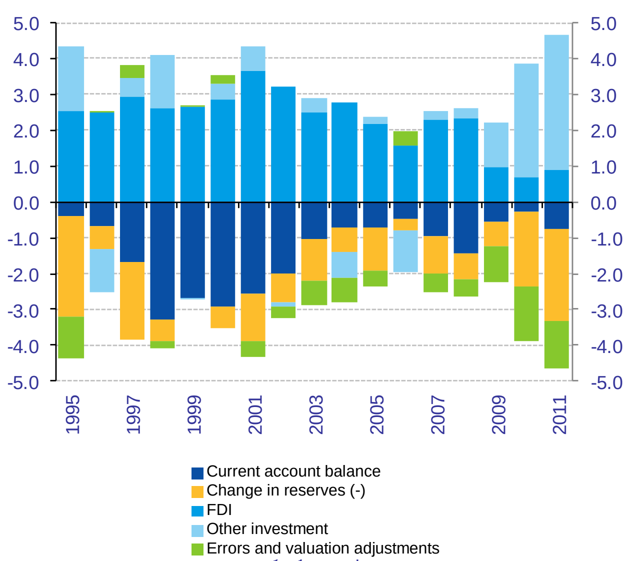
Mexico Weekly Flash

Next week…

- **Overseas sector: reduced deficit and no funding problems**
  - The end of last week confirmed Mexican economic growth in 1Q12 above that in the previous quarter and also above forecasts (1.3% q/q vs. 0.7% q/q). With this, and alongside everything else, our 3.7% growth forecast for 2012 has an upward bias. The "alongside everything else" is particularly important with regard to a global scenario with financial markets prioritizing a move away from risk in search of profitability.
  - Banxico is set to release the Current Account Balance for 1Q12 (Friday, May 25) which will be important not only for the size of the support for foreign savings in the Mexican economy but also for how funding received is structured. As the chart shows, neither the size of the deficit nor its funding mean major weaknesses for Mexico: foreign direct investment continues to cover the current deficit and other investment flows are the counterweight to the build-up of international reserves. Public finances with a limited deficit and low inflation are supports for the financial solidity of the foreign sector in the Mexican economy.
  - Inflation for the first two weeks of May will also be released next week (Thursday, May 24) which should move up from 3.4% in April to 3.6%. There are no changes on the inflation horizon for monetary policy.

- **Global risk aversion continues with the MXN in tune with Europe**
  - Despite domestic interest rates falling at the end of the week, the lack of major flows as well as significant moves in the shape of the curve suggest that investors remain fussy and hesitant in the face of the complex global scenario. Intraday volatility remains high for the MXN.

Chart 1
Mexico, Balance of Payments
Percentage of GDP %



Source: BBVA Research with Banxico data

Chart 2
USDMXN vs. implied 1-month volatility for the MXN

Source: BBVA Research and Bloomberg

Calendar: Indicators

Inflation for the first two weeks in May (Thursday, May 24)

Forecast: -0.62% bi-weekly 3.55% y/y	Consensus:-0.46% bi-weekly	Previous: -0.31 q/q 3.41% y/y

Next Thursday sees the release of inflation figures for the first two weeks in May. Consumer prices saw a fall over the period driven by lower electricity prices due to the summer rates plan. Although monthly inflation for May will be negative, given the base effect in comparison to last year and the higher likelihood of an upswing in agriculture prices according to our wholesale price check, in annual terms inflation will rise to 3.55%. We estimate a bi-weekly rise of 0.03% in core inflation, a moderate performance due to offers on tourist services prices. In annual terms, core inflation will come in at 3.4%, highly stable with regard to the previous month.

Appropriate Trade Balance in April (Friday, May 25)

Forecast: 1007 md	Consensus: 810.50	Previous: 1575 md

Next Friday sees the release of the appropriate trade balance in April. The lower expected surplus with regard to March is due to the reduction in Mexican oil blend over the period (110 dpb vs. 114 dpb in March) and lower exports. In the current context, we believe the trade balance will continue in surplus for a few months thanks to the lower peso, which makes exported manufactured goods relatively cheaper and, with everything being favorable, the cycle of oil revenue. Nonetheless, we believe annual growth rates both for exports and imports will moderate as a result of the comparison effect with 2011 in a scenario where US demand will not increase significantly.

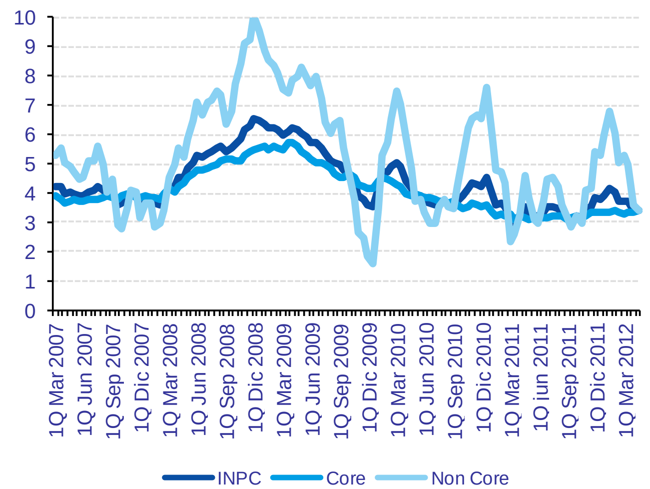
Retail sales (Wednesday, May 20)

Forecast: 0.5 m/m 5.4 y/y SA	Consensus: N.A.	Previous: 0.2 m/m 3.9 y/y SA

This week sees the publication of retail sales performance in March. We believe that given the positive performance in indicators linked to salaries and consumer confidence, retail sales should have bounced back in the third month of the year.

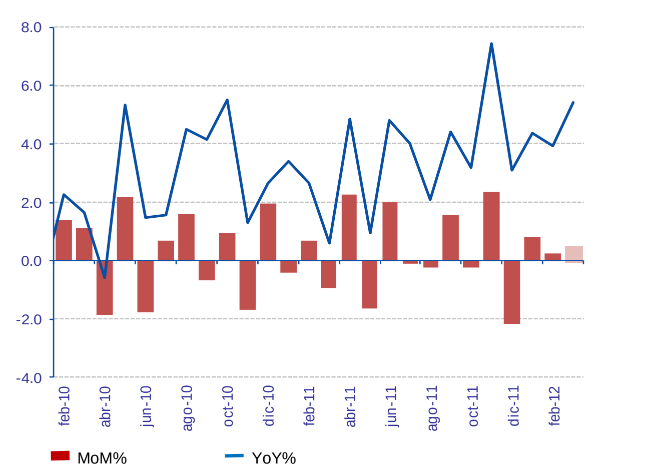
It should be stated that contributions from formal employment and real wages in the sector to payroll have been jointly positive for over a year and this contribution to growth in the real payroll (4.8% y/y and in 4Q11 and 1Q12) has been stable in the recent quarters. This situation has also contributed to continued improved consumer confidence, albeit far below pre-2008 levels. Average monthly growth in confidence in the first three months of the year were above the last quarter of 2011. It should be stated that the good retail sales figures will contribute to confirmed good performance in the private consumer component for the first quarter of the year.

Chart 3
Inflation breakdown (% y/y change, bi-weekly series)



Source: BBVA Research with INEGI data

Chart 4
Retail Sales (% y/y and m/m)



Source: BBVA Research with INEGI data

Markets

- ## Global risk aversion continues

Last Friday, in a session with low liquidity and with no news or economic data from Europe or the US, the domestic curve average (nominal) fell 4bp. This ends a volatile week which has added a fair amount of uncertainty to domestic markets. Despite interest rates falling at the end of the week, the lack of major flows as well as significant moves in the shape of the curve suggest that investors remain fussy and hesitant in the face of the complex global scenario. The market would seem to be starting to move toward a higher financial support context with monetary boosts at global level. In Mexico, some nodes, especially the middle, are fairly saturated with foreign and domestic flows, and are trading in the over-valuation zone. In this way, if this support scenario appears, care will be needed with a sell response in the face of confirmation of expectations that led to buying.

- ## MXN in tune with Europe

- The MXN again saw high intraday volatility on Friday and ended slightly stronger than the day before. Nevertheless, the currency accumulated losses of around 1.8% over the week due to the continued increase in risk premiums in the Eurozone, added to surprise negative data in US output. We therefore see this high intraday volatility and bias to greater weakness continuing to prevail in coming weeks, although we cannot rule out strengthening if any positive news comes in. A strengthening trend will be difficult to sustain, at least before the European summit and the elections in Greece in mid-June.

Technical Analysis

IPC

Source: BBVA, Bancomer, Bloomberg

Movement over the week was important since it led to the IPC coming in below a very important support level - 37,500pts. This break marks a trend change on the daily index chart and set the 200-day rolling average as the short-term target. (36,500pts for the IPC.) The IPC has not traded below this level since November. A downward break would be a major sign of weakness on the market. Due to the high over-sell readings in IPC issuers, we believe the market will respect the new support level. Half the 35 listed on the index, as well as the IPC itself, are trading with readings below 30pts on the RSI. This points to an advanced fall.

Previous Rec.: The first step for the IPC is to hit above the 30-day rolling average, i.e. above 39,300pts.

MXN

Source: BBVA, Bancomer, Bloomberg

The dollar brushes MXN14.00 over the week, where it started a lateral move. We believe that the MXN13.80-MXN14.00 range is a short-term sell zone due to readings in short-term oscillating indicators being advanced and the dollar having to seek an adjustment toward MXN13.50.

Previous Rec.: The over-purchasing in oscillating indicators does not suggest that it should return to MXN13.20 zone in the next few sessions.

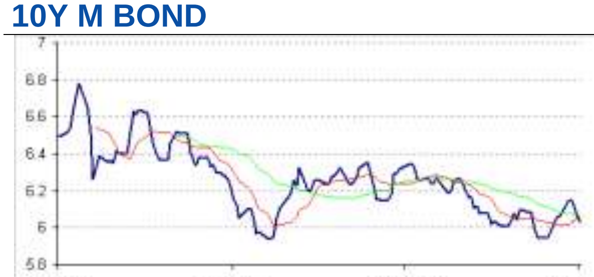
3Y M BOND

Source: BBVA, Bancomer, Bloomberg

3-YEAR BOND: (yield): Hitting resistance at 5% and starting an adjustment. This backward move could find a floor in the 4.78% zone where several short-term rolling averages sit, as well as the 200-day rolling average.

Previous Rec.: Given the over-purchasing in oscillating indicators, we see it breaking up through 5%-5.05% as difficult.

10Y M BOND



Source: BBVA, Bancomer, Bloomberg

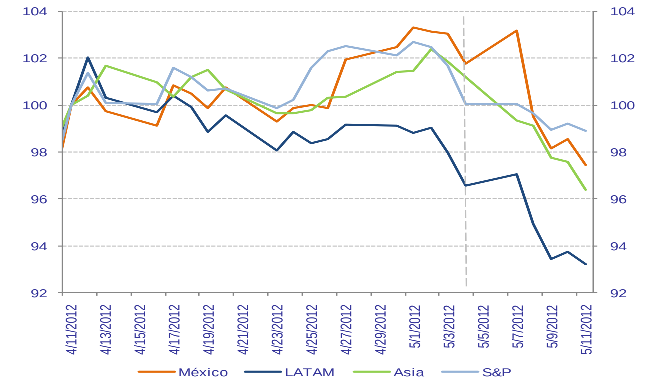
10 YEAR M BOND: (yield): Attempts to bounce in the week but finds resistance at the 30-day rolling average at 6.15%. It may return to the 6% zone.

Previous Rec.: It should at least seek out the 6.15%-6.2% zone in the short-term and again find resistance.

Markets

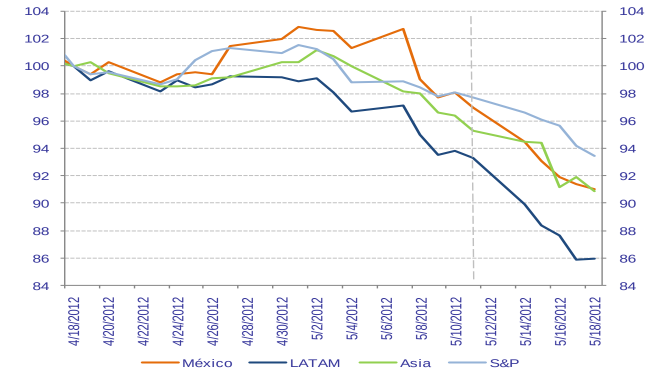
- **The failure of Greek political party leaders to form a coalition government increased fears of a possible Greek exit from the euro. This led to falls on stock markets and a general decline in currencies over the week.**

Chart 7
Stock Markets: MSCI Indices (Apr 18, 2012 index = 100)



Source: Bloomberg & BBVA Research

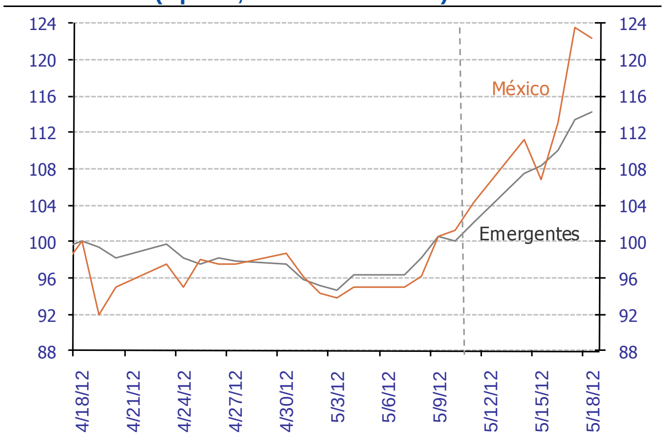
Chart 8
Foreign exchange: dollar exchange rates (Apr 18, 2012 index = 100)



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

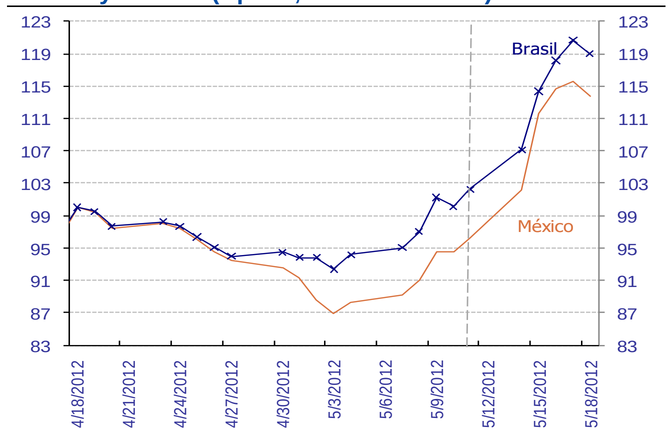
- **A considerable increase in risk aversion in the face of an uncertain political scenario in Greece, after new elections were called for this coming June 17.**

Chart 9
Risk: EMBI+ (Apr 18, 2012 index = 100)



Source: Bloomberg & BBVA Research

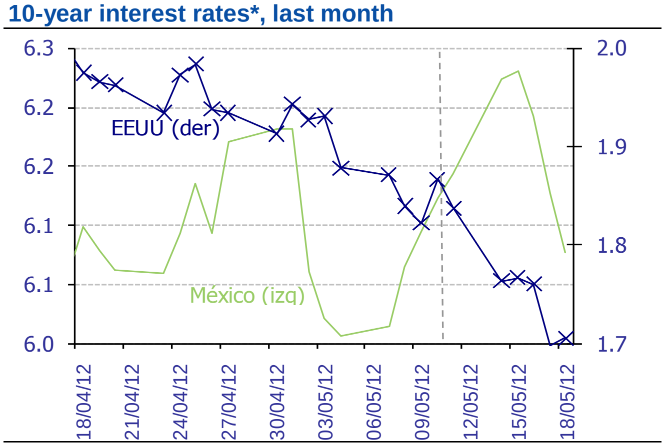
Chart 10
Risk: 5-year CDS (Apr 18, 2012 index=100)



Source: Bloomberg & BBVA Research

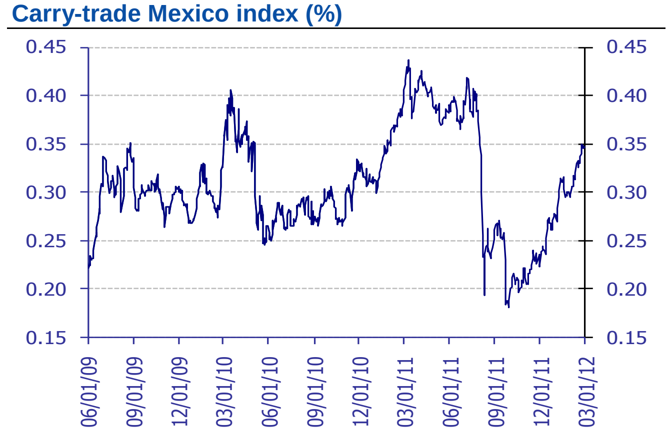
- **Fall in Mexican interest rates over the week after long-term yields again take up their positive correlation with Treasuries**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

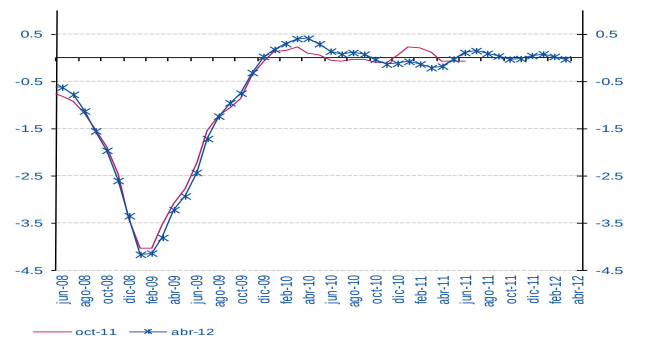


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

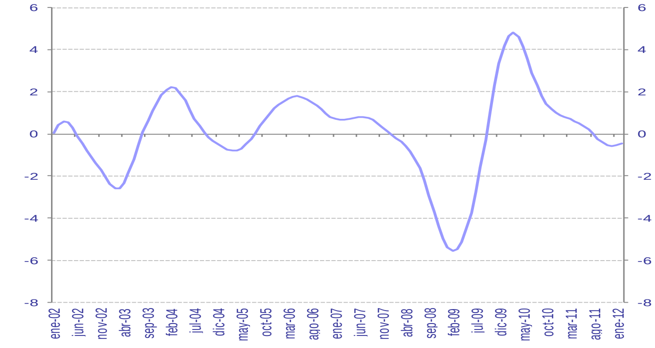
- **Output holds positive performance, situation indicators point to 1Q12 with quarterly rates around 0.5%.**

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.

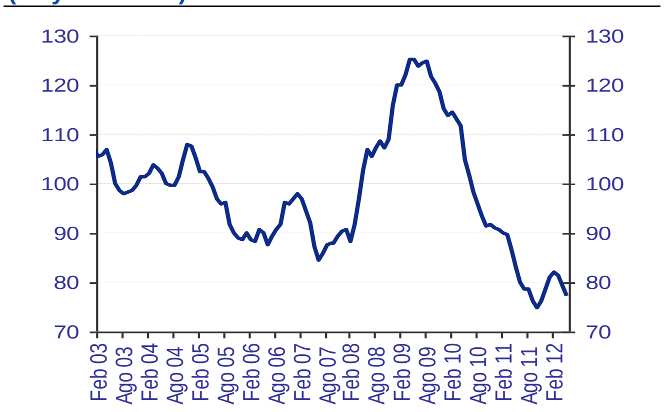
Chart 14
Advance Indicator of Activity (% change y/y)



Source: INEGI

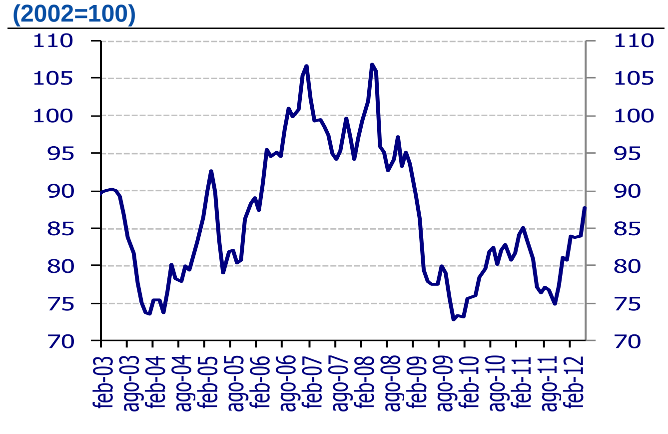
- **Both the recent inflation and output surprises were downward.**

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.

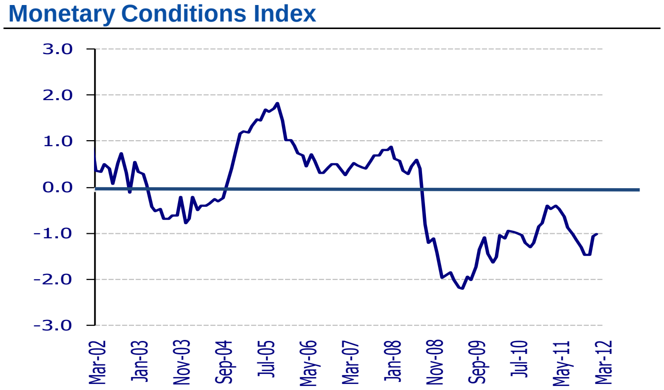
Chart 16
Activity Surprise Index (2002=100)



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.

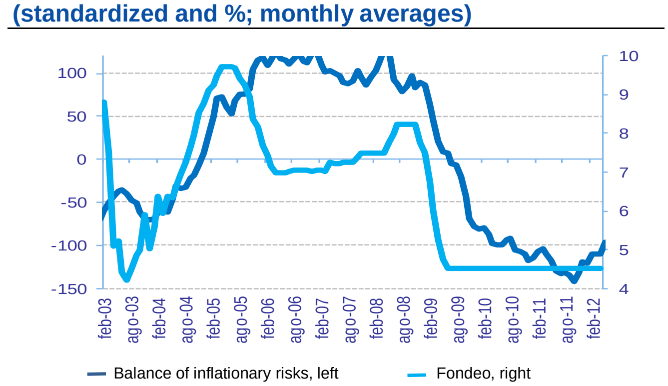
- **Monetary conditions near neutral zone**

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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