

Weekly Watch

Mexico

17 June 2011

Economic Analysis

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Market Analysis

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Next week...

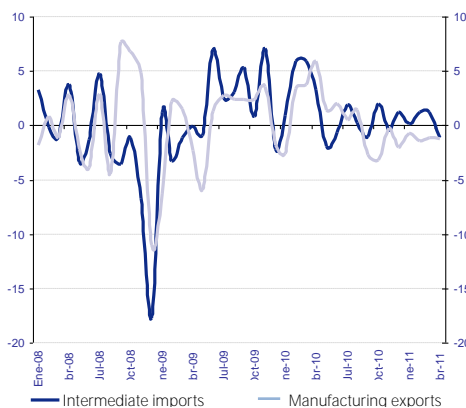
... Lack of inflationary pressure to be confirmed and impact of US slowdown on Mexico to be seen

This week sees the release of lots of data (details for GDP in 1Q11 on spending, retail sales in April and the trade balance, and jobless figures for May). With regard to output, the most important information is the trade balance, especially after the downward adjustment in April for exports and imports - something we see as temporary due to the effects of the earthquake in Japan on economic output. Support for this comes from the bounce in released indicators for May (formal employment, confidence) but there is a downward risk from the lower US output growth rate. Next week will also see inflation figures released, which will move up 0.2% in the first two weeks of June (3.4% y/y). Some favorable non-core factors in May will disappear, such as the fall in electricity tariffs due to the warm season, but other will remain such as the falls in agricultural prices. Core inflation (0.1% fortnightly, 3.2% annual) will remain under upward pressures due to processed food, although the other components will remain in check thanks to their determining factors - continuing favorable domestic demand the exchange rate. We see inflation ending 2011 at between 3.5% and 3.8%, with a slightly downward bias risk.

One of the most volatile weeks for the MXN since the start of the year and a bounce in aversion leading to sell-offs in domestic curves

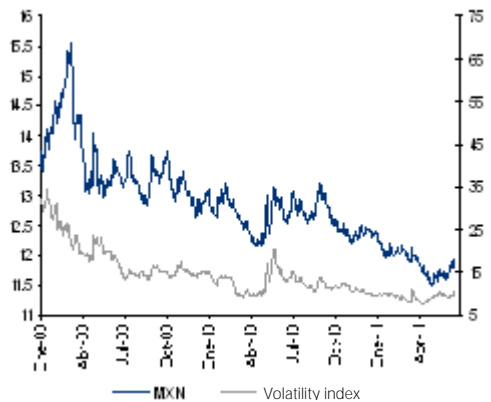
The prolonged uncertainty up to mid-July on the solution to the Greek sovereign debt problem and doubts as to US cycle strength marked a week of high volatility, leading to the MXN trading in a wide range between 11.78 and 12 ppd. Everything points to this currency volatility continuing. This scenario led to a sale bias in domestic curves for fixed income, led by local investors maintaining a cautious approach.

Chart 1
Manufacturing exports and intermediate imports
(real % change m/m in dollars)



Source: BBVA Research

Chart 2
Exchange Rate and Volatility (ppd, index)



Source: BBVA Research and Bloomberg

SEE IMPORTANT INFORMATION AND ANALYST CERTIFICATION ON PAGE 7 OF THIS DOCUMENT

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Calendar: Indicators

GDP for demand 1Q11 (Aggregate Demand). Tuesday 21 June

Forecast: 1.6% (5.8% y/y) Consensus: N.A. Previous: 0.5% (6.8% y/y)

Economic Analysis

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Given the fluctuation of GDP in the first few months of the year, this week INEGI will release the components for demand behind this growth. The relevant domestic and foreign demand indicators point to the observed moderation in the first quarter (1.1% q/q in 4Q10 to 0.5% in 1Q11) was in part due to lower performance for private consumption and exports. In this way, indicators such as retail sales went from average monthly growth of 0.5% in the last quarter of the year to -0.1% in the first quarter of this year. In turn, total export in real pesos went from average growth of 2.6% in 4Q10 to 2.2% in 1Q11. In turn, there are signs that the investment factor for domestic demand will start to reactivate: capital goods imports grew from 0.8% in the last quarter of last year to 2.7% in the first few months of this year, pointing to a reactivation in capital formation, specifically from the private sphere.

Further, with initial output data for 2Q11, the key variables evolution points to the moderation seen in 1Q11 being temporary and likely to recover towards Q2 this year.

Inflation for the first two weeks in June. Thursday 23 June

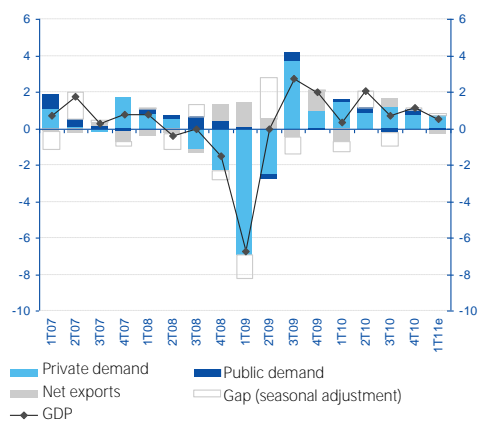
Forecast: 0.16% bi-weekly. (3.41% y/y) Prev. -0.74% m/m, (3.25% y/y) Consensus: 0.14% bi-weekly y/y

Appropriate trade balance in May. Friday 24 June

Forecast: 857 md. Consensus: N.A. Prev. 767 md April

Very important data to obtain more clues as to whether the slowdown in manufacturing trade in April, where both manufacturing exports and intermediate imports contracted, is temporary and linked to the negative effects of the earthquake in Japan or if, in addition, the manufacturing sector is starting to reflect the slowdown in the US economy. With regard to the Trade Balance, we forecast it remaining positive thanks to the higher price of oil exports and the continuing weakness in both consumer and capital imports.

Chart 3
GDP Mexico (q/q % change and components)



Source: BBVA Research with INEGI data.

Chart 4
Inflation: Forecast for June (% change y/y and m/m)

	Weight (%)	Monthly change (%)				Annual change (%)		
		Average 2003-2009	Abr-11	May-11	Jun-11	Abr-11	May-11	Jun-11
CPI-Mx	100.0	0.14	-0.01	-0.74	0.14	3.36	3.25	3.43
Core-Mx	74.8	0.28	0.08	0.18	0.22	3.18	3.12	3.20
Goods	37.0	0.26	0.35	0.28	0.20	4.07	4.12	4.35
Food products	14.7	0.37	0.58	0.51	0.37	5.98	6.25	6.87
Other Goods	22.4	0.18	0.17	0.11	0.07	2.60	2.48	2.41
Services	37.7	0.29	-0.15	0.09	0.23	2.44	2.30	2.24
Rent	17.9	0.24	0.20	0.20	0.17	2.19	2.14	2.09
Education	5.2	0.15	0.07	0.03	0.07	4.47	4.42	4.38
Other serv.	14.7	0.38	-0.56	0.00	-0.34	1.93	1.67	1.60
Non Core-Mx	25.2	-0.35	-0.28	-3.80	-0.10	3.90	3.45	3.96
Farm products	8.1	-1.41	3.06	-3.86	-1.30	3.70	3.26	4.12
Fruits/Vegetables	3.3	-3.51	7.22	-9.72	-3.39	5.71	4.14	4.89
Meat/Eggs	4.8	-0.04	0.16	0.51	0.28	2.33	2.87	4.07
Public managed	17.2	0.32	-2.11	-3.77	0.59	4.04	3.59	3.79
Energy	7.8	0.48	-3.25	-6.10	0.68	5.00	4.38	4.74
Controlled prices	9.4	0.08	-0.03	0.35	0.36	2.62	2.84	2.70

Source: BBVA Research and Banxico

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Markets

One of the most volatile weeks for the MXN since the start of the year...

As in last month, the two main factors for currency performance were related firstly to the uncertainty on the expected bail-out for Greece, the participation of private investors in the plan and the approval of budget cuts in the local parliament. Secondly, uncertainty remained with regard to the US economic cycle, although this reduced at the end of the week. Given the approval and final details of the Greek bail-out are not expected until mid-July, we forecast volatility to continue to be high in the near-term.

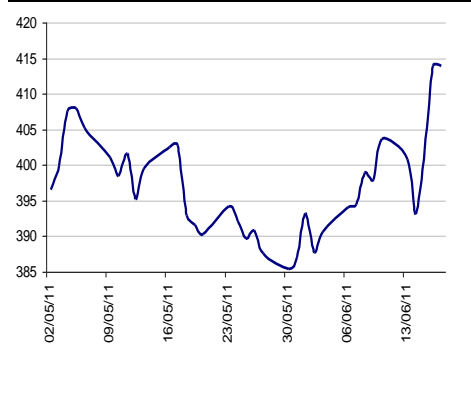
...and higher aversion leading to sell-offs in domestic curves

The aforementioned global uncertainty led to market fluctuations without a clear trend. This high volatility scenario led to a sale bias in domestic curves headed by local investors maintaining a cautious approach in the face of a clear scenario for UST performance lacking. The spreads between the medium and short part (as well as the long and belly) are in attractive ranges and the rate differences between Mexico and the US are above 410bp, a zone where we have seen increased demand for MBonds from foreign investors.

Global markets continue under pressure from cyclical fears, but the IPC managed to close with a slight gain.

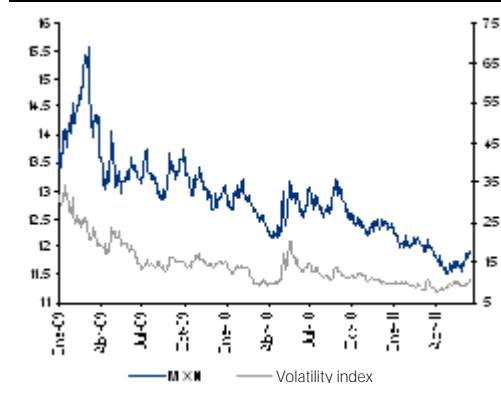
In this setting, most global markets continued to see falls, with only Asia having a marginally positive performance and Latin America seemingly the most affected, except Mexico which, in the first few days of last week, saw gains which were partially corrected at the end of the week due to prolonged uncertainty about Greece. This coming week, US indicators on the cyclical position will be important, specifically for the real estate market. Equally, the content of the Federal Reserve economic policy release (Wednesday 22) on the output balance of risk will be important for the capital market.

Chart 5
Rate Differences, Mexico and US (bp)



Source: BBVA Research with data from Bloomberg

Chart 6
Exchange Rate and Volatility (ppd, index)



Source: BBVA Research with data from Bloomberg

Market Analysis
Equities

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Technical Analysis IPC Stock Market Index



IPC: The IPC tried for the 2nd time in a month to break through its 30-day rolling average. It closed the week just under this technical level and, for the moment, we maintain a return to the 36,000pts zone where the 200-day rolling average comes in. Oscillators such as the RSI are still far from the short-term over-buy zone. With this positive perspective we restate the importance of the 34,800pts floor, although a close below 35,000pts would mean positions needed to be reduced.

Previous rec.: 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.

Source: BBVA, Bancomer, Bloomberg

MXN

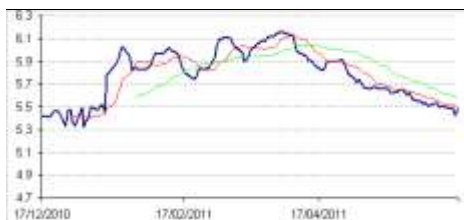


After breaking through the P\$11.80 resistance level, the dollar maintained its upward move and reached the P\$12.00 resistance level where it has reached in recent sessions without breaking through. We believe the upward move may stop at this level and look for a return to the P\$11.80 zone.

Previous rec.: The upward break in resistance places the next target at P\$12.00, P\$0.20 above the resistance.

Source: BBVA, Bancomer, Bloomberg

3Y M BOND

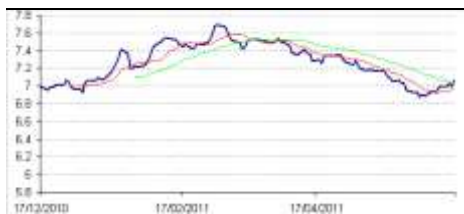


3 Y M BOND: (yield): Maintaining its downward move below the 10-, 30-, and 200-day rolling averages. We continue to believe it should see a bounce toward the 30-day rolling average (5.57%).

Previous rec.: We continue to forecast an upturn toward 5.65%.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND



10-YEAR M BOND (yield): Maintaining the bounce it started at the 200-day rolling average. It is already above the 30-day rolling average, meaning it could maintain the bounce toward 7.2%. Support level at 6.975%.

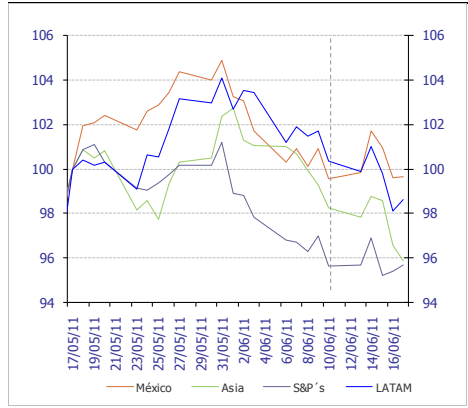
Previous rec.: We believe it could extend toward 7.15% and if it breaks, this would mark a short-term trend change.

Source: BBVA, Bancomer, Bloomberg

Markets

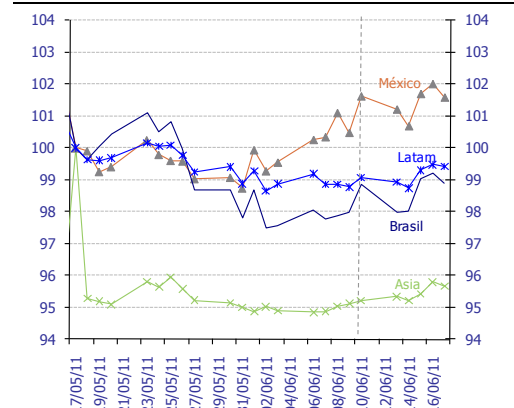
The advances in negotiations between European leaders on a new Greek bail-out and data above expectations for the advanced economic indicator in the US halt declines on stock markets. The FX market saw a general strengthening.

Chart 7
Stock Markets: MSCI Indices
(May 17, 2011 index = 100)



Source: Bloomberg & BBVA Research

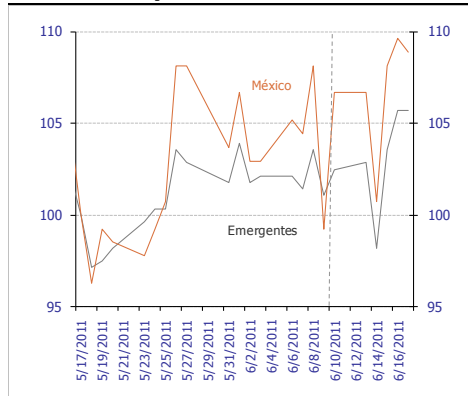
Chart 8
Foreign exchange: dollar exchange rates
(May 17, 2011 index = 100)



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

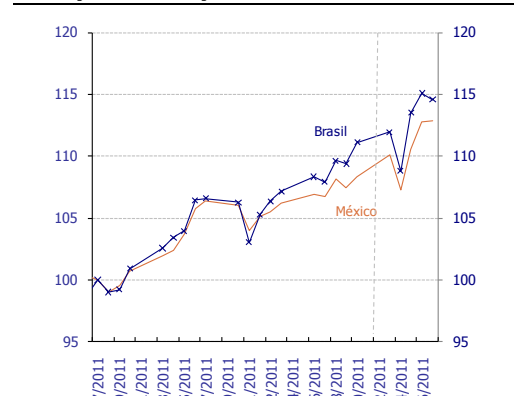
Slight fall in risk aversion, influenced by better-than-expected U.S. figures and advances in the Greek bail-out area

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



Source: Bloomberg & BBVA Research

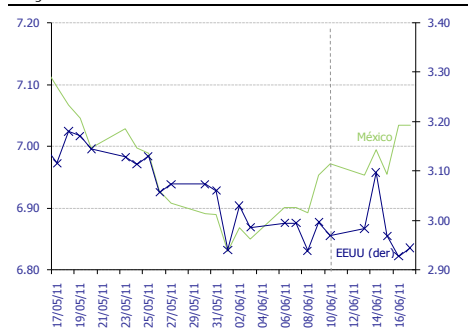
Chart 10
Risk: 5 year CDS (May 10, 2011 index=100)



Source: Bloomberg & BBVA Research

Increase in rates in the USA and slight fall in Mexico due to the lower risk aversion

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

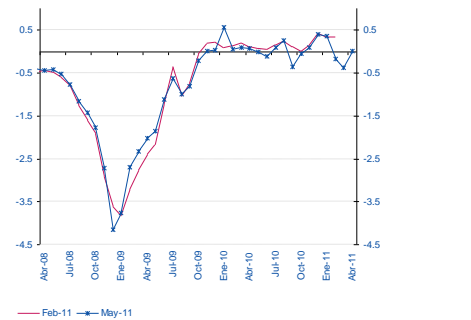


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

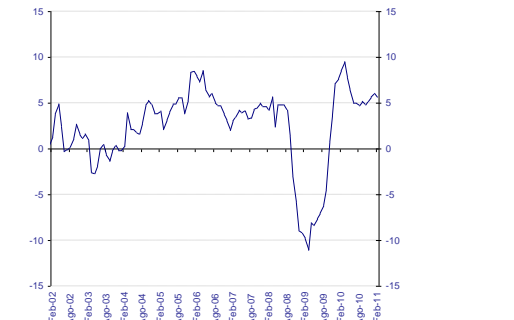
For the time being, recent output data point to moderation in April being temporary linked to industrial output

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.

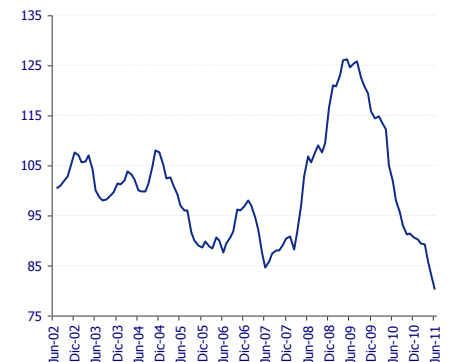
Chart 14
Advance Indicator of Activity (% change)



Source: INEGI

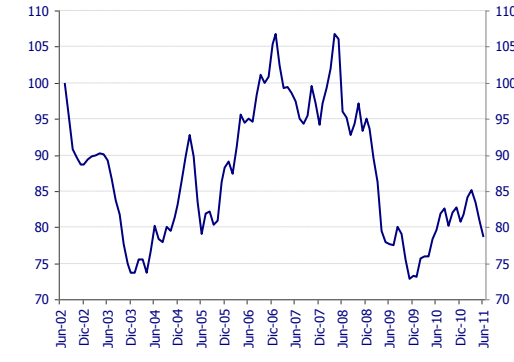
Recent inflationary surprises have been downward, while those concerning output have been mixed.

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.

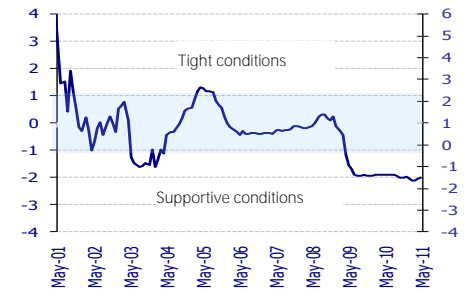
Chart 16
Activity Surprise Index (2002=100)



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

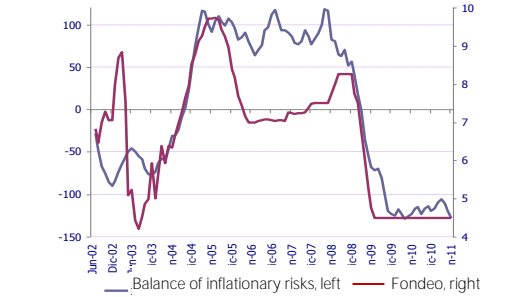
The monetary conditions have not changed and continue to be loose, with this loosening in fact increasing slightly in recent days.

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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