BBVA | RESEARCH

Weekly Watch

Mexico

24 June 2011

Economic Analysis

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Market Analysis

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Next week...

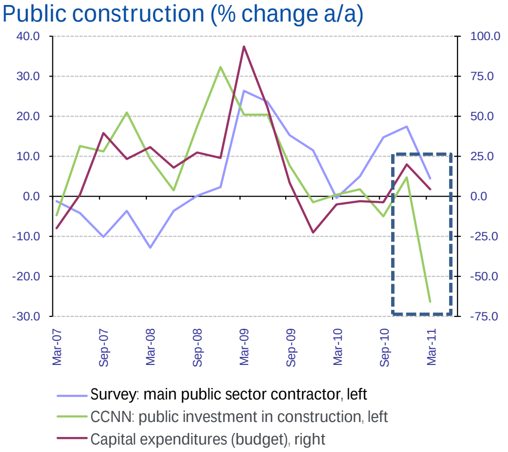
... we will see if public investment boosts construction

After a week marked again by doubts on markets as to the strength of the global cycle and, again in Mexico, by below-forecast inflation, next week special attention will be paid to the Monthly Construction Company Survey for April and public finance data for May. The first could confirm the scenario shown by other indicators such as industrial output and formal private employment in the sense that construction continues to expand in the second quarter, albeit at a lower rate than in the first quarter (4.9%). A delay in public sector activity explains most of this relative decline. The data are especially timely given the contradictory outlook from available figures on public investment in construction: Is it slowing as monthly survey data from companies state or in freefall, as quarterly national accounts point to? The gap between both representative variables for the same sector appears unreasonable. In addition, the fact that quarterly variations in public and private investments were respectively the lowest/highest since the release of national accounts with the new year as a basis leads us to believe some reclassification in investment is possible. We shall see, although everything points to a temporary halt in figures produced by INEGI given the improving scenario for public revenue and current investment plans. Public finance figures in May will help clarify the situation. (Cont. on next page.)

...and MXN fluctuation between 11.80-11.95 due to global risks; meanwhile, there is space for a rally in debt curves thanks to possible downward inflation

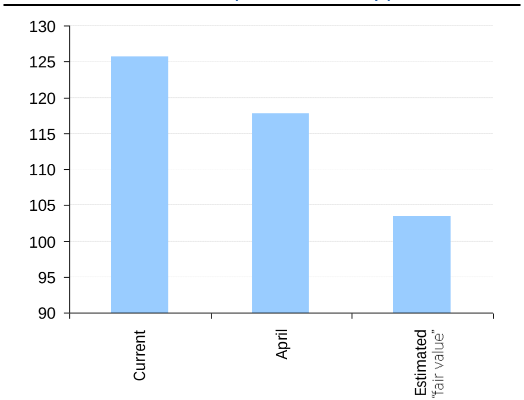
After messages on lower expected growth in the US from the Fed, alongside the uncertainty still surrounding the Greek bailout, the MXN showed its sensitivity to news on global risks and fluctuated around 11.9 at the end of the week. In turn, curves in Mexico allocate greater weight to inflation surprises for the week. The balance of risks continues to point to a longer monetary pause whereby the current slope will tend to reduce, mainly in the long vs. medium curve trenches.

Chart 1
Public construction (% change a/a)



Source: BBVA Research

Chart 2
Average spread between the long and medium trenches of the curve (zero curve, bp)



Source: BBVA Research and Bloomberg

Economic Analysis

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Calendar: Indicators

(cont. from previous page) We will also see traditional bank saving (demand-deposit plus fixed-term) and total current credit for commercial banking **performance.** May is expected to show the growth rate for saving slightly more moderate than seen in April (10.3%) due to the annual comparison level for 2010 being higher than that recorded in April for that year. In turn, real annual credit growth in May is forecast to possible by slightly higher than for last April (9.6%) due to the growth seen in economic output and employment.

IGAE in April. Tuesday 28 June

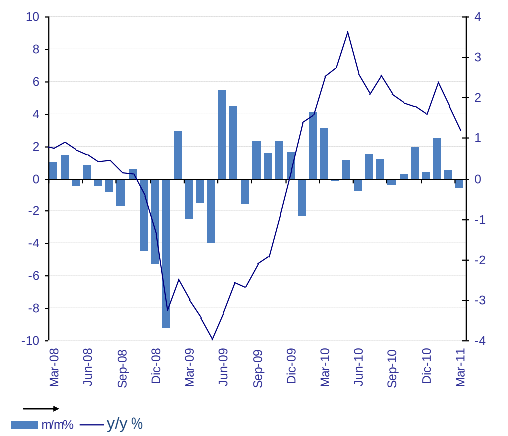
Forecast: 0.1% m/m (3.2% y/y) Consensus: N.A. Previous: -0.2% (3.0% y/y)

The moderation in industrial output shown in the monthly fall over the last three months (February to April) will also be shown in the services sector which represents almost 64% of the added value for output. Some indicators such as consumer confidence and employment started to show signs of moderation in March and April respectively, which could have been passed on to services activities more exposed to external dynamics (transport, communication, storage or retail). Based on available information, we forecast output to have expanded around 0.1% in April (CSV), meaning an annual variation of 3.2%, below the average for the first three months in 2011 in the IGAE (4.5%).

Public Finances. Thursday 30 June

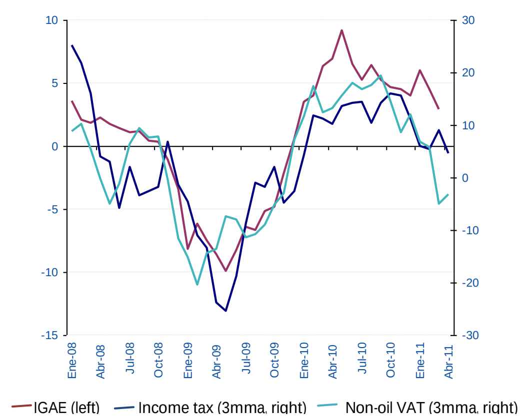
The development in public finances in May will be released this week. As stated, in addition to contributing to public sector capital expenditure analysis for the first months of the year and with a view to the second quarter, the revenue component will be important as a sign to activity and, specifically, the collection of some taxes such as income tax and non-oil VAT. Until now, these indicators have shown a trend to moderation in annual terms, where the comparison is even negative with regard to what was seen in real terms a year before. This moderation has been particularly important for non-oil VAT (-4.5% change y/y for March-April 2011 vs. -3.7% in the previous two months).

Chart 3
IGAE Total (% change y/y and m/m)



Source: BBVA Research with INEGI data.

Chart 4
Tax collection and IGAE (% change y/y)



Source: BBVA Research and INEGI

Markets

Monetary release from the Fed reduces prospects of a new liquidity cycle (QE3), but appetite for risk falls in response to cyclical messages

Financial markets continued to await news of the resolution of the Greek crisis, and this time the highlight for Mexico was the monetary messages from the Federal Reserve. In its release, the Fed made a downward revision to its growth forecasts for 2011 and 2012, and slightly upward for core inflation. Nonetheless, It stressed that it is closer to its dual objective (growth-inflation), thus reducing the possibility of an additional quantitative easing (QE3).

In this scenario, the MXN started the week with a slight appreciation trend which reversed after the Fed's release on lower economic growth. Over the week, the MXN will continue to be sensitive to news on the Greek Parliament's decision on fiscal strategy (Thursday 30) and cyclical news in the US. We forecast the fluctuation range over the week to come in 11.80 and 11.95 ppd.

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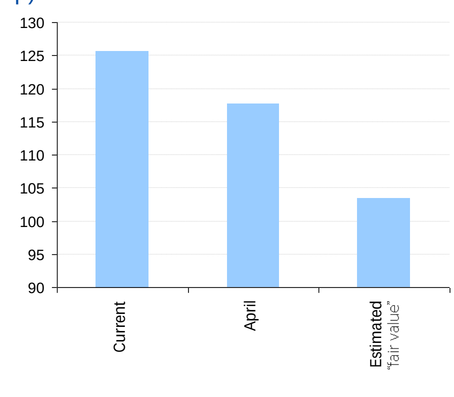
Downward inflationary risks: we see space for a rally in debt curves

The curve is steep is as result of global risk aversions and is not in line with the domestic balance of risks. In addition, there has been no outflow of foreign capital on the Bond market, foreign investors even continue to increase their positions, albeit at a more moderate rate. The difference between Mexican and US rates suggests foreign capital flows will continue to increase.

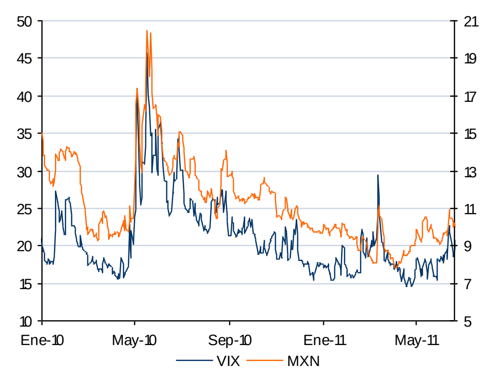
The balance of risks continues to point to a more prolonged monetary pause and inflation remaining at Central Bank target levels. Therefore, the current slope will tend to reduce, mainly in the long and medium trenches of the curve. The spreads come in above the 80% and even 90% percentiles, which are very high given the monetary pause and contained inflation scenario which will have been in place for over 7 months.

Chart 5
Average spread between the long and medium trenches of the curve (zero curve, 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

Source: BBVA, Bancomer, Bloomberg

IPC: The IPC managed to end the week above the 10 and 30 day rolling averages for the first time since the first week of April. The 10-day rolling average is about to go above the 30-day and short-term oscillators remain far from over-buying zones. All this leaves us with the perspective of a move in the IPC toward the 36,000pts or even the 36,240pts zone where the 200-day rolling average comes in. A close above 35,490, a high from the last 9 sessions, would accelerate this upward move. A short-term sell sign could be seen where indices move down beyond the IPC 34,600pts support level.

Previous rec.: We restate the importance of the 34,800pts floor, although a close below 35,000pts would mean positions needed to be reduced.

MXN

Source: BBVA, Bancomer, Bloomberg

Over the week it returned to the P$11.80 zone and from the 30-day rolling average where it started to bounce to come in above the 10-day rolling average. We believe that it could extend toward P$12.00, although we do not think it could exceed this zone since it will come with high over-sell readings.

Previous rec.: We believe that the upward move may stop at this level and look for a return to the P$11.80 zone.

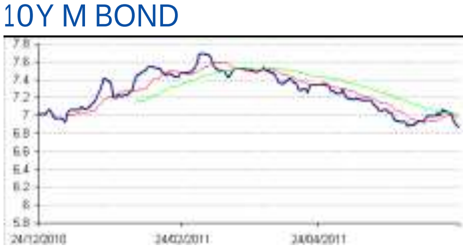
3Y M BOND

Source: BBVA, Bancomer, Bloomberg

3 Y M BOND: (yield): Maintaining its downward move and surpassing the low of the previous week. Possible move to 5.3% where it would find support. Change in trend with a bounce above 5.6%.

Previous rec.: We continue to believe it should see a bounce toward the 30-day rolling average (5.57%).

10Y M BOND



Source: BBVA, Bancomer, Bloomberg

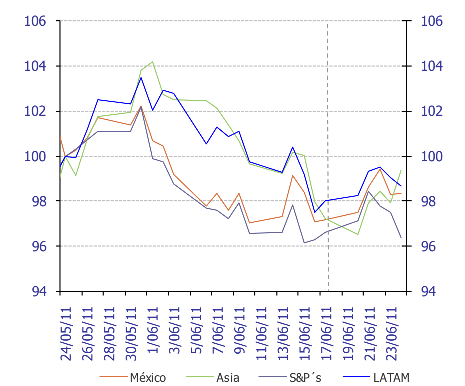
10-YEAR M BOND: (yield): Unable to break the resistance on the 30-day rolling average (7%) and return to below the 200-day rolling average (6.94%). If the 6.9% support is broken downward, it may accelerate down to the next floor at 6.75%.

Previous rec.: It is already above the 30-day rolling average, meaning it could maintain the bounce toward 7.2%. Support level at 6.975%.

Markets

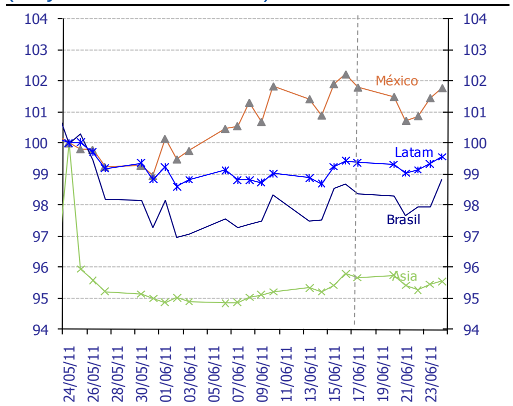
The Mexican stock market manages to de-couple from the downward performance in the US helped by the upward move in shares linked to copper production. The peso falls in a week marked by volatility due to the Greek crisis and its possible knock-on effects in other European countries

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



Source: Bloomberg & BBVA Research

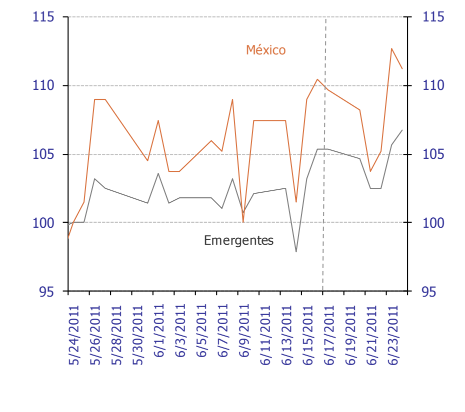
Chart 8
Foreign exchange: dollar exchange rates (May 17, 2011 index = 100)



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

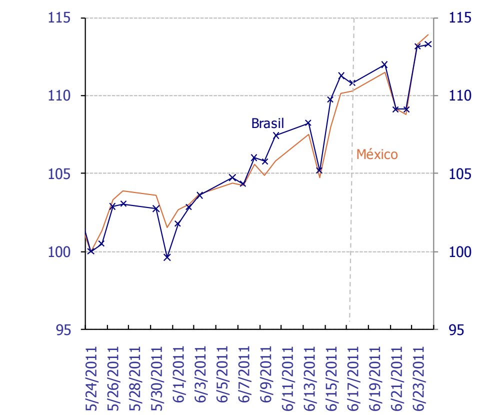
The risk aversion continues up over the week in light of the uncertainty surrounding the Greek crisis. Nonetheless, it recorded a slight fall at the end of the week due to above-forecast data on durable goods orders in the US

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



Source: Bloomberg & BBVA Research

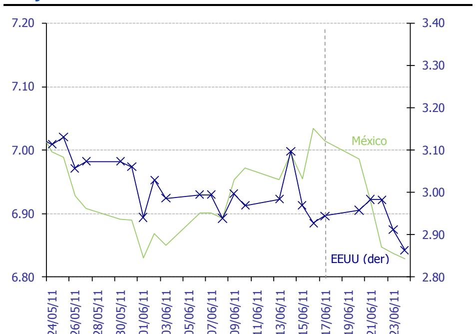
Chart 10
Risk: 5 year CDS (May 10, 2011 index=100)



Source: Bloomberg & BBVA Research

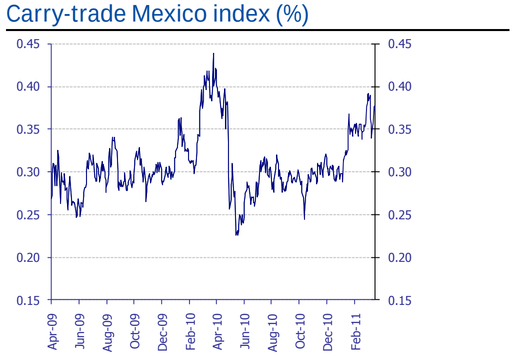
Fall in US rates in light of global risk aversion. Rates in Mexico fall due to the surprise fall in inflation which already discounts an unchanged lending rate for the remainder of 2011

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

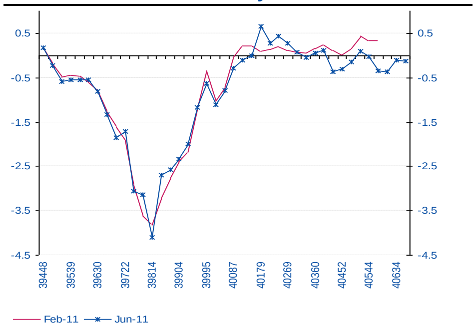


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

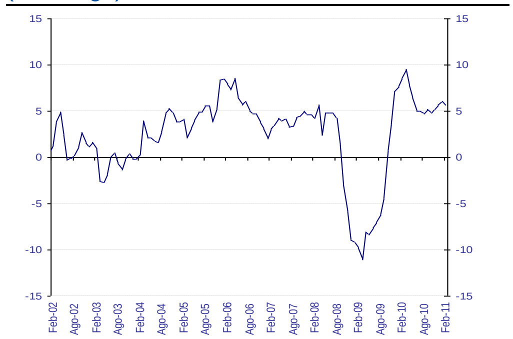
For the time being, recent output data point to moderation in April being temporary linked to industrial output

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.

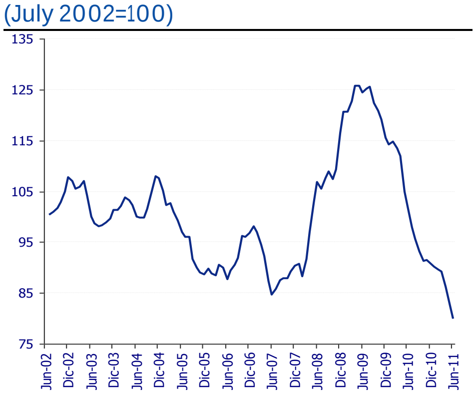
Chart 14
Advance Indicator of Activity (% change)



Source: INEGI

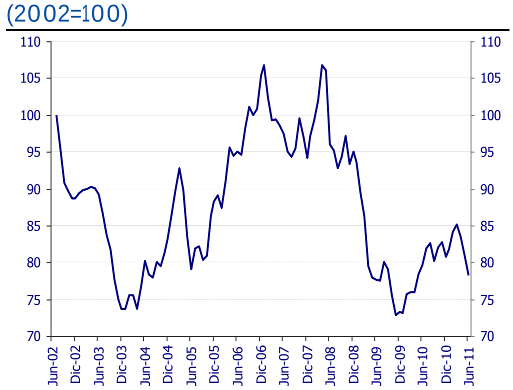
Recent inflationary surprises have been downward, while those concerning output have been mixed.

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.

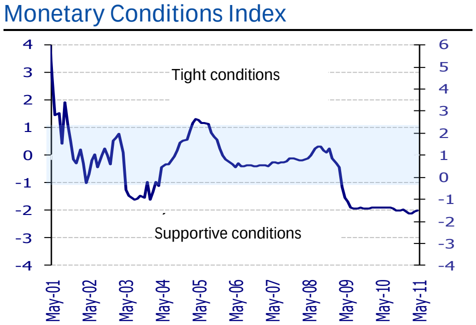
Chart 16
Activity Surprise Index (2002=100)



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

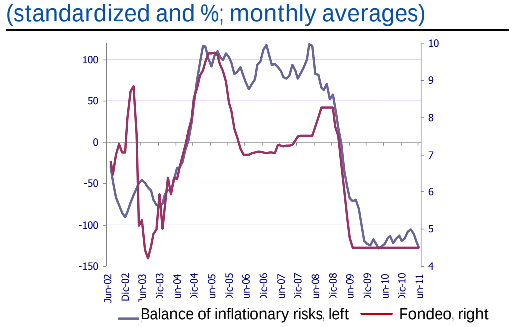
The monetary conditions have not changed and continue to be loose, with this loosening in fact increasing slightly in recent days.

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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