# Weekly Watch

Mexico

May 6, 2011


Economic Analysis

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## Next week...

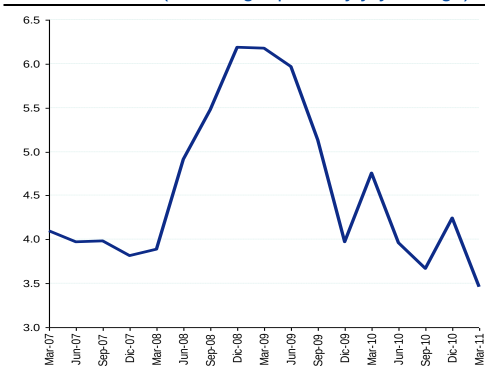
### Inflation takes center stage

Next week sees the release of the Banxico inflation report for 1Q2011. The document will provide information on the Central Bank's most recent outlook on economic activity and inflation, and give us indications of the parameters to be used for future monetary policy decisions. The April inflation rate will be published on Monday 9. The figure was surprisingly low in the first half of the month for factors we consider to be temporary. We also believe that the risk factors pushing inflation upwards are continuing. These are mainly related to grain and oil prices on international markets. We expect the monthly inflation figure for April to be 0.02%, and the annual figure 3.4%. The final April figures could influence Banxico's analysis of the inflation situation to be released in the quarterly report on Wednesday 11. However, given that 1Q11 was in line with expectations, we do not expect any significant changes with respect to the 4Q10 report.

### Local markets troubled by global news: employment in the U.S., the monetary situation in Europe and China and sovereign risk in Portugal.

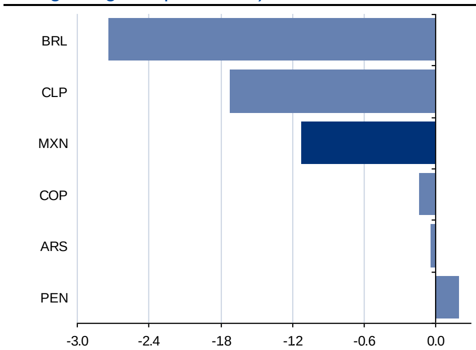
A combination of global factors resulted in falls in the MXN, though these were partially corrected at the close of the week. There was also increased volatility, which could continue into this week. The bond market registered lost its correlation with the U.S. and posted initial losses in the face of an upturn in risk aversion. However, they bounced back on the release of U.S. payroll figures. The Mexican stock market posted losses despite good corporate results.

Chart 1
Mexico: Inflation (% average quarterly y/y change)




Source: BBVA Research

Chart 2
Weekly change in Latin American currencies (% weekly change, neg. = depreciation)




Source: BBVA Research and Bloomberg

# Calendar: Indicators

## Industrial production in March

Wednesday, May 12. 0.4% m/m, 4.2% y/y (previous: -0.4, 5.2%)

Economic Analysis

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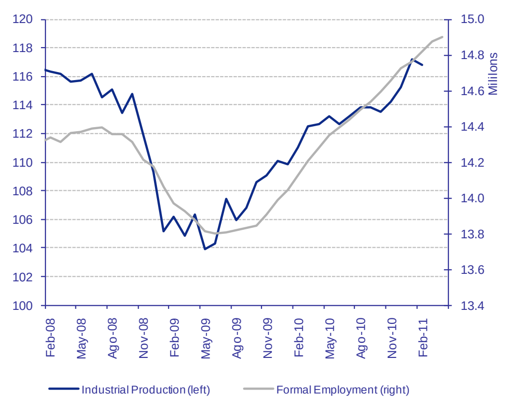
The industrial production figures for March will be released this week. Following a volatile start to the year (positive surprise in January, negative in February), we estimate that the rates will tend towards moderate stabilization. One factor to take into account is that industry in the U.S. performed well in the third month of the year (0.8% m/m, 5.9% y/y). Particularly notable were significant increases in production of durable goods, with an average monthly rise of 1.3% in the first three months of the year. This compares with the manufacturing of non-durable goods, whose average monthly rise was 0.1% over the same period. Given that Mexico is the exporter of manufactured goods with the biggest increase in market share of durable goods, the recent trend in this respect will tend to benefit the domestic industry.

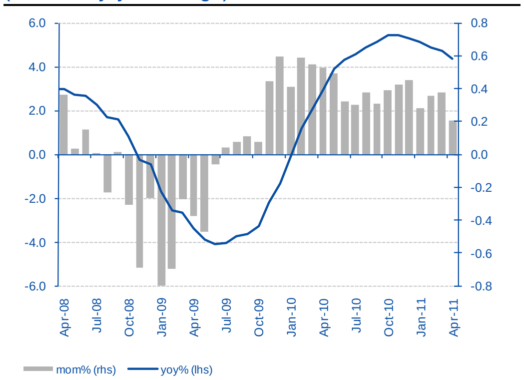
Friday will also see the release of total employment data (ENOE) for the first quarter of the year. It is important to note that the IMSS figures continue to show historically high increases (0.4% a month on average for more than 20 consecutive months). However, the Achilles heel of employment is the quality of many of the new jobs created since the start of the recovery. The total employment indicators will provide valuable information in this respect on the labor market by income bands, branches of activity and types of jobs.

Chart 3
Formal private-sector employment and industrial production




Source: BBVA Research and INEGI

Chart 4
Formal private-sector employment (level and y/y % change)




Source: BBVA Research and INEGI

# Markets

## Weakness in the MXN due to global determinants, but a partial correction with continued volatility cannot be ruled out

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*Technical Analysis*
Alejandro Fuentes

Last week most Latin American currencies weakened in reaction to a combination of global factors: 1) restrictive language in the Central Bank of China's quarterly report and restrictive monetary policy cycles in the region (the Philippines, Malaysia, India and Vietnam; 2) a less restrictive communication from the ECB in keeping its benchmark rate unchanged; 3) the Portuguese rescue for USD 78 bn; and 4) U.S. employment figures, with negative surprises in the ADP survey, employment benefits and the unemployment rate; in contrast, there were favorable results in the non-agricultural payroll. As a result, the EUR began the week stronger, but ended by closing with significant losses, while the currencies in emerging economies tended to depreciate. Against this background, the MXN was extremely volatile, and weakened for most of the week, approaching the level of 11.75. This was partially corrected at the close of the week following the publication of the non-agricultural payroll figures. The wide range of fluctuation could continue this week, but with a bias for appreciation towards 11.5. Overall, we would recommend long peso positions as the MXN approaches 11.7.

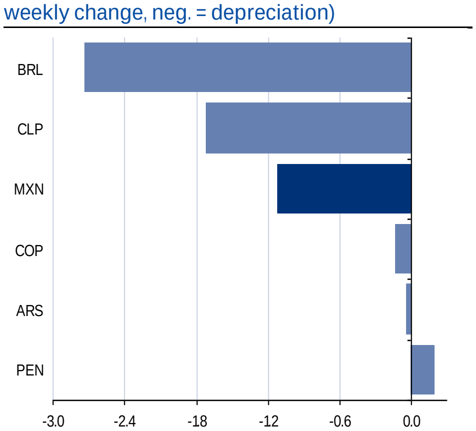
## Local bond markets recover losses at the close of the week

In the context of uncertainty that led to sale positions in *commodities* and other risk assets (e.g. silver, with weekly losses of 27%), there was a greater appetitive for safe-haven assets. Thus the U.S. curve moved down 10 bps on average over the week. Mid-way through the week domestic bonds decoupled from those of the U.S., in the wake of outflows in emerging countries due to greater risk aversion. However, the losses were recovered at the end of the week on more optimistic employment data in the U.S. The biggest rally was in the mid-part of the curve, and there were attractive *flatteners* between it and the short end.

## The capital markets contract despite the corporate results

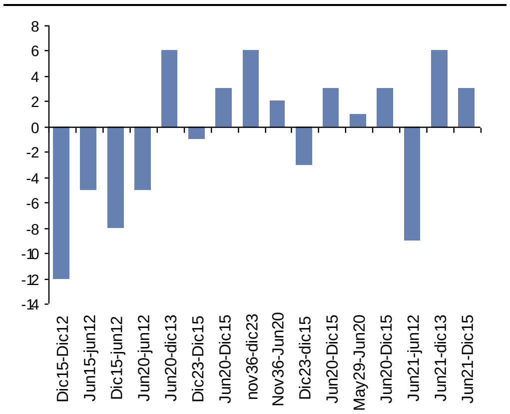
Stock markets worldwide were in the red due to the global environment, despite positive results from the reporting seasons in most markets. In particular, the Mexican stock market posted strong falls in reaction to changes in the regulatory environment of the telecommunications sector, with a fall of 7% in AMX (the main share on the IPC index, at 24% of the total). This fall came despite favorable corporate results in Mexico, with increases in sales, EBITDA and net profits all up on the IPC by 13.3%, 10.2% and 31.6% y/y, respectively.

Chart 5
Weekly change in Latin American currencies (% weekly change, neg. = depreciation)




Source: BBVA Research with data from Bloomberg

Chart 6
Change in bond slopes (bps)




Source: BBVA Research with data from Bloomberg

Market Analysis
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# Technical Analysis

## IPC Stock Market Index

IPC: with the IPC's high level of dispersion against its 30-day moving average, we consider that there could be a technical upturn in the market at any moment, which will bring the IPC back to levels of close to 37,000 pts. Although we cannot rule out a movement in the IPC towards 34,700/34,500 pts, we recommend taking positions that try to anticipate this upturn in the short term. AMX, which accounts for 25% of the IPC, is also trading with greater negative dispersion over the last 12 months against its 30-day moving average, and Cemex is very close to its minimum level for the last 12 months. This could help provide a floor for the IPC.

Previous recommendation: Since several issuers listed on the IPC, some with high market weighting, came in at major support levels and high oversell readings, it is highly likely that the IPC may experience a technical upturn over the coming days.

Source: BBVA, Bancomer, Bloomberg

## MXN

Upturn over the week from the psychological support of MXN 11.50, with resistance in the 30-day moving average (MXN 11.72). With the oscillators giving buy signals, we could expect an appreciation in the peso towards levels of MXN 11.50, where the new floor should be.

Previous recommendation: At 11.50, the dollar is trading at the low part of the negative range on the weekly chart and we believe there could be a technical upturn in the short term.

Source: BBVA, Bancomer, Bloomberg

## 3Y M BOND

3Y M BOND: (yield): Maintains its downward trend and is under its initial 5.8% support. Next floor at 5.6%. The dispersion between the 10-day and 30-day moving averages is still not so strong, so it may maintain its downward movement.

Previous recommendation: Continues to trade below the 10 and 30-day moving averages, meaning that the downward move remains in play.

Source: BBVA, Bancomer, Bloomberg

## 10Y M BOND

10 Y M BOND (yield): Still trading below the 10 and 30-day moving averages. We maintain short-term objectives at 7.2% and 7%.

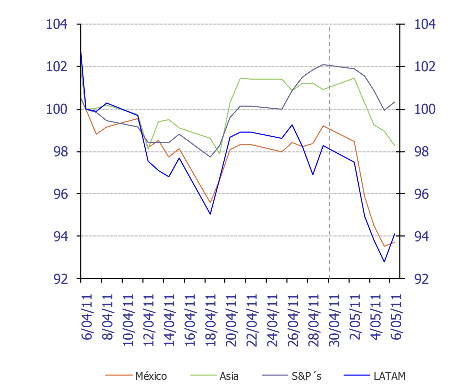
Previous recommendation: Resistance at 7.27% and 6.98%..

Source: BBVA, Bancomer, Bloomberg

# Markets

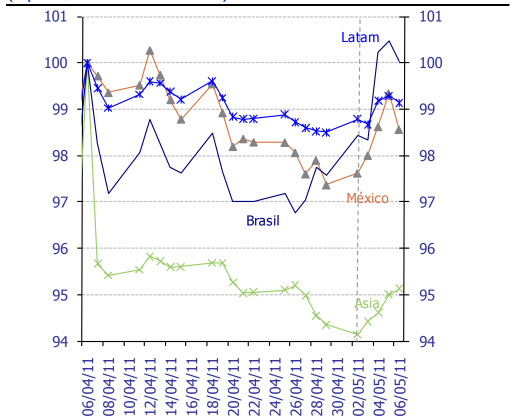
The IPC has uncoupled from the gains generated by the better-than-expected U.S. employment figures due to falls in América Móvil and Peñoles. Appreciation in Latin American currencies due to data supporting economic recovery.

Chart 7
Stock Markets: MSCI Indices
(Apr 6, 2011 index = 100)




Source: Bloomberg & BBVA Research

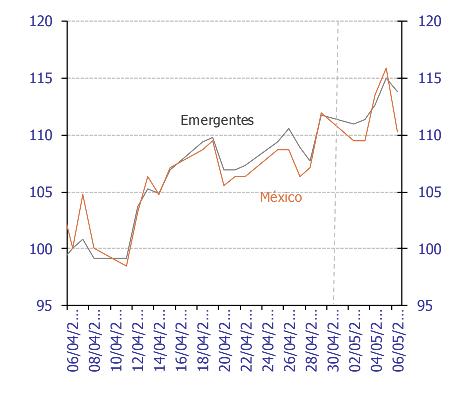
Chart 8
Foreign exchange: dollar exchange rates
(Apr 6, 2011 index = 100)




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

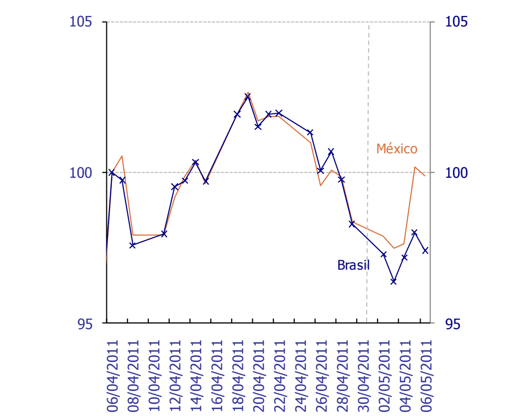
Marginal fall in risk aversion, influenced by better-than-expected U.S. figures that prevail over the rumor of a Greek exit from the EU

Chart 9
Risk: EMBI+ (Apr 06, 2011 index = 100)




Source: Bloomberg & BBVA Research

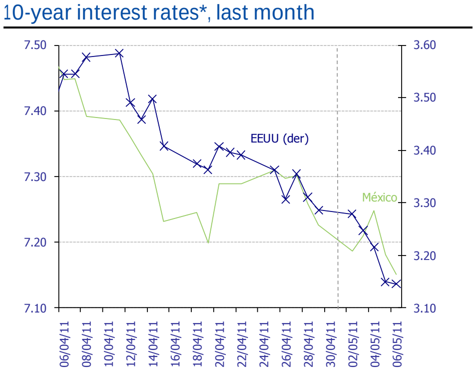
Chart 10
Risk: 5-year CDS (Apr 06, 2011 index=100)




Source: Bloomberg & BBVA Research

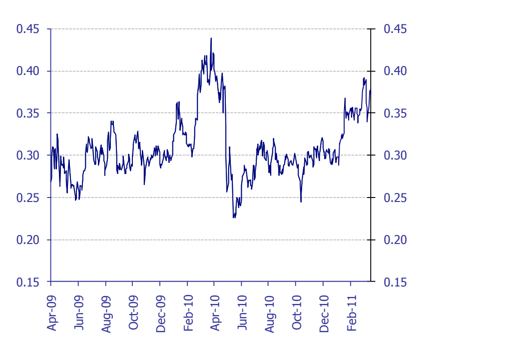
Fall in U.S. interest rates influenced by the flight to quality in the face of rumors about Greek exit from the EU. Rates in Mexico continue to fall, boosted by the entry of foreign flows

Chart 11
10-year interest rates*, last month




Source: BBVA Research with Banxico data

Chart 12
Carry-trade Mexico index (%)

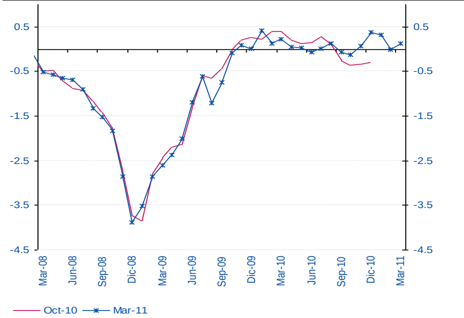


Source: BBVA Research with data from Bloomberg

# Activity, inflation, monetary conditions

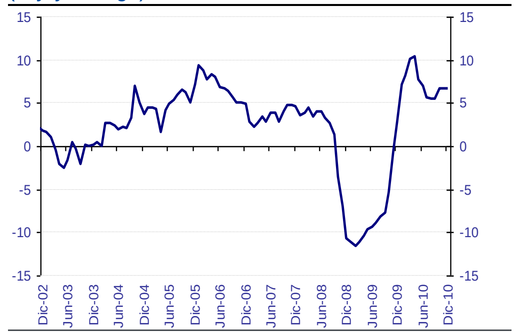
Activity continues to recover moderately, headed by industrial production and followed more slowly by the service sector

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 indicators of activity, expenditure and expectation, based on trend series.

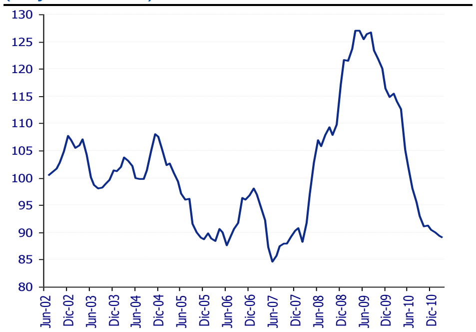
Chart 14
Advance Indicator of Activity
(% y/y change)



Source: INEGI

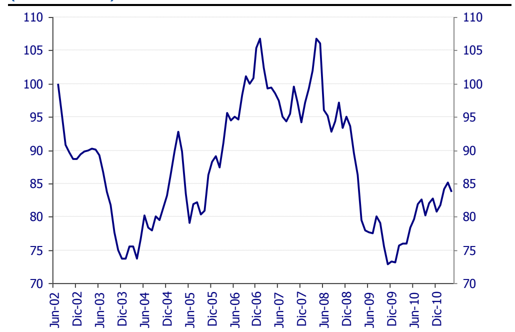
Surprises in inflation continue slightly downwards, while in activity, the trend is mildly in the up side.

Chart 15
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.

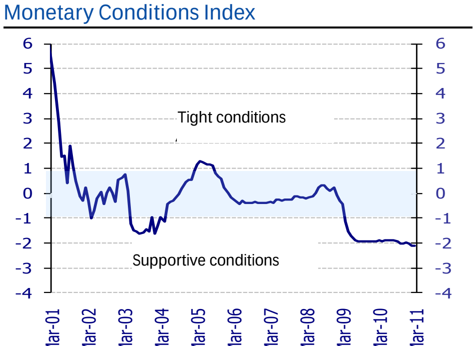
Chart 16
Activity Surprise Index
(2002=100)



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.

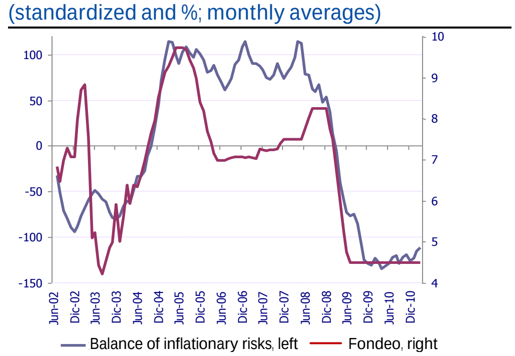
The monetary conditions in which the economy is moving continue to be helpful, although with a very slight deterioration in the balance of inflationary risks

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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