

Weekly Watch

Mexico

July 15, 2011

Economic Analysis

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Market Analysis

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Next week...

... a look at retail consumption with a side view on the job market

In a week where, on a global scale, news on the sovereign debt crisis in Europe and the debate on the US debt ceiling will continue to dominate, at home attention will center around the outlook of household spending giving a direct overview on retail sales performs and an indirect pointer on the job market, with unemployment figures for June. Job market and payroll performance means improvements in household income, especially in the formal market. Available income data from the overall job market run to 3Q10 since the Inegi has not still not supplied absolute employment levels in Mexico from the ENOE national survey with the 2010 Census still to be incorporated.

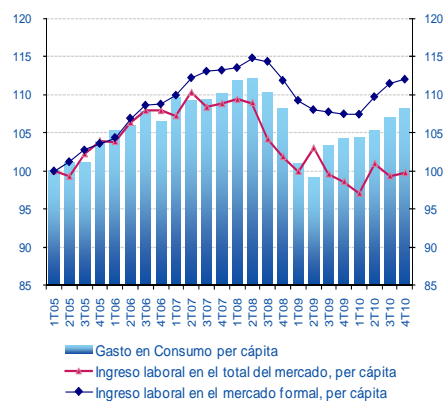
Nevertheless, an improvement in total payroll will surely be less marked than in the formal market, even more so when we consider the relatively small downward correction to the jobless rate from the maximums seen in 2009, something we will continue to see in June.

Finally, we will also need to look closely at inflation in the 1st fortnight of July to be released first by Inegi and the minutes from Banxico on its last monetary policy meeting. These figures should not have a major impact on the market. In this way, the second half of the year marking a moderate acceleration path for prices coming in under the maximum inflation variability margin set by Banxico is discounted. With regard to the minutes, the most important information will perhaps be the opinions given on the inflation forecast response to the data on downward movements and how this sits with the central bank's long-term target.

The U.S. and the EU continue to generate high volatility across global markets

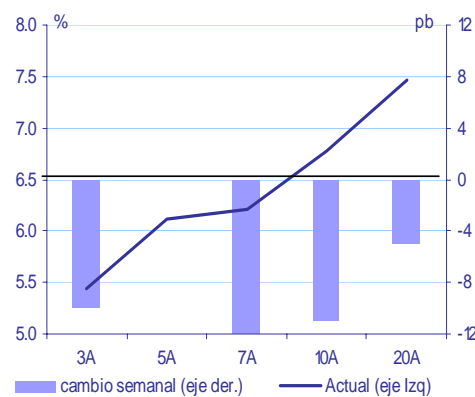
Concerns regarding potential contagion from the situation of Greece, Portugal and Ireland to other countries (Spain and Italy) continue to generate flight from risk assets. This has been countered by expectations of a third round of quantitative easing by the Fed, though the signals are still not strong. The MXN will continue in a wide trading range (11.6-11.80 ppd) while the uncertainty in economic output will continue to benefit local curves.

Chart 1
Income from Wages and Consumption per capita (1Q05=100)



Source: BBVA Research with data from Bloomberg

Chart 2
Bond Curves: Current and weekly change (% and bp)



Source: BBVA Research with data from Bloomberg

Calendar: Indicators

Inflation for the first two weeks in July (July 21)

Forecast: 0.2% bi-weekly (3.4% y/y) Consensus: 0.2% bi-weekly Previous: 0.0% (3.45% y/y)

After three months in a row of zero or negative inflation, prices will see a typical seasonal monthly rise in July due to higher agriculture prices and some services linked to the start of the summer holiday season. The core component in the basket should rise 0.13% over the two weeks, with an outlook for food prices being the only component seeing major upward pressure. Meanwhile, the remainder will maintain a good performance supported by lack of demand pressure in the economy and the higher exchange rate. The improvement in the inflationary risk balance Inflationary risk improved in the last three months and we subsequently estimate inflation to close the year at around 3.5%, a figure not free from upward risk and requiring constant monitoring.

Economic Analysis

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Commercial Establishments (May, July 20)

Forecast: 0.7% m/m (4.4% y/y) Consensus: N.A. Prev: 1.1% m/m (4.7% y/y)

Service Sector Indicator (May, July 20)

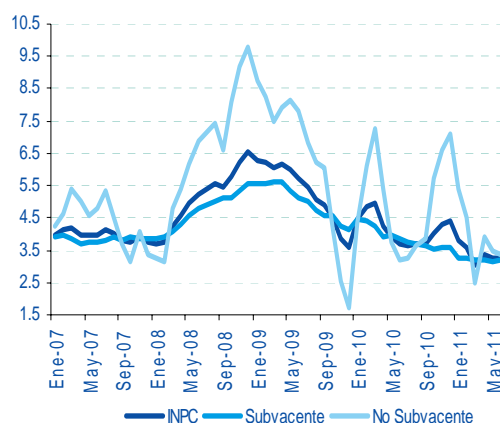
Forecast: 0.9% m/m (5.2% y/y) Consensus: N.A. Prev: 3.0% m/m (4.9% y/y)

Open Unemployment Rate (June, July 21)

Forecast: 5.3% of EAP Consensus: N.A. Previous: 5.5%

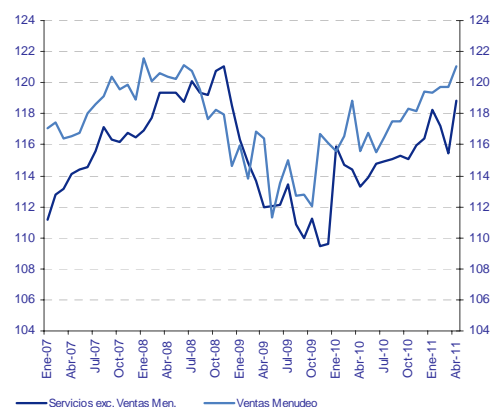
Although disposable income for the subsection of workers registered at the IMSS has recovered to above pre-crisis levels, the figure for the remaining workers (around 70% of the active population) is still well-below that level. In turn, the improvement in disposable income in the formal sector is in line with that in private consumption and among situation indicators, it linked to the improvement in retail sales. In contrast, the other large service sector component including activities linked to domestic demand such as sales in restaurants and hotels, real estate services, transport, etc. is still showing a lag meaning pre-crisis levels have not yet been reached. This is why, despite several of these activities being closely linked with the overseas trade cycle and specifically with manufacturing output, the lag is considerable and improvement is still very slow. This week will see the performance of these variables (retail sales and the service sector indicator) as well as some job market analysis elements, specifically the jobless and under-employment rate with a major cyclical component.

Chart 1
Inflation breakdown (% y/y change)



Source: BBVA Research with Banxico data

Chart 4
Retail Sales and Services Indicator
(Index, 2003=100)



Source: BBVA Research and INEGI

Markets

Sovereign tensions are heightened with the uncertainty about the second Greek bailout, falls in credit ratings in Europe and the Fed's statements

There were episodes of volatility and flows to safe-haven assets last week as a reaction to the lack of conclusions on the second Greek bailout plan, Moody's downgrades of Portugal and Ireland to under investment grade, and the U.S. credit rating being put under review. Although Ben Bernanke's statements highlighted the level of uncertainty with respect to the labor market, they left the door open to any additional quantitative stimulus that may be necessary and led to a recovery in the main risk assets. Despite this, the Fed Chairman's vision continues to be one of recovery for the rest of the year, and we do not see clarity in the greater appetite for risk derived from a QE3.

The MXN depreciated by over 1% in response to the elements of risk aversion and the maintained sensitivity to elements linked to the North American economic cycle. In the face of continued sovereign and cyclical risks around the world, we cannot rule out the peso maintaining a wide trading range between 11.60 and 11.80.

Appetite for safe-haven assets, the uncertainty in economic output could benefit local curves.

The greater risk aversion scenario has led to greater appetite for safe-haven assets, leading to the UST curve moving down 9 bp over the week. In turn, domestic debt curves have benefitted from the aversion and the notches in the medium section of the curve show greater gains (see chart, that for 7 years saw an 18 bp rally). We believe the uncertainty in economic output will continue to benefit local curves.

Start of positive corporate reporting in the US, we forecast growth between 12 and 14% for Mexico.

Activity will intensify this week in Mexico. Until now, among the companies listed on the IPC only Televisa and Gmodelo have reported with mixed results showing modest positive surprises in revenue and EBITDA, albeit with figures slightly below expectations in terms of net profits. We recall that for the IPC selection we expect growth between 12% and 14% in Sales and EBITDA while growth in EPS could be substantially higher.

Market Analysis

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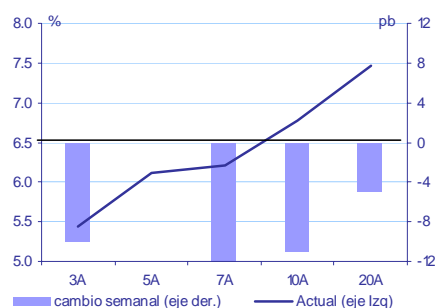
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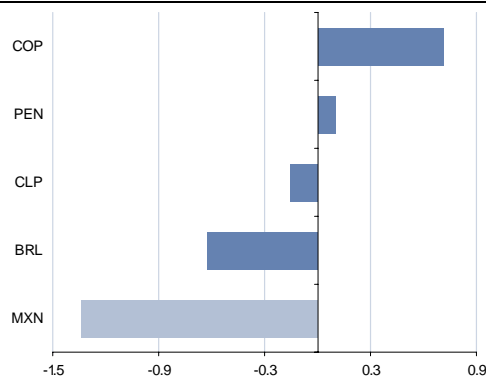
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Chart 5
Bond Curves: Current and weekly change (% and bp)



Source: BBVA Research with data from Bloomberg

Chart 6
Weekly changes in LatAm currencies (%)



Source: BBVA Research with data from Bloomberg

**Market Analysis
Equities**

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Technical Analysis

IPC Stock Market Index

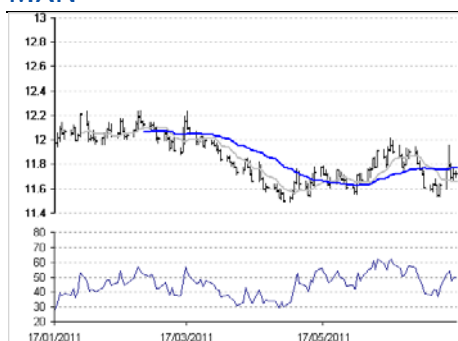


IPC: In July the IPC slipped back -757pts, still within the range we have been forecast for two weeks. It continues to trade above the 30-day rolling average and 35,800pts. Over recent months this level showed major resistance for short-term moves in the IPC. It is very important for the market to start stabilizing its moves when it approaches these levels since a break downward in the 30-day rolling average (35,763pts) would mean a negative short-term trend and open up the way for a return to the lows we saw in June around 34,650pts. We believe these floor zones should be respected and we could start to see a technical bounce.

Previous rec.: The 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.

Source: BBVA, Bancomer, Bloomberg

MXN

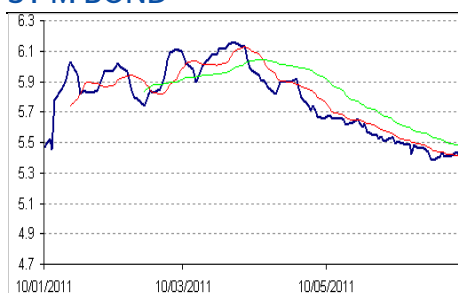


The dollar started the week with a major bounce, even touching P\$11.90. It stayed within an enclosed range of P\$11.80 and P\$11.67 in the last three sessions of the week. The position of the oscillators and the opening of averages suggest we could see the P\$11.80 resistance level being broken moving toward P\$12.00. This will continue as long as it does not break downward through P\$11.66.

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

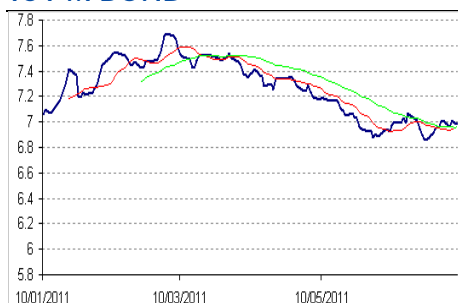


3-YEAR M BOND (yield): No trend change and coming in above the 30-day rolling average, breaking the 5.4% and 5.3% floor. It may carry this decline toward 5.26%.

Previous rec.: We cannot talk about a change in trend until it breaks the 5.46% level, which is the 30-day rolling average.

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%.

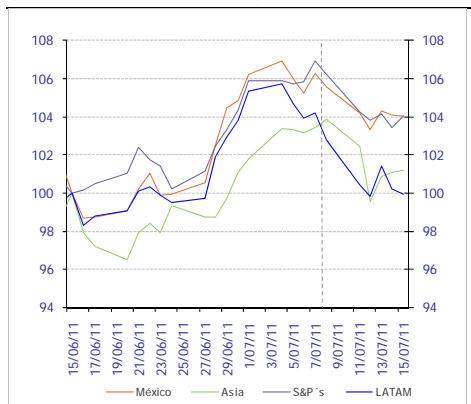
Previous rec.: Possible move toward 7.1% and 7.2%.

Source: BBVA, Bancomer, Bloomberg

Markets

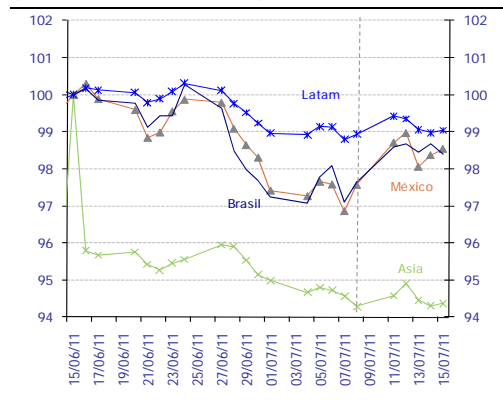
Marginal moves on stock markets toward the end of the week after consumer and manufacturing confidence data in the US came in below expectations and despite warnings on lowering the US debt rating. The peso fell over the week.

Chart 7
Stock Markets: MSCI Indices
(June 15 2011 index=100)



Source: Bloomberg & BBVA Research

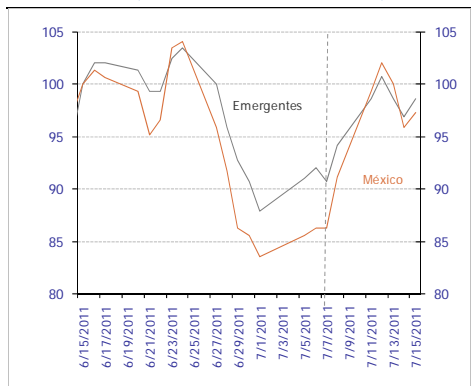
Chart 8
Foreign exchange: dollar exchange rates
(June 15 2011 index=100)



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

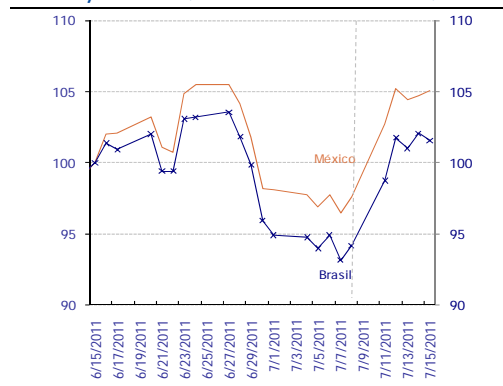
Increase in risk aversion over the week after the increased uncertainty regarding the European debt crisis.

Chart 9
Risk: EMBI+ (June 15 2011 index=100)



Source: Bloomberg & BBVA Research

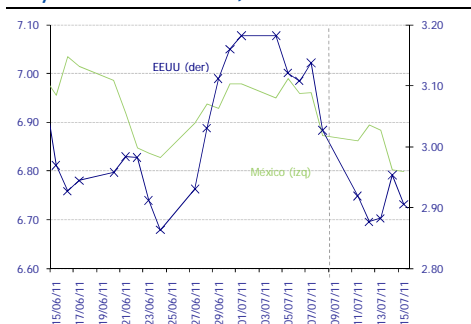
Chart 10
Risk: 5-year CDS (June 15 2011 index=100)



Source: Bloomberg & BBVA Research

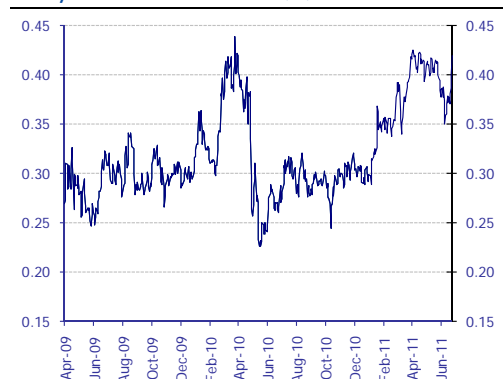
Fall in U.S. rates following increased risk aversion. Rates in Mexico fall influenced by Treasuries.

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

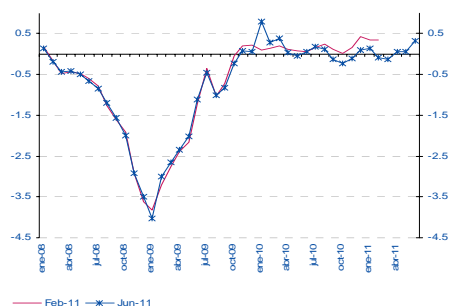
Activity, inflation, monetary conditions

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

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

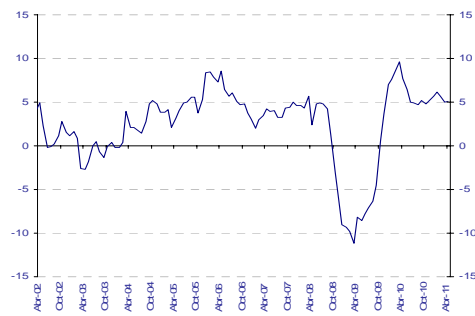
The monetary conditions have not changed and continue to be loose, with this loosening in fact increasing slightly in recent days.

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)



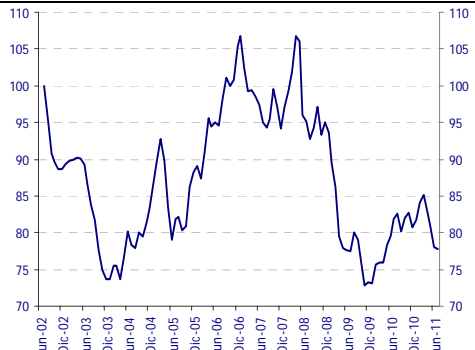
Source: INEGI

Chart 15
Inflation Surprise Index (July 2002=100)



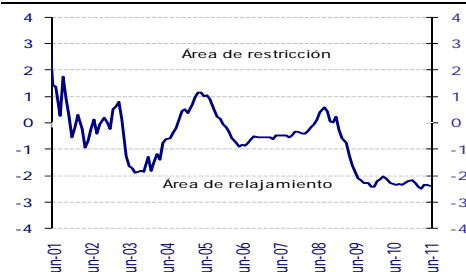
Source: BBVA Research with data from Banxico from the monthly surveys on the expectations of economic specialists in the private sector.

Chart 16
Activity Surprise Index (2002=100)



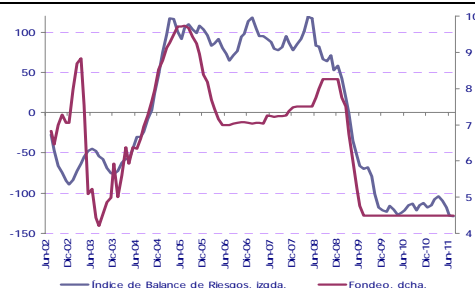
Source: BBVA Research with Bloomberg data. Difference between recorded data and the Bloomberg consensus for seven activity variables in Mexico. Standardized index. Rises (falls): positive (negative) surprises.

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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