming Wednesday.

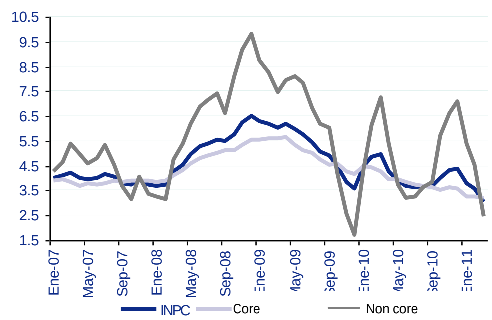
Open Unemployment Rate

Wednesday, April 20

Forecast (5.2%) previous (5.3% CSV)

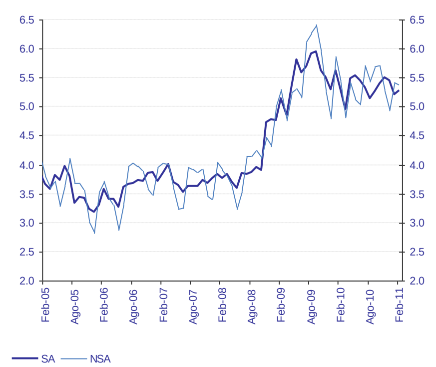
Jobless numbers will continue around 5%, significantly above pre-crisis levels. In this way, despite the job creation rate particularly among those in the formal sector, this is not enough to cover employment demand. In this sense, additional job market indicators point to major residuals, particularly in quality for a lot of employment: the rate of underemployment (% of employed population that needs and is willing to dedicate more time to work than what his/her current position allows), will continue around 8% of those employed.

Chart 3
Inflation breakdown (% change y/y)



Source: BBVA Research and Banxico

Chart 4
Open Unemployment Rate
(% of the EAP)



Source: BBVA Research and Banxico

Markets

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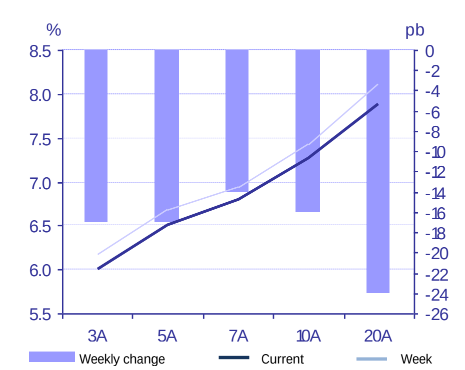
Global factors point to mixed performances on the currency market, but the MXN closes with gains that could be corrected in coming sessions.

Latin American currencies saw mixed performances over the week. In the first few days they depreciated as a result of three factors: one, the nuclear alerts in Japan; two, initial corporate reports from the U.S. below market expectations; and three, profit taking in the EUR, with figures below expectations. However, as the days passed the market refocused on differing monetary policies and most currencies recovered. This was stressed on Friday when US inflation data led to new USD losses against other major currencies. With this, the MXN broke the downward 11.70 level and closed with a weekly appreciation of 0.5%. Taking into account technical factors (RSI 14d) at oversell levels and speculative positioning at maximums, we cannot rule out a corrections in coming sessions.

Gains continue in domestic debt curves, the long stretch reducing to 24 bp (20 years)

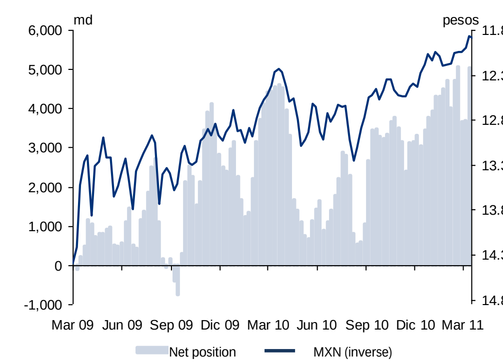
Positive week for US T-Bills (15 bp rally for 10 year whereby the curve flattened 5 bp, 10/2 years slope) in the face of a higher tension due to fiscal problems in European periphery nations and upward pressures in *commodities* prices. This led to investors demanding more refuge assets, leading to gains on the Mexican debt market. In this way, the bond yield curve saw a 24 bp fall in the long stretch (20 years) and 17 bp in the short (3 years). This performance was also seen on the swap curve (11 bp and 23 bp rally respectively in the 26x1 and 130x1). We maintain our spreads recommendation of 2/10 and 1/2 years.

Chart 5
Bond Yield Curve (% and bp)



Source: BBVA Research with Banxico data

Chart 6
MXN: Long Non-Trading Positions in CME (US$mn)

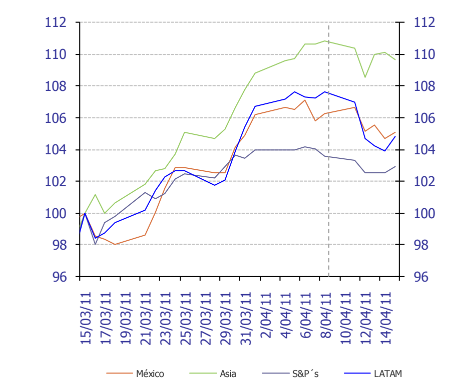


Source: BBVA Research with data from Bloomberg

Markets

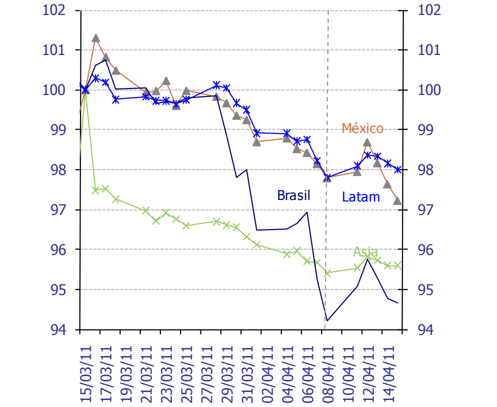
Stock market falls over the week. In Mexico, lower-than-expected corporate earnings took the market below 37,000 points. The peso appreciated, influenced by lower-than-expected US inflation and the monetary stimulus continuing.

Chart 7
Stock Markets: MSCI Indices
(Mar 8, 2011 index = 100)



Source: Bloomberg & BBVA Research

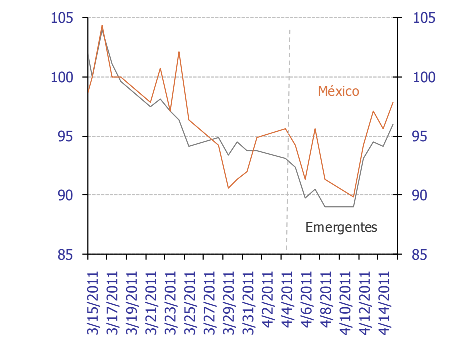
Chart 8
Foreign exchange: dollar exchange rates
(Mar 8, 2011 index = 100)



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

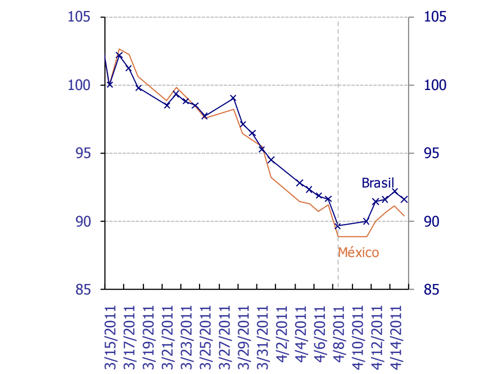
Slight Increase in aversion to risk influenced by the increased nuclear alert level in Japan and lowered rating for Ireland

Chart 9
Risk: EMBI+ (Mar 9, 2011 index = 100)



Source: Bloomberg & BBVA Research

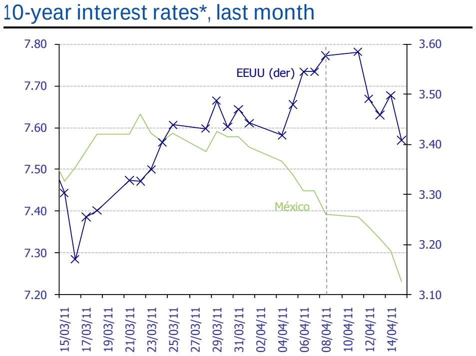
Chart 10
Risk: 5 year CDS (Mar 8, 2011 index=100)



Source: Bloomberg & BBVA Research

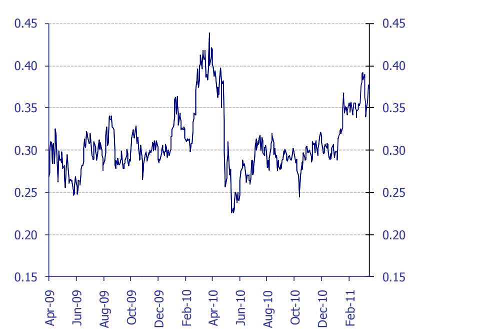
Fall in U.S. interest rates due to a search for safe assets. Rates in Mexico continue downward due to capital inflows and a forecast for the lending rate to remain unchanged until the end of 2011

Chart 11
10-year interest rates*, last month



Source: BBVA Research with Banxico data

Chart 12
Carry-trade Mexico index (%)

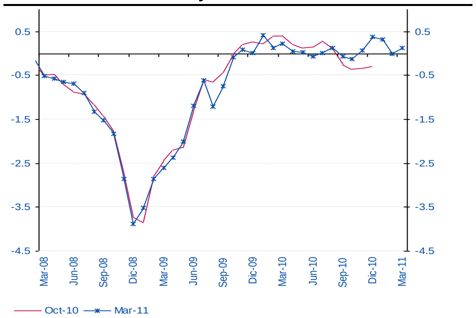


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

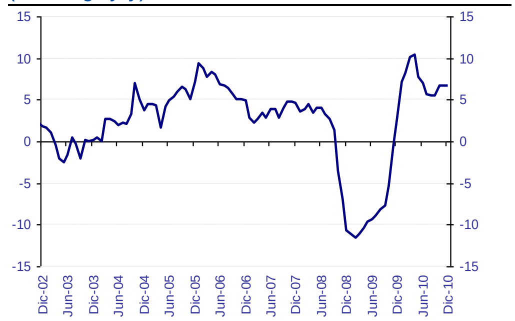
Economic output in Mexico bounced in the last quarter of 2010 and, although seeing some ups and downs, recent data point to a continuing good economic performance.

Chart 13
BBVA Research Synthetic Activity Indicator 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 a trend series.

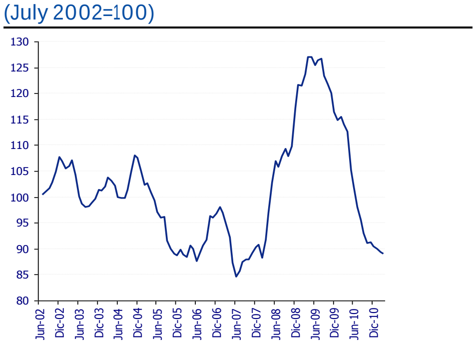
Chart 14
Advance Indicator of Activity
(% change y/y)



Source: INEGI

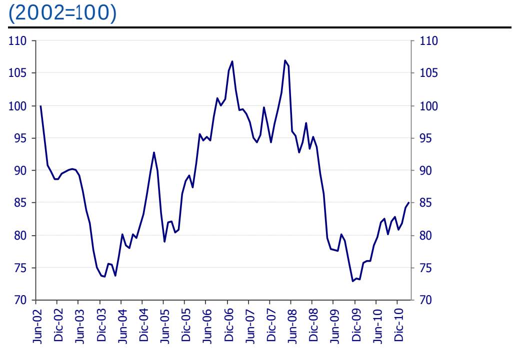
Inflation surprises continue to be slightly downward. While surprises in output are slightly upward

Chart 15
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.

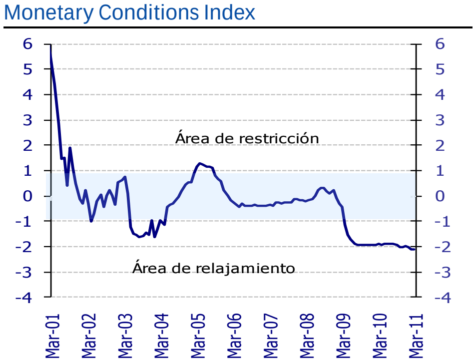
Chart 16
Activity Surprise Index
(2002=100)



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

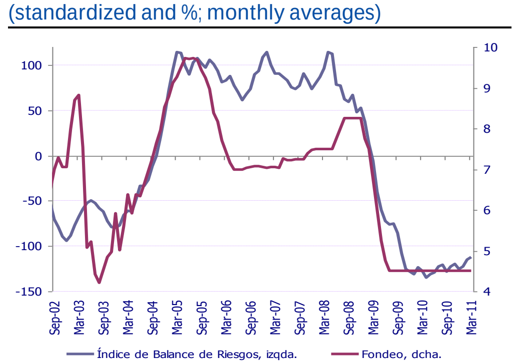
The monetary conditions in which the economy is moving continue to be helpful, although with a slight deterioration in the balance of inflationary risks

Chart 17
Monetary Conditions Index



Source: BBVA Research

Chart 18
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 index points to a greater weight of inflationary risks over growth risks and thus a greater possibility of monetary restriction

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