Mexico Weekly Flash

Next week…

- ### Banxico Minutes: discussion leads to neutrality

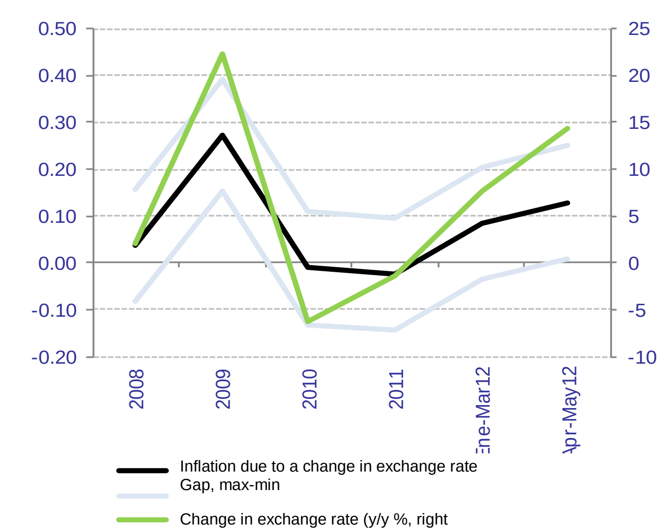
This coming Friday sees the release of the minutes from the monetary policy meeting on June 8. The statement signaled a more neutral tone than previously seen. We believe the continuing debate on the Board surrounding the appropriateness of a cut in the monetary policy rate will remain in the minutes, albeit here influenced by a worsening world economic growth outlook and an 8.75% fall in the exchange rate since the March 27 meeting. These conditions led board members to conclude that the balance of risks for output worsened and that for inflation remained unchanged, although with a higher level of uncertainty due to the possible effect of the factors set out above. In this way, attention will need to be paid to the opinions on the knock-on effect of the exchange rate for inflation since the statement highlighted that it is a risk not be ruled out, albeit reaffirming that it has weakened in recent years. This last assertion was supported this week by the results presented by ***Banxico*** in its ***Report on Regional Economies for January to March 2012***. In a survey of 500 business managers across all regions in the country, executives stated their reluctance to revise prices for their products or services due to the exchange rate volatility and the higher competition they currently face.

In turn, attention will need to paid to board members' opinions on whether the most recent economic data from the US are due to a seasonal effect or could already be pointing to adverse effects from the crisis in Europe.

- ### Major foreign inflows into domestic fixed income contributing to a higher MXN

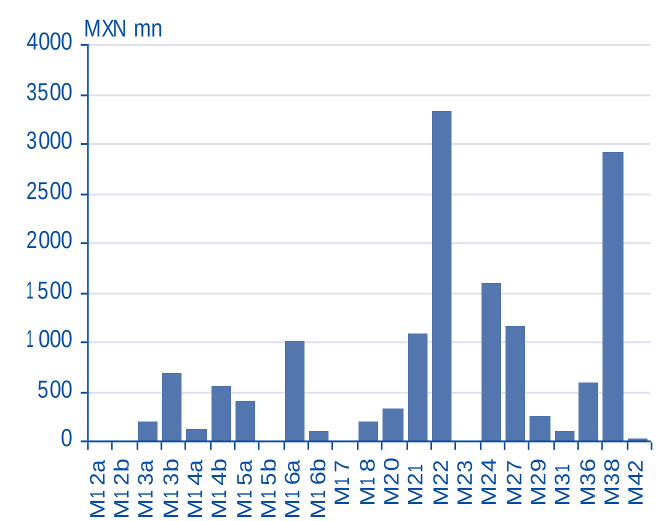
After starting with losses due to uncertainty in Europe, the MXN (and other risk assets) slowed its drop at the end of the week. This recovery is due to speculation surrounding additional quantitative easing at the Fed. The move may continue if a favorable outcome in Europe is seen and with statements of support from the G20 and Eurogroup. Net foreign purchases on the first three days of the week (to Wednesday) ran to almost USD1.0bn (MXN13.7 billion).

Chart 1
Estimated knock-on of exchange rate on prices and exchange rate (% and % y/y)



Source: BBVA Research

Chart 2
Mexico: Foreign capital flows to Mbonds (June 11 through 13, MXN mn)



Source: Bloomberg and BBVA Research

Calendar: Indicators

Inflation in the first two weeks of June (June 22)

Forecast: 0.15% bi-weekly, 4.2% y/y	Consensus: 0.15% bi-weekly	Previous: -.32% m/m, 3.89% y/y

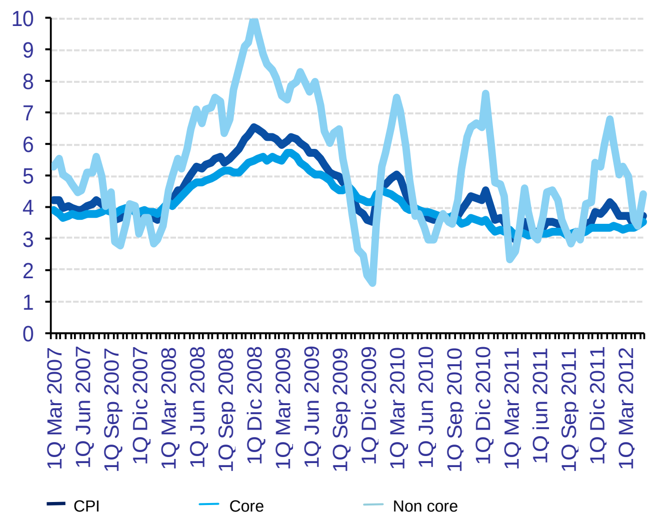
Next week inflation for the first two weeks in June will be published. We expect it to come in at 0.15% for the fortnight, implying a bounce in the annual rate to 4.2% y/y from 3.9% in May. This price increase is mainly due to the annual comparison effect with June 2011. Although inflation will come in above 4%, we believe the performance to date is in line with it closing the year within the Banxico target variability range (3% +-1%). We forecast core inflation to come in at 0.14% bi-weekly, with slight price pressures in non-food goods and other services. We believe inflation remains under control due to the lack of demand pressures, the limited knock-on of the exchange rate and the rise seen in fruit and vegetable prices being temporary. In turn, inflation may be favored in coming months if international energy and grain prices continue to moderate.

Retail sales in April (June, 20)

Forecast: 1.0% m/m, 2.9% y/y csv	Consensus: N.A.	Previous: -0.5% q/q, 4.1% y/y csv

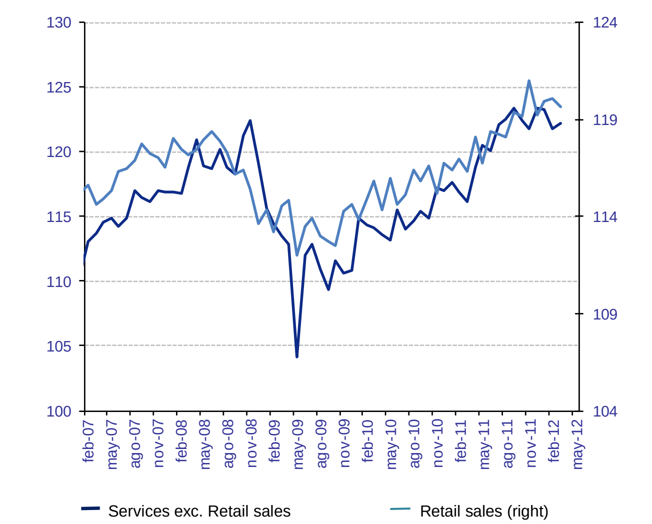
Retail sales indicators and service sector revenue in April to be released this week will continue to show the relative strength in domestic demand. This was seen by 1% growth q/q in private consumption in national accounts' components released last week. In this way, retail sales will have increased by around 1% in the month (2.9% y/y) while we estimate service sector revenue seeing 0.6% growth (3.5% y/y). While no data on real wages in the formal sector are yet available for May, indicators to April pointed to year-on-year growth of 0.7%. Meanwhile, IMSS employment continued to expand at a rate slightly above 4% in April. In turn, wages alongside bank and non-bank finance continue to prop up private consumption.

Chart 3
Inflation and components (y/y % change, fortnightly series)



Source: BBVA Research with INEGI data

Chart 4
Retail Sales and Services Indicator (Index, 2003=100)



Source: BBVA Research with INEGI data

- **The MXN ended practically stable (weekly devaluation of 0.1%)**

After starting with heavier losses due to the announcement of financial support for some Spanish banks and the subsequent downgrade for the country, the MXN slowed its drop at the end of the week. In turn, in line with most risk assets, the recovery is attributed to speculation surrounding additional quantitative easing at the Fed due to lower-than-expected economic data.

- **The MXN rally could extend over the week**

We believe the rally may extend in coming days if favorable results in the Greek election are seen with quantitative easing at several global central banks which, in turn, could be signaled at the G20. In all, we see the rally possibly running to levels not beyond 13.60. We should recall that the cyclical and sovereign risk continues to be high and, in our opinion, the contagion factor for other peripheral nations will not disappear in coming weeks, at least not before the European summit.

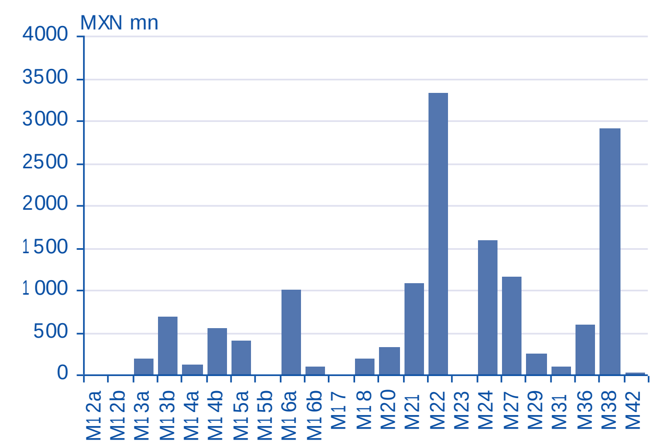
- **Major foreign inflows into domestic fixed income also favoring the MXN**

Net foreign purchases on the first three days of the week (to Wednesday) ran to almost USD1.0bn (MXN13.7 billion). As a result of Wednesday's negotiations, flows have expanded toward the long yield tranches. As a reference, despite the M2022 starting the week at 5.95%, it closed the day at 5.95%. The price effect, as we have stated, only appears as the USTs provide a margin. We should recall that the higher inflows in the past only coincided with a rally half the time.

The Siefores saw no major flows. Only 244 million pesos (USD 0.017 bn), despite them purchasing MXN 4.065 billion pesos of the M2022 in Tuesday's auction. Trading was dominated by the M2022 at the Tuesday auction.

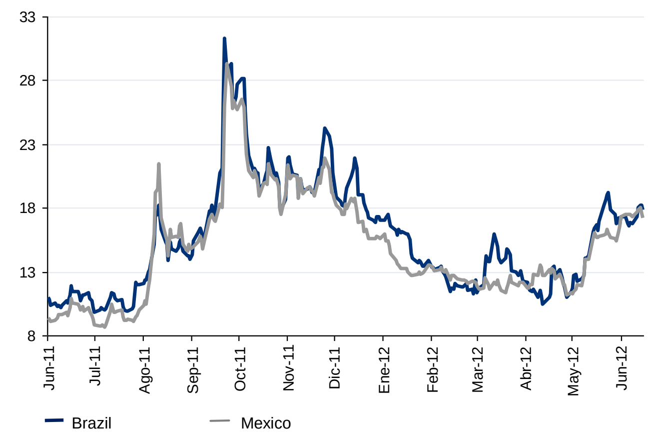
Mutual funds saw outflows of 2.6 billion MXN (USD 0.204 bn). Other national investors saw sales of MXN 937 million (USD 0.07bn).

Chart 5
Mexico: Foreign capital flows to Mbonds (June 11 through 13, MXN mn)



Source: Bloomberg and BBVA Research

Chart 6
LatAm: Implied 1-month exchange-rate volatility



Source: Bloomberg

Technical Analysis

IPC

Source: BBVA, Bancomer, Bloomberg

The IPC is still not triggering entry signs. The most important sign was the bounce from the 200-day rolling average at the start of the week. It has to break two major short-term resistances to consider a short-term upward signal. Firstly, the 30-day rolling average (37,775pts) and then 38,200pts where the previous high sits. Oscillating indicators, taking an upward trend and far from the over-purchase zone, suggest the upward move may remain in the short-term. We believe that it will at least try 38,000pts and only if the Dow manages to come in above the 200-day rolling average, could the IPC break through this resistance. An upward break through 38,200pts would set the next resistance at 39,500pts.

Previous Rec.: 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.

MXN

Source: BBVA, Bancomer, Bloomberg

The dollar saw a later move over the week, hovering between the resistance marked by the 10-day rolling average and the 30-day rolling average support. It closes the week slightly below the support and, given that the oscillating indicators have still not reached over-sell, we believe it could still hit the MXN13.70 level.

Previous Rec.: The next candle should be negative to be able to see a downward trend change pattern. Short-term over-purchasing remains very high.

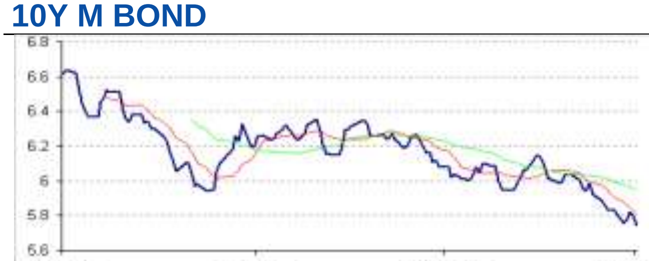
3Y M BOND

Source: BBVA, Bancomer, Bloomberg

3Y M BOND (yield): Downward break through the 200-day rolling average. The downward move may extend toward 4.7% and, without a bounce, to 4.55%.

Previous Rec.: Exit if it breaks down through 4.75%. Initial resistance at 4.85%.

10Y M BOND



Source: BBVA, Bancomer, Bloomberg

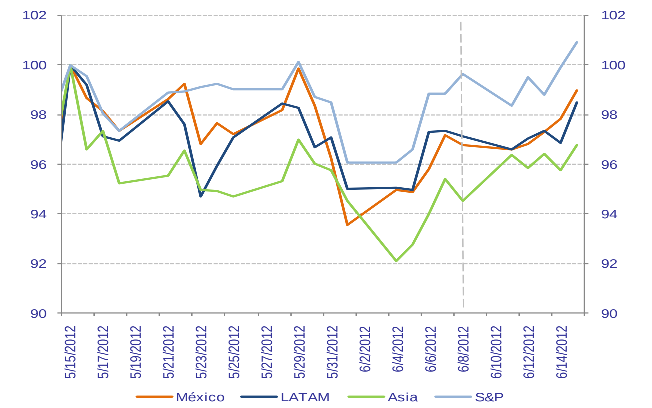
10 Y M BOND: (yield): Maintaining its downward move and surpassing the low of 2011. It may extend the fall toward the 5.6% or 5.4% zone.

Previous Rec.: Any bounce from this support could hit resistance at 5.9%.

Markets

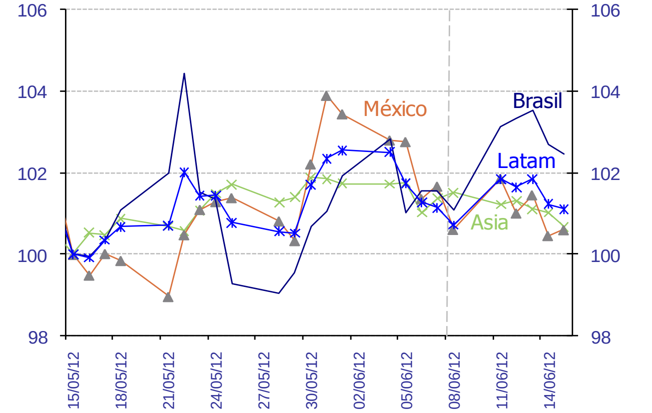
- **Lower-than-expected figures for industrial output and consumer confidence in the US, linked to the uncertainty surrounding the Greek election on Sunday, increase market expectations of further monetary support from central banks. This led to gains on stock markets and a stronger peso.**

Chart 7
Stock Markets: MSCI Indices (May 15, 2012 index = 100)



Source: Bloomberg & BBVA Research

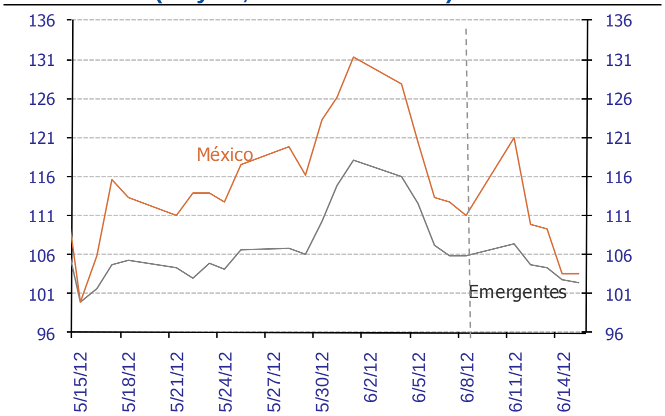
Chart 8
Foreign exchange: dollar exchange rates (May 15, 2012 index = 100)



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

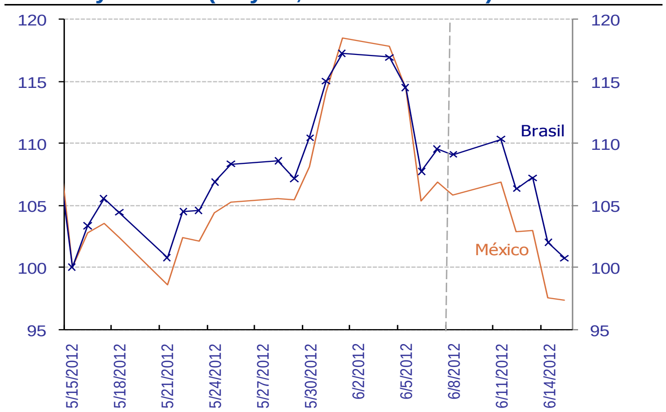
- **Decline in global risk aversion over the week after market expectations that central banks will take additional stimulus measures.**

Chart 9
Risk: EMBI+ (May 15, 2012 index = 100)



Source: Bloomberg & BBVA Research

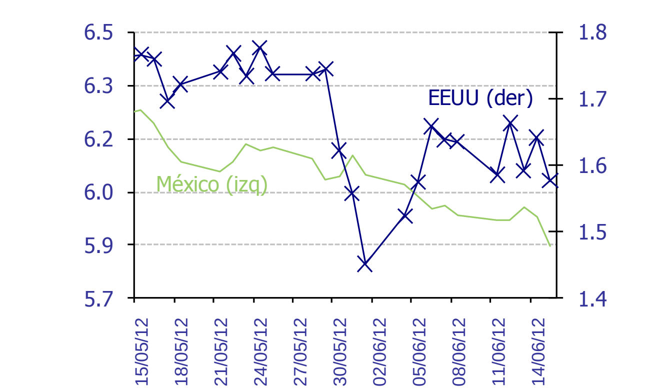
Chart 10
Risk: 5 year CDS (May 15, 2012 index=100)



Source: Bloomberg & BBVA Research

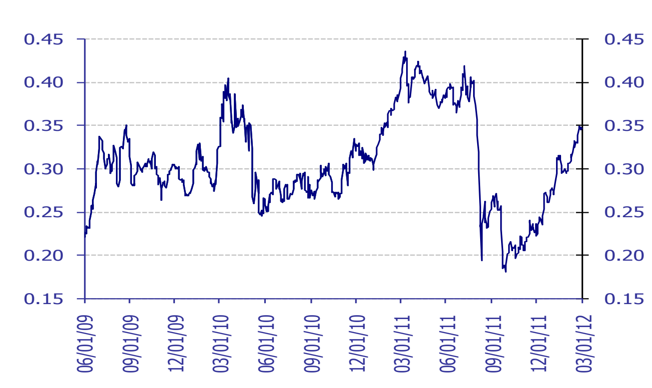
- **10Y interest rate in US moves down slightly over the week. Rates in Mexico see a fall, boosted by inflows over the week.**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

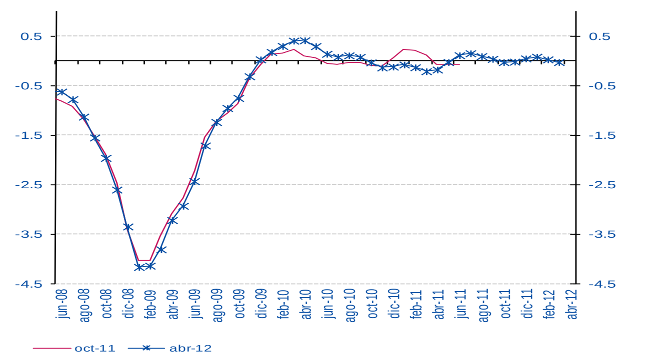


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

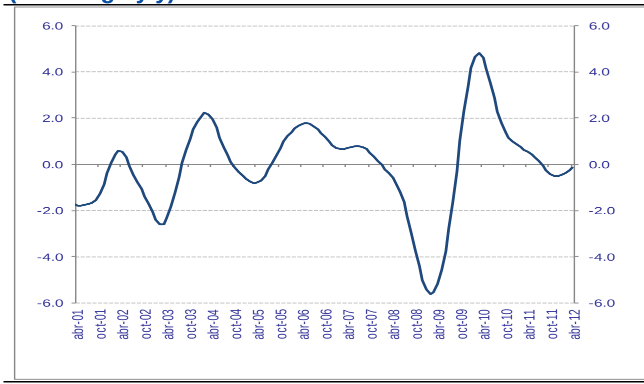
- **Output holds positive performance, situation indicators point to 2Q12 with quarterly rates around 0.7%.**

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.

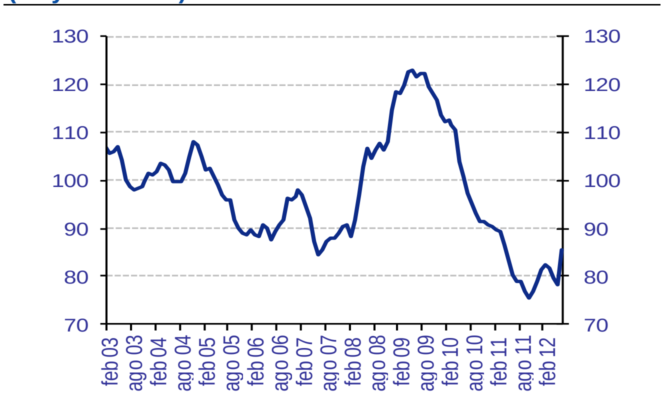
Chart 14
Advance Indicator of Activity, trend (% change y/y)



Source: INEGI

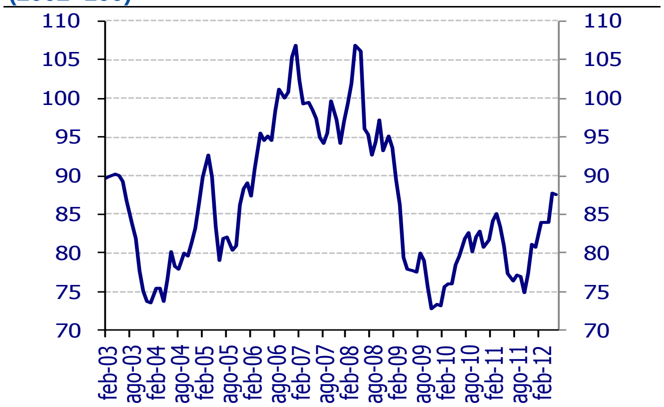
- **Inflation ceases downward surprises while output moved up.**

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.

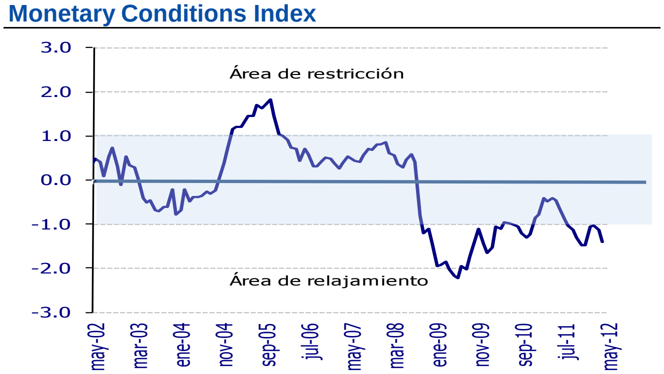
Chart 16
Activity Surprise Index (2002=100)



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.

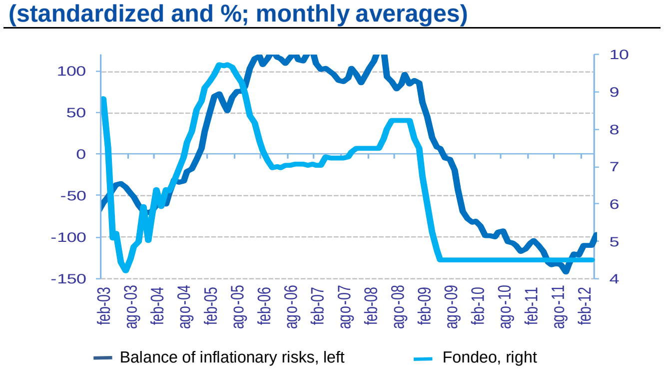
- **Monetary Conditions ease due to exchange rate depreciation in May**

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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