Mexico Weekly Flash

Next week…

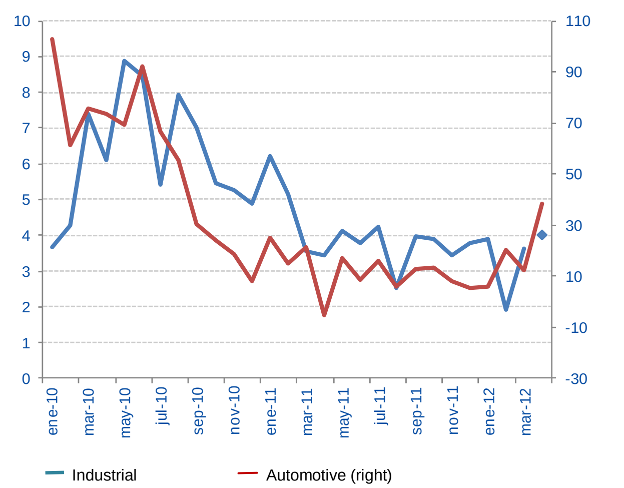
- **... Focus on industrial output for April - the first major activity data in the second quarter**

Industrial output in April should have increased in line with our estimate of 0.6% per month, driven by manufacturing and construction. Some key branches such as transport equipment output should see a positive annual comparison base effect linked to the exceptional fall in April 2011 due to the lack of supplies after the Japan tsunami. In this sense, automotive output data for April 2012 (AMIA) are already known, seeing an annual 38.5% increase spurred by the comparison with a monthly decline in April 2011 of 20%, a decline only surpassed during the global collapse at the start of 2009. The construction industry should see growth driven mostly by private development, although it should be highlighted that public sector construction output has gained share in the first quarter of the year. Industrial output figures for April will be very important for surveying the growth outlook for the entire Mexican economy in the second quarter of the year, not only due to uncertainty in the global setting but also to the statistical effect the correction for the leap year could cause.

- **Monetary policy should not affect the MXN. Holding the short Udibonos section recommended**

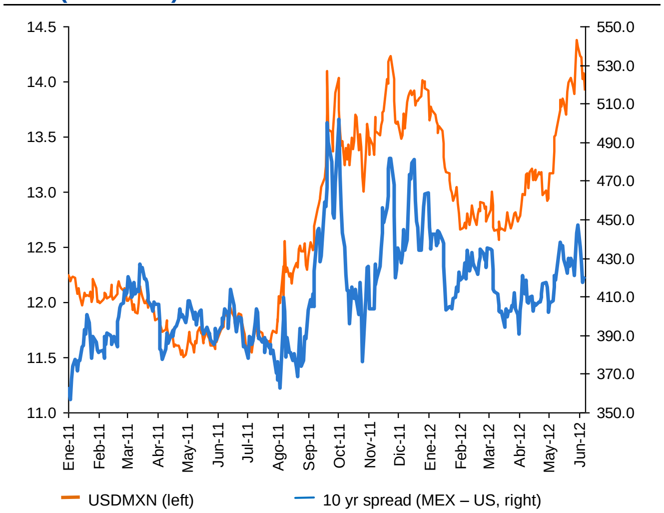
Monetary policy statement is neutral with Banxico again leaving the possibility of a move at any time open. We do not think a quick rise is likely but nominal curves are at difficult-to-sustain levels. Given the seasonal inflation rises, we stay long in the short section of the Udibonos curve. As for currencies, we expect the MXN to continue to fluctuate due to external factors and therefore remain cautious.

Chart 1
Automotive and industrial output (y/y % change)



Source: BBVA Research with data from INEGI and AMIA

Chart 2
10-year bond spread (Mexico less US, bp) and Exchange rate (USDMXN)



Source: Bloomberg

Calendar: Indicators

Industrial Output for April (June 11)

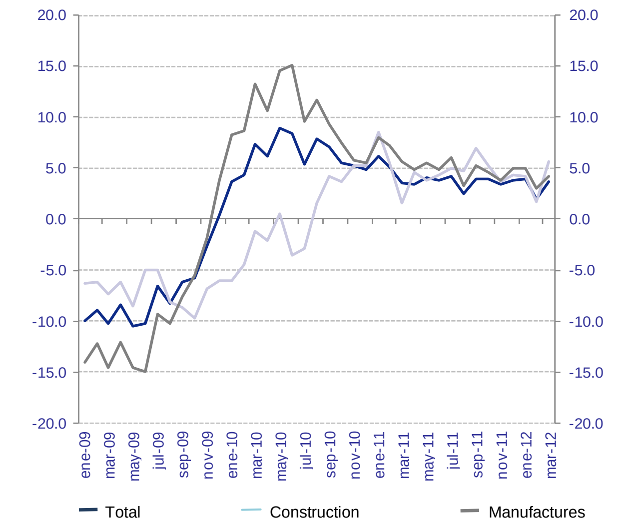
Forecast: 0.6% m/m, 4.0% y/y SA	Consensus:N.A.	Previous: 1.5% m/m, 3.6% y/y SA

GDP 1Q12, demand components (June 14)

Forecast: AD 1.5% q/q, 3.5% y/y SA	Consensus: N.A.	Previous: AD 0.0% q/q, 3.9% y/y SA

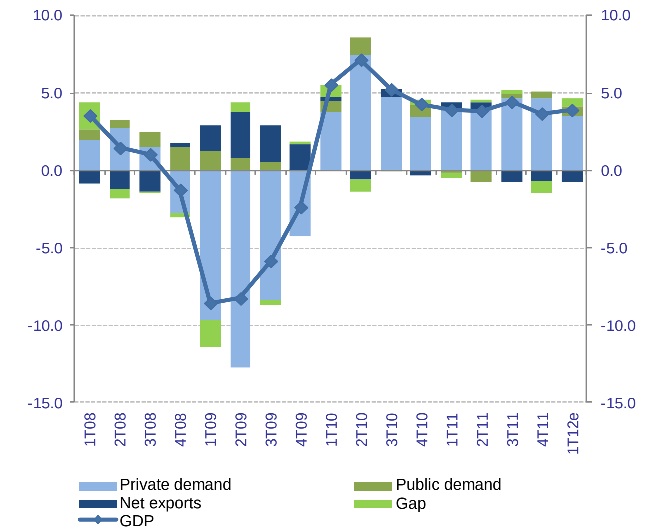
With GDP growth figures for 1Q12 known, seeing a higher-than-expected increase (0.8% e, 1.3% q/q o), the composition of this growth will be important. Based on the performance of variables such as retail sales, consumer confidence and jobs and salary growth in real terms, we believe private consumption will have continued to rise at a good rate in the first months of this year. In this way, on the output side, GDP in the services sector expanded over said period at 0.8% q/q, double that from the previous quarter. Additionally, manufacturing will likely have continued its recovery at the start of the year, as signaled by the gross fixed capital indicator with 7.4% annual growth in the first two months of the year vs. 5.8% in the last quarter of 2011. Capital goods imports were also better at the start of the year than at the end of last: 17% vs. 12.2%. In all, we expect domestic demand components to have been key to GDP growth in the first quarter and maintain our forecast for the year at around 3.7%.

Chart 3
Industrial output (% change y/y)



Source: BBVA Research with INEGI data

Chart 4
GDP and components (y/y % change and contribution)



Source: BBVA Research with INEGI data

• We continue outside nominal curves

Although the monetary policy statement is neutral, Banxico again leaves the possibility of a move at any time open. We do not see a quick rise but nominal curves at a difficult-to-sustain levels, global risks do not appear to be decreasing and the likelihood of more financial stimulus seems to be consolidating. We therefore remain outside nominal curves and await clearer triggers so as to apply directional strategies.

Global markets seem to see Mexican bonds as a type of safe-haven asset which has steadied the correlation between the MXN and domestic debt instruments. This means that the greatest threat to domestic assets would be an upward correction in the risk premium (minimums in the US and Mexico) and not so much a moderate decline in global economic conditions.

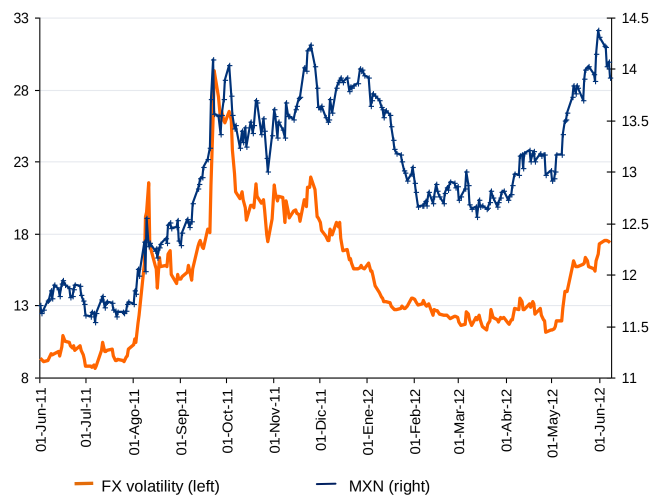
In this way, and based on the current level, nominal curves could be more reactive to upward triggers (even in an overseas inflow context). As there is no clear motivation for domestic monetary action and given the seasonal upswings in inflation, we remain long in the short part of the Udibonos curve, which will continue to be a safe-haven asset for domestic and foreign investors.

• Banxico stance should not affect the MXN

Although it highlights the currency's recent weakness, Banxico sees the MXN as a key stabilizing factor. The central bank has given no signs for now of considering new interventionist measures or changing the current auction mechanism of USD400mn.

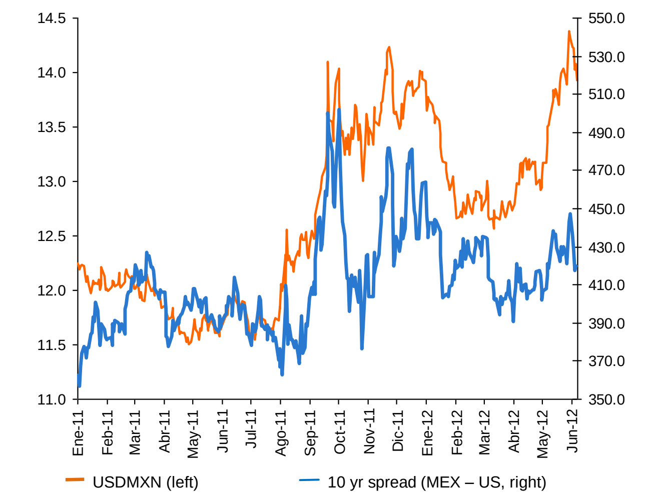
We expect the MXN to continue to fluctuate due to external factors and therefore remain cautious.

Chart 5
Mexico: MXN/USD and implied 3-month volatility (%)



Source: Bloomberg

Chart 6
10-year bond spread (Mexico less US, bp) and Exchange rate (USDMXN)



Source: Bloomberg

Technical Analysis

IPC

The IPC short-term outlook remains unchanged. It continues to trade above the 200-day rolling average (36,879pts) although the attempted bounce over the week was not enough to place it above the 10-day rolling average (37,500pts) despite trading above this for two sessions during the week. Until it breaks down through the 200-day rolling average, we do not recommend closing short-term positions. Above the 10-day rolling average, the next resistance sits at the 30-day rolling average at 38,130pts.

Previous Rec.: It found resistance at 38,00opts over the week and we cannot rule out that, after hitting this level, it has started a short-term downward move.

Source: BBVA, Bancomer, Bloomberg

MXN

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.

Source: BBVA, Bancomer, Bloomberg

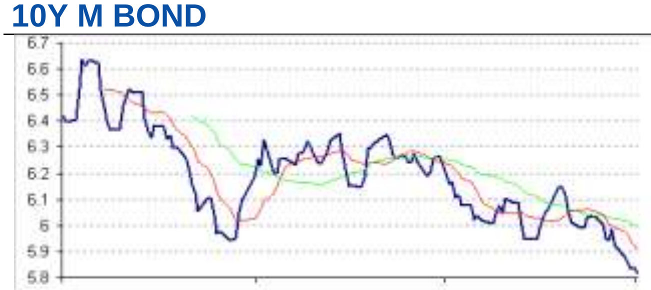
3Y M BOND

3-YEAR M BOND (yield): With no major changes, it continued to trade at 200-day rolling average levels. Exit if it breaks down through 4.75%. Initial resistance at 4.85%.

Previous Rec.: 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.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND



10-YEAR M BOND (yield): Breaking the support by coming in below 5.93%, meaning the bond is at the 2011 minimum and the RSI at 30 points. Any bounce from this support would hit resistance at 5.9%.

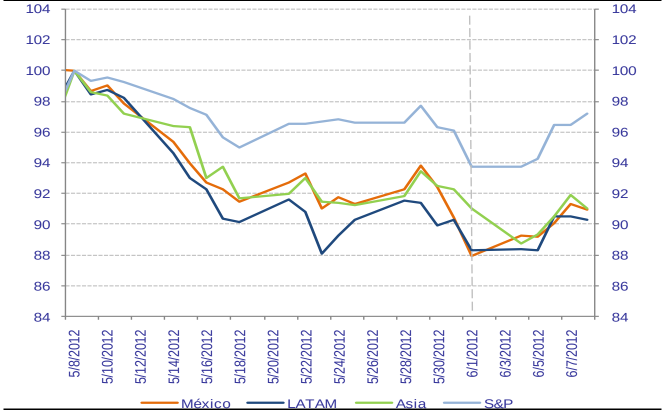
Previous Rec.: We do not recommend an exit unless it breaks downward through 5.93%.

Source: BBVA, Bancomer, Bloomberg

Markets

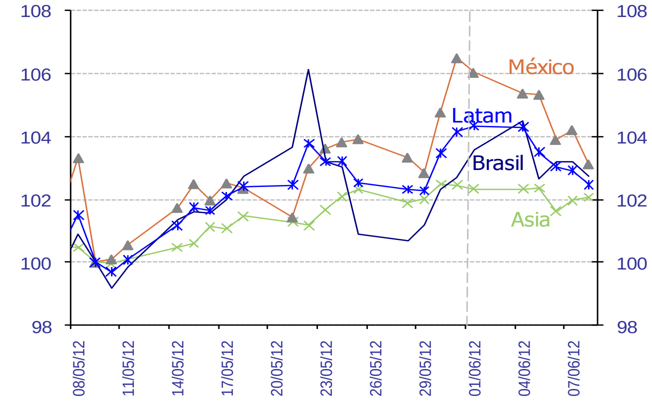
- **In a context of economic data pointing to cycle slowdown, market expectations of more monetary support from central banks increase. This leads to gains on stock markets and stronger LatAm currencies.**

Chart 7
Stock Markets: MSCI Indices (May 8, 2012 index = 100)



Source: Bloomberg & BBVA Research

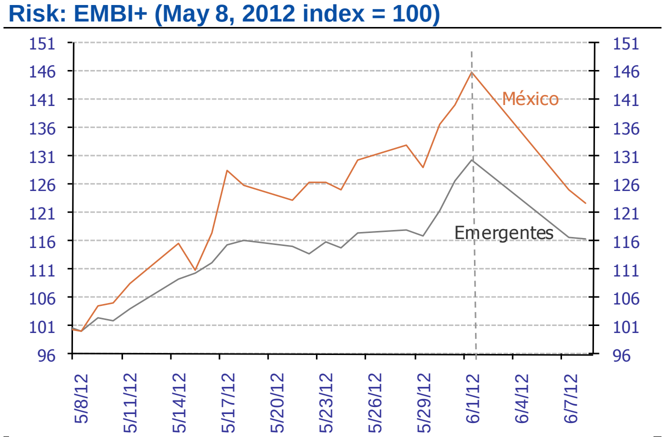
Chart 8
Foreign exchange: dollar exchange rates (May 8, 2012 index = 100)



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

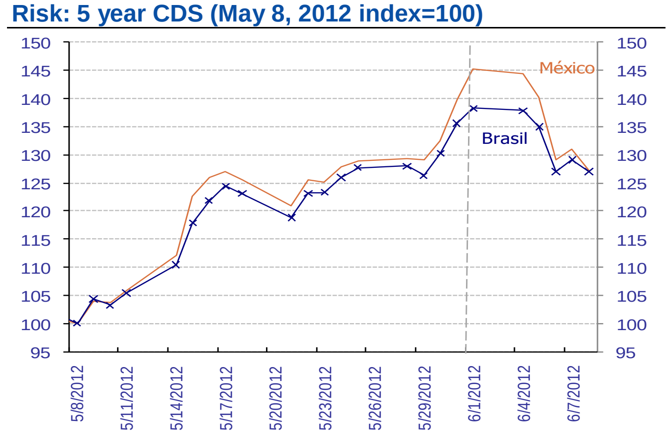
- **Fall in global risk aversion over the week after statements from the ECB chairman on a readiness-to-act as the region's growth outlook declines.**

Chart 9
Risk: EMBI+ (May 8, 2012 index = 100)



Source: Bloomberg & BBVA Research

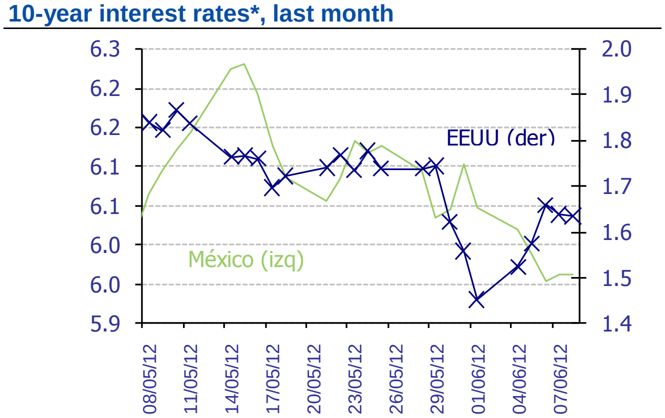
Chart 10
Risk: 5 year CDS (May 8, 2012 index=100)



Source: Bloomberg & BBVA Research

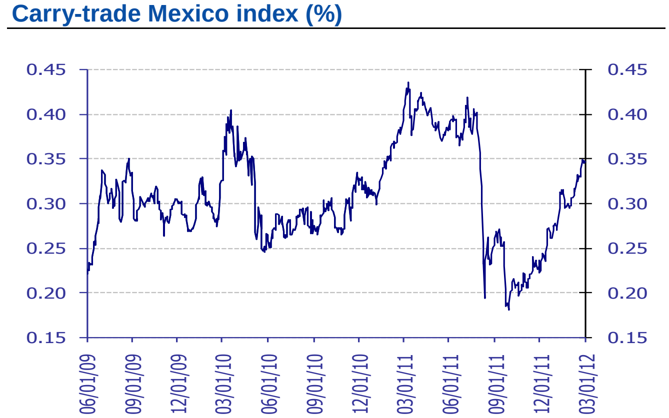
- **10Y interest rate in US moves up slightly over the week after hitting all-time lows. Rates in Mexico record a slight fall over the week.**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

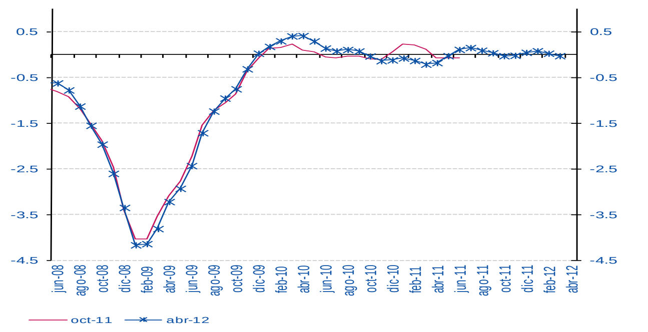


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

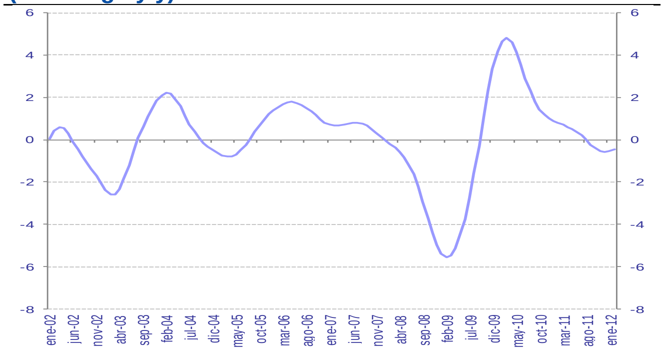
- **Output holds positive performance, situation indicators point to 2Q12 with quarterly rates around 0.7%.**

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.

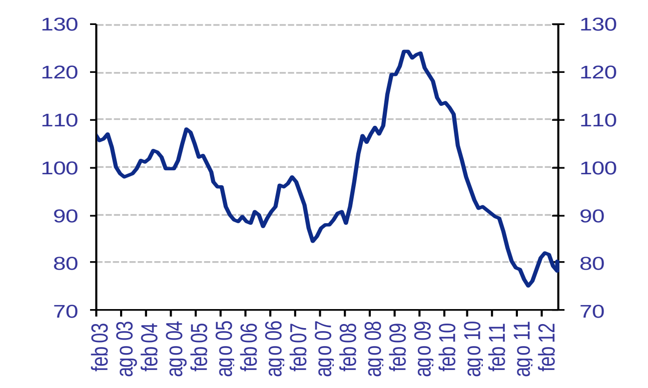
Chart 14
Advance Indicator of Activity (% change y/y)



Source: INEGI

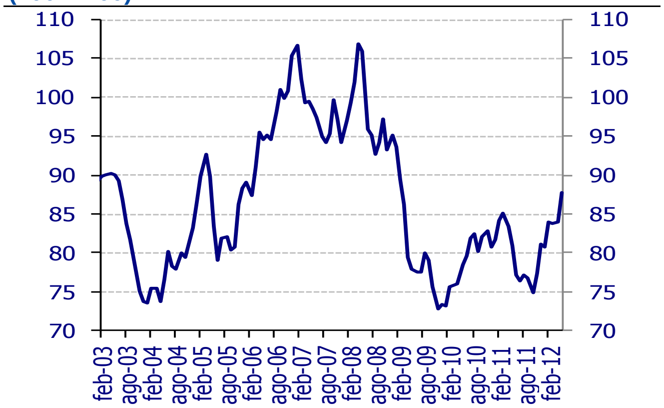
- **Inflation ceases downward surprises while output moved up.**

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.

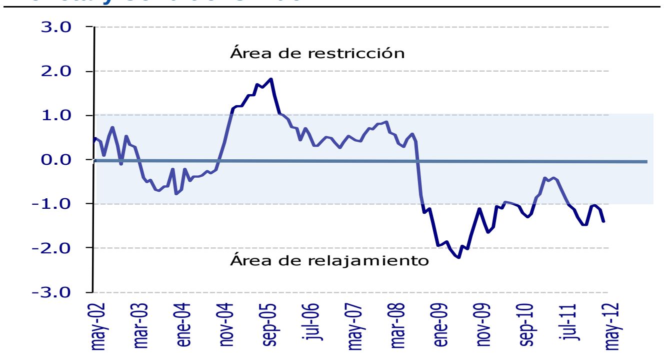
Chart 16
Activity Surprise Index (2002=100)



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.

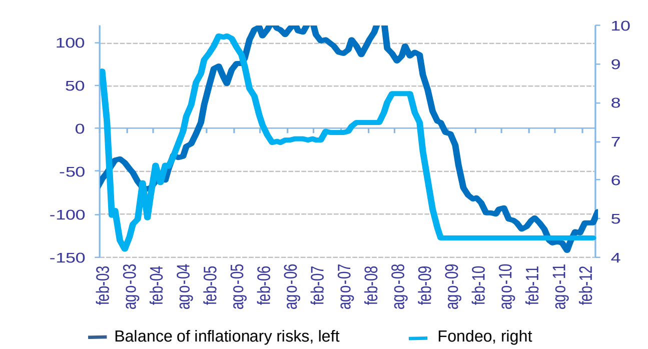
- **Monetary Conditions ease due to exchange rate depreciation in May**

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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