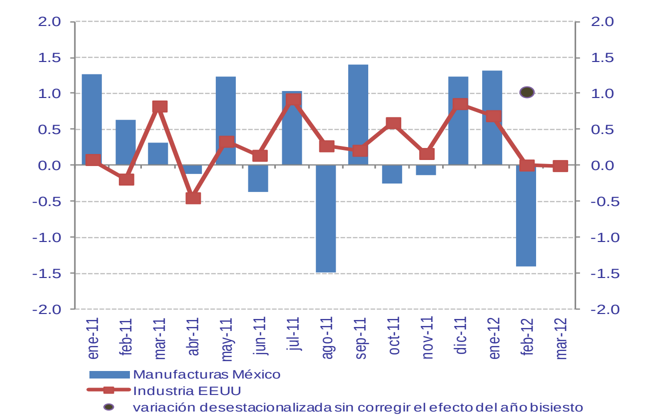
Mexico Weekly Flash

Next week…

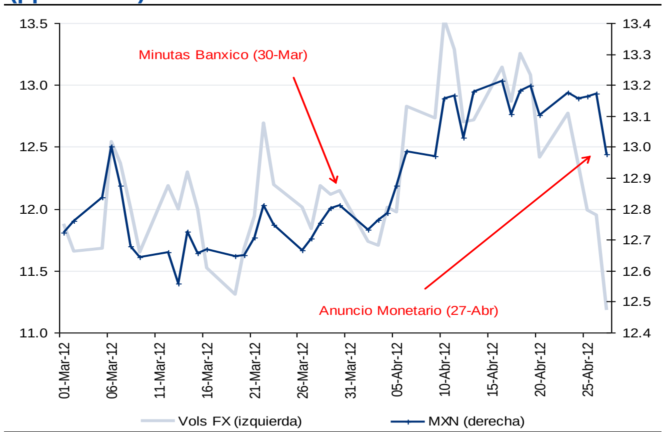
- **... first economic data for 2Q12 to clarify a diagnosis for the economic scenario which must taken into account the leap year correction in indicators**
  - This coming week sees the release of **consumer confidence and manufacturing sector indicators for April, the first economic data for 2Q12** *(see page 2)*. This is especially important information at the moment since the diagnosis of the output and expenditure data from 1Q12 has to take into account the required **correction for the leap year effect**. This calendar regularity means **major declines in corrected figures for seasonal variations in February every four years which are compensated by an upswing in March**. In this way, at least part of the unexpected intense monthly declines in manufacturing output (see chart) or in the IGAE are due to a statistical adjustment which will likely be offset in March. The important situation indicators for manufacturers such as industrial output in the US or qualitative data collected by the IMEF Indicators are not in line with a sharp intense downturn in domestic output
  - The impact of this statistical effect has had to be taken into account in the diagnosis made by Banxico Board members on the production output situation and the slack to deal with demand increases without price pressures. As is well known, the central bank has considered maintaining lending rates at 4.5% in a scenario where risks to domestic growth have improved.
  - In all, our reading continues to be in line with an increase in GDP in 1Q12 slightly above the 0.4% for the quarter seen in 4Q11
- **MXN: dependent on global factors. Bonds: extend holding duration after monetary statement**
  - With implicit marker expectations of a cut in the lending rate not materializing, the MXN strengthened a lot and came in below 13.0 (vs. 13.3 in mid-April). Despite this, a prolonged *rally* will depend on global risk appetite. We estimate fluctuations in the 12.9 to 13.3 range in view of the global scenario. In bonds, the forecast of a prolonged pause favors extending the length of holdings.

Chart 1
Mexico, manufacturing output % m/m



Source: BBVA Research.

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



Source: BBVA Research, Banxico, Indeval

Calendar: Indicators

Public Finances to 1Q2012 (Monday, April 24)

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

Next week sees the release how public finances have faired in the first quarter of 2012. We believe real major growth will be seen in revenue driven by higher oil revenue which, until February, had seen a 17.4% y/y increase. In all, we believe coming quarters may see more moderate growth if crude prices remain at current levels in addition to an unfavorable base effect over 2011. In turn, we believe tax revenue will have started the year with a reasonable growth rate since cumulative receipts to February increased 3.7% y/y, driven by ISR income tax revenue (9% y/y). We believe VAT will speed up its growth rate (2% to February) while we expect the economy and, consequently, employment to continue to see growth in coming quarters. In terms of spending, it will be important to see if spending on physical investment remains on its positive trend (it increased 31.7% y/y to February) and if a rebalance is seen between direct and indirect physical investment which have moved along different paths, -1.4% y/y and 34.5% y/y respectively to February. We underscore the certainty that at year-end the budgeted target public deficit of 2.4% of GDP will be hit and that fiscal consolidation begun at last year will continue.

Consumer and Producer Confidence (Thursday 3 and Friday 4 May)

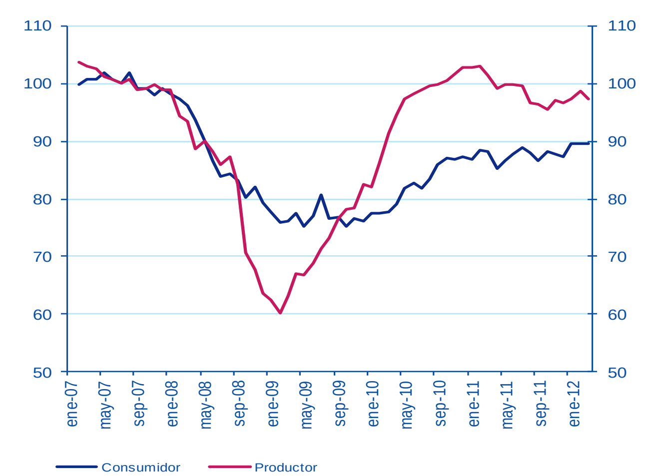
Forecast: Producer 0.3 m/m 54.6 level	Consensus: N.A.	Previous: -1.3 m/m, 54.6 level
Forecast: Consumer 0.0 m/m 93.8 level	Consensus: N.A.	Previous: -0.1 m/m, 93.8 level

Performance in consumer and producer confidence indicators for April will be important since it will provide additional clues to expected economic performance in the first part of the year, more so taking into account the statistical blip caused by the leap year effect correction. In this way, for example, the seasonal adjustment for February pointed to year-on-year variations in industrial output of 5.9% in non-adjusted data versus 1.7% in the seasonally adjusted series. Sub-indices such as expected export demand or domestic demand expected by business will be particularly important, with growth in both instances for March.

Monday 30 also sees the release of the output indicator for construction companies for February. This will outline the share of private production in the construction industry which has moderated in previous months and only partly offset by the increase in public construction.

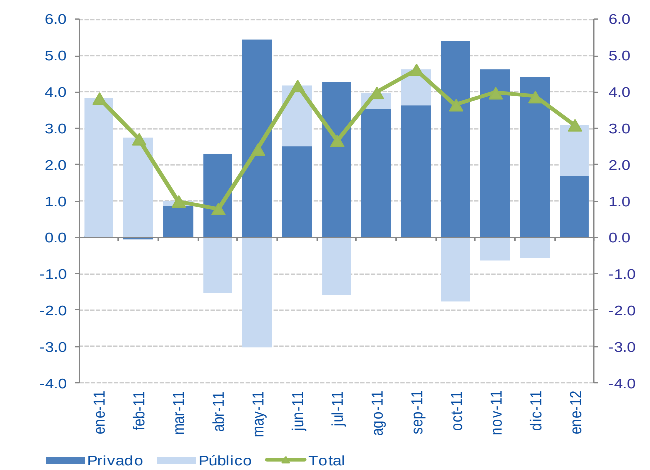
In all, the performance of output variables such as industrial output, retail sales and service sector output indicators generally pointed to output growth in 1Q12, slightly above that seen in 4Q11.

Chart 3
Confidence: Consumer and Producer (July 07 = 100)



Source: BBVA Research with INEGI data

Chart 4
Construction company survey, output value in real terms, annual contribution



Source: BBVA Research with INEGI data

Monetary pause set to continue although Banxico states it is watchful of any improvement on international financial markets

- Despite the market having a more "*dovish*" reading in previous Minutes (March 30), Banxico maintains the main messages from its last statement: a gradual economic improvement in the US; resistance in Mexican output to the adverse external scenario; reduced exchange rate price knock-on effects, and inflation in line with Central Bank forecasts. Nonetheless, it leaves a possible easing open if there is an improvement on international financial markets. Global uncertainty sources, however, are far from dissolving in the short-term and, in any case, the base scenario for sustained albeit moderate growth with inflation anchored above 3% points to a prolonged pause to mid-2013, to then start a cycle of moderate rises.

Is the MXN rally sustainable? Main motors to be external

- The MXN's sensitivity to monetary news increased after the March 30 Minutes and the market incorporating an expected 25 bp cut. This led to a devaluation trend (highs at 13.3) which saw major corrections on Friday since said move did not materialize (close 12.97). We believe the rally will be short although MXN carry opportunities will continue to depend a lot on risk appetite incorporated in international markets. Negative cyclical indicators, sovereign fears reappearing and political tensions in Europe lead us to believe risk appetite is still far from reducing. We cannot rule out the MXN fluctuating in the short-term in the 12.9 to 13.3 range.

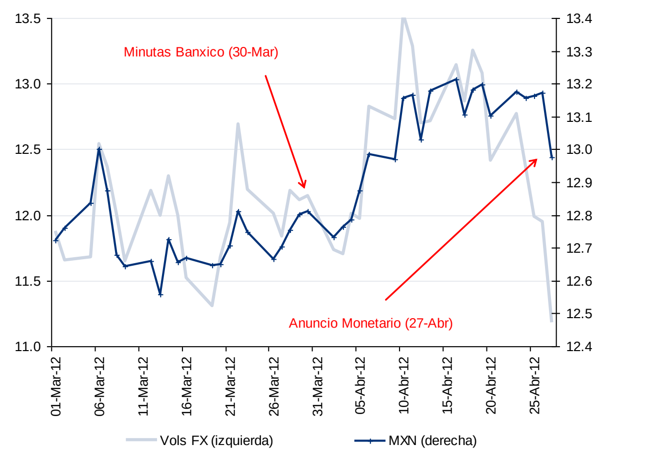
Attractive values in the long part of the curve.

- The current risk balance points to a prolonged monetary pause. however, the "*dovish*" bias at Banxico remains and leaves the door open for cuts if global risks decrease. Current monetary arguments continue to support the long part of the curve as lending rate rises in the year are ruled out and given the current inflation scenario. This opens up space to extend the duration of holdings against those which had incorporated cutes (curve "*belly*").

Reporting season supports our optimistic medium term outlook for the Mexico IPC.

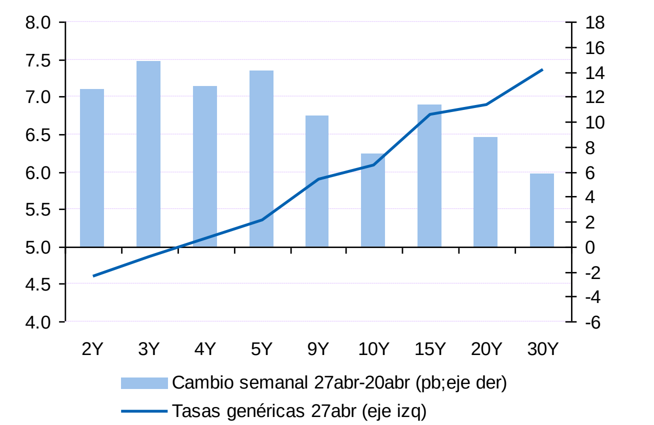
- Twenty-two of the thirty-five IPC companies have delivered earnings, with sales increasing 16.7%, EBITDA 10.1% and net profits 14.6%. Food, Construction, Media and TMTs positively stood out in sales while some industries and Media stood out in EBITDA. Sales came in almost 5% above estimates while EBITDA was in line (-0.6%). This points to commodity pressure for businesses continuing. The 14.6% growth in net profits is explained by the positive surprise at Amx.

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



Source: BBVA Research and Bloomberg

Chart 6
Mexico: General rates and weekly change (% bp)



Source: BBVA Research and Bloomberg

Technical Analysis

IPC Stock Market Index

Source: BBVA, Bancomer, Bloomberg

The decline at Walmex led to a negative weekly balance on the IPC which could not correlate with the upswing on US markets. Nevertheless, it did respect the 30-day rolling average at all times. The spread between the rolling 10-day and 30-day averages closed and the market could retake an upward trend toward the 39,500 and 40,000 pts resistances.

Previous Rec.: In order to be in a short-term buy scenario, we recommend waiting for one of these events: a return to 38,000pts or an upward break through 40,000pts.

MXN

Source: BBVA, Bancomer, Bloomberg

The dollar still remains in the trading range from previous sessions, between MXN13.00 and MXN13.20. The 10-session run in this range continues to point to an upward break toward MXN13.40, as long as it does not return below MXN13.00.

Previous Rec.: 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.

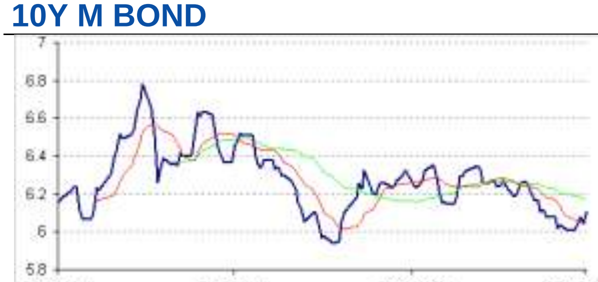
3Y M BOND

Source: BBVA, Bancomer, Bloomberg

3-YEAR M BOND: (yield): Bounce from the 10-day rolling average, in line with the spread between this level and the 30-day rolling average. Resistances at 4.9% and 5.05%, with support at 4.75%.

Previous Rec.: The opening between this level and the 30-day rolling average makes us consider a bounce toward 4.9% with stop loss below 4.7%.

10Y M BOND



Source: BBVA, Bancomer, Bloomberg

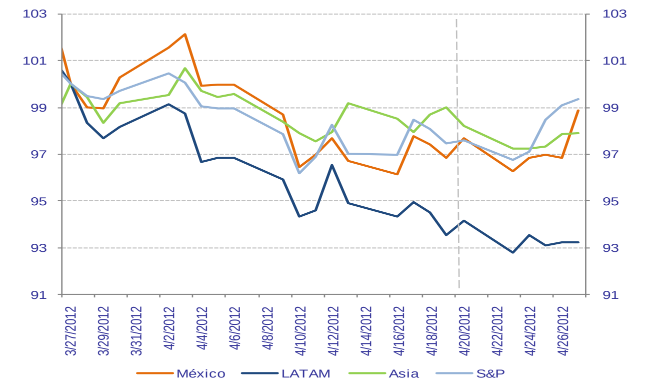
10Y M BOND (yield): Start of a bounce from 6%. It could keep bouncing to 6.4%, maintaining the floor at 6%.

Previous Rec.: We believe at this level it could bounce with an initial target at 6.2%.

Markets

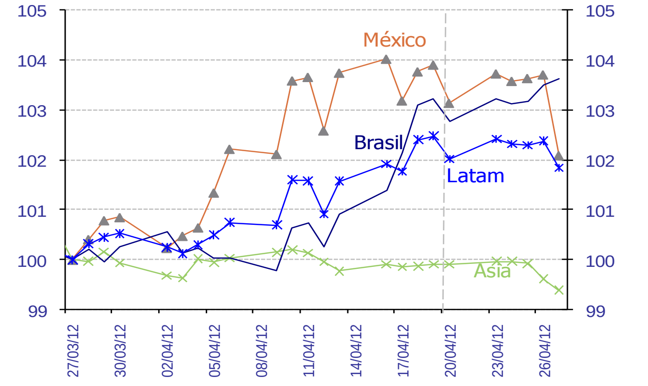
- **Consumer confidence data and better-than-expected corporate reporting lead to gains on stock markets, after the Federal Reserve adopted a slightly less accommodating tone in its mid-week statement. The Peso strengthens thanks to Banxico's decision to keep the lending rate unchanged.**

Chart 7
Stock Markets: MSCI Indices (Mar 27, 2012 index=100)



Source: Bloomberg & BBVA Research

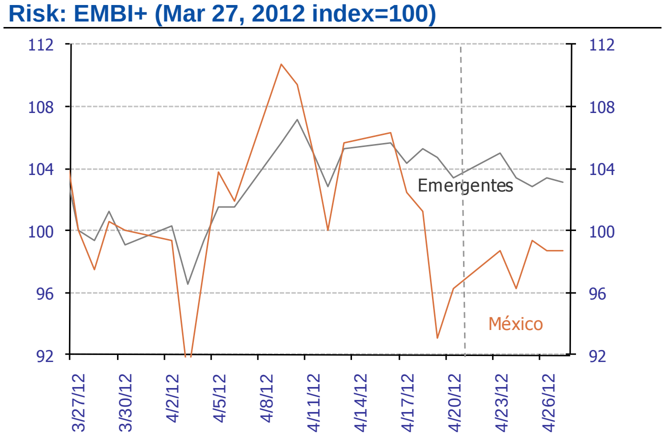
Chart 8
Foreign exchange: dollar exchange rates (Mar 27, 2012 index=100)



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

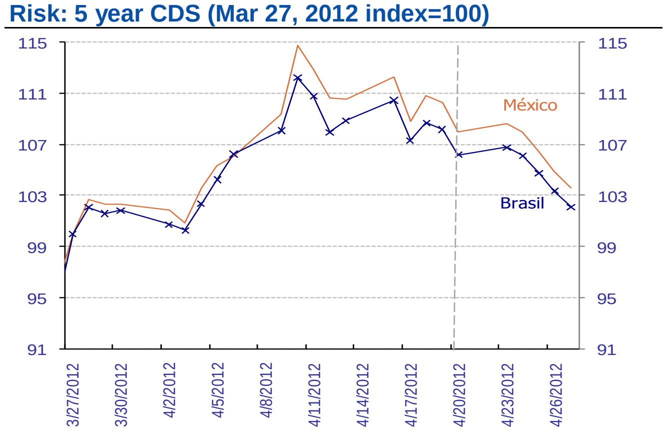
- **Fall in risk aversion after the slightly less accommodating tone from the FED**

Chart 9
Risk: EMBI+ (Mar 27, 2012 index=100)



Source: Bloomberg & BBVA Research

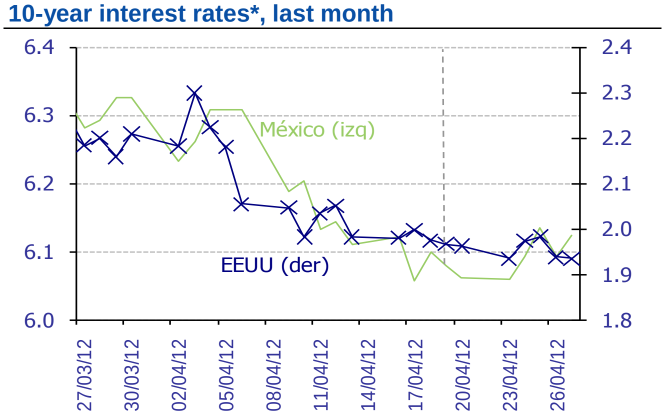
Chart 10
Risk: 5 year CDS (Mar 27, 2012 index=100)



Source: Bloomberg & BBVA Research

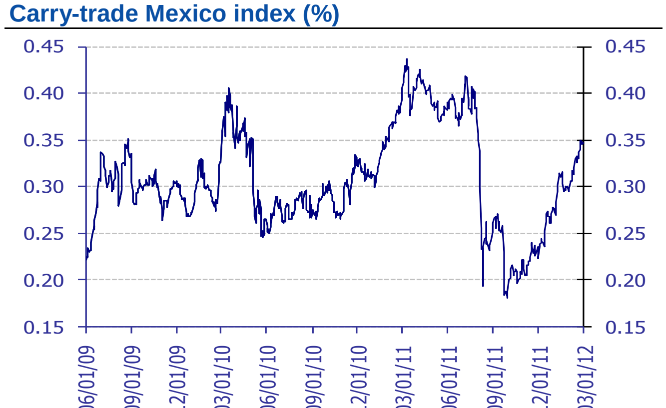
- **Rates in Mexico rise at the end of the week after Banxico keeps the lending rate unchanged with the market already discounting a cut**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

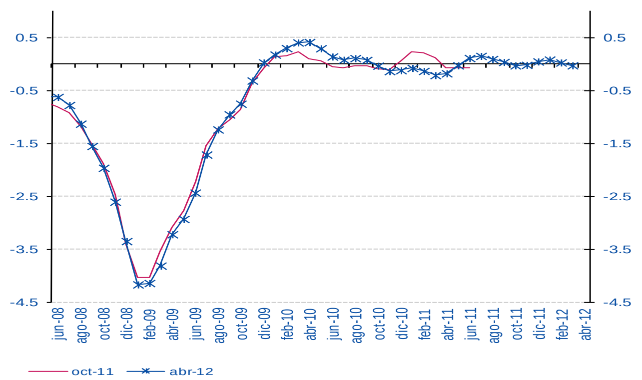


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

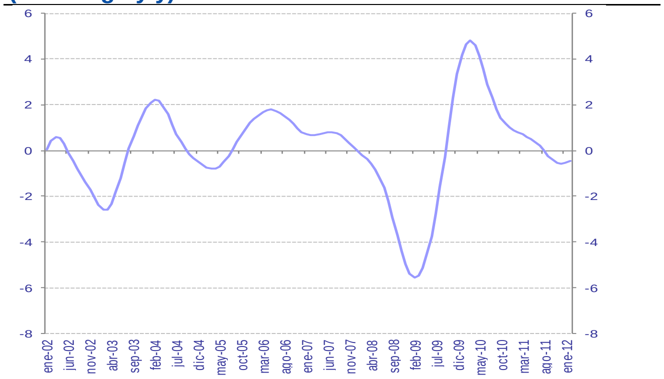
- **Output holds positive performance, situation indicators point to 1Q12 with quarterly rates around 0.5%.**

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.

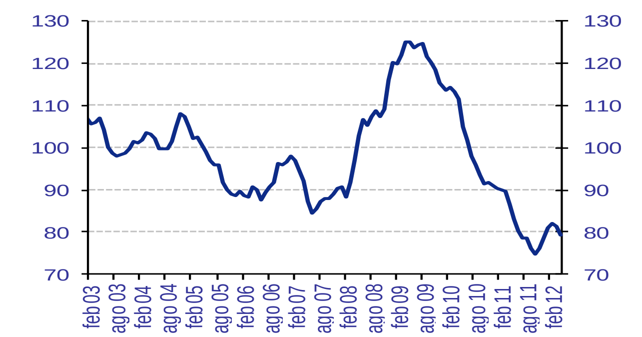
Chart 14
Advance Indicator of Activity (% change y/y)



Source: INEGI

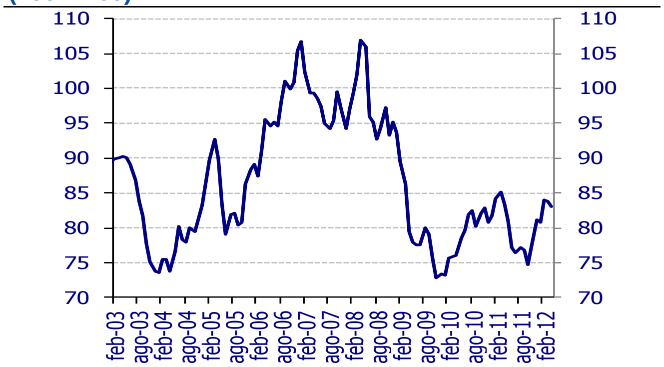
- **Both the recent inflation and output surprises were downward.**

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.

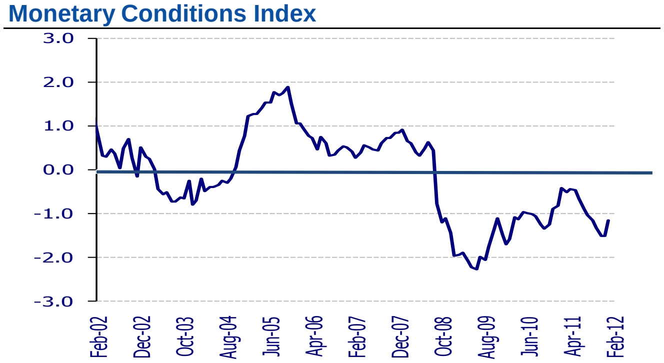
Chart 16
Activity Surprise Index (2002=100)



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.

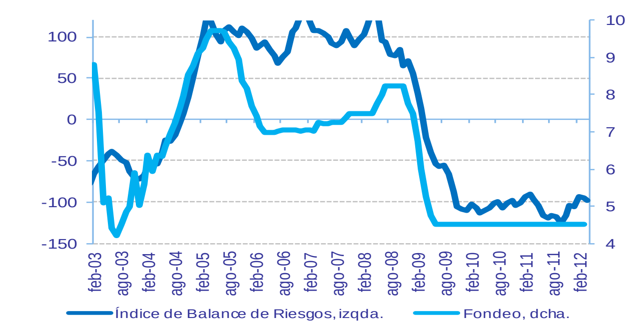
- **Monetary conditions slightly strained due to recent exchange rate appreciation.**

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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