

# Mexico Weekly Flash

## Next week...

- **Banxico: monetary pause and neutral stance**

Friday next week sees Banxico release its monetary policy decision. The decision comes in an external scenario of volatility on financial markets due to the debt crisis in Europe and lower-than-expected US jobs and activity data, reflected by a fall in the peso against the dollar of 9.5% in May. Domestically, output remains resistant and inflation sees an upswing. GDP growth in the first quarter came in above expectations (1.3% vs. 0.8% q/q) while inflation hit 3.7% in the first fortnight of May, with non-core inflation falling below expectations and core inflation seeing a slight upturn.

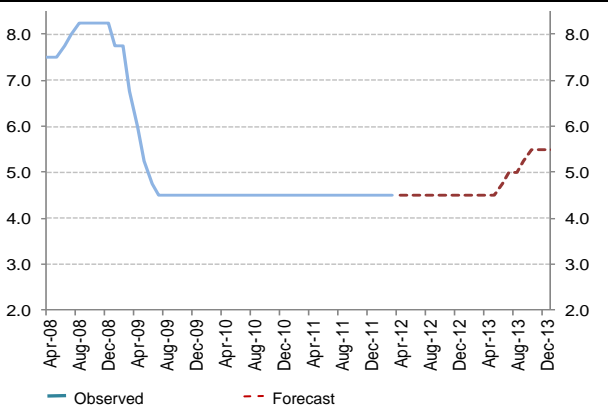
In this scenario, we expect that Banxico will maintain the monetary pause and its neutral stance. Specifically, we believe Banxico will emphasize the major downward risks due to the financial system in Europe and structural problems in the US economy; the latter will maintain its slack. In terms of domestic output and inflation, we do not expect to see any changes in terms of balance risks while, given the recent decline in the exchange rate, the idea that the fundamentals of the economy anchoring the exchange rate is likely to reoccur, as in statements from the last quarter of 2011.

In short, we expect Banxico to maintain the monetary pause and its neutral stance in the face of international volatility. Nonetheless, we emphasize the likelihood of a cut being increased if domestic output slows. This may happen if the data trend seen in output and jobs in the US consolidates.

- **Markets set to continue being sensitive to cyclical and global sovereign news**

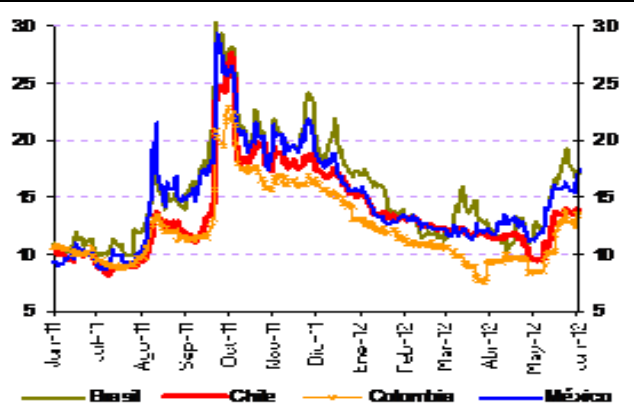
The MXN hit highs since the start of 2009 which can be explained more by global factors than by structural elements in the Mexican economy. On the government bonds market, May saw net FDI similar to 2011 despite global uncertainty.

Chart 1  
**Lending rate (%)**



Source: BBVA Research and Banxico

Chart 2  
**LatAm currencies: 1m Implied Volatility (%)**



Source: Bloomberg

# Calendar: Indicators

## Inflation in May (June 7)

Forecast: -0.26% m/m 3.91% y/y      Consensus:N.A.      Previous: -0.31% m/m 3.41% y/y April

Next week sees the release of inflation figures for May which, based on the first fortnight, will see an upward surprise with a major upswing in agricultural prices; these meant that a reduction in inflation in May this year, which we estimate at -0.26% could be much less intense than that seen in the same month in 2011, where inflation fell -0.74% m/m. For this reason, headline inflation in annual terms will rise from 3.4% y/y in April to around 3.9%. For core inflation, we estimate a 0.25% m/m increase and that this will speed up in annual terms from 3.3% y/y to 3.5% y/y thanks to the re-emergence of some pressures in the processed food sub-index. However, we believe that core inflation remains fundamentally anchored whereby, as pressures affecting the exchange rate could be temporary, the knock-on will be moderate. Volatile prices, especially for agricultural products, have changed trend and in the short-term will increase inflation. Nevertheless, we believe that conditions for this to come in below 4% at the end of the year remain in place.

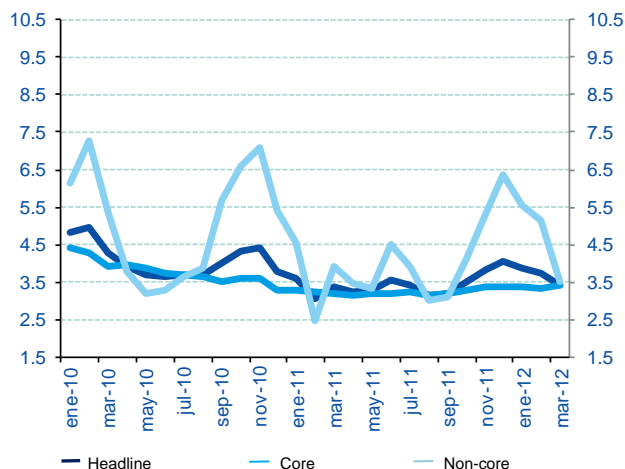
## Consumer and producer confidence in May (June 4)

Forecast: Consumer 0.2% m/m 94.5 pts      Consensus: N.A.      Previous: 0.0% m/m 94.6 pts  
 Forecast: Producer -0.1% m/m 54.6 pts      Consensus: N.A.      Previous: 0.3% m/m 54.5 pts

Consumer indicators will continue to show the uncertainty of the current situation. However, we believe that good jobs and real wages data will contribute to marginally improving consumer outlook, the level of which, however, is still far below that seen prior to the crisis. The major upswing in the sub-index for the possibility of purchasing a durable good in coming months should be highlighted which, in April, saw the strongest growth since May 2010. This may point to private consumption seeing a good performance for the first months of this year.

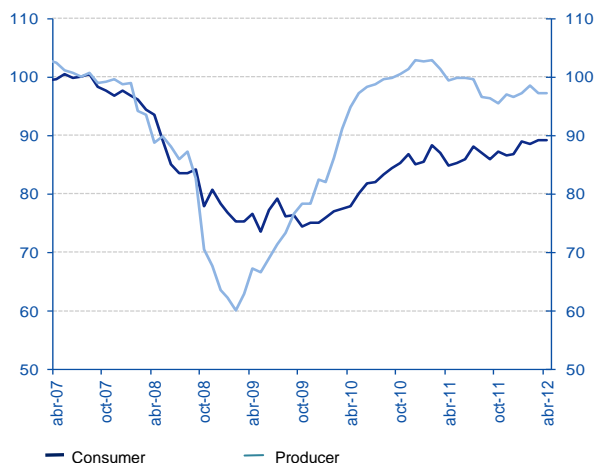
In turn, the indicator measuring manufacturing confidence is likely to have fallen slightly due to the uncertainty and some moderation surrounding the favorable outlook for both US economic performance and the end to the crisis in Europe. Despite this, consumer confidence in the first months of the year came in above that for the last months of last year. This was, in turn, seen in output indicators, specifically for manufacturers.

Chart 3  
**Inflation breakdown (% change y/y)**



Source: BBVA Research with INEGI data

Chart 4  
**Confidence: consumer and producer (July 07 = 100)**



Source: BBVA Research with INEGI data

- MXN up to an intraday 14.66 level due to higher global risk aversion**

The exchange rate hit its highest levels over the week (Friday close, 14.3) which had not been seen since the start of 2009 after the US financial crisis (2008). In turn, implied volatility for MXN futures contracts hit its highest volatility in the year. This performance is shared by the main currencies in Latin America and could be down to international factors surrounding European uncertainty (the financial situation in Spain and capitalization forms, the situation in Greece, proposals on fiscal and governance issues in the region but without any definitive solutions) and signs of economic output weakness in the US (jobs figures) and in China (manufacturing).

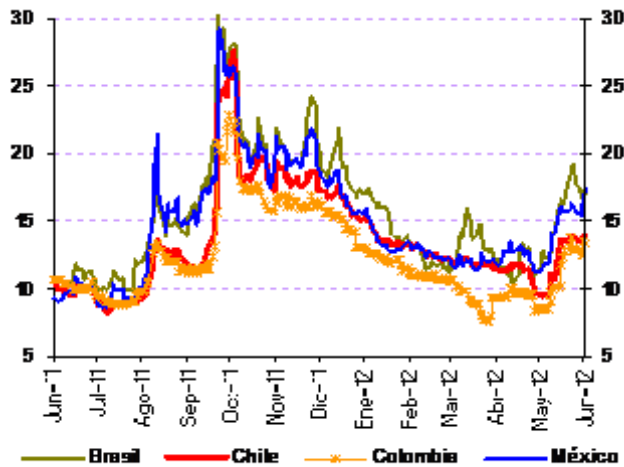
This scenario led to the peso hitting levels igniting the dollar auction mechanism at Banxico: USD400mn were offered, of which only 107 were placed. We believe structural factors (see chart, greater political noise) were secondary to international events although we cannot rule out them generating temporary influence as seen in previous elections. The high transaction volatility is likely to continue over the week at levels near 14.0-14.5

- Foreigners continue to invest in Mbonds**

Throughout May, overseas investors maintained a positive net position of around MXN26.4bn. This represents a similar performance to the average monthly transactions since 2011. The highest transactions were made in mid-sections of the curve and highest sales at the long end. The short tranche of the curve saw positive albeit reduced flows.

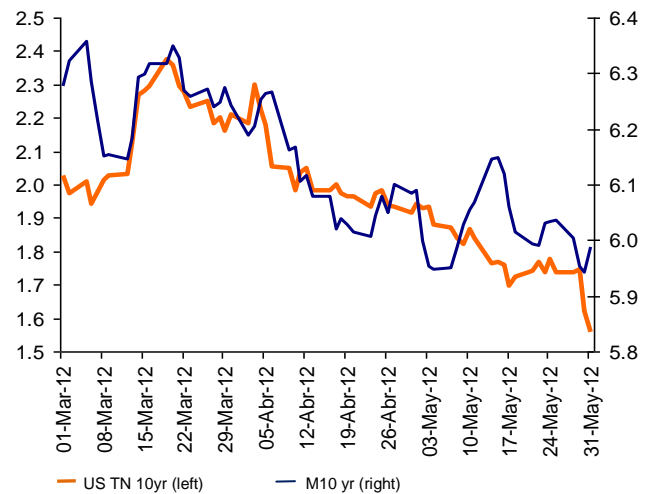
In April, the fixed income investment strategy was aggressive and favored the long section of the curve. Therefore, May confirmed our outlook that a higher risk aversion scenario would not necessarily lead to outflows, although this may lead to a market with more dynamic transactions, i.e. movements along the curve based on global risk patterns.

Chart 5  
**LatAm currencies: 1m Implied Volatility (%)**



Source: Bloomberg

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



Source: Bloomberg

# Technical Analysis

## IPC



Source: BBVA, Bancomer, Bloomberg

The weekly balance for the IPC was neutral, although unable to end the week above the 10-day rolling average. In this case, the 200-day rolling average is relatively distant, up to 36,600pts, which provides a buffer of around 1,000pts. Nonetheless, due to possible contagion of a possible US exit signal, we prefer to continue to hold a low investment level in the short-term. It found resistance at 38,000pts over the week and we cannot rule out that, after hitting this level, it has started a short-term downward move.

Previous Rec.: In order to consider a short-term upward move, the IPC has to return trading above its 30-day rolling average (38,700pts).

## MXN



Source: BBVA, Bancomer, Bloomberg

The dollar remained trading with a major upward move and ended the week above the important resistance of MXN14.30, representing the maximum of the previous year. Although it managed to trade above MXN14.50, it returned big in the intraday, with doji candlestick appearing. The next candle should be negative to be able to see a downward trend change pattern. Short-term over-purchasing remains very high.

Previous Rec.: An over-reaction toward MXN14.30 cannot be ruled out.

## 3Y M BOND



Source: BBVA, Bancomer, Bloomberg

3 YEAR M BOND: (yield): Although trying a bounce, it was not able to again come in above the 10- and 30-day rolling averages. There is no exit signal since it continues to trade above the 20-day rolling average (4.79%) and oscillating indicators do not point to over-purchasing.

Previous Rec.: We see a zone where a bounce may begin and would only consider an exit if it breaks down through 4.79%.

## 10Y M BOND



Source: BBVA, Bancomer, Bloomberg

10 YEAR M BOND: (yield): Continued trading below short-term rolling averages, but respecting the floor it has marked since February. We do not recommend an exit unless it breaks downward through 5.93%.

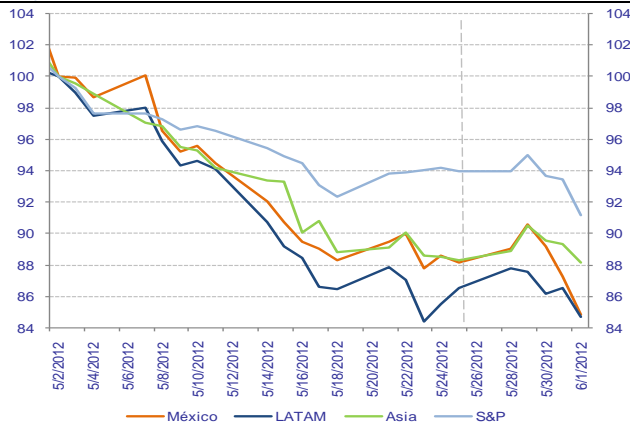
Previous Rec.: We believe it could restart an upward move toward 6.2%

# Markets

- Lower-than-expected US jobs and output data, as well as uncertainty due to the European debt crisis, lead to falls on financial markets and lower currencies.

Chart 7

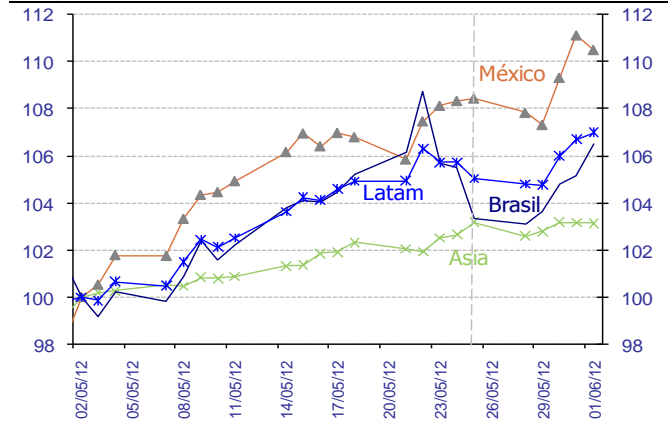
**Stock Markets: MSCI Indices (May 2, 2012 index = 100)**



Source: Bloomberg & BBVA Research

Chart 8

**Foreign exchange: dollar exchange rates (May 2, 2012 index = 100)**

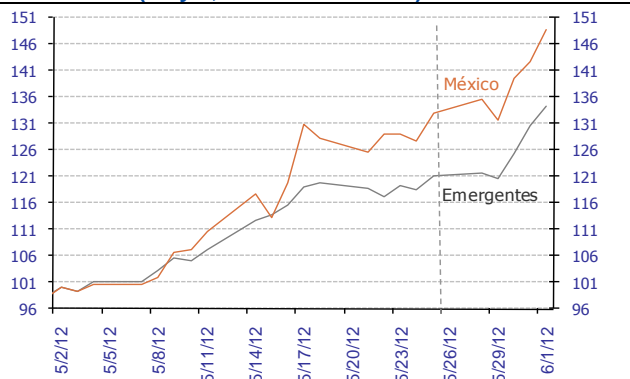


Source: Bloomberg and BBVA Research. Note: LATAM includes Argentina, Brazil, Chile, Colombia and Peru. Asia includes the Philippines, South Korea, Taiwan, Singapore, Indonesia and Thailand. Non-weighted averages

- Increased risk aversion after May jobs data point to moderate growth in the US

Chart 9

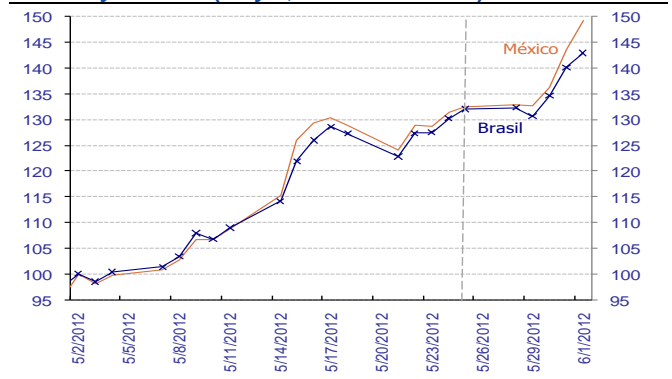
**Risk: EMBI+ (May 2, 2012 index = 100)**



Source: Bloomberg & BBVA Research

Chart 10

**Risk: 5 year CDS (May 2, 2012 index=100)**

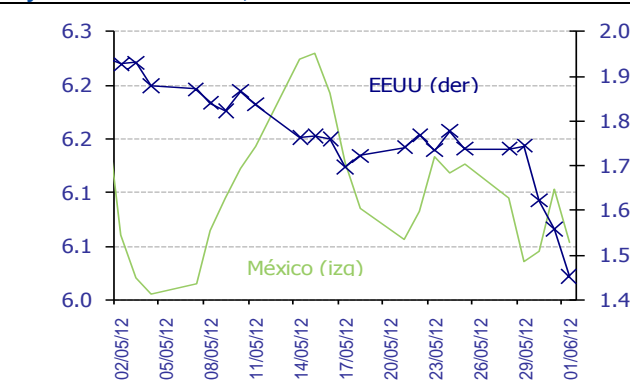


Source: Bloomberg & BBVA Research

- 10Y interest rate in US hits all-time lows due to a search for safe haven assets. Rates in Mexico fall over the week.

Chart 11

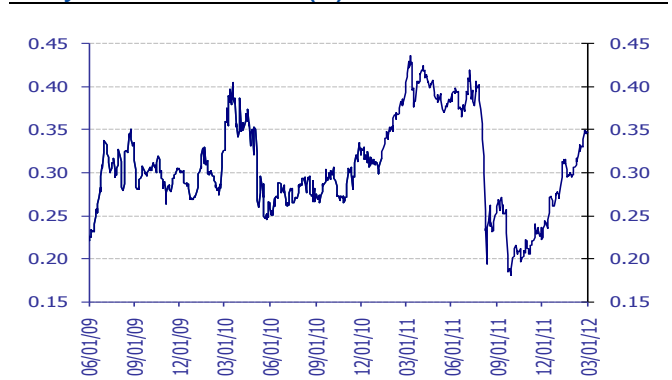
**10-year interest rates\*, last month**



Source: Bloomberg & BBVA Research

Chart 12

**Carry-trade Mexico index (%)**

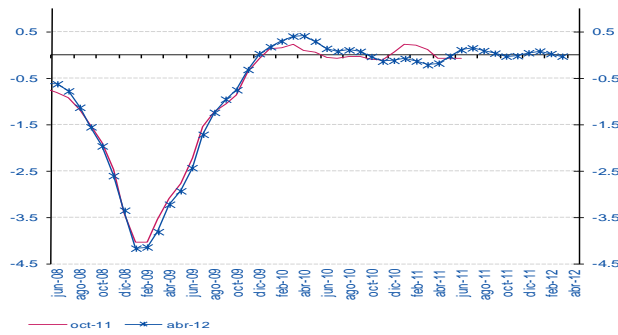


Source: BBVA Research with data from Bloomberg

# Activity, inflation, monetary conditions

- Output holds positive performance, situation indicators point to 2Q12 with quarterly rates around 0.7%.

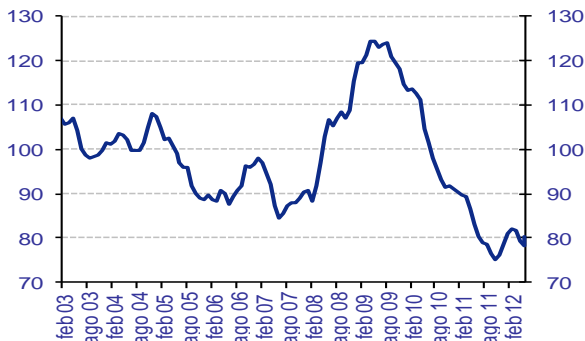
Chart 13  
**BBVA Research Synthetic Activity Indicator for the Mexican economy**



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.

- Inflation ceases downward surprises while output moved up.

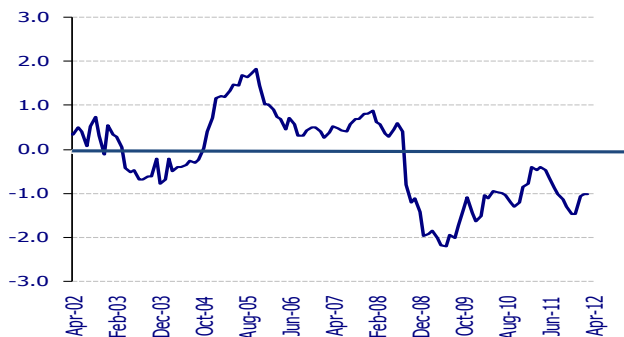
Chart 15  
**Inflation Surprise Index (July 2002=100)**



Source: BBVA Research with data from Banxico from the monthly surveys on the expectations of economic specialists in the private sector.

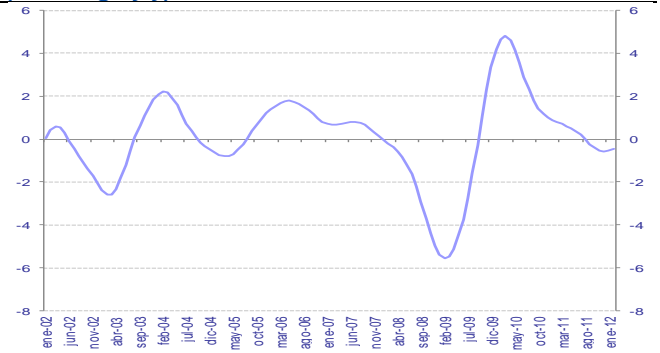
- Monetary conditions near neutral zone

Chart 17  
**Monetary Conditions Index**



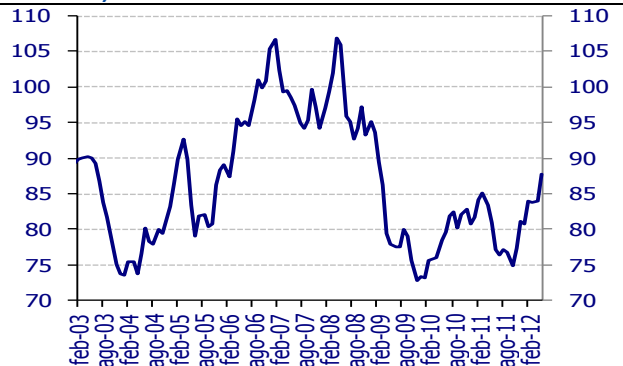
Source: BBVA Research.

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



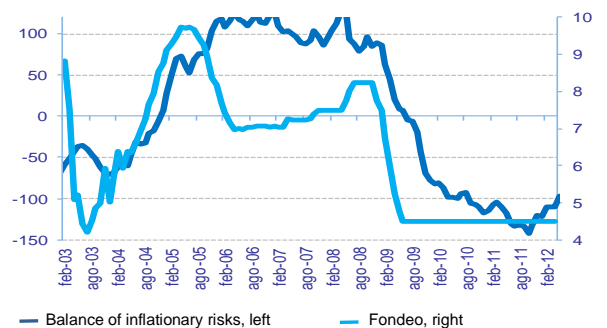
Source: INEGI

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.

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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