BBVA | RESEARCH

Weekly Flash

Mexico

March 9, 2012

Economic Analysis

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Market Analysis

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Next week…

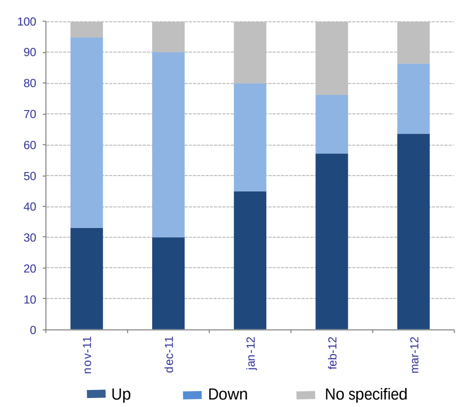
… Lending rate at 4.5% with no outlook for change

Banxico will release its monetary policy decision on Friday, March 16. **In line with most analysts, we expect the lending rate to remain unchanged**. In addition, we believe the tone of the release will continue to suggest a neutral monetary outlook, **with no signs that could anticipate for the market a coming** change in the rate. On the one hand, the chance of a rate cut is decreasing given the improvement in US output indicators and domestic inflation near the upper limit of the Banxico target variability range. In this way, in line with our forecasts, **inflation will come in above 4% between March and September**. On the other hand, the lack of domestic pressures from demand, wages or the exchange rate, and the **anchoring of medium-term inflation forecasts** avoid a downturn in the inflationary risk balance and, therefore, a change in monetary policy. Finally, attention will need to be paid to any mention in the release regarding the impact of the recent higher oil prices on the Mexican economy.

Major inflows on the fixed income securities market and the good performance of the MXN

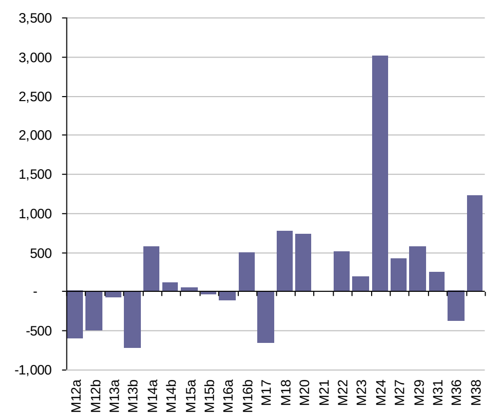
Last week, both foreign investors and domestic institutional investors saw major activity on the Mbonds market. The Siefores closed as net sellers while foreigners closed with major net purchases. In turn, the MXN saw a better relative performance among the G10 and emerging market currencies. Global liquidity conditions, with a slight moderation in cyclical and sovereign risks, could continue to support additional strengthening (short-term range: 12.55-12.95).

Chart 1
Expectations regarding the next move in the lending rate (% analysts)



Source: BBVA Research with data from the Financial Market Analysts' Forecast Survey collected by Banamex

Chart 2
MBond: Net foreign inflows over the week (millions of MXN)



Source: BBVA Research with Bloomberg and Indeval

Calendar: Indicators

Economic Analysis

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Industrial Output in January (Tuesday, March 13)

Forecast: 0.2% m/m 3.0% y/y | Consensus: 0.2% m/m | Previous: 0.9% m/m (3.5% y/y)

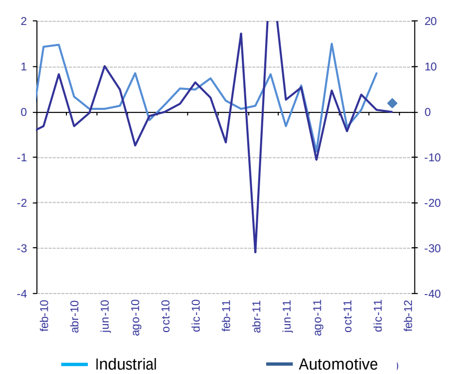
Awaiting the release of automotive output indicators and employment in February, industrial output in January is the first data for 2012 corresponding to all industrial output. **The forecast increase, below that from last December** is in line with known performance in variables linked to manufacturing output such as automotive output (0.0% m/m SA vs. 2.1% on average in the two previous months). In turn, **US industrial and manufacturing output also saw monthly declines.** This was seen in the contraction in intermediate goods imports (-1.3% m/m in January vs. 0.4% on average in the previous three months). Further, the other major component to industrial output - construction - saw a slower pace toward the end of 2011, especially in its main component, building.

Q4 GDP demand components (Wednesday, March 14)

Forecast: Aggregate demand.- 1.3% q/q 5.6% y/y | Consensus: 4.7 | Previous: 2.2% q/q (4.8% y/y)

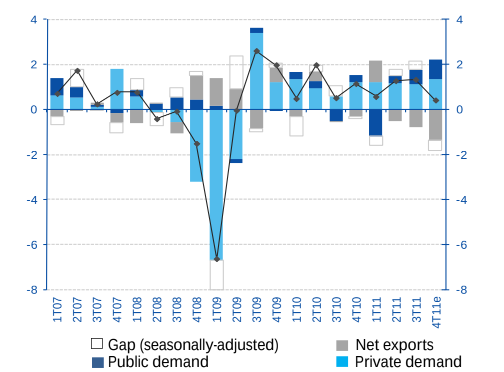
On Wednesday we will learn the breakdown for public, private and external demand for GDP in 4Q11, released a few weeks ago (0.4%q/q). **We forecast private consumption will have seen slower growth**, although increasing above the rate of GDP, **from 2%q/q in Q4 to near 0.8% in the last quarter of the year**. This is in line with the **slower expansion rate in available income** in real terms for the formal sector. This grew at lower rate throughout 2011. For the economy as a whole, employment income per worker in real terms has seen annual declines over 15 consecutive quarters. This situation has been partially offset by higher employment. In turn, capital goods imports increased in the last three months of the year from -2.1% on average in Q311 to 2% in the last quarter. This could be reflected in **better investment**, especially private investment which we estimate to have recorded growth of around 1% per quarter vs. -0.6% in the previous quarter.

Chart 3
Industrial Output and Automotive Industry (% change m/m)



Source: BBVA Research with data from INEGI and AMIA

Chart 4
GDP demand components (q/q % change and components)



Source: BBVA Research with INEGI data

Markets

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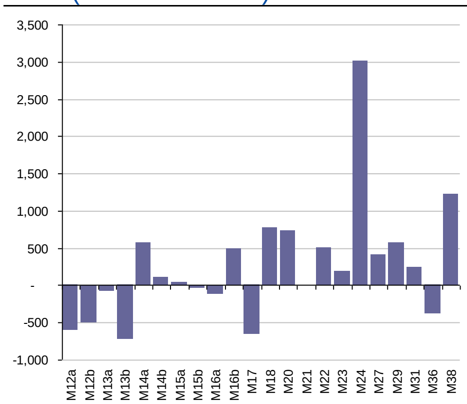
Major institutional and foreign investor inflows dominate the week on the fixed income market

Last week, both foreign investors and domestic institutional investors saw major activity on the Mbonds market, mainly in medium- and long-term maturities. Nonetheless, the data may be misleading. The Siefores ended the week as net sellers. Therefore, after carrying an aggregate of over MXN 3.5bn up to Wednesday, they closed at only MXN 1.3bn. In turn, foreigners were also highly active with net purchases of MXN 5.8bn (a strong week). However, 50% of this investment went to a single reference, the M2024.

MXN sees better relative performance among G10 and EM currencies

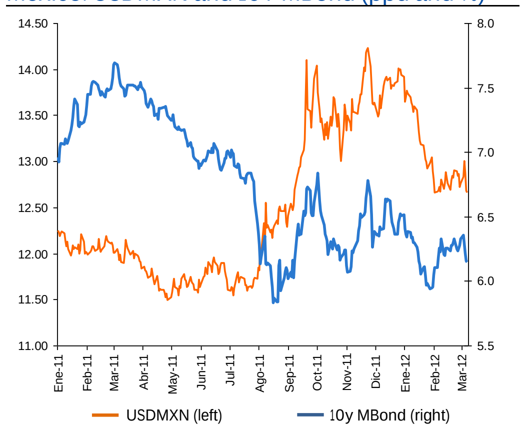
Uncertainties linked to the Greek PSI over the week (and the later announced results) as well as the series of economic indicators (especially the positive surprises in US employment data) led the MXN closing the week with a better relative performance among G10 and EM reference currencies, strengthening around 1%. This not without hitting a high of 13.0 (the highest depreciation among emerging currencies) the first two days of the week. In this sense, with regard to other currencies, **the currency saw a higher response margin to the "news" factor**, although still without taking into account any direction scenario. We believe it could hold sway in the short term. It should be highlighted that the correlation with domestic fixed income assets again took hold, both benefitting from foreign inflows. In this way, **global liquidity conditions, in a scenario where both cyclical and sovereign risks have moderated slightly, could continue to support additional strengthening**. The above would be limited to the set short-term range of 12.55-12.95.

Chart 5
MBond: Net foreign inflows over the week (millions of MXN)



Source: BBVA Research with Bloomberg and Indeval

Chart 6
Mexico: USDMXN and 10Y MBond (ppd and %)



Source: BBVA Research and Bloomberg

Market Analysis
Equities

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Technical Analysis

IPC Stock Market Index

The IPC saw a profit-taking week leading it to again attempt the 37,500pts floor where it again found a bottom. The bounce at the end of the week was not strong enough to take the market above the 10- and 30-day rolling averages. In order to consider a short-term buy signal, it would need to come in above these technical levels (37,900pts) and, more importantly, above 38,400pts, the resistance level in February. The floor remains at 37,500pts and, below this, at 36,500pts.

Previous Rec.: We recommend watching this floor since a downward break would set off an adjustment signal which we believe could find a floor of 36,500pts, -4% below current levels.

Source: BBVA, Bancomer, Bloomberg

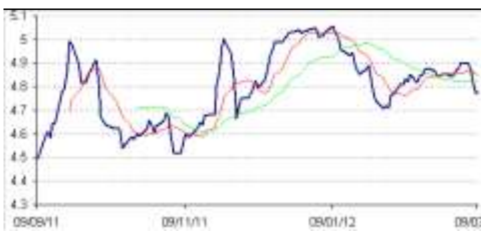
MXN

The dollar tried to break up through the MXN13.00 resistance mark for the third week in a row, without success. It returned to test the floor of MXN12.60, where we see it trying a new upswing. The trend change signal would only be given with a upward break through MXN13.00.

Previous Rec.: With a major floor at MXN12.60, we do not recommend taking long positions unless it manages to hit above the resistance.

Source: BBVA, Bancomer, Bloomberg

3Y M BOND

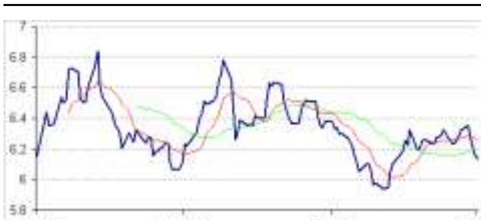


3Y M BOND: (yield): Finds floor at the 200-day rolling average (4.9%) and sits below the 10- and 30-day rolling averages. The adjustment could continue to the 4.7% range.

Previous Rec.: We maintain a target 5% and a floor at 4.8%.

Source: BBVA, Bancomer, Bloomberg

10 YEAR M BOND



10 YEAR M BOND: (yield): Hits the 200-day rolling average at the start of the week but finds resistance and begins adjusting. This move could continue to the 6% range.

Previous Rec.: Resistance at 6.46% in the 200-day rolling average. Oscillating indicators support a move toward this level.

Source: BBVA Bancomer, Bloomberg

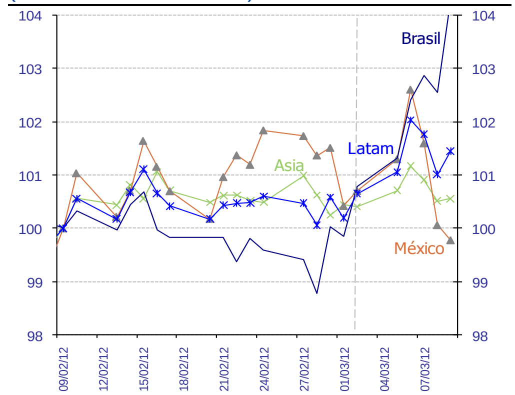
Markets

Better-than-expected US employment data and "agreement" among Greek authorities and private creditors lead to a higher exchange rate at the end of the week. Highs hit on stock markets which, in general, fail to compensate for the fall mid-week

Chart 7
Stock Markets: MSCI Indices
(Feb 9, 2012 index=100)

Source: Bloomberg & BBVA Research

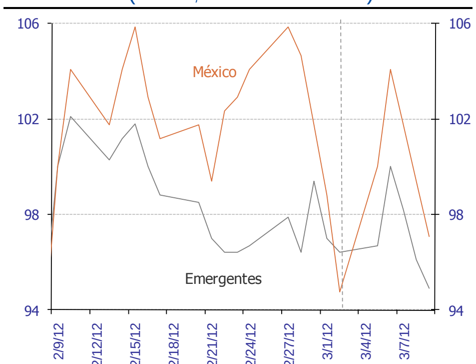
Chart 8
Foreign exchange: dollar exchange rates
(Feb 9, 2012 index=100)



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

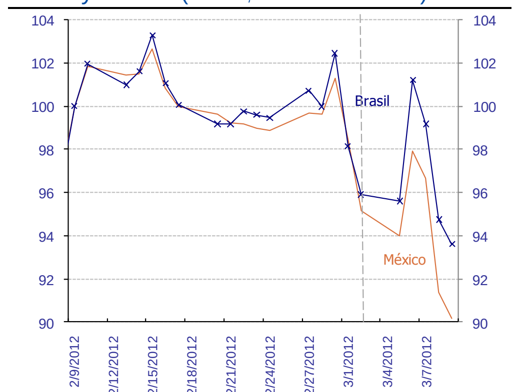
Greek debt swap relaxes risk aversion at the end of the week

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



Source: Bloomberg & BBVA Research

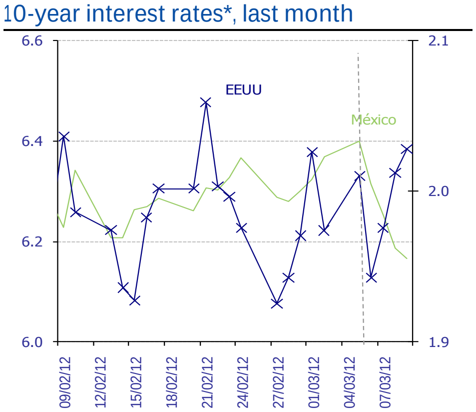
Chart 10
Risk: 5-year CDS (Feb 9, 2012 index=100)



Source: Bloomberg & BBVA Research

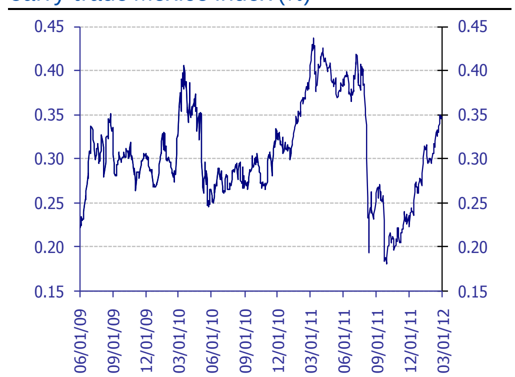
US rates up and Mexican rates down in the face of greater risk appetite at the end of the week

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

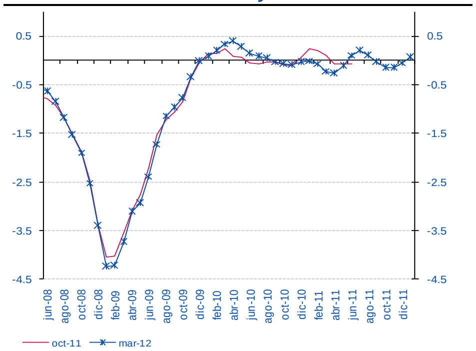


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

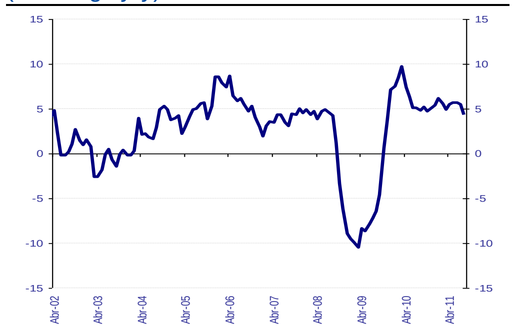
Output holds positive performance, situation indicators point to 1T12 with quarterly rates around 0.6%

Chart 13
BBVA Research Synthetic Activity Indicator for the Mexican economy



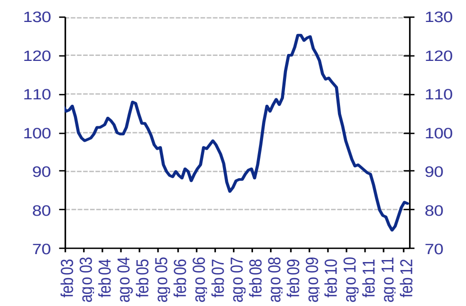
Source: BBVA Research with data from INEGI, AMIA and BEA
Weighted sum of 21 different indicators of activity, expenditure and expectation, based on trend series.

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



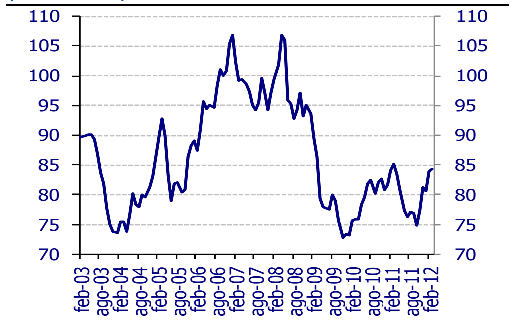
Source: INEGI

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.

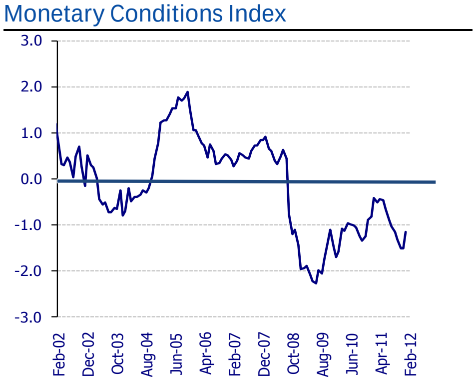
Chart 16
Activity Surprise Index (2002=100)



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.

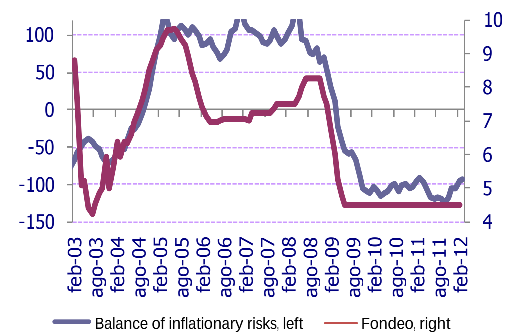
Monetary conditions slightly strained due to recent exchange rate appreciation

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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