RESEARCH

Weekly Flash

Mexico

March 16, 2012

Economic Analysis

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Market Analysis

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Next week...

... More situation data: will the positive tone remain for the first quarter of the year?

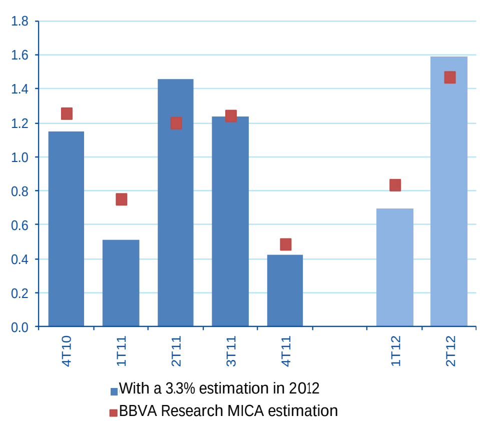
Inegi will be releasing three highlights this week to check domestic demand strength: the Retail Survey, the IGAE (both for January) and the relevant job figures for February. Current situation data lead to an increased BBVA Research forecast in 1Q12 GDP over the last two months. This improvement came about especially after the release of indicators closely linked to foreign demand performance and industrial output, as well as formal employment figures and indicators on consumer and manufacturer confidence recording increases. In this context, it will be important to see if the current positive bias remains in indicators more linked to domestic demand: the IGAE (where it will be especially important to assess service sector performance), retail sales (as a representative variable in household spending) and the employment situation across the economy as a whole.

In turn, the CPI for the first fortnight of March will be released. Here we expect to see growth of 0.33% which, in annual terms, points to inflation running at 4.1% *(more on page 2)*.

Banxico's stance favors a strong MXN but fails to provide an excuse to exit the recent range

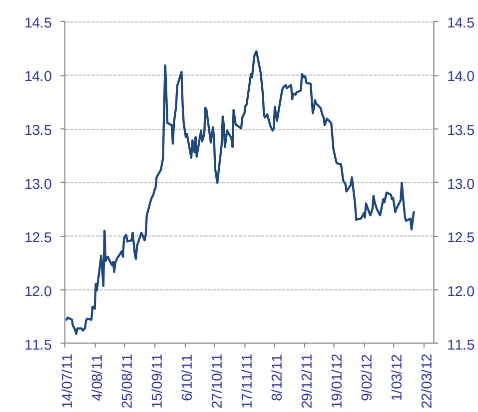
The local yield curve is attractive due to an expected prolonged pause in monetary policy, a positive growth scenario and strong fiscal policy. The MXN is set to remain within its ranges. Banxico's neutral stance favors *carry* and continues to stoke arbitrage opportunities between the *forward* and Cetes curves. In turn, the lack of interventionist language marks the MXN as more attractive than other LatAm currencies. In short, downward risks give a support level near 12.50

Chart 1
BBVA MICA estimate, 1 and 2Q 2012 (q/q%)



Source: BBVA Research.

Chart 2
Peso exchange rate, Pesos per Dollar



Source: BBVA Research with data from Bloomberg

Economic Analysis

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Calendar: Indicators

IGAE in January (Tuesday, March 20)

Forecast: 0.3% m/m (3.7% y/y)	Consensus: N.A.	Previous: 0.4% m/m (4.1% y/y)

Labor market indicators in February (Friday, March 23)

Forecast: Unemployment 4.7% EAP	Consensus: N.A.	Previous: 4.8% EAP

Retail Sales in January (Friday, March 23)

Forecast: 0.3% m/m (4.1% y/y)	Consensus: N.A.	Previous: -2.6% m/m (3.0% y/y)

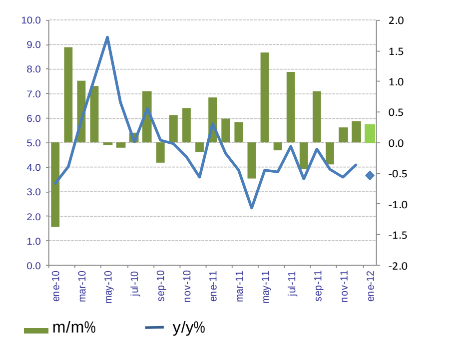
With the January industrial output figures (0.8% m/m), we forecast services could have continued expanding at a similar rate to the previous month (0.2%). This would point to global growth in the first month of the year at 0.3% m/m. In this way, formal sector employment in the first two months of the year maintained its growth rate with much of this, around 60%, in services. More job market figures will come in with the unemployment rate for the first two months of 2012 seeing some resistance to decline despite the good performance in activity and spending. In turn, we see retail sales experiencing a more normal performance in January after two non-typical months impacted by the "El Buen Fin" ("Success") program in November (3.5% m/m) and the later decline in December (-2.6%). January's figures will help discern the program's final impact.

Inflation for the first two weeks in March (Thursday, March 22)

Forecast: 0.33% bi-weekly (4.01% y/y)	Consensus: 0.17% bi-weekly	Previous: 0.2% m/m (3.87% y/y)

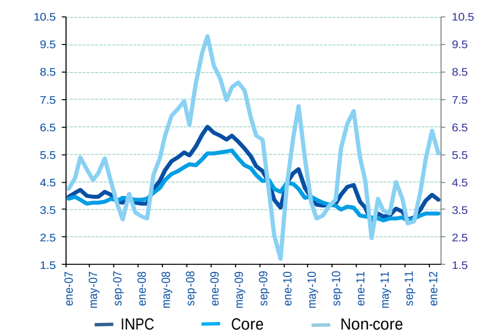
Inflation will again hit 4% in March. This increase is due to the start of moderate price increases for fruit and vegetables which had seen major falls in February. In addition, public rates will make an upward addition in the monthly rate of consumer prices once the effect of the ownership tax cancelation hits. Further, the increase in the non-core component will hit inflation. Core inflation will continue to place upward pressure on processed food prices. However, other goods prices will benefit from the stronger peso. In turn, services will see a slight upswing in the annual rate due to an unfavorable base effect, a checked upturn given the prevailing economic slack. In short, inflation will remain above 4% in coming months and be near the 3.5% level at the end of the year. Attention will need to be paid to possible upward shocks in commodity prices such as grains. These may cause additional upswings in consumer prices over the short term. The impact of possible oil price increases should be reined in thanks to the current oil subsidy program.

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



Source: BBVA Research with INEGI data

Chart 4
Inflation breakdown (% y/y change y/y)



Source: BBVA Research with INEGI data

Markets

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Flows and fundamentals suggest going long, Mbond 10Y-30Y, but we prefer to wait for better entry levels

The local yield curve continues to face expensive curves and the lack of sparks for upward yields. Discount values over the Mbond curve obtained through our estimates suggest the curve level is very near its *fair value*, with some maturities even below it. In fact, capital inflows from overseas explain most of the low yield levels. In this sense, due to current monetary policy and average liquidity risk premiums, the 10Y should be trading nearer 6.5% than 6.0%. It is clear that this gap does not represent the trading targets. Capital flows and positioning become even more important when economic and financial detonators seem to remain behind the barrier. In other words, slight and gradual changes in the economic scenario will not mean a more active role for monetary policy.

The local yield curve is attractive due to an expected prolonged pause in monetary policy, a positive growth scenario and strong fiscal stance. A slightly more positive growth outlook from Banxico, albeit with an output gap far from being closed alongside lower inflation risks, not only point to a prolonged monetary policy pause but also to a margin to go long in the long section of the curves. We continue to think that the mid-curve should hit higher yield levels given the current ones continuing to reflect a more accommodating policy stance. We therefore prefer to wait for instruments to become more attractive to add long positions to our strategy (especially if we take into account rate volatility).

Banxico's stance favors a strong MXN but fails to provide an excuse to exit the recent range

The moves in the MXN in recent months have been more of a directional factor for the Banxico bias than the contrary. In the year to date, the MXN has outperformed most of the main currencies by strengthening nearly 10%. This dispels some of the concern that the strengthening may affect inflation, as seen last year when the currency weakened. Liquidity and expectations for an economic rebound in Mexico and the US have driven the MXN upswing. Nonetheless, these factors are not expected to continue to contribute as much to a stronger MXN as was the case in the first two months of 2012. In fact, we forecast a consolidation in the current range. Central banks around the world have moderated their soft bias thanks to the increased prices for commodities and favorable surprises in economic indicators. In addition, the BBVA economic analysis team does not expect positive surprises to persist. This is in line with local growth forecasts indicated by Banxico. With this, the MXN is set to remain within its ranges. Banxico's neutral stance favors *carry* for the MXN and continues to stoke arbitrage opportunities between the forward and Cetes curves. In turn, the lack of interventionist language marks the MXN as more attractive than other LatAm currencies. Nonetheless, prevailing downward risks give a support level around 12.50.

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Technical Analysis

IPC Stock Market Index

The IPC tested the major 37,500pts support level over the week, staying within it and initiating a bounce. It will again test the 38,400pts resistance level which it was unable to surpass on several occasions in February. An Amx reaction could help this break which would set 38,700pts as the next target (the IPC historical maximum) and, after this, 39,300pts, a result of projecting the 900pts from the lateral range above 38,400pts.

Previous Rec.: 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

Source: BBVA, Bancomer, Bloomberg

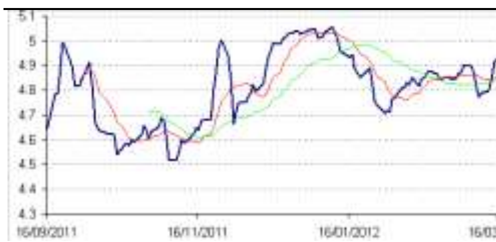
MXN

The dollar remained in the low section of the lateral range where it has traded since the end of January. We believe that the MXN12.50 to MXN12.60 range could be taken as a buy range, expecting an upswing toward MXN12.90/13.00. .

Previous Rec.: 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.

Source: BBVA, Bancomer, Bloomberg

3Y M BOND

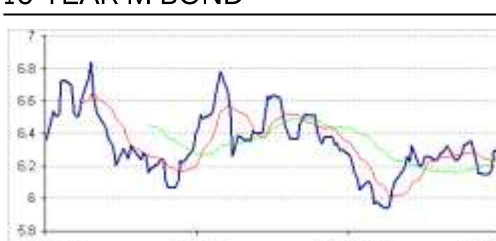


3Y M BOND (yield): Quick recovery of the break in short-term averages and hitting through the previous maximum. This sets the next upward target at 5% by hitting through the 200-day rolling average.

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): Although returning above the 10- and 30-day rolling averages, it fails to produce an entry signal by still trading below the 200-day rolling average (6.41%). If it breaks this level, we can expect a movement toward 6.6%.

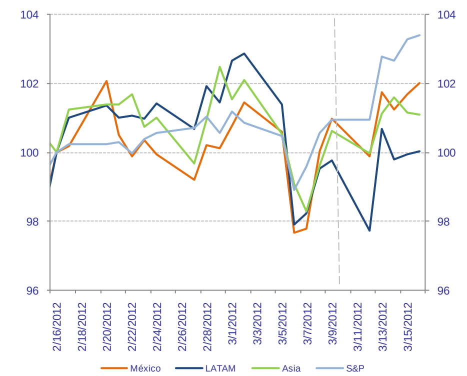
Previous Rec.: This move could continue to the 6% range.

Source: BBVA Bancomer, Bloomberg

Markets

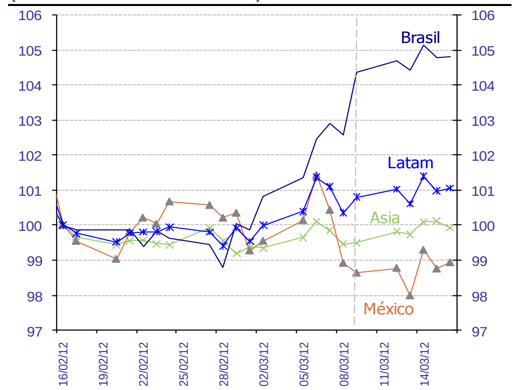
Stock markets up over the week supported by better-than-expected US retail sales and employment data. Exchange rate sees marginal changes over the previous week.

Chart 7
Stock Markets: MSCI Indices (Feb 16, 2012 index=100)



Source: Bloomberg & BBVA Research

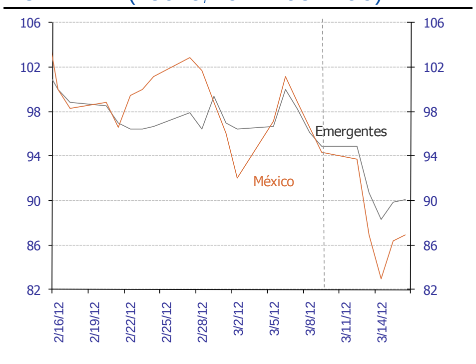
Chart 8
Foreign exchange: dollar exchange rates (Feb 16, 2012 index=100)



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

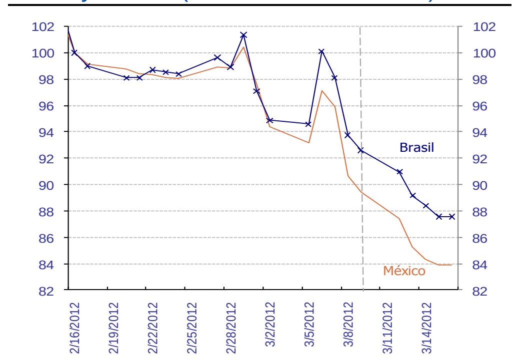
Major fall in risk aversion due to the improvement in the Federal Reserve's prognosis mid-week.

Chart 9
Risk: EMBI+ (Feb 16, 2012 index=100)



Source: Bloomberg & BBVA Research

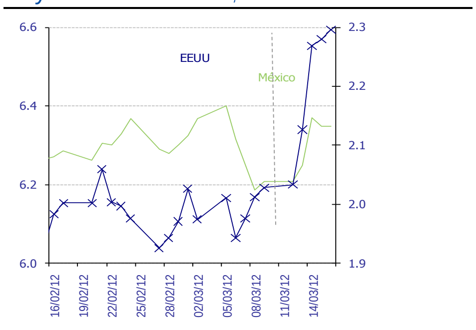
Chart 10
Risk: 5-year CDS (Feb 16, 2012 index=100)



Source: Bloomberg & BBVA Research

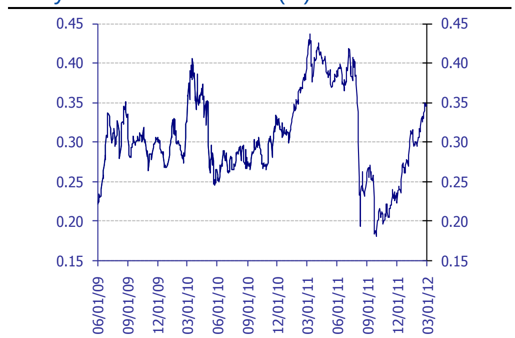
Major rise in US interest rates due to greater appetite for risk. Rates in Mexico move in line.

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

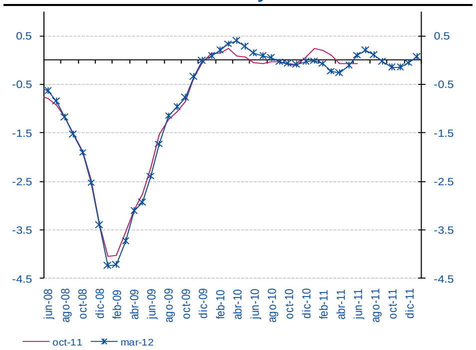


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

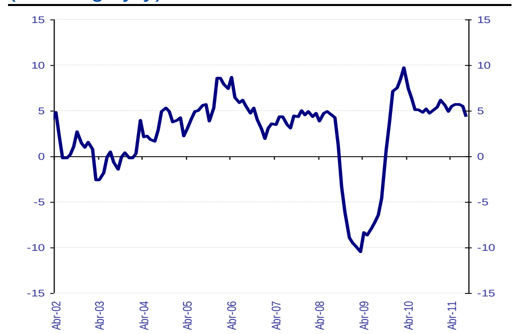
Output holds positive performance, situation indicators point to 1Q12 with quarterly rates around 0.6%

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.

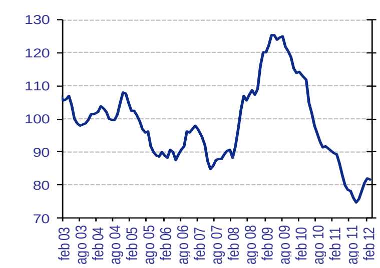
Chart 14
Advance Indicator of Activity (% change y/y)



Source: INEGI

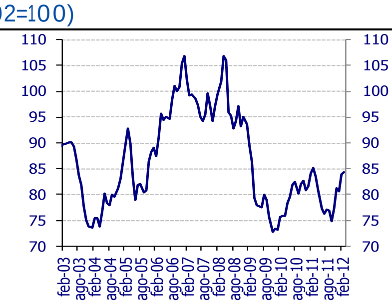
The last inflation surprise was downward while, in general, activity continues to offer positive surprises

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.

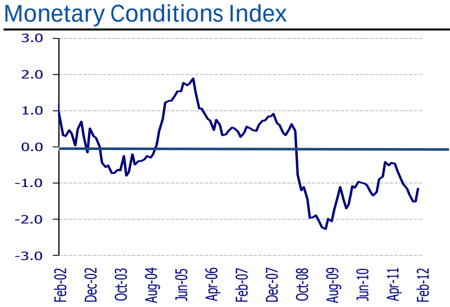
Chart 16
Activity Surprise Index (2002=100)



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.

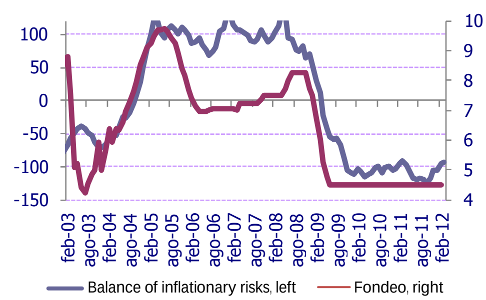
Monetary conditions slightly strained due to recent exchange rate appreciation

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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