# Weekly Watch

Mexico

May 27, 2011

Economic Analysis

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## Next week...

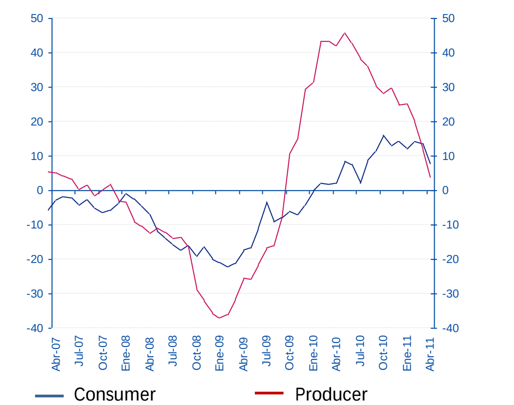
### Awaiting pointers on output performance in 2Q11

Information on producer and consumer confidence indicators for May is to be released this week. It will be especially important due to the negative surprise in both seen in April, particularly consumer confidence. We believe the moderation in private formal employment in April (0.2% m/m after seeing average growth rates of 0.4% m/m over the last 18 months) is a key factor providing pointers on the current moderation. In this sense, indicators such as the opportunity to purchase a durable good as well as the expected domestic and foreign demand level for products by companies will be variables to monitor closely. It should be stated that in April we should have seen some negative effect due to the tsunami in Japan on the Mexican automotive industry and employment which, added to the moderation in foreign demand indicators, mark a temporary downward bias in output in 2Q11, without going further than that.

### Greater risk aversion in the face of global uncertainty on the sustainability of the U.S. cycle and sovereign risk performance in Europe

In a week of concern about the economic cycle and sovereign debt, there was a bigger bias to risk aversion in markets and increased volatility. In an international context, there was softer language in the Banxico release which led to a strong rally in local bonds and a flattening out of the curve. On the exchange market, the USDMXN rate reversed losses at the end of the week and saw greater currency sensitivity to global factors on local events. Over the week, parity could fluctuate between 11.65 and 11.70.

Chart 1
Confidence: consumer and producer (% change y/y)




Source: BBVA Research and INEGI

Chart 2
MXN: FX and Implicit Volatility (ppd and 1%)


Source: BBVA Research and Bloomberg

# Calendar: Indicators

Economic Analysis

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## Public Finances in April

On Monday, the SHCP will release the April Public Finance report, important information to see if there is a speeding up in budget revenue recovery which only grew a real 1.6% in the 1Q11. Factors more affecting income include the incipient growth in tax collection of barely 0.9% y/y in the 1Q11. This result was mainly due to a 3.5% y/y fall in VAT collection. Spending also slowed, increasing 2.7% y/y (3.6% y/y 2010), with the low growth in physical investment of 0.9% y/y standing out due to a -3.7% y/y decrease in direct investment. Decreased spending also had positive sides such as the -17.3% y/y reduction in public sector financing costs. Equity holdings continued to increase, albeit at a moderate rate of 3.7% (vs. 11.8% y/y in 2010). The incipient recovery in tax revenue meant total revenue is yet to reach pre-crisis levels. This year, however, will see benefits from higher oil revenue due to higher crude prices and platform stabilization. Despite this, there is concern that economic growth is not based more on increased tax income.

## National Construction Companies Survey

According to the National Construction Companies Survey (ENEC), the start of the year has seen mixed signals in construction: although in aggregate the negative trend running from mid-2008 to mid-2010 has reversed, there are still residuals and ups-and-downs in the components. On the building side, which contributes nearly 50% of industry output value, there was some move in housing and other private sector buildings (offices and industrial plants) but, in contrast, there was a slow start to the year in public works which put a stop to projects such as hospitals and transport works. In this way, a negative reading of the ENEC results for March (Monday 30) would not necessarily be a bad sign for the future. In a setting of economy recovery, surpluses in oil revenue and a coming election, spending on public works is likely to start to stabilize in the second quarter.

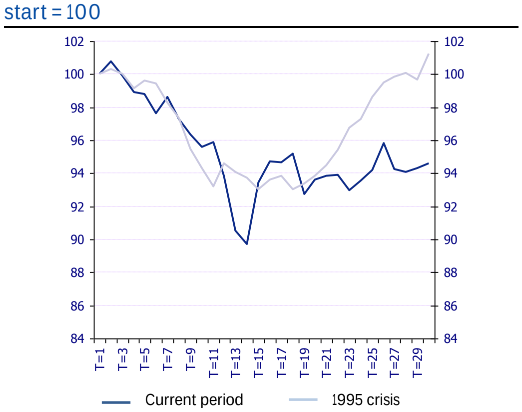
## Consumer Confidence in May

| Forecast: 89.0 | Consensus: 90.2 | Previous: 89.3 |
|---|---|---|

## Producer Confidence in May

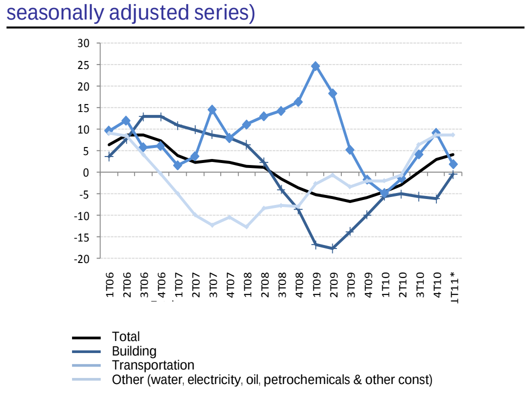
| Forecast: 54.8 | Consensus: N.A. | Previous: 55.1 |
|---|---|---|

Chart 3
Public revenue in a Crisis (1995 and 2008) recession start = 100




Source: BBVA Research with Banxico data and SHCP

Chart 4
Construction: amount of output (annual % change seasonally adjusted series)




Source: BBVA Research and INEGI.

# Markets

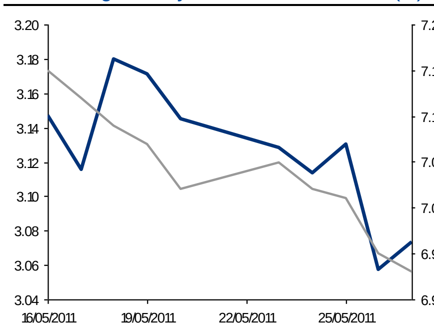
## The MXN closed the week with a slight gain, correctly losses from previous days and showing sensitivity to external risks

After starting last week with falls, the MXN closed the week with a slight strengthening and traded at levels near 11.61. This performance saw greater currency sensitivity to global factors on local events. Specifically, performance was set by by the sovereign risk premium in the Eurozone and by cyclical risk, mainly in the U.S. Despite the measures announced in Greece (budget cuts and privatizations), uncertainty remained about the possibility of a debt restructuring. In turn, there was a surprising fall in economic indicators in the U.S., so concerns remained regarding the global economic cycle which moderated at the end of the week after G-8 statements. In this context, US data on the non-farm payroll and the ISM could lead to a weakening in the MXN to the 11.65-11.70 range.

## Gains in local bonds extended due to global factors and the possibility of a longer monetary pause.

The week was marked by higher cyclical risk premiums (with the release of weak US data) and sovereign debt in the Eurozone. This led to an increase in refuge asset demand. This was seen in the solid results for US T-Bill auctions and German Bunds, whose 10-year yields came in close to 3.05% and 3% respectively. Added to this in the international context was the announced inflation containment in the first fortnight of May, as well as a more *dovish* tone in the Banxico release (improved inflationary risk balance and moderate economic growth). This led to an increased likelihood of Banxico increasing its rate in the 1Q12 (93% in February 2012). The above led to a strong rally in local bonds and a flattening out of the curve over the week with higher movement in the long part over the short part of the curve. We continue to see a space for a rally in bonds.

Chart 5
Yield change in 10-year bonds: MX vs. U.S. (%)




Source: BBVA Research with data from Bloomberg

Chart 6
MXN: FX and Implied Volatility (ppd and 1%)


Source: BBVA Research with data from Bloomberg

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# Technical Analysis

## CPI Stock Market Index

CPI: This weekly gain sees the CPI return to levels near 36,000pts. There is major resistance in this zone with the 30 and 200-day rolling averages coming in there, as well as the short-term negative trend line under which the CPI has been trading since it started its fall at 38,000pts. Although the CPI could stop the bounce right at this level, especially if we take into account the US public holiday at the start of the week, we believe the market has a good chance of restarting the upward bounce in the coming week and trying to come in above this resistance level.

Previous rec.: The technical readings we commented on last week (high oversell, opening of over 1,000pts between 10 and 30-day rolling averages) remain present and the perspective of a short-term bull bounce remains valid.

Source: BBVA, Bancomer, Bloomberg

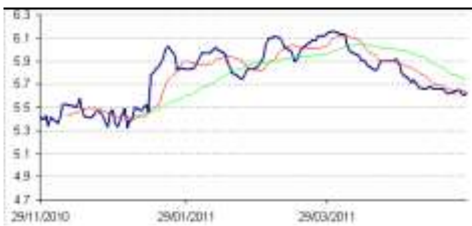
## MXN

For the second week in a row, the trading range came in at P$11.60 / P$11.80. This meant the over-purchased oscillating indicators slowly came close to the oversell zone. We believe that it should remain in this trading range in coming session with chances of moving downward and hitting P$11.50.

Previous rec.: We believe it could again come close to the P$11.50 zone to again try this floor.

Source: BBVA, Bancomer, Bloomberg

## 3Y M BOND



3 YEAR M BOND: (performance): Side move over the week but not enough to come in above short-term rolling averages. Support remains at 5.5%. A close above 5.75% would mean a change to an upward trend.

Previous re.: It may try floors at 5.55% and 5.51% - the 200-day rolling average level.

Source: BBVA, Bancomer, Bloomberg

## 10Y M BOND

10 YEAR M BOND: (performance): The downward move accentuates over the week, reaching the 6.9% support level. It would have to come in at least above 7.15%, the 10-day rolling average, to be able to consider an upward bounce.

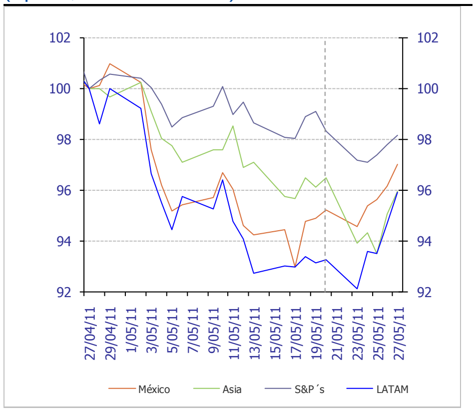
Previous rec.: A downward move remains with supports at 6.9% and 6.85% where the 200-day rolling average sits.

Source: BBVA, Bancomer, Bloomberg

# Markets

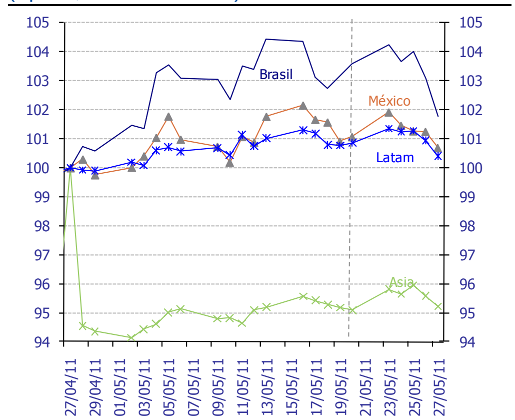
Higher recovery forecasts announced by the G8 and higher-than-expected consumer confidence data in the US generate upswings on share markets at the end of the week. As a consequence, the peso strengthens.

Chart 7
Stock Markets: MSCI Indices
(Apr 27, 2011 index = 100)




Source: Bloomberg & BBVA Research

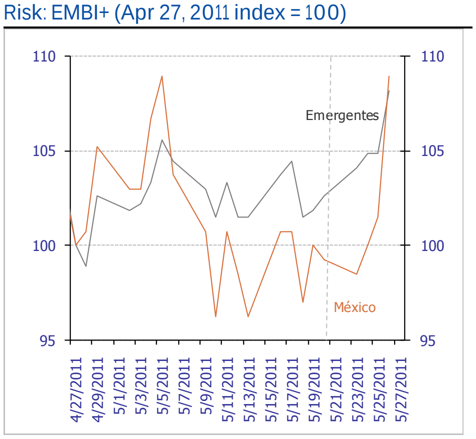
Chart 8
Foreign exchange: dollar exchange rates
(Apr 27, 2011 index = 100)




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

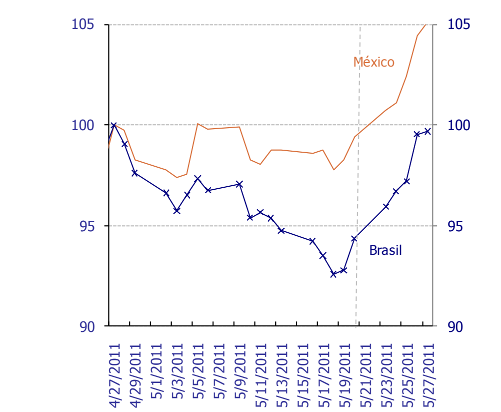
Risk indicators in Mexico were affected over the week by the Greek crisis and the fall in existing home sales and durable goods orders in the US to well-below forecasts.

Chart 9
Risk: EMBI+ (Apr 27, 2011 index = 100)




Source: Bloomberg & BBVA Research

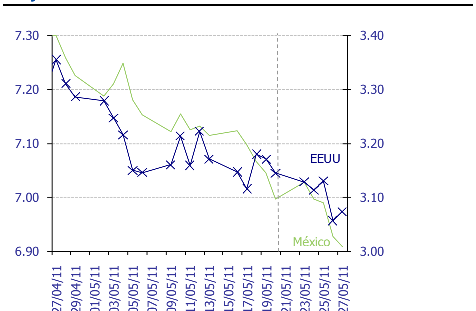
Chart 10
Risk: 5-year CDS (Apr 27, 2011 index=100)




Source: Bloomberg & BBVA Research

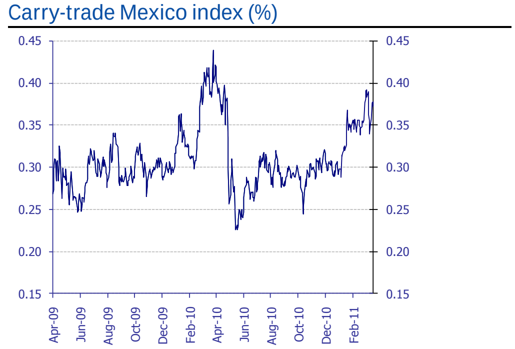
US interest rates fall over the week due to an expected worsening of the situation in Greece. Rates in Mexico fall due to a perception that Banxico is set to maintain its monetary pause throughout 2011

Chart 11
10-year interest rates*, last month




Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

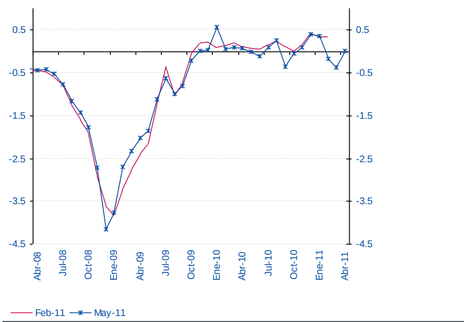


Source: BBVA Research with data from Bloomberg

# Activity, inflation, monetary conditions

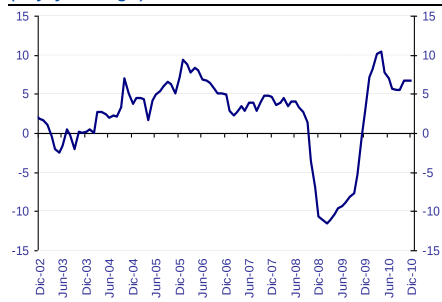
Output showed a moderation trend since the end of the 1Q11 linked to the negative effects of the tsunami in Japan and moderate foreign demand

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.

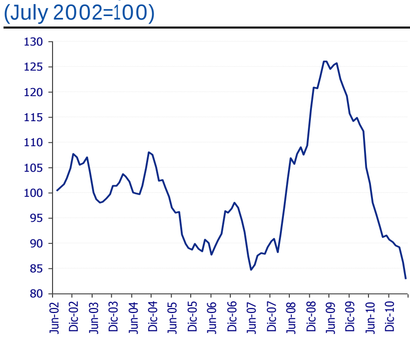
Chart 14
Advance Indicator of Activity
(% y/y change)



Source: INEGI

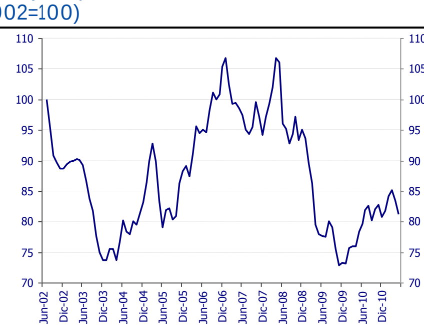
There was a surprise downward move in latest inflation and output data. This means economic growth is still not causing price pressures.

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.

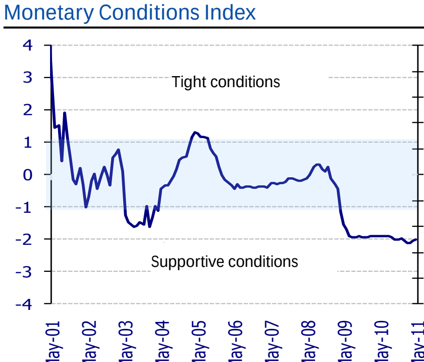
Chart 16
Activity Surprise Index
(2002=100)



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.

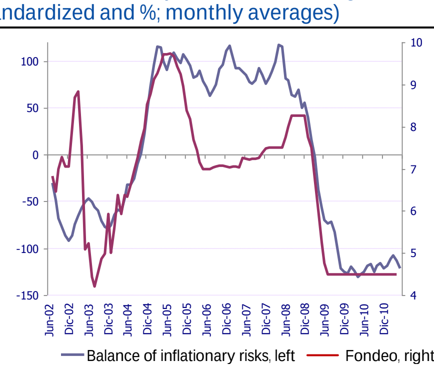
The monetary conditions have not changed and continue to be loose, with this loosening in fact increasing slightly in recent days.

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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