RESEARCH

Weekly Flash

Mexico

February 17, 2012

Economic Analysis

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Next week...

The Balance of Payments for 2011 will show a lack of external risks

Next Friday sees the release of the Balance of Payments for 2011. We forecast the Current Account balance to come in with a highly reduced and without funding risks deficit of 0.8% of GDP. Such low Current Account deficits are in line with domestic demand which is recovering less intensely than foreign demand meaning a higher performance from exports in comparison to imports. In addition, oil exports benefitted from the high oil prices over much of last year. The exchange rate devaluation in the latter months of the year must also have helped keep the foreign balance deficit lower. With regard to financing, direct foreign investment more than covered the foreign deficit with holding inflows favoring higher reserves. We expect the Current Account balance to continue expanding with a recovery in Mexican domestic demand albeit limited to its rate. The flexible exchange rate and the certainty that the public sector will see moderate debts in comparison to the rest of the world make us see a lack of foreign financing problems for the country.

Market Analysis

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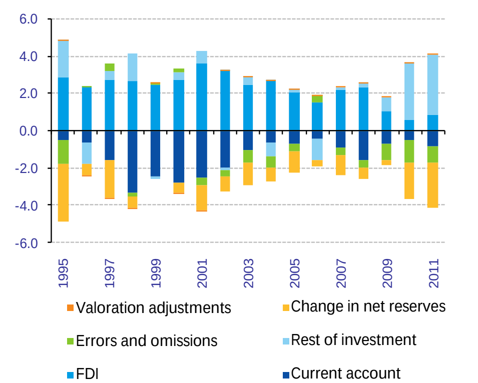
Ups-and-downs due to Greek news but markets ended the week in the black.

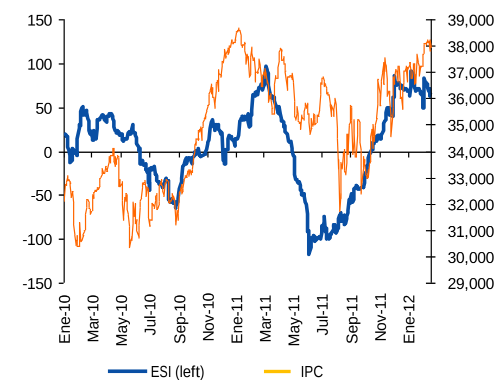
The intraday volatility on the currency market signals caution with the trading range remaining in place. The MXN rose almost 0.5% on Friday in response to the expected agreement in the EMU this week. In this way, the currency ended the week 0.3% higher after having hit an intraday high mid-week of 12.97. In turn, the Mexican stock market will continue to see defensive posturing in adjustment periods and be less positive in periods of global risk premium reduction.

Chart 1
Balance of payments (% GDP)



Source: BBVA Research and Banxico. 2011 is the rolling sum of the last available quarters not the forecast.

Chart 2
Economic surprise index for the US (ESI) and Mexican Stock Market (IPC)



Source: BBVA Research with INEGI data

Calendar: Indicators

Economic Analysis

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Inflation for the first two weeks in February (Thursday, February 23)

Forecast: 0.0% bi-weekly 3.94% y/y	Consensus: 0.18% bi-weekly	Previous: 0.71% m/m (4.05% y/y)

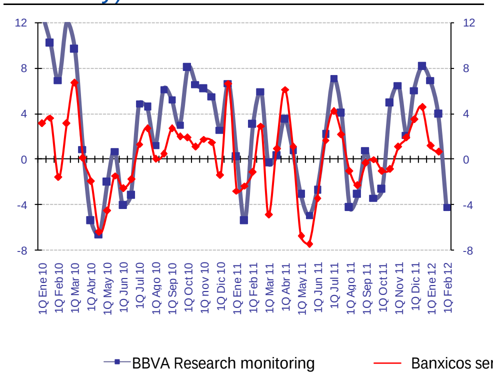
After surpassing 4% in January, inflation in the first half of February will be around 0% due to the forecast falls in fruit and vegetable prices based on the recent performance in the prices of these products at supply centers. The disappearance of price pressures for livestock products (chicken, eggs, port and beef) will also help the standstill in consumer prices these two weeks. We forecast core inflation to see a 0.18% bi-weekly rise with food and other products on the up albeit with a downward cycle in services prices. Although inflation for the month may not go higher than 4%, with core inflation at 3.3%, we estimate this annual rate hold will be temporary due to the expected impact from the base effect in coming months.

Retail Sales (Wednesday, February 22, for December)

Forecast: 0.5% m/m 5.7% y/y	Consensus: N.A.	Previous: 2.2% q/q (7.4% y/y)

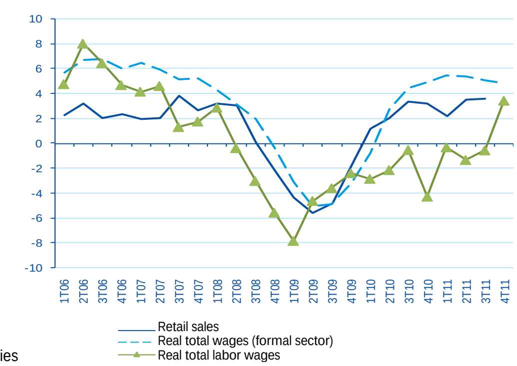
The positive effect linked to the "El Buen Fin" ("success") commercial policy contributed to the monthly 2.2% rise in November for monthly change in sales, one of the highest growth rates since the start of the recovery. In turn, despite the notable recovery in those in employment (4.1% and 5.5% annual growth in the formal employment sector and in the economy as a whole), the real income per capita for total employment income continues to be, on average, lower than a year ago. Income per capita is negative for workers on average (-)1.9% y/y and barely positive (0.8%) for the formal sector. In this way, available income for those in work recovered strongly due to employment, not to real per capita income. In short, we estimate that sales will have expanded around 0.5% m/m in December. In this sense, sales should have expanded at an average rate of 0.9% per month in the last quarter (0.6% in the previous).

Chart 3
BBVA Research monitoring of agricultural product inflation (% change bi-weekly)



Source: BBVA Research with INEGI data

Chart 4
Retail Sales and Total Income from Wages (y/y % change)



Source: BBVA Research with INEGI data

Markets

Market Analysis

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Ups-and-downs due to Greek news but markets ended the week in the black.

After postponing the finance ministers' meeting on Wednesday, investors turned skeptic regarding a quick solution and led to comments from some authorities regarding Europe being in a better position to take on Greece exiting the euro. For the moment, European authorities want to be completely sure that Greece will not try to renegotiate the agreement after the election. The positive note came on Friday with statements from German authorities pointing to a will to resolve the situation (an agreement with private creditors and a second bailout package) in a single negotiation. This would at least reduce the period of uncertainty.

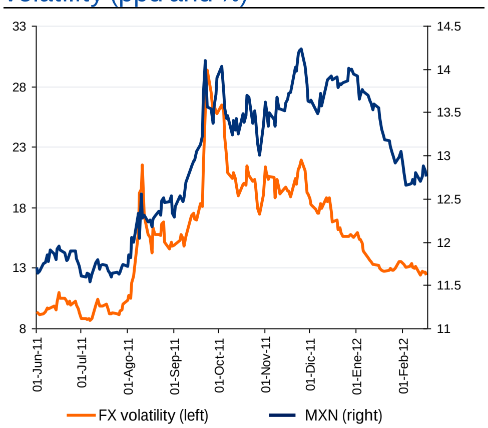
USDMXN: intraday volatility on the currency market signals caution with the trading range remaining in place

The MXN rose almost 0.5% on Friday in response to the expected agreement in the EMU this week. In this way, the currency ended the week 0.3% higher after having hit an intraday maximum midweek of 12.97. The quick return to the set trading range in recent weeks points to the fact that although caution remains due to Greek risks, these are not enough for a sudden gain reversal. In turn, the CFTC position report showed that the preference for USD again took hold against most EM and G10 currencies. However, this was explained mostly by a JPY long position close and therefore did not respond to a sentiment for risk appetite or aversion. The net MXN long position increased by USD 270mn (hitting USD 1.6bn on February 14). The change was in line with the MXN strengthening.

Mexican stock market performance to continue on defensive

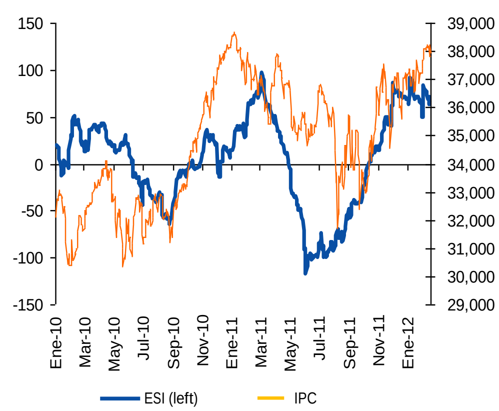
In the face of global growth forecasts, profit estimates for 2012-2013 remain under pressure. We therefore stress a possible short-term, consolidation of ranges or tight adjustments on stock markets. We see relative performance in Mexico continuing to be more defensive in adjustment periods and less positive in periods of global risk premium reduction, mainly linked to output performance in the US. Nine IPC companies have delivered earnings: sales grew 17.4%, EBITDA 10.6% and net profits 19.0%. Although the number of companies is small, they represent almost 47% of sales last year

Chart 5
Mexico: MXN/USD and implied 1-month volatility (ppd and %)



Source: BBVA Research and Bloomberg

Chart 6
Economic surprise index for the US (ESI) and Mexican Stock Market (IPC)



Source: BBVA Research and Bloomberg

Market Analysis
Equities

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Technical Analysis

IPC Stock Market Index

The IPC saw a marginal gain over the week meaning it continues to trade above the 10-day rolling average and 38,000pts. We maintain important resistance at 37,800pts matching the historical peak but see it as difficult for the market to break through this level given the overbuying on oscillating indicators. Femsa and Tlevisa already reacted to the overselling and only Amx managed to drive the market in subsequent days. We recommend taking advantage of the possible upswing in coming sessions to take profits.

Previous Rec.: In a lateral week, it managed to stay above the 38,000pts level and, therefore, has not generated an exit signal.

Source: BBVA, Bancomer, Bloomberg

MXN

The dollar tried to react over the week but hit resistance at MXN13.00, returning to the support zone set out by the rolling 10- and 200-day averages. At this time, the MXN12.74 level is the short-term support and a downward break could set the floor at MXN12.60/12.50.

Previous Rec.: The close above MXN12.80 signals a move toward the resistances of MXN13.00 or even MXN13.28 where the 30-day rolling average sits.

Source: BBVA, Bancomer, Bloomberg

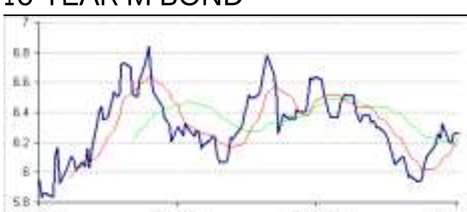
3Y M BOND

3-YEAR M BOND: (yield): The upswing remains and sits above the 10-day rolling average. It could hit resistance at 4.9% although the position on oscillating indicators points to a move toward 5% where the 200-day rolling average sits.

Previous Rec.: It may hit resistance at 4.9%.

Source: BBVA, Bancomer, Bloomberg

10 YEAR M BOND



10-YEAR M BOND: (yield): The upswing remains and sits above the 30-day rolling average. We believe it could continue this trend toward 6.5% at the 200-day rolling average.

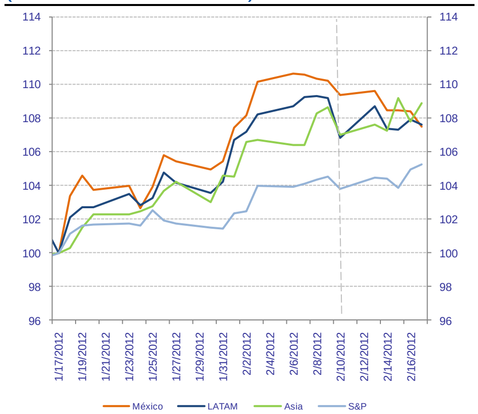
Previous Rec.: This break points to a move toward 6.3%.

Source: BBVA Bancomer, Bloomberg

Markets

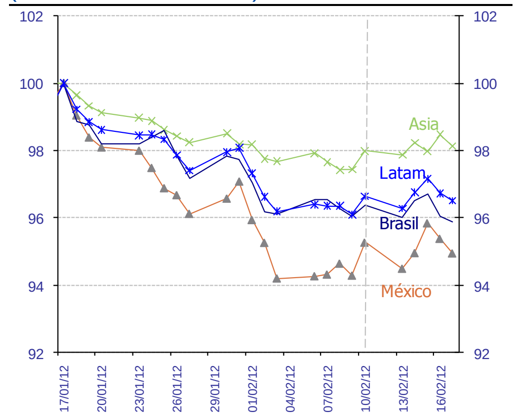
Falls on stock markets and a lower peso which, in general, reversed toward the end of the week after expectations that the EU finance ministers in the Eurozone would approve the second bailout package for Greece this coming Monday

Chart 7
Stock Markets: MSCI Indices (Jan 17, 2012 index=100)



Source: Bloomberg & BBVA Research

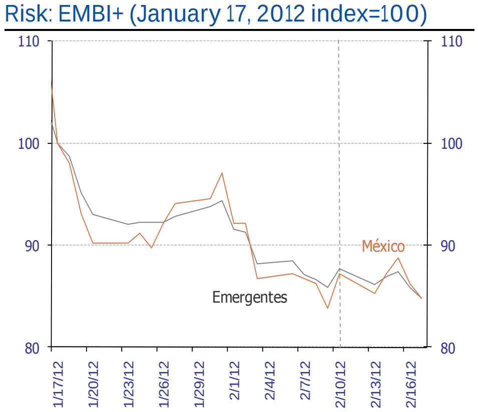
Chart 8
Foreign exchange: dollar exchange rates (Jan 17, 2012 index=100)



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

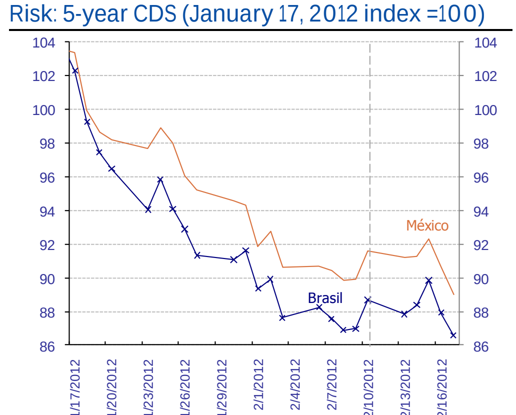
Slight upswing in risk aversion midweek due to the European authorities delaying over granting Greece the second bailout package

Chart 9
Risk: EMBI+ (January 17, 2012 index=100)



Source: Bloomberg & BBVA Research

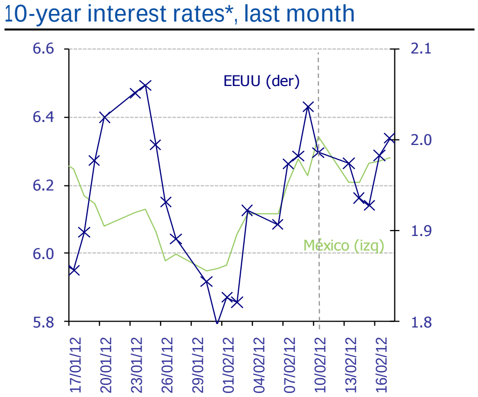
Chart 10
Risk: 5-year CDS (January 17, 2012 index =100)



Source: Bloomberg & BBVA Research

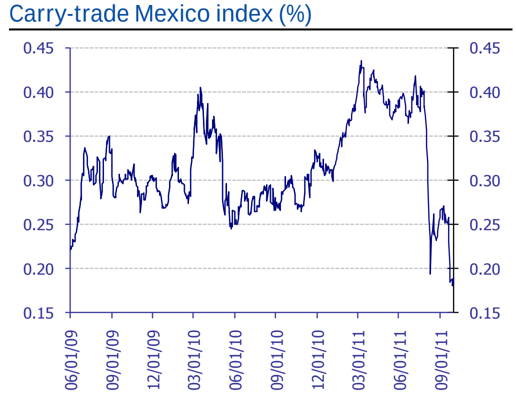
US and Mexico interest again correlate after the midweek risk aversion episode

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

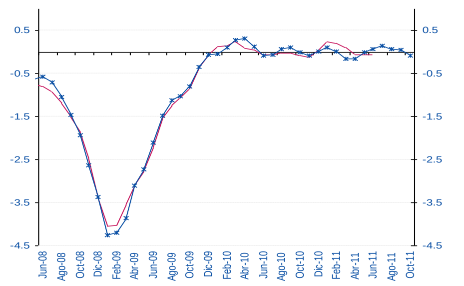


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

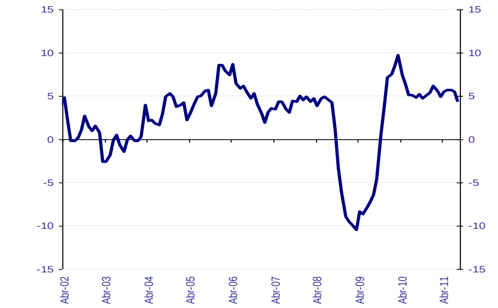
Output holds positive performance, situation indicators point to 1T12 with quarterly rates around 0.4%

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.

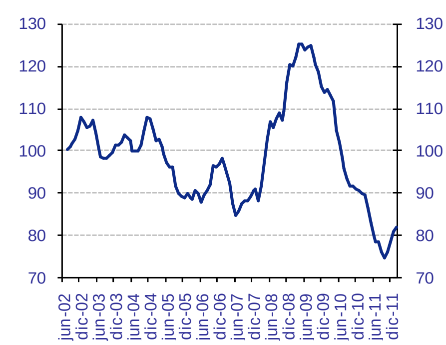
Chart 14
Advance Indicator of Activity (% change y/y)



Source: INEGI

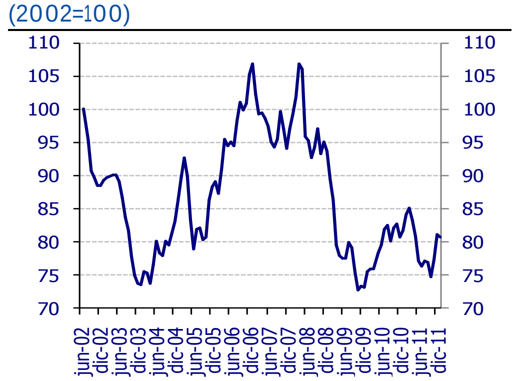
Both the recent inflation and output surprises continue to rise

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.

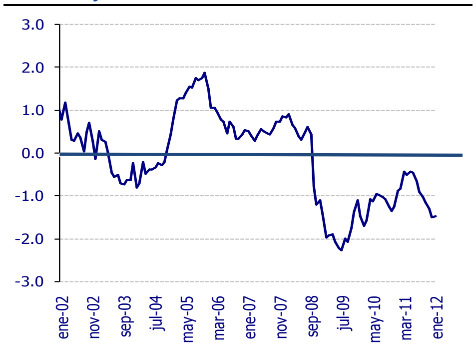
Chart 16
Activity Surprise Index (2002=100)



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.

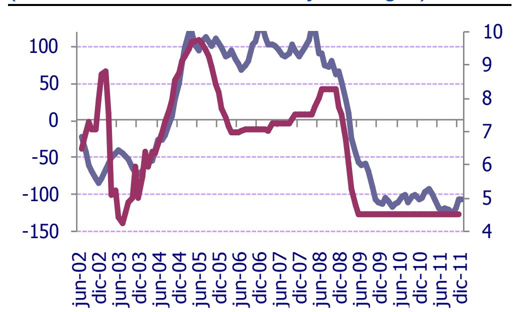
Monetary Conditions remain relaxed although halt their downward trend.

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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