BBVA | RESEARCH

Weekly Watch

Mexico

July 8, 2011

Economic Analysis

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Market Analysis

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Next week...

... manufacturing activity shows signs of improvement

Industrial Production (May, Tuesday July 12)

Forecast: 0.3% m/m (2.7% y/y) Consensus: N.A. Previous: -0.1% (2.8% y/y)

Information on indicators related to industrial production, such as manufacturing production confidence, employment, imports of intermediate goods, exports of manufactured goods and motor vehicle production in May and June, as applicable, suggests an improvement in most recent data. This would reinforce the assumption that the slowdown recorded throughout the first four months of 2011 would have been temporary, related to the interruption in the supply chain in key sectors such as the motor vehicle industry as a result of the tsunami in Japan and the moderation in net external demand due to a drop in disposable income resulting from high oil prices, which are already being corrected. This benign scenario should be corroborated by an improvement in industrial activity in Mexico in May, which we estimate at 0.3% m/m, the first positive data in monthly terms after three consecutive drops. However, we believe that in coming quarters the activity will show a recovery (from the 0.5% q/q posted in the first quarter) and that in the second quarter growth could be around 1%.

Sovereign uncertainty in the euro zone, cycle sustainability in the U.S. and monetary messages from Banxico translated into increased volatility

Despite the fiscal agreements in Greece, sovereign uncertainty continues in the region and there are increased fears about other economies (Portugal and Ireland). In addition, positive cyclical data in the U.S. were reversed at the close of the week, thus increasing volatility of the MXN. In fixed-income, and following the publication of the Banxico release, the IRS curve discounts the first move in the lending rate in February 2012, and a 50 bp move in June 2012. In equity, the corporate reporting season begins in the U.S., which will attract investor attention.

Chart 1
Industrial production indicators % change m/m

	Producer Conf.	Employment	Interm. G. Imports	Manuf. Exports	Autom. Prod.	Industrial Prod.
March	-1.9	0.4	18.0	13.9	17.1	-0.2
April	-3.3	0.2	-12.2	-14.8	-25.6	-0.1
May	1.8	0.4	13.1	14.4	24.0	0.3
June	0.2	0.3				

Source: BBVA Research

Markets

Global news increase market volatility: MXN sensitive to cyclical risk in the U.S.

Last week, MXN performance was volatile in the face of a combination of elements: persistent sovereign uncertainty in Europe (private participation in the rescue in Greece, Portugal downgrade and possibility of a selective default in Greece), and surprises –in both directions– in the labor market which ultimately proved to be adverse. Thus, the MXN showed its high exposure to the U.S. cycle: gains at the start of the week were reversed on the release of bad non-agricultural salary figures from the U.S. The global risk elements remain, and we expect the wide operating ranges to continue (between 11.55 and 11.75). We thus recommend taking short positions in pesos when the minimum range is reached.

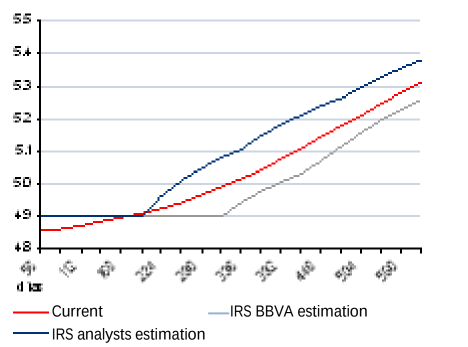
The IRS curve discounts the first move in the lending rate in February 2012, and a 50 bp move in June 2012.

Following Banxico's monetary policy statement, we expect the market to price a monetary policy scenario slightly more *relaxed*. Thus, we see receiving 9x1 and 13x1 on the swaps market as being attractive: although the difference between the current IRS and the one estimated according to our monetary scenario (prolonged pause, see chart 5) is not so large, it still shows value. Because the latest monetary policy statements suggest a pause for the coming quarters, the room for directional *flattening* strategies has been reduced. Insofar as global risks recede, the room will open for implementing these strategies. Current monetary policy should benefit the middle of the curve. We thus believe that there is still room for flattening, despite the fact that there could be corrections derived from international volatility and the uncertainty surrounding the U.S. cycle.

The reporting season begins in the U.S., and this will impact the IPC in Mexico.

Although falls were recorded last week in the capital markets in Mexico in the face of the difficult global environment, this week the stock exchange will be affected by the start of the reporting season in the U.S.(Alcoa, Citigroup, JPMorgan and Google stand out). Market consensus expects a 12% y/y expansion in earnings per share (vs. 18% y/y in 1Q11). Reported earnings above expectations, above all in the financial sector, could boost the market.

Chart 5
IRS curve: Observed vs. lending scenarios (%)



Source: BBVA Research with data from Bloomberg

Chart 6
USD, non-commerce net position on the CFTC (US million)

Source: BBVA Research with data from Bloomberg

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Technical Analysis

IPC Stock Market Index

IPC:. The week's decline was not sufficiently strong to take the short-term oscillating indicators to their respective overselling zones. The gap between the 10- and 30-day moving averages continues to be high (830 pts). These technical readings maintain a high risk of a negative move for next week, where the IPC could reach between 36,000 and 35,800 pts, which would represent an adjustment of around -1.7%. The approaching annual highs in the Dow and S&P indexes, combined with oscillating indicators already in the over-buying zone, also support the prospect of profit-taking next week toward floors of 12,200 pts in the Dow index and 1,310 pts in the S&P index.

Previous rec.: After a bounce of just over 2,200pts, the IPC stock market index is already recording high over-purchase levels in short-term oscillating indicators and hits the 2nd standard deviation in 30- and 60-day regressions.

Source: BBVA, Bancomer, Bloomberg

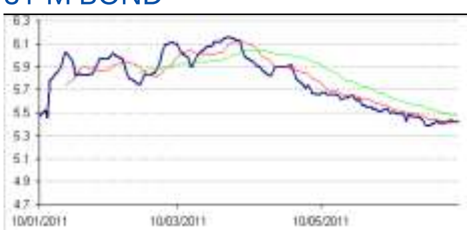
MXN

During the week, the dollar reached the floor zone between P$11.60 and P$11.55. We believe that in this zone we can start seeing stabilization in the dollar and even a rebound toward the P$11.75 zone owing to overselling in the short-term oscillating indicators.

Previous rec.: The move may extend toward the P$11.60/11.55 zone where we believe it may start to stabilize.

Source: BBVA, Bancomer, Bloomberg

3Y M BOND



3Y M BOND: (yield): It has started to find a floor above 5.4%. It already trades above the 10-day moving average, although we cannot talk about a change in trend until it breaks the 5.46% level, which is the 30-day moving average.

Previous rec.: A change in trend would only be seen with a 5.5% upward break.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND

10Y M BOND (yield): It already trades above the 10-, 30- and 200-day moving averages. Consider floor at 6.95% and resistance at 7.1%.

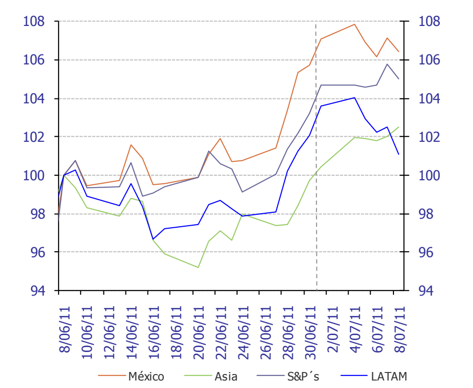
Previous rec.: Possible move toward 7.1% and 7.2%.

Source: BBVA, Bancomer, Bloomberg

Markets

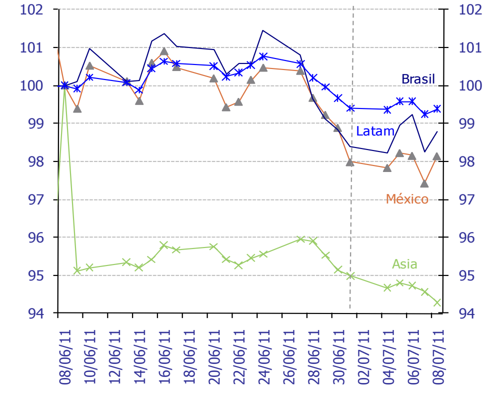
Widespread fall in stock markets and foreign currency depreciation at the end of the week following the release of lower-than-expected U.S. job creation figures

Chart 7
Stock Markets: MSCI Indices (June 8 2011 index=100)



Source: Bloomberg & BBVA Research

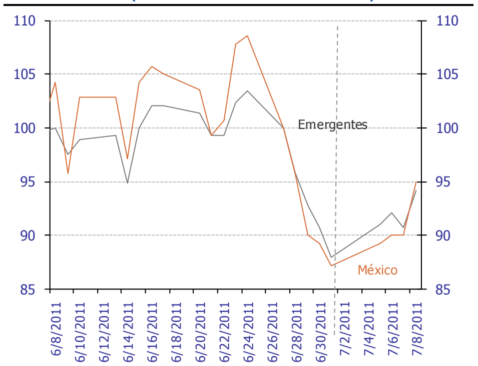
Chart 8
Foreign exchange: dollar exchange rates (June 8 2011 index=100)



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

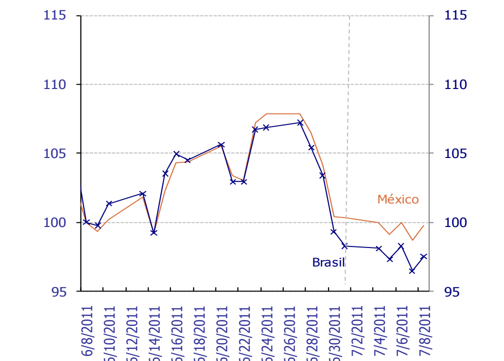
Increased risk aversion as a result of U.S. employment figures, which maintains the uncertainty around the length of the drop in the rate of economic activity recovery

Chart 9
Risk: EMBI+ (June 8 2011 index=100)



Source: Bloomberg & BBVA Research

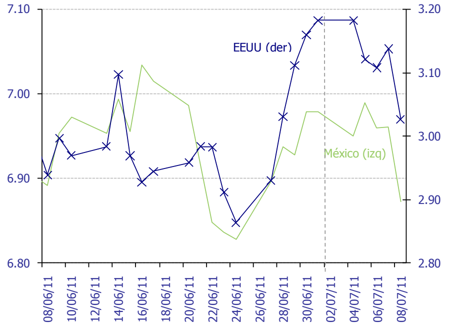
Chart 10
Risk: 5-year CDS (June 8 2011 index=100)



Source: Bloomberg & BBVA Research

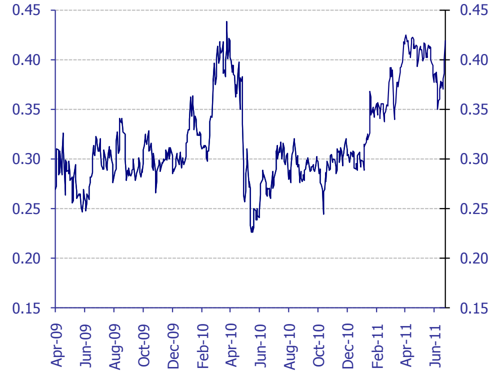
Fall in U.S. rates following increased global risk aversion. Rates in Mexico move in line with U.S. Treasury bonds.

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

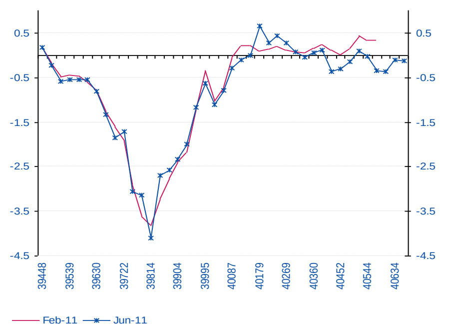


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

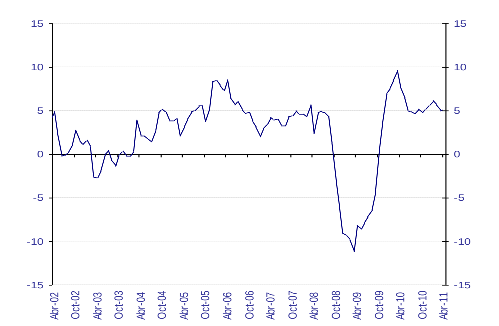
For the time being, recent output data point to moderation in April being temporary and linked to industrial production

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.

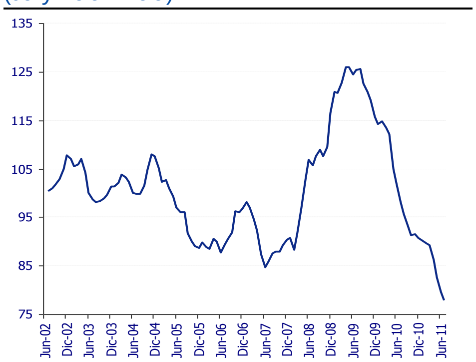
Chart 14
Advance Indicator of Activity (y/y % change)



Source: INEGI

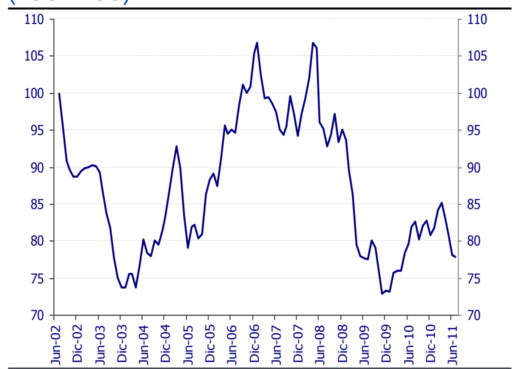
Recent inflationary surprises have been downward, while those concerning economic activity have been mixed.

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.

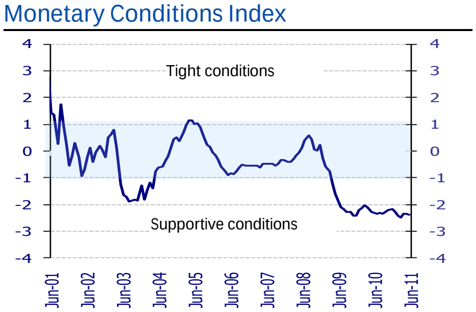
Chart 16
Activity Surprise Index (2002=100)



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.

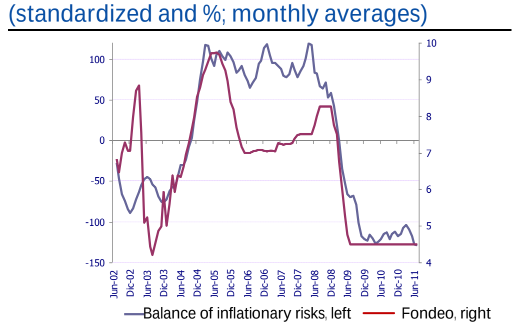
The monetary conditions have not changed and continue to be loose, with this loosening in fact increasing slightly in recent days.

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 likelihood of monetary restriction

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