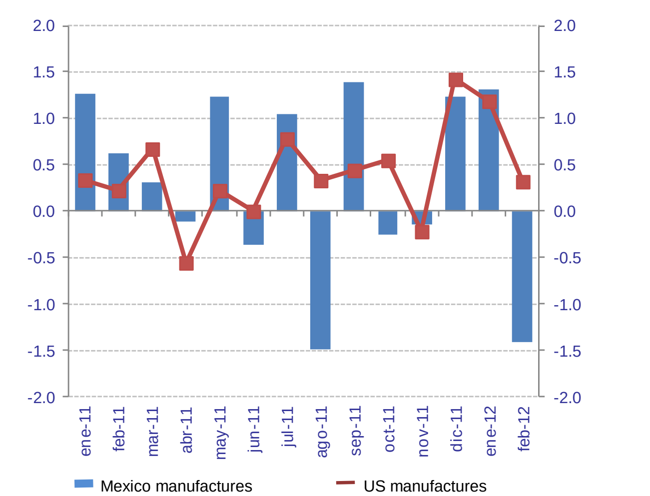
Mexico Weekly Flash

Next week…

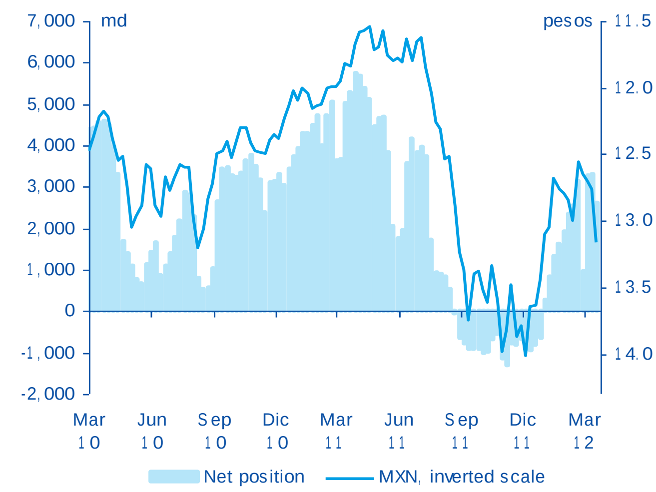
- **No changes in domestic growth but watch for possible job slowdown signs in the US**
  - With the release of formal employment in March (0.4% m/m, 4.5% y/y), job market data to be released next week (unemployment rate in March) will continue to support a growth scenario for the Mexican economy in 1Q12 at rates we expect to be slightly above the 0.4% q/q seen in 4Q11.
  - The poor industrial output figure for February released this past week (-1.7% m/m vs. 0.3% m/m forecast by BBVA Research) could have case doubts on the Mexican growth rate which, in our opinion, are overdone since: i) the correction of the leap year effect on industrial output figures has a lot to do with the major decline (we calculate that without said correction for the effect of the additional output day, the IPI would have seen 1.2% growth for the month) and ii) other situation indicators continue to be in line with a moderate growth scenario, with no sudden downward adjustments.
  - In any event, US job market data need to be closely followed. They seem to strike a somewhat less positive cyclical note which, alongside domestic inflation and the FED meeting next week, could be very important for the next monetary policy decision in Mexico.
- **An upswing in risk aversion over the week:**
  - In line with most global risk assets, those in MXN reacted not only to external risk aversion elements (linked to the global economic cycle, the US and China) but also to a possible rate cut by the Bank of Mexico.

Chart 1
Manufacturing Industrial Output (% m/m, csv)



Source: BBVA Research and INEGI

Chart 2
Mexico: Long non-trading positions in CME (US$mn)



Source: BBVA Research with data from Bloomberg

Calendar: Indicators

Indicators for Occupation and Employment, March (Friday, March 20)

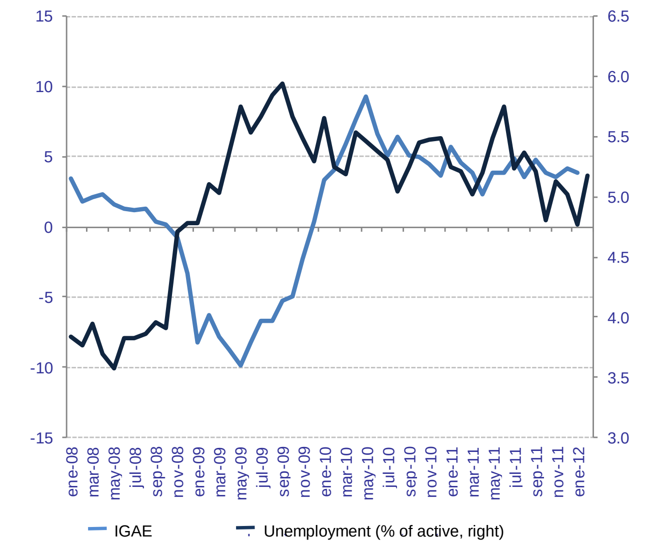
Forecast: 5.3%	Consensus: N.A.	Previous: 5.2%

This Friday sees the release of key employment indicators for March. It should be stated that both the unemployment and underemployment rates remain at high levels and above those seen prior to the 2009 crisis. The unemployment rate however is somewhat below that for most of 2011. The performance of these employment and underemployment indicators contrasts with the economy's performance as a whole which has seen stable growth.

In this sense, performance data on formal private sector workers (IMSS) released today and showing good growth in March (0.4% m/m, 4.5% y/y) remain the good performance dynamic for this indicator, coming in just slightly below the last three months (0.5% m/m on average) and above the 2011 average (0.3%).

Chart 3

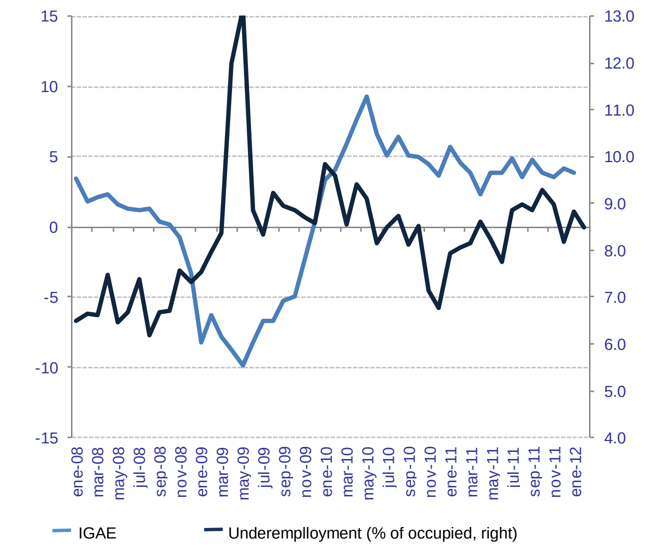
IGAE and unemployment Rate (% change y/y SA and % SA)



Source: BBVA Research with INEGI data

Chart 4

IGAE and underemployment rate (% change y/y SA and % SA)



Source: BBVA Research with Banxico data

Markets

- ## An upswing in risk aversion over the week: MXN falls

  - In line with most global risk assets, the MXN closed with over a 1.1% fall on Friday accumulating a weekly loss of almost 1.5%. In this way, the currency weakened proportionally more than other emerging and G10 currencies, reacting not only to external risk aversion elements (mainly those linked to the global economic cycle) but also to a possible rate cut by the Bank of Mexico. In this sense, we believe the weakness could continue over the next two weeks before the Central Bank meeting. The meeting of G20 ministers will be another key event to follow (there is a chance IMF funds will be discussed). Nonetheless, we continue to see no necessary driving force for a return to levels below 13.0 in coming days. Our outlook for the currency remains positive for the coming months. For now, however, we remain cautious since any "negative" news could lead to markets over-reacting.

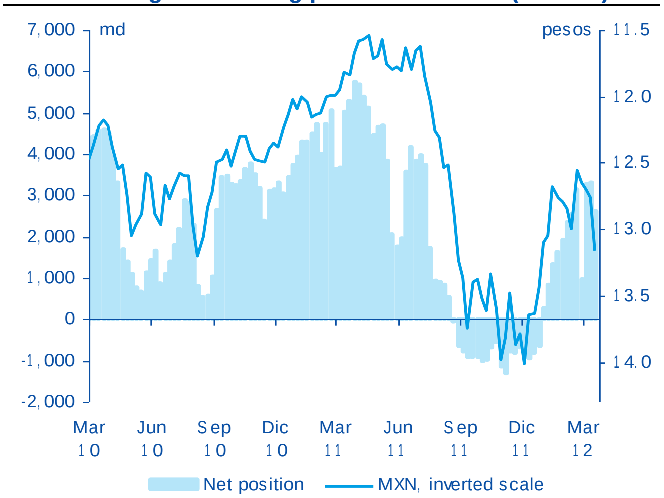
- ## The short section of the curve can be left.

  - Given the chance that a 50bp cut by Banxico at the end of April may happen, we have looked at different scenarios and investment times in different sections of the curve. Our conclusions: 1) the short section already has a bank lending rate at 25bp priced in. For the next 6 months; 2) we do not expect to see a cut but the chances are finely balanced; 3) if Banxico cuts 50bp, the market may try to price in an additional drop and if this is not the case, the least we will see is a prolonged pause scenario but with a lower rate level, supporting the long sections; 4) if Banxico does not cut, the rate upswing will be seen in the short section and, given the high liquidity levels and macro stability, the long sections should continue to be attractive

- ## Fears for sovereign contagion lead to global market falls, Mexico stands out in the black. Reporting season.

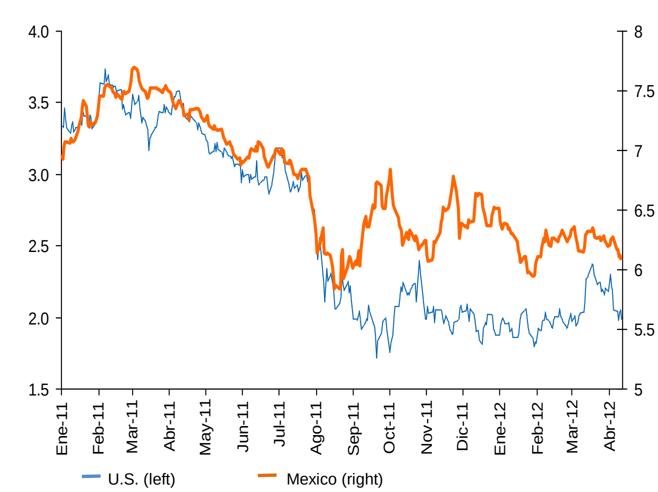
  - The corporate reporting seasons in the US kicks off with positive earnings (Alcoa, Google, JPM and WFC) but growth forecasts for the S&P500 are narrow for the quarter (+2.6% and +2.1% in sales and EPS). We expect to see increases in Mexico of 14.3% and 12.1% in sales and EBITDA, while net profits could see a more modest performance (5.5%)

Chart 5
Mexico: Long non-trading positions in CME (US$mn)



Source: BBVA Research.

Chart 6
10-year Bond: Mexico and US (%)



Source: BBVA Research with data from Bloomberg

Technical Analysis

IPC Stock Market Index

After hitting 40,000ots, the IPC has begun a short-term adjustment process. This is to be expected given such high over-buy readings short-term oscillating indicators hit. We believe this move may extend toward the 38,000pts zone. Let us not forget that for six weeks markets were trading in a lateral range between 37,600 and 38,200pts. Therefore, this zone should be the short-term floor.

Previous Rec.: With a new floor at 38,700pts, we believe it could extend the move toward the 40,000pts psychological level

Source: BBVA, Bancomer, Bloomberg

MXN

The week saw the end of the dollar trading in the lateral range of MXN12.60 and MXN13.00. The upward break through the higher range sends out a major upward signal with an initial target at MXN13.40. This is due to an upward projection in the lateral range of 40 centavos. A valid signal while it trades above MXN13.00.

Previous Rec.: Set to find resistance in the MXN12.90/13.00 range and we still see no trend change above this ceiling level.

Source: BBVA, Bancomer, Bloomberg

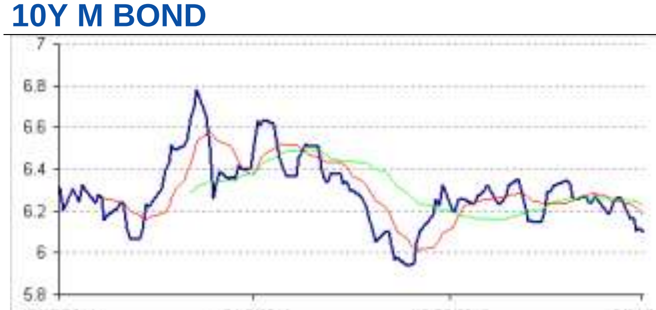
3Y M BOND

3Y M BOND: (yield): It ends the week with a major upswing to the 4.8% zone. It may extend the move toward the next resistance at 4.95%.

Previous Rec.: It is important it respect the 4.84% zone since, if not, it would search out 4.7%.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND



BOND M 10A (yield): Remains downward trend with a move below the 10 and 30 day rolling averages which it may extend toward the 6% zone.

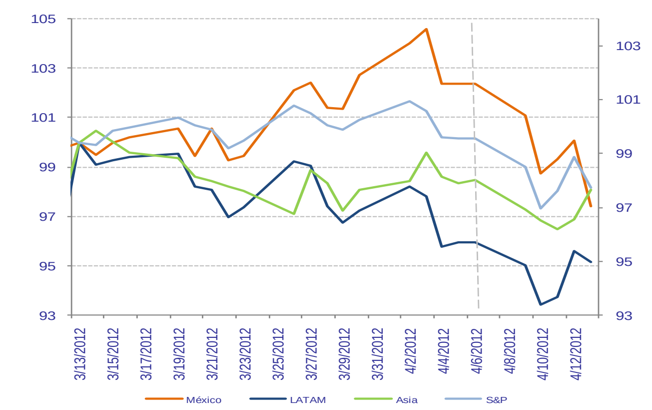
Previous Rec.: Still failing to produce an entry signal as still trading below the 200-day rolling average (6.41%).

Source: BBVA, Bancomer, Bloomberg

Markets

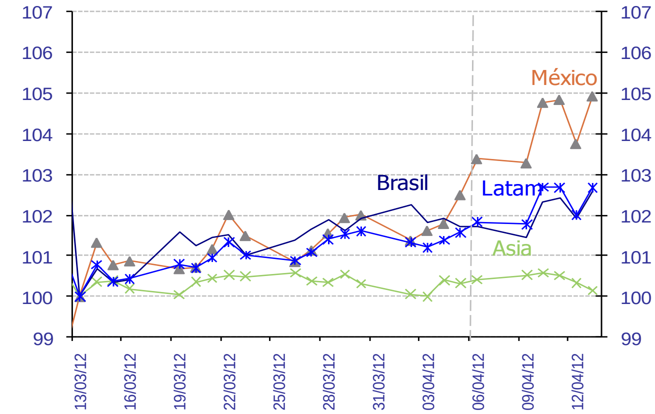
- **Stock markets see losses in the face of lower-than-expected consumer confidence data in the US and Q1 growth in China. The market in Mexico falls over 2% at close of business on Friday, attributed to "system errors". The exchange rate falls over the week in the face of the increase in risk aversion due to the debt crisis in Spain and the expected lending rate cut in Mexico.**

Chart 7
Stock Markets: MSCI Indices (Mar 13, 2012 index=100)



Source: Bloomberg & BBVA Research

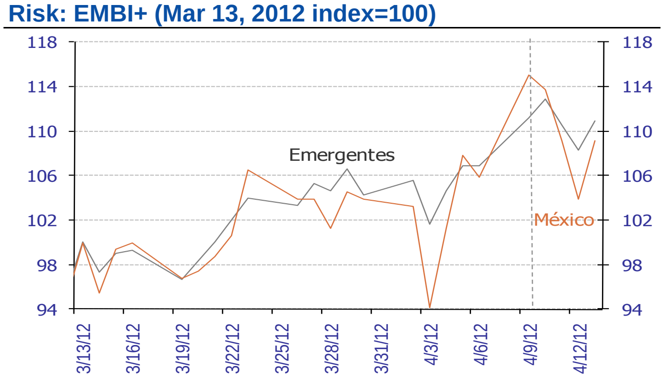
Chart 8
Foreign exchange: dollar exchange rates (Mar 13, 2012 index=100)



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

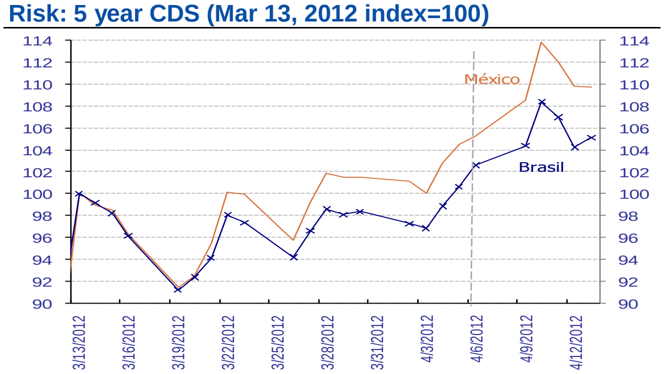
- **Upswing in risk aversion again due to the debt crisis in Europe**

Chart 9
Risk: EMBI+ (Mar 13, 2012 index=100)



Source: Bloomberg & BBVA Research

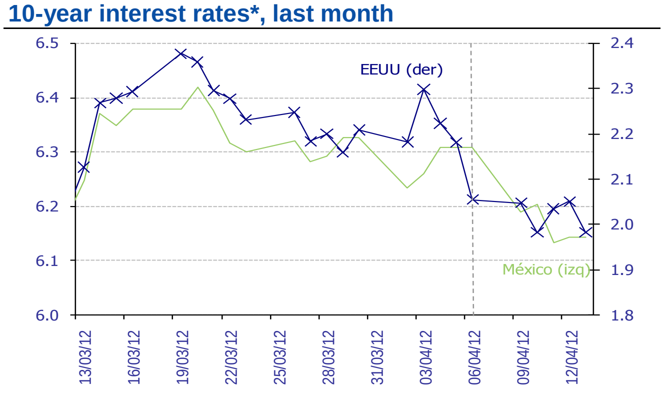
Chart 10
Risk: 5 year CDS (Mar 13, 2012 index=100)



Source: Bloomberg & BBVA Research

- **Fall in Mexico's interest rates due to lower-than-expected March inflation figures after the relaxed tone in the Banxico minutes**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

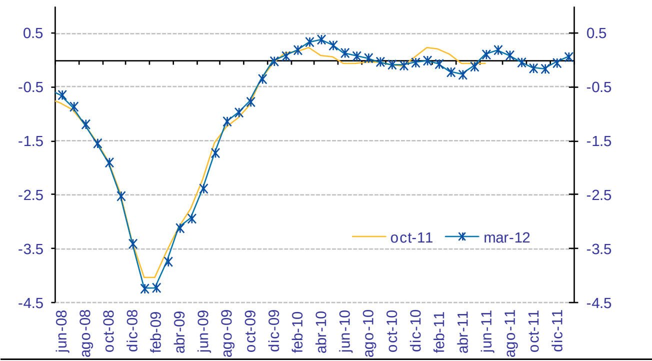
Chart 12
Carry-trade Mexico index (%)

Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

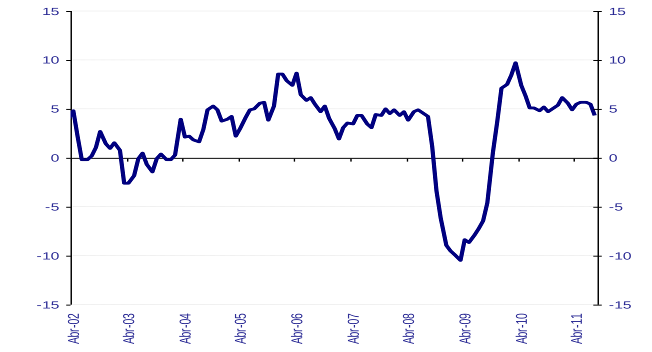
- **Output holds positive performance, situation indicators point to 1Q12 with quarterly rates around 0.6%.**

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.

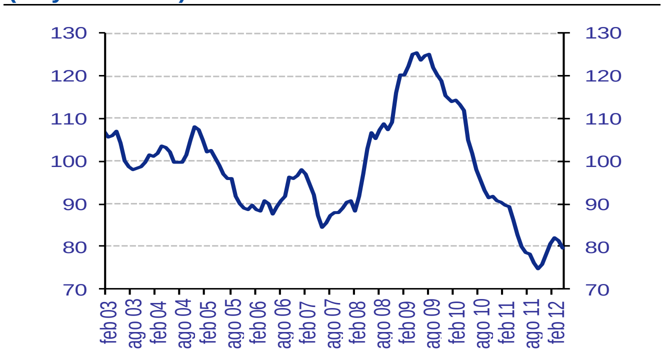
Chart 14
Advance Indicator of Activity (% change y/y)



Source: INEGI

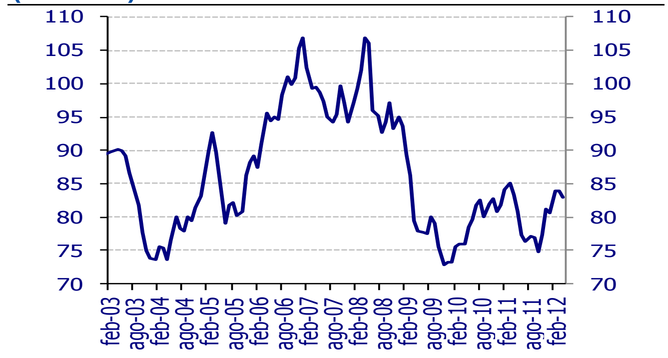
- **The last inflation surprise was downward while, in general, activity continues to offer positive surprises.**

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.

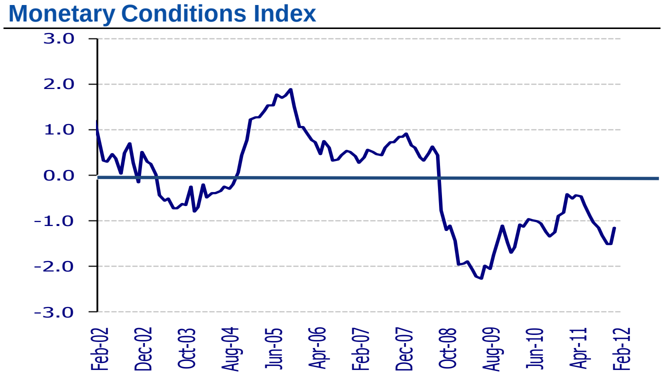
Chart 16
Activity Surprise Index (2002=100)



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.

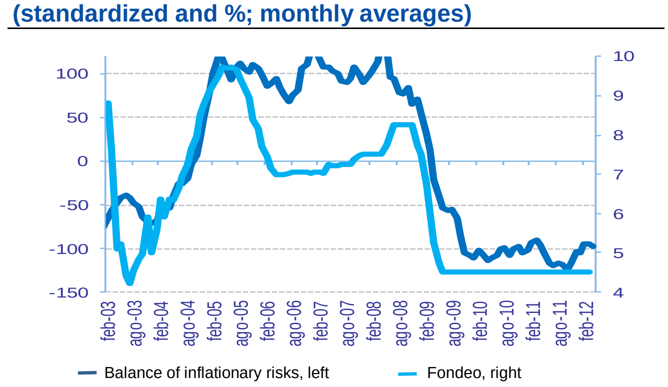
- **Monetary conditions slightly strained due to recent exchange rate appreciation.**

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

Claudia Ceja
claudia.ceja@bbva.bancomer.com
+5255 5621 9715
Octavio Gutiérrez Engelmann
o.gutierrez3@bbva.bancomer.com
+5255 5621 9245
Iván Martínez
ivan.martinez.2@bbva.com

Pedro Uriz
pedro.uriz2@bbva.com

Julian Cubero
juan.cubero@bbva..com

Ociel Hernández
o.hernandez@bbva.bancomer.com
+5255 5621 9616
Rodrigo Ortega
r.ortega@bbva.bancomer.com
+52 55 5621 9701

Alejandro Fuentes Pérez
a.fuentes@bbva.bancomer.com
+52 55 5621 9705
Arnoldo López
arnoldo.lopez@bbva.com

Cecilia Posadas
c.posadas@bbva.com

BBVA RESEARCH | Av. Universidad 1200, Col. Xoco, Mexico 03339 D.F. | researchmexico@bbva.bancomer.com | www.bbvaresearch.com

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