Weekly Watch

Mexico

May 13, 2011

Economic Analysis

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Next week...

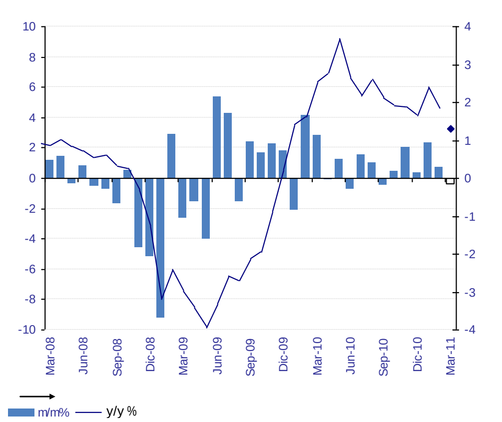
The past takes center stage

This week brings the first official GDP estimate for 1Q11 when pointers for how 2Q11 is going with April data on confidence, employment and automotive output. We expect INEGI to confirm that the Mexican economy continued to expand in the 1Q11 at a rate of nearly 1% (our forecast is 1.1% and Banxico's, published last Wednesday, is 0.6%). Therefore, for now, it seems to be a quarter with higher growth than 2Q11. Most recent data on domestic and US formal employment, industrial output and forecasts are in line with a GDP slowdown in the current quarter. In any case, the first half of 2011 would see growth shown in a change in the composition from higher contributions from overseas and domestic demand where the conditions for growth (an improvement in available household income, favorable financing conditions) continue.

The balance for the last week shows a wide operating range for the MXN and an increase in government bond curves

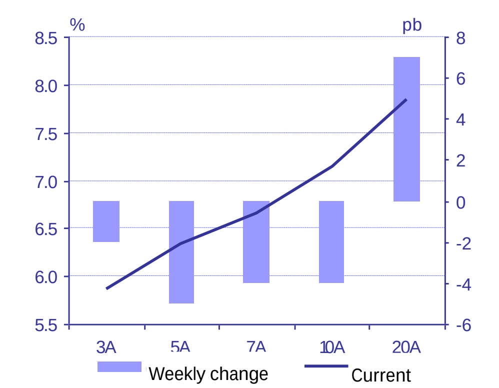
External determining factors continue to dominate movement on financial markets in Mexico where the MXN saw a wide fluctuation range (11.54-11.74) according to the flow of cyclical, sovereign and international monetary news. Nonetheless, liquidity factors remain whereby parity could reach floors of 11.55 if risk premiums ease. On bond markets, the downward move and increased slope is in line with what was seen in the US. The reduction in risk premiums for some corporations also stood out over the week after the Supreme Court's ruling on the telecoms sector.

Chart 1
IGAE Total (% change y/y and m/m)



Source: BBVA Research

Chart 2
Bond Yield Curve (% and bp)



Source: BBVA Research and Bloomberg

Calendar: Indicators

Economic Analysis

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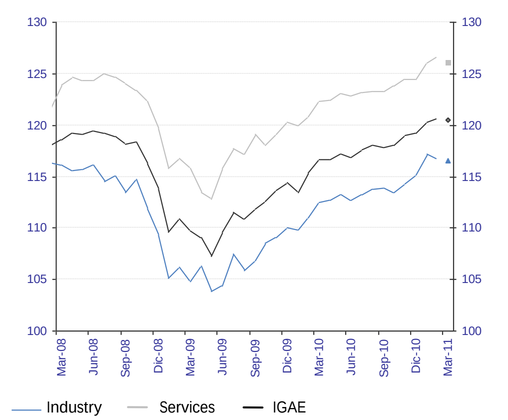
IGAE in March
GDP in 1Q11

IGAE: Thursday, May 19. -0.1% m/m, 3.3% y/y (previous: 0.3% m/m, 4.6% y/y)
GDP: Thursday, May 19. 1.1% q/q, 5.6% y/y (previous: 1.3% q/q, 4.4% y/y)

This Thursday sees the release of first quarter GDP figures on the supply side. We believe it will come in positive, perhaps even better than expected at the start of the year, although recent data point to some weakness. Industrial output continued to improve largely due to the good performance in key areas such as the automotive industry, machinery and equipment, and basic metals. In this way, the average monthly variation in the first three months of the year for industry was 0.2%, somewhat below the 0.9% average growth in the last quarter of last year. In turn, the average change in the first two months of the year was 0.9% (0.2% in 4Q10) in the service sector. However, given industrial performance in March seeing a contraction for the second month in a row, we should expect some slowdown in services, especially in those linked to manufacturing. In all and in contract with the start of the recovery, up-to-date data point to growth driving output is now more balanced and service components linked to domestic demand tending to maintain more decided growth.

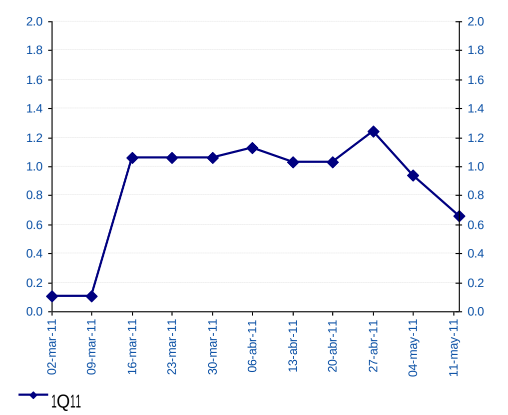
We forecast the March IGAE could have slightly slid back (-0.1% m/m), with changes of (-)4% m/m in services and a primary sector which could somewhat recover from the negative production in the previous three months (e. 7.6% m/m). W forecast growth of around 1.1% q/q in GDP for 1Q11, although with March output data known and April confidence and employment, we cannot rule out output adjustment having to a negative bias leading to a lower performance.

Chart 3
IGAE, SA
(Indices, 2003=100)



Source: BBVA Research and INEGI

Chart 4
GDP 1Q11: % change q/q, estimate



Source: BBVA Research and INEGI. Estimate based on current output indicators model.

Markets

MXN see a wide operating range but the liquidity factor is maintained meaning support could come at 11.55 based on US news

Last week, the MXN was in a wide operating range of 11.54-11.74 due to different external factors. On the one hand, most LatAm currencies were weaker in the face of greater monetary restrictions in other countries (China and the UK) and a slowdown in the global cycle. In turn, this led to a general fall in commodities prices. On the other, the European risk premium and news on another possible rescue package for Greece led to pressure on most risk assets. Nonetheless, the liquidity factor remained and, therefore, any news from the US would lead to support levels being sought on the market (11.55). We expect this to continue in the short-term. In this sense, and given the global outlook continues without clear directional dynamic, we forecast volatility to remain high in the near future.

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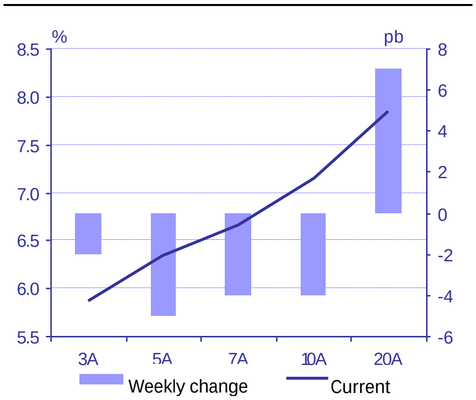
Downward move in the curve and increased curvature

The balance last week in the bond market showed an average 2bp downward move in the curve with higher movement in the medium part (see chart the 5-year bill saw a 5bp rally), although a sell bias remained in the long parts (see chart, 20-year increased 7bp). In turn, the curvature increased: the slope between 20/10 years came in at 11bp. The move is in line with US T-Bills, where the curve rose 2bp.

Reduction in risk premiums for some corporations after the Supreme Court's ruling on the telecoms sector

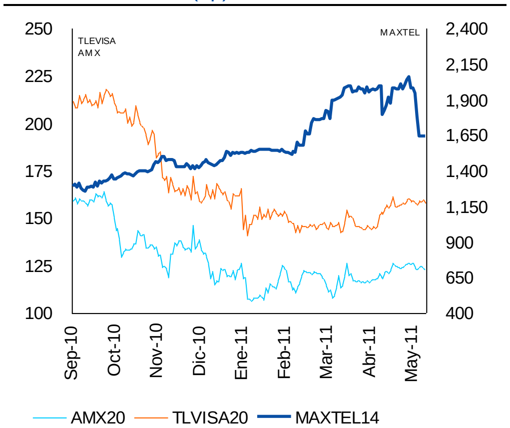
The risk premiums for some Mexican companies in the telecoms sector reduced after the Supreme Court refused the suspension of Cofetel actions. This means all interconnection resolutions this Commission sets when operators fail to reach an agreement will be applicable. This decision could directly lead to a higher operating cashflow for some companies in the sector which use the interconnection service of the large Mexican telcos.

Chart 5
Bond Yield Curve (% and bp)



Source: BBVA Research with data from Bloomberg

Chart 6
Corporate spreads in dollar-denominated bonds in the telecoms sector (bp)



Source: BBVA Research with data from Bloomberg

Technical Analysis

Market Analysis
Equities

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IPC Stock Market Index

IPC: The IPC ended the week around the psychological support level of 35,000 pts, while Amx operated slightly below P$30.00. We continue to believe that a technical upswing could be seen from these levels in line with the lessons on overselling. If the market is not able to respect this support, the following floor would come in around 34,200 pts. This week's movement led to the spread between 10 and 30 day rolling averages on the IPC running to 1,000 pts. In the last 24 months, this spread level was only reached twice before. Both occasions saw major bounces.

Previous rec.: 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.

Source: BBVA, Bancomer, Bloomberg

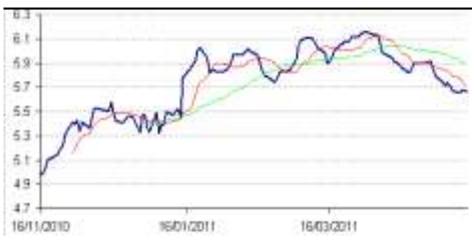
MXN

Over the week it again came close to the P$11.50 floor from where it bounced and managed to close above the 30-day rolling average (P$11.66). This break leads to the possibility of a move toward P$11.90 levels, while the support area comes in at P$11.60, where the 10 and 30-day rolling averages converge.

Previous rec.: 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.

Source: BBVA, Bancomer, Bloomberg

3Y M BOND



3Y M BOND: (yield): Maintains its downward trend and is under its initial 5.6% support. In order to consider a technical bounce, it needs to break 5.7% and head toward 5.9%.

Previous rec.: The spread between the 10-day and 30-day rolling averages is still not so strong, so it may maintain its downward movement.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND

10Y M BOND (yield): Reaches 7.2% and lateralizes move. Significant resistance comes in at 7.3% and only breaking this level would lead us to consider a trend change. Meanwhile, the following floor holds at 7%.

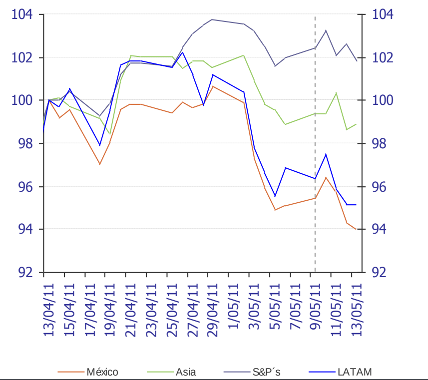
Previous rec.: We maintain short-term objectives at 7.2% and 7%.

Source: BBVA, Bancomer, Bloomberg

Markets

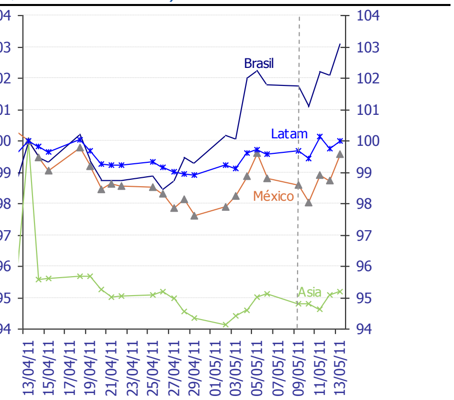
Stock markets saw falls in the face of speculation on a cooling in emerging nations' economies. The IPC was also influenced by the fall in América Móvil. LatAm currencies saw losses due to this speculation.

Chart 7
Stock Markets: MSCI Indices
(Apr 13, 2011 index = 100)



Source: Bloomberg & BBVA Research

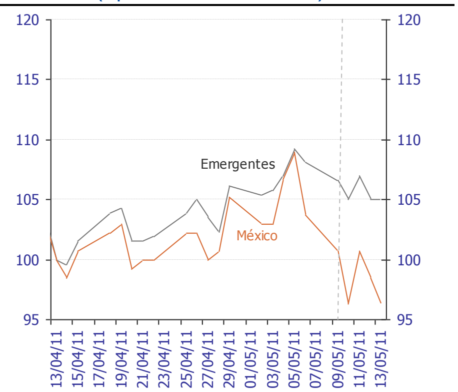
Chart 8
Foreign exchange: dollar exchange rates
(Apr 13, 2011 index = 100)



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

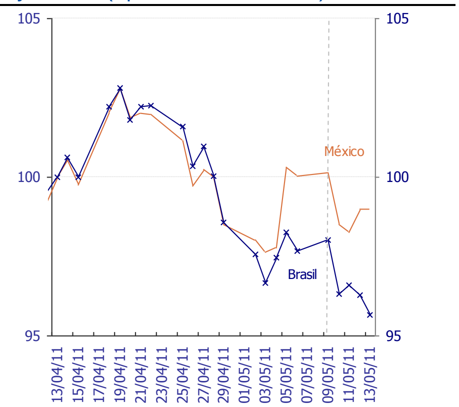
Marginal fall in risk aversion after the rumor of a Greek exit from the EU.

Chart 9
Risk: EMBI+ (Apr 13, 2011 index = 100)



Source: Bloomberg & BBVA Research

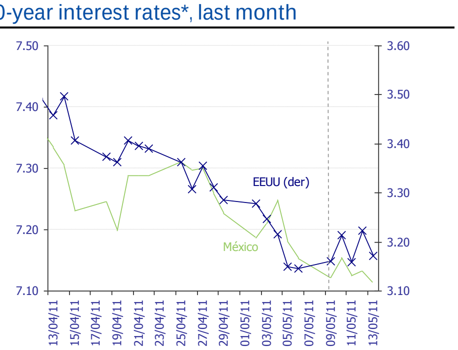
Chart 10
Risk: 5-year CDS (Apr 13, 2011 index=100)



Source: Bloomberg & BBVA Research

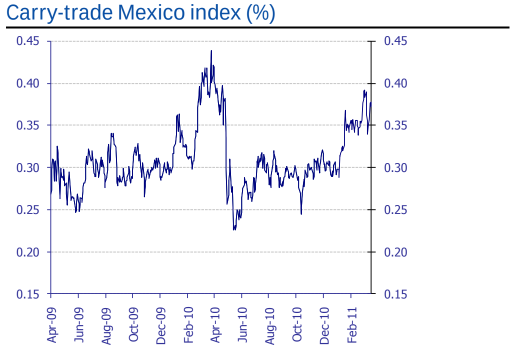
US and Mexican interest rates fell due to the possibility of global growth coming in lower.

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

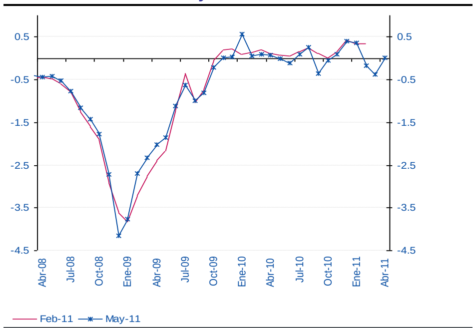


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

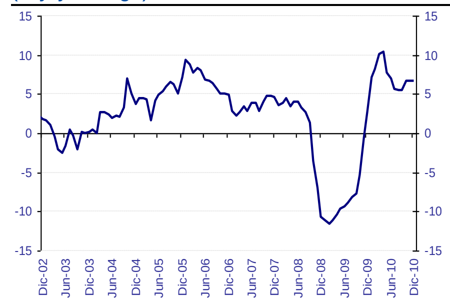
Activity continues to recover moderately, headed by industrial output and followed more slowly by the service sector

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.

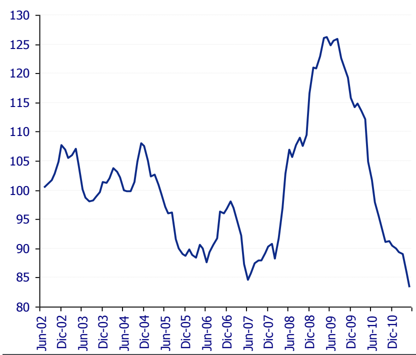
Chart 14
Advance Indicator of Activity
(% y/y change)



Source: INEGI

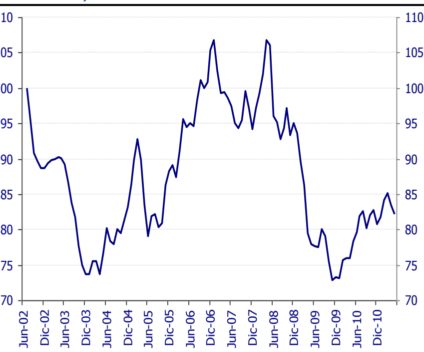
Surprises in inflation are biased downwards, while in activity, they are mildly upwards.

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.

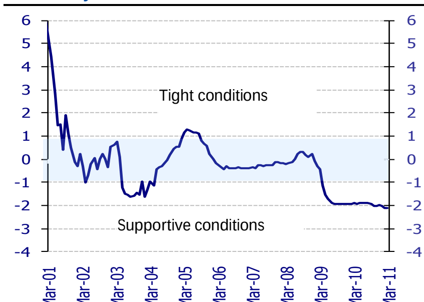
Chart 16
Activity Surprise Index
(2002=100)



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.

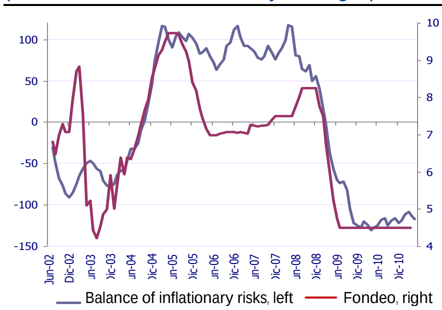
The monetary conditions have not changes and continue to be loose, although with a very slight deterioration in the balance of inflationary risks

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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