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BBVA Economic Research
Department

Weekly Watch

Mexico

June 10, 2011

Economic Analysis

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Market Analysis

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Next week...

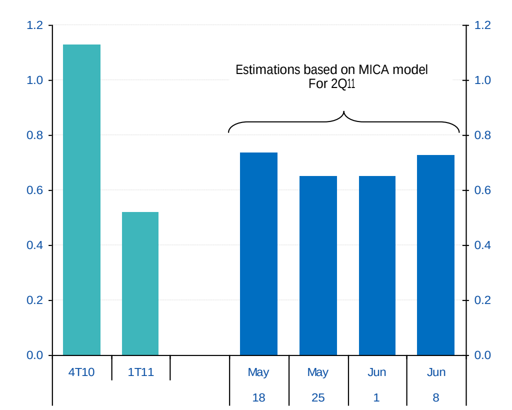
More evidence on the performance of the Mexican economy in 2Q11 while US slows

For the second quarter of the year, relevant data on the Mexican economy underline the idea that the negative surprise in output in April in indicators such as employment, confidence, automotive production and the jobless rate was temporary. Although the data on the global outlook and, specifically, the US, were below expectations, available information for Mexico continues to reasonably point to GDP growth similar to 1Q11. The April IGAE has yet to be published (it is set for release at the end of this month), but industrial production out on Monday 13 should provide valuable information regarding the size of the possible impact of overseas moderation in Mexico. In this sense, US economic indicators have come in below forecasts, pointing to an uncertain slowdown in terms of intensity and length but generating debate even around a possible third round of quantitative easing (QE3). However, it is highly unlikely that the Fed uses this measure since the economy continues to grown and, for now, there are no deflation risks and financial markets are operating normally. In any case, the Fed seems set to continue on its balance sheet reinvestment strategy and assessing the need for additional measures which would not be announced, where applicable, until the end of August at Jackson Hole.

Weaker US cycle leads to safe-haven effect in markets

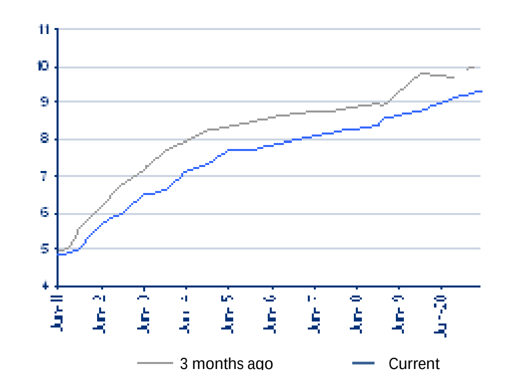
There was a general strengthening in the USD over the week faced with high risks where a weaker US cycle (and the re-emergence of debate around QE3), the uncertainty on Greek sovereign debt and the ECB monetary pause set market performance. In this sense, the MXN saw major drops due to its link with the US cycle. In fixed income, short sections of the curve seem to have factored in a prolonged monetary pause in Mexico in the face of good inflation data and the tone in Banxico releases, while the long sections are awaiting more clarity about the balance of risks for output.

Chart 1
Mexico: GDP 2Q11 based on the MICA model (% change q/q)



Source: BBVA Research

Chart 2
TIIE Futures (%)



Source: BBVA Research and Bloomberg

Calendar: Indicators

Economic Analysis

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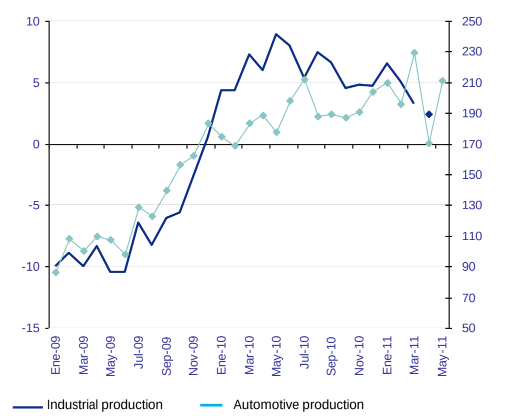
Industrial Production April 2011

Forecast: -0.7% (2.4% y/y) Consensus: N.A. Previous: -0.2% (3.2% y/y)

Industrial production in April was affected as a consequence of low parts supply from Japan due to the tsunami in March. It should be stated that vehicle production fell 10.4% y/y in April, affected by the technical stoppages in July and August that are usually scheduled to prepare production of new models being brought forward. Other indicators were also affected in April including producer and consumer confidence which meant negative surprises - both being influenced by the relatively weak job numbers in the formal private sector for the fourth month of the year, increasing by just 0.2% m/m.
The released automotive production and manufacturing production indicators in the US for April should be considered (including May figures for automotive production) which showed weak performance linked in some way to events in Japan. Based on these indicators, we forecast Mexican industrial production to come in at the lower end our forecast range (-0.7% m/m), giving the lowest monthly change since August 2009.

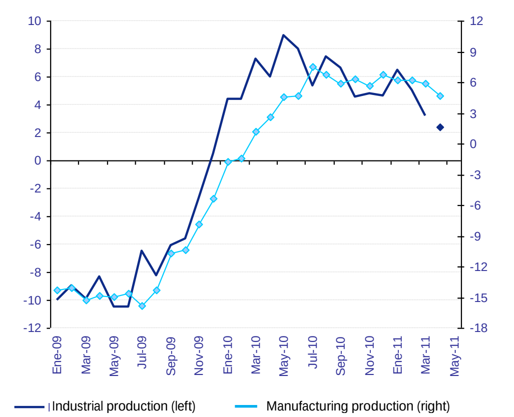
In any case, with regard to May, both confidence and employment, as well as automotive production, saw a bounce to, in some way, compensate for the previous data. It should be stated that we still do not have relevant data on the services sector which usually reacts with a certain lag. In this sense, with the information to date, the MICA model based estimate points to a quarterly change in GDP for 2Q11 of 0.7%, 0.2 pp above the 0.5% seen in the first quarter. This figure has a certain downward bias awaiting the final impact of the current slowdown in the US on the quarter.

Chart 3
Industrial production and automotive production (% change y/y and level, thousands of units)



Source: BBVA Research with data from INEGI and AMIA

Chart 4
Industrial Production and Manufacturing Production in the US (y/y % change)



Source: BBVA Research and INEGI.

Markets

Generalized appreciation in the USD as a safe-haven asset; the MXN is one of the most affected currencies due to its exposure to US cycle

As has been the case since mid-May, last week the behavior of global currencies was determined by cyclical risk premiums in the U.S. and sovereign risk in the European periphery, as well as ECB monetary policy expectations. However, this time there was a change in the trend of the USD as a result of a negative surprise in the economic indicators. The U.S. dollar appreciated against most developed and emerging currencies, and once more took on the role of risk-free currency. The above occurred even with the market awaiting the ECB's decision. In this sense, with the chance of a more hawkish stance appearing (this was not the case), a strengthening of the euro could have occurred. In all, LatAm currencies showed mixed performances. The most affected was the MXN given Mexico's greater exposure to the US economy. We expect it to continue trading with high volatility (11.65-11.85 range).

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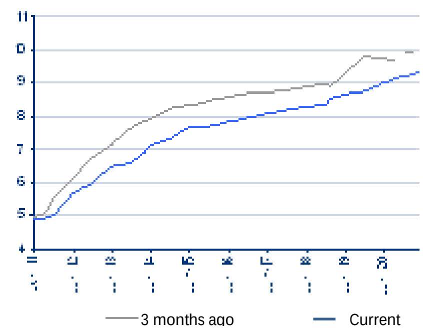
No clear movements over the week

The short sections in the MBONDS and IRS curve price in a prolonged monetary pause up to 2012, but the higher maturities are still to fully incorporate this scenario. Inflation for May in Mexico confirms upward pressure being higher contained, significantly reducing the likelihood of Banxico moving its policy rate in 2011. This should eliminate the short-term monetary risk premium and extend the exposure level to Treasuries performance. Thus, US economic data in the coming week could be determining factors for markets to define a clearer direction trend given the doubts surrounding the global cycle.

Stock markets under pressure with global economic data and sovereign risk.

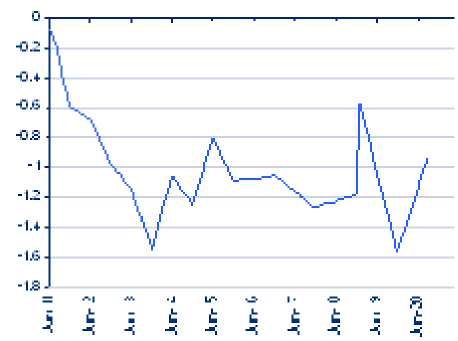
Mexican companies with exposure to Peru (namely Amx and GMexico) have a negative contribution on market performance last week. Macro figures will be key this week, with special weight put on US and China industrial production data. The lack of definition on Greece may continue to weigh in the short-term, but values reached after the adjustment have recovered their attraction. Therefore, we could see direction moves as the solution date approaches.

Chart 5
TIIE Futures (%)



Source: BBVA Research with data from Bloomberg

Chart 6
Change in TIIE future (3 months)



Source: BBVA Research with data from Bloomberg

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Technical Analysis

IPC Stock Market Index

IPC:. The market's attempted bounce over the week was not strong enough to place the IPC above 10- and 30-day rolling averages and change to a positive short-term trend. The IPC ended the week above the 34,800pts benchmark but until its again starts to trade above 35,360pts, the risk of a downward slide remains. In this scenario, we have set the following floor at between 34,000 and 34,200 pts.

Previous rec.: the short-term outlook should continue to be under pressure as long as the 30-day (35,69 pts) and 200-day (36,000 pts) rolling averages fail to rise.

Source: BBVA, Bancomer, Bloomberg

MXN

The dollar breaks the P$11.60/11.80 lateral range over the week, where it has traded for a month. The upward break in resistance places the next target at P$12.00, P$0.20 above the resistance, corresponding to the lateral range high.

Previous rec.: Oscillating indicators point to a new return to the high part of this range. Above this resistance comes in at P$11.90 and below the support at P$11.50.

Source: BBVA, Bancomer, Bloomberg

3Y M BOND

3 YEAR M BOND: (performance): Spent the week trading around the 200-day rolling average without managing to come in above 10- and 30-day averages. We continue to forecast an upturn toward 5.65%.

Previous rec.: the 200-day rolling average comes in at 5.54% from where we could see a bounce.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND

10-YEAR M BOND: (yield): Bounce from the 200-day rolling average, closing the week slightly above the 10 day rolling average. We believe it could extend toward 7.15% and if it breaks, this would mark a short-term trend change.

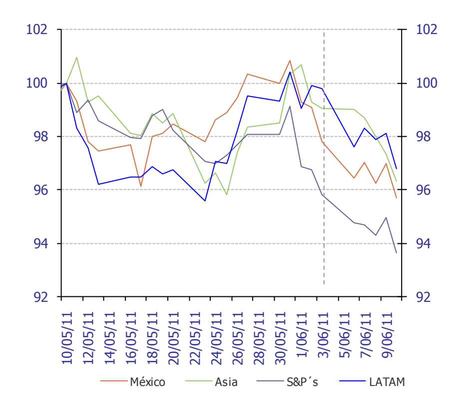
Previous rec.: Hits 200-day rolling average at 6.88%. We could expect a bounce with resistance at 6.97% and 7.15%.

Source: BBVA, Bancomer, Bloomberg

Markets

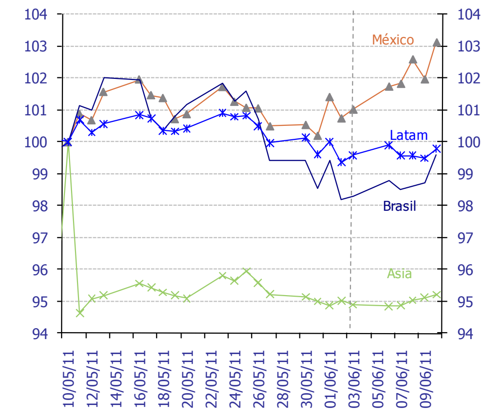
The gall in Chinese exports and cut to growth forecasts for 2011 by the World Bank increase concerns about economic recovery and lead to falls in stock markets. LatAm currencies fall due to a search for safe-haven assets.

Chart 7
Stock Markets: MSCI Indices
(May 10, 2011 index = 100)



Source: Bloomberg & BBVA Research

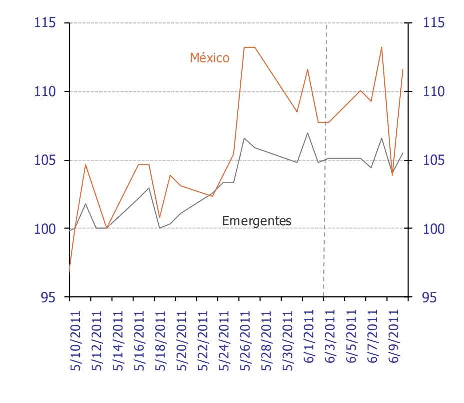
Chart 8
Foreign exchange: dollar exchange rates
(May 10, 2011 index = 100)



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

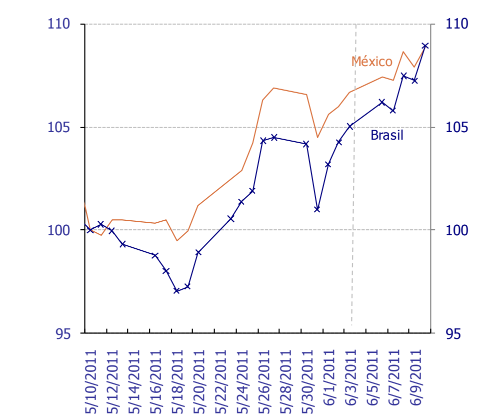
A rise in risk aversion due to uncertainty surrounding the length and size of lower economic output rates seen in recent data.

Chart 9
Risk: EMBI+ (May 10, 2011 index = 100)



Source: Bloomberg & BBVA Research

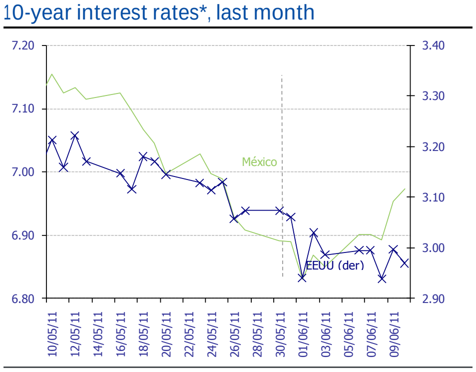
Chart 10
Risk: 5 year CDS (May 10, 2011 index=100)



Source: Bloomberg & BBVA Research

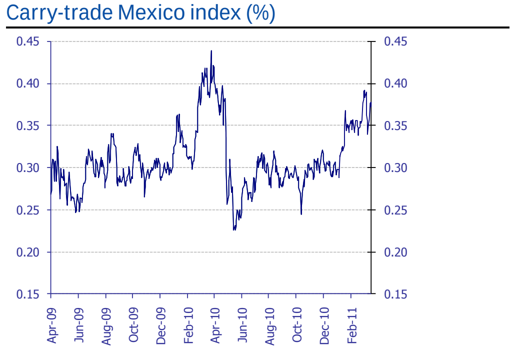
US interest rates fall while rates in Mexico close higher due to increased risk aversion and the search for safe-haven assets.

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

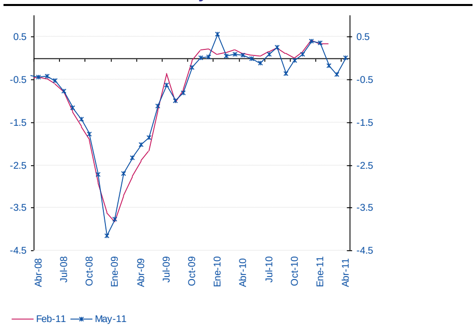


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

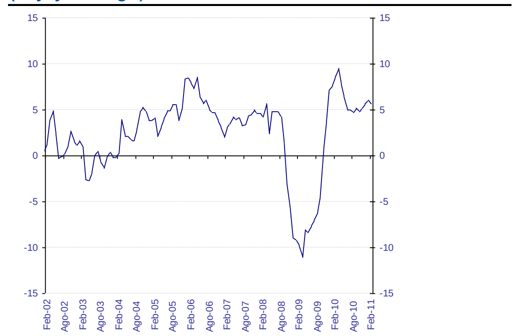
For the time being, recent output data point to moderation in April being temporary linked to industrial production

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.

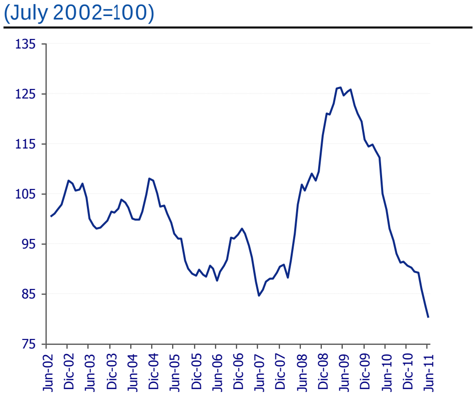
Chart 14
Advance Indicator of Activity
(% y/y change)



Source: INEGI

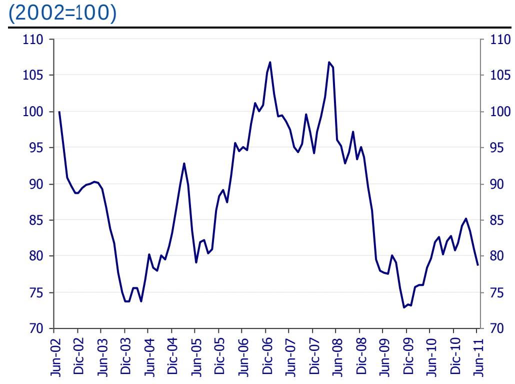
Recent inflation data continue to show downward surprises, improving outlooks for the year. Meanwhile, output data are mixed within the moderation context.

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.

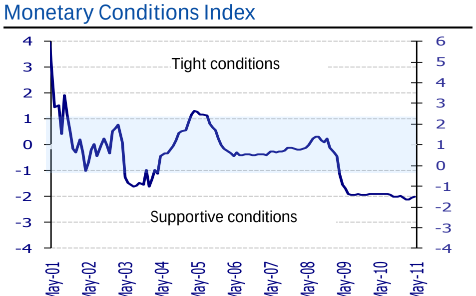
Chart 16
Activity Surprise Index
(2002=100)



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.

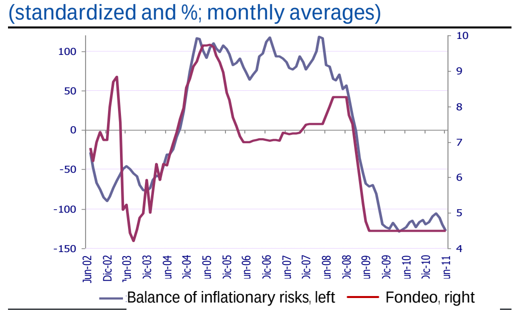
The monetary conditions have not changed and continue to be loose, with this loosening in fact increasing slightly in recent days.

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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