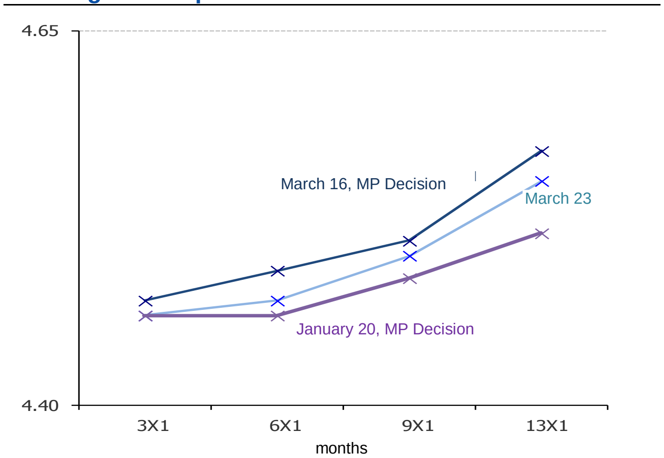
Mexico Weekly Flash

Next week…

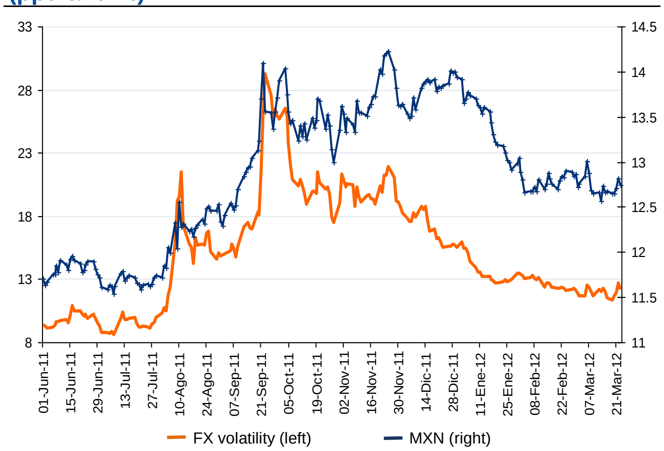
- **Monetary policy meeting minutes: more awareness of the improved inflationary risk balance?**
  - Banxico will release the minutes from the March 16 monetary policy meeting next week. The most important point will likely be the viewpoints of the Board members on the situation and the coming risks for inflation and growth after highlighting the improvement in both risk balances in the last release. Firstly, we will especially need to see how positions on inflation coincide more after the discussions seen in previous minutes. Secondly, comments will need to be followed on domestic situation indicators which are consistent with an improvement over the end of 2011 in line with an improved outlook for overseas. The central bank's opinions on whether this situation will last will be key at a time when the short-term inflation outlook is improving. Lastly, Board members' opinions on the increase in oil prices and the possible effect on inflation and growth will be important after being mentioned as a risk element in the last statement.
- **Financial assets in Mexico sensitive to economic data in coming weeks**
  - Volatility was high for the MXN over the week despite scant global news on the cyclical situation. We continue to see no driving force for a break through the currency trading range; trades between 12.55-12.90 are not ruled out. In turn, capital flows have favored the short and long end of the curve since the beginning of the year. Net foreign positions over the week are estimated at MXN5.3bn. With regard to institutional investor strategies, the Siefores increased their net long position of MXN0.55bn, the first in March, but at a very low trading volume.

Chart 1
Lending Rate implied in IRS contracts



Source: BBVA Research and Valmer

Chart 2
Mexico: MXN/USD and implied 1-month volatility (ppd and %)



Source: BBVA Research with data from Bloomberg

Calendar: Indicators

February Trade Balance (Monday, March 26)

Forecast: 996 md	Consensus: 313 md	Previous: -287 md

The trade balance for February will be released on Monday which we believe will be in surplus by around 900md. This favorable performance will mainly be due to two factors: first, the higher oil price seen in the month in comparison to January (110 dpb vs. 107 dpb in January) and second, the good performance in industrial output in Mexico for January - a favorable sign for manufacturing exports in the short term. If the US economy's dynamism continues in a scenario with high oil prices over the year, we should see a highly reduced deficit in the trade balance. Overseas dynamism will outpace the recovery in domestic consumption, limiting imports of these types of goods. Nonetheless, we will need to watch US industrial performance since it has slowed since December and the possible effects the high oil prices may have on US household spending.

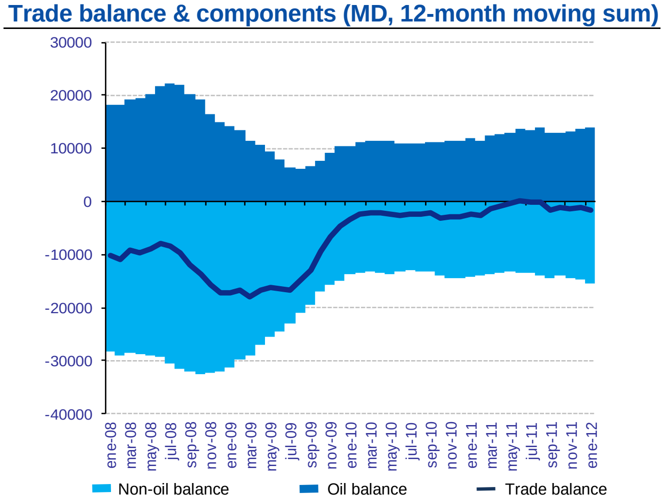
Public Finances in February (Friday, March 30)

Forecast: N.A.	Consensus: N.A.	Previous: N.A.

Next week sees the release of public finances in February which should continue to show the strength of oil receipts. These increased by a real 31.5% in January and drove total federal revenue up by a real 10.5%. The approved 2012 budget set out an oil price at 84.9 dpb. However, the price of Mexican oil blend over the year has averaged 110 dpb which if the Mexican economy sees growth at or above the forecast 3.3% in the budget would mean a major source of extraordinary revenue for the government. This increase, due to the rules whereby extraordinary oil revenue is distributed, would not mean a deficit below 2.4% of GDP, also forecast in the budget since it would go to increase the share for state governments, the stabilization fund and Pemex infrastructure investment, in addition to meeting the increased implicit subsidy for gasoline. In short, the size of the in principle favorable impact on the Mexican economy will depend on how effective spending is of these higher resources, mainly in states.

Chart 3

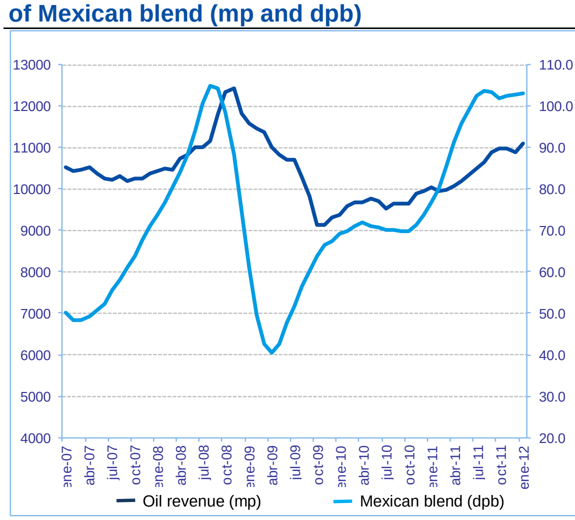
Trade balance & components (MD, 12-month moving sum)



Source: BBVA Research with INEGI data

Chart 4

12-month moving sum for oil revenue and average prices of Mexican blend (mp and dpb)

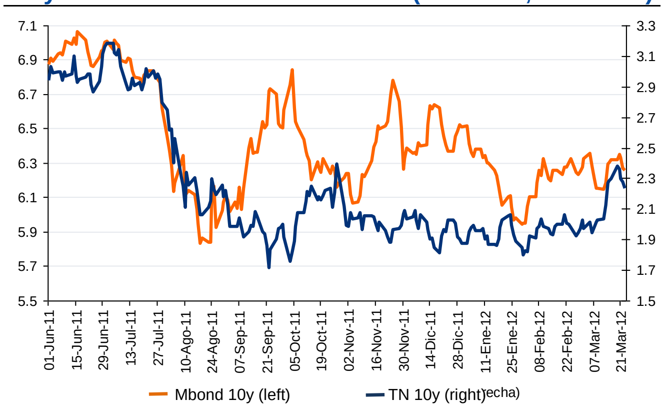


Source: BBVA Research with Banxico data

Markets

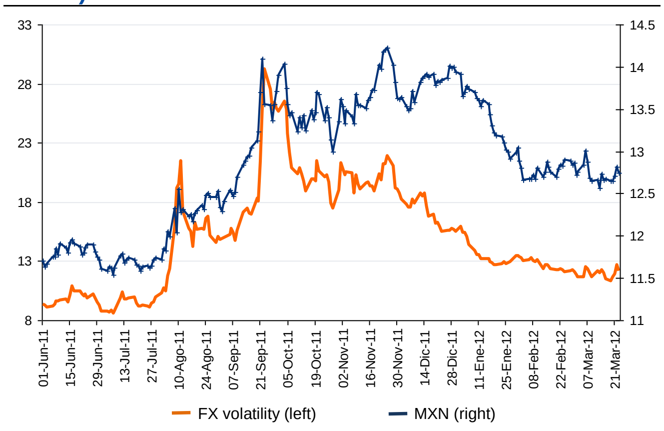
- **Capital flows have favored the short and long end of the curve since the beginning of the year.**
  - Net foreign positions were estimated at MXN5.3bn over the week. In contrast to the start of March, flows were concentrated in the short end of the curve and in the *belly*. This means that foreigners were net sellers in the long part of the curve while their net position in tranches was higher than at the start of the month. In short, capital flows have favored the short and long end of the curve since the beginning of the year. 40% of the estimated flows into the MBond market in 1Q12 (MXN 48bn) was allocated to the long part of the curve while 44% went to shorter tranches (estimated net flows are calculated using market prices and trades).
  - The Siefores investment strategy over the week led to a net long position of MXN0.55bn, the first in March, but at a very low trading volume. Preferred holdings were the M27, M36 and M38. In the month to date, estimated net sales were around MXN -4.4bn with major exits from M2012 and M2031 but long positions in the M2038.
- **After a negative bias over most of the week, the MXN closed on Friday with a strengthening of 0.3%.**
  - The currency saw high volatility over the week. The lack of major determining factors pushed the market into a more aggressive reaction to any type of news linked to global cyclical expectations. We believe investors will continue to be highly sensitive to economic data in coming days, although with regard to the end of the week, attention will again focus on the EMU and expectations that the EFSF and ESM act jointly. In all, we continue to see no driving force for a break through the recent 12.55-12.90 trading range.

Chart 5
10-year bond in Mexico and the US (annual %, fixed rate)



Source: BBVA Research.

Chart 6
Mexico: MXN/USD and implied 1-month volatility (ppd and %)



Source: BBVA Research with data from Bloomberg

IPC Stock Market Index

Source: BBVA, Bancomer, Bloomberg

Slight upswing week on the IPC stock market, despite the US adjustment. It managed to end the week in the lateral range resistance zone where it has traded since February (37,500/38,400pts). We believe an upward break is still likely setting a target of 39,300pts, a result of projecting up the 900pts from the lateral range. We have to take the 30-day rolling average (38,000pts) as the initial floor, although the positive trend would only halt with a downward break through 37,500pts.

Previous Rec.: 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.

MXN

Source: BBVA, Bancomer, Bloomberg

A positive dollar trend over the week, bouncing from MXN12.60 to the 50-day rolling average (MXN12.90). With this, it returns to the lateral range resistance zone where it has traded since January. At this point, we recommend taking short positions awaiting a return to MXN12.60. Only an upward break of MXN13.00 would provide a short-term buy.

Previous Rec.: 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.

3Y M BOND

Source: BBVA, Bancomer, Bloomberg

3-YEAR M BOND: (yield): Return over the week for the bond again coming in below the 200-day rolling average. It is important it respect the 4.84% zone since, if not, it would search out 4.7%.

Previous Rec.: This sets the next upward target at 5% by hitting through the 200-day rolling average.

10Y M BOND

Source: BBVA, Bancomer, Bloomberg

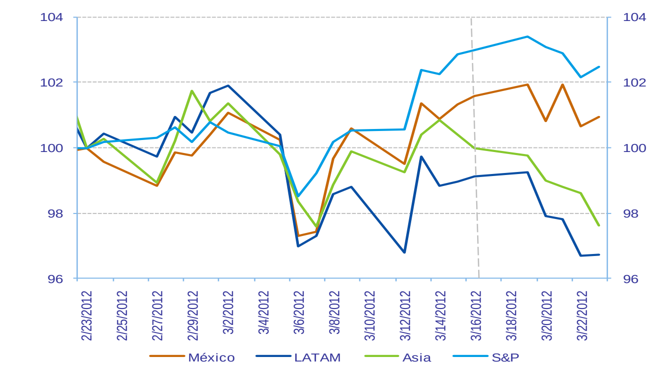
10-YEAR M BOND: (yield): Unable to hit entry as it failed to break the 200-day rolling average. We would only see a buy signal with an upward break of 6.41% or a return to the 6.1% floor.

Previous Rec.: Still failing to produce an entry signal as still trading below the 200-day rolling average (6.41%).

Markets

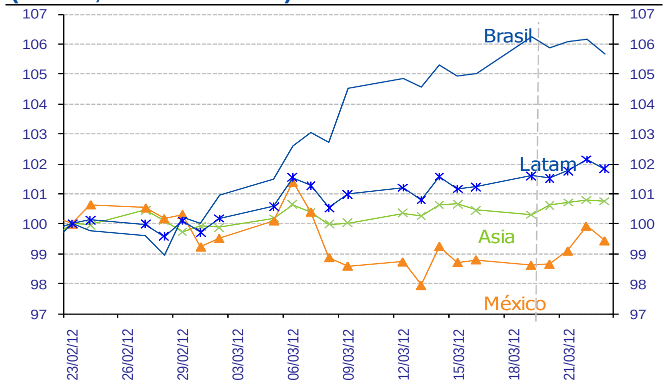
- **Stock markets see losses over the week after the release of lower-than-expected manufacturing data in China and Europe. The exchange rate fell over the week.**

Chart 7
Stock Markets: MSCI Indices (Feb 23, 2012 index=100)



Source: Bloomberg & BBVA Research

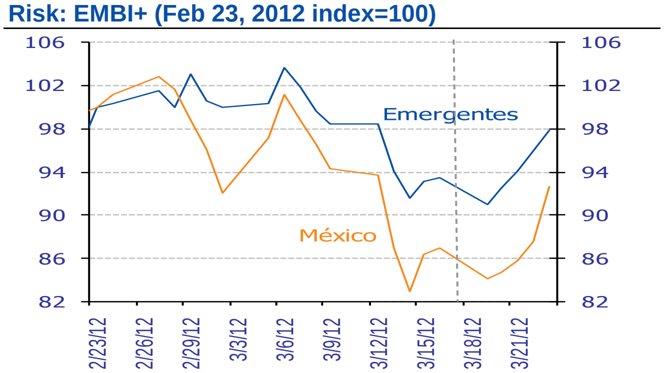
Chart 8
Foreign exchange: dollar exchange rates (Feb 23, 2012 index=100)



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

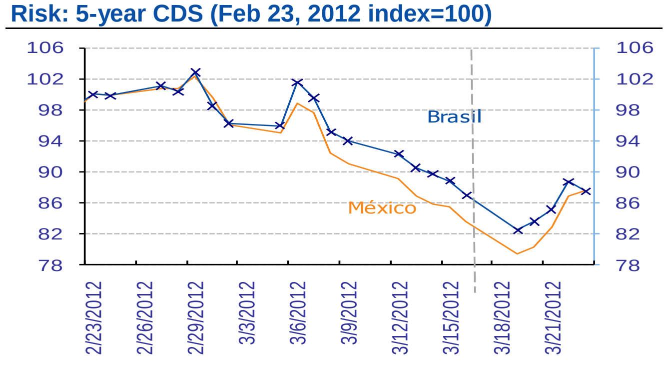
- **Higher risk aversion influenced by data showing lower economic activity in China**

Chart 9
Risk: EMBI+ (Feb 23, 2012 index=100)



Source: Bloomberg & BBVA Research

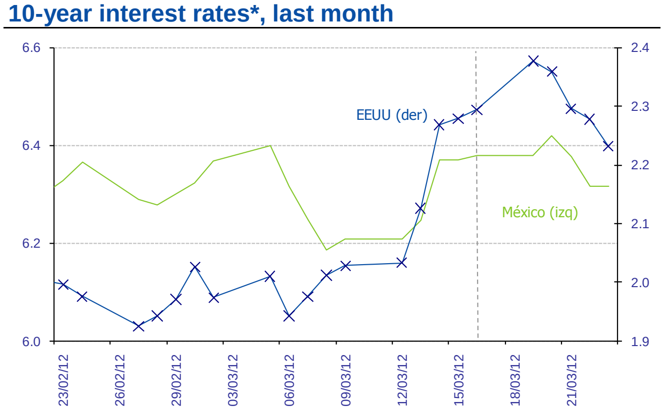
Chart 10
Risk: 5-year CDS (Feb 23, 2012 index=100)



Source: Bloomberg & BBVA Research

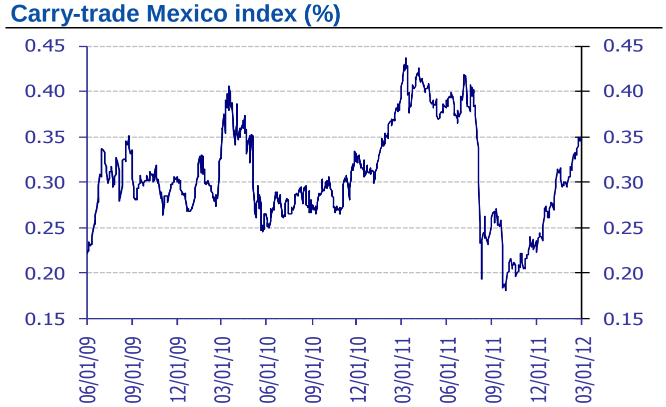
- **Fall in rates in the US due to increased risk aversion mid-week. Rates in Mexico maintain a positive correlation with US Treasury rates.**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

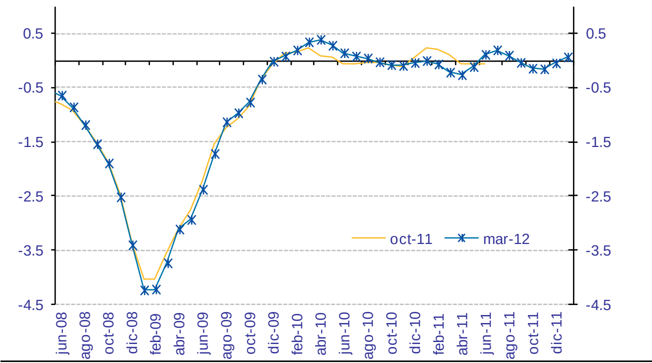


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

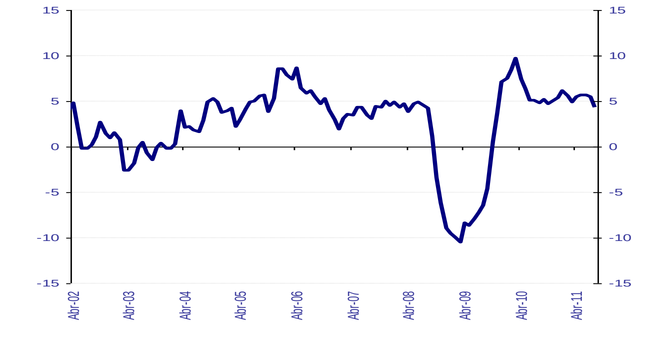
- **Output holds positive performance, situation indicators point to 1Q12 with quarterly rates around 0.6%.**

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.

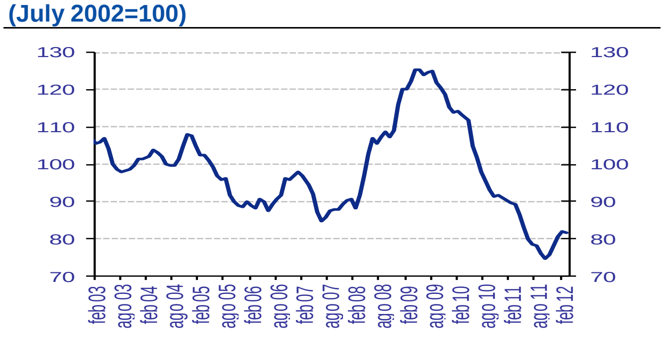
Chart 14
Advance Indicator of Activity (% change y/y)



Source: INEGI

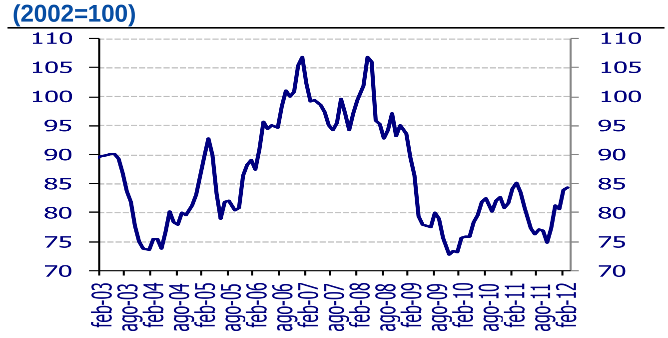
- **The last inflation surprise was downward while, in general, activity continues to offer positive surprises.**

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.

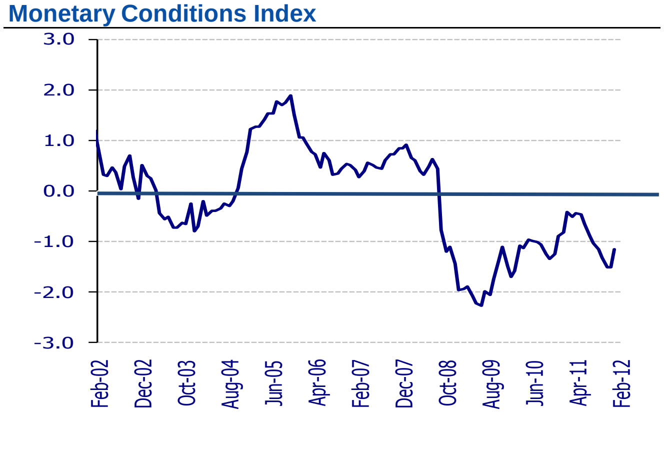
Chart 16
Activity Surprise Index (2002=100)



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

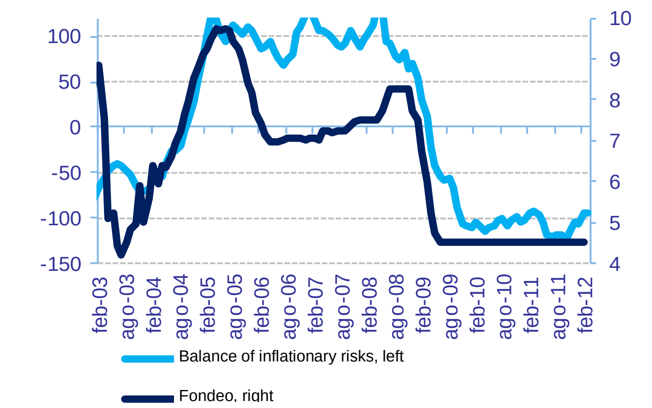
- **Monetary conditions slightly strained due to recent exchange rate appreciation.**

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 and weighted index (of inflation and economic growth) based on economic indicators of economic activity and inflation. A rise in the index points to a greater weight of inflationary risks over growth risks and thus a greater possibility of monetary restriction

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