Mexico Weekly Flash

Next week…

- **Focus on the effect on financial markets of decisions taken by the European Council and euro countries**

The consequences of yesterday's and today's meeting of the European Council will me measured on financial markets this coming week. In advance, the effects should be better-than-expected given the agreements reached by Eurozone countries. In this sense, according to the statement, in order to **break the vicious circle of sovereign and bank risk** there are plans to: i) attain effective banking supervision in the area as quickly as possible (for the end of 2012) so that the **financial support mechanisms can recapitalize banks directly, without going through the government**; ii) **the support to recapitalize Spanish banks who require it will not have preferential status**. It also confirms that everything necessary will be done to ensure financial stability in the area through the use of financial support mechanisms on debt markets on the condition that it will not be different to what is set out in the Stability and Growth Pact or in the Macroeconomic Imbalance Procedure.

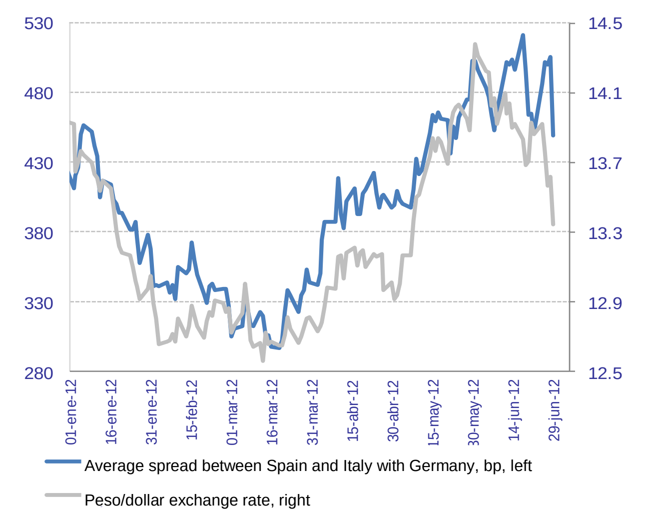
Doubts **remain** surrounding the **terms for effectively implementing banking supervision** in the area or the fact that the **funds available for the support mechanisms are limited** for highly adverse liquidity pressure scenarios. Nonetheless, they are a **step in the right direction** which, alongside plans to effectively move the banking (deposit guarantee, resolution) and fiscal union forward, will mean the risk premium markets allocate to the disappearance of the euro disappears.

On a purely domestic front, focus next week will be on the performance of formal employment in June which should continue to see growth at rates nearing 0.4% for the month.

- **Domestic markets see major gains**

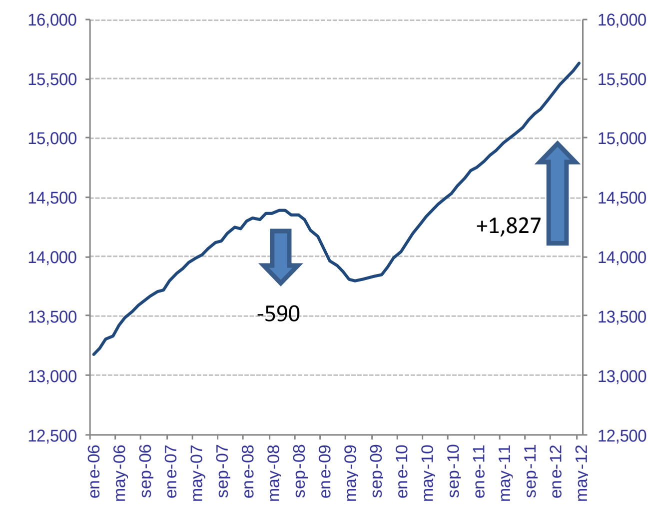
The MXN broke with emerging currencies and those of the G10 over the week, strengthening over 4.1%. We believe that foreign inflows are the reason for these moves, especially the close of recent MXN fixed income hedging and the chance of more FDI. In all, sensitivity to news on global risk will remain. In terms of the curve, the week was fairly volatile, although rates in the Mbond and TIIE curves again closed at lows, falling on average by over 10bp on Friday.

Chart 1
10-year debt spread in the Eurozone and Mexican peso exchange rate



Source: BBVA Research and data from Bloomberg

Chart 2
Mexico: formal private-sector employment, thousands of people



Source: BBVA Research with STPS data

Calendar: Indicators

Confidence: consumer and producer (July 4)

Forecast: Consumer 0.1% m/m 97.1pts	Consensus: N.A.	Previous: 0.2% m/m, 97.0 pts
Forecast: Producer -0.2% m/m, 52.7pts	Consensus: N.A.	Previous: -1.6% m/m, 52.8 pts

Formal Employment in the private sector (over the week)

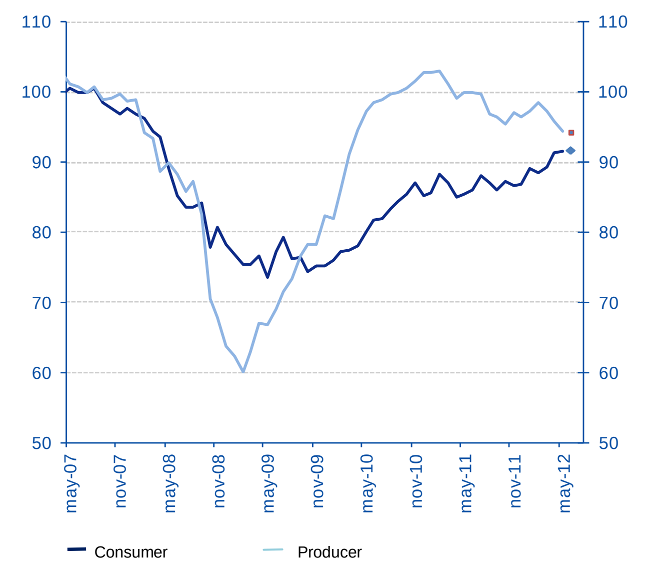
Forecast: 0.4% m/m, 4.6% y/y	Consensus: N.A.	Previous: 0.4% m/m, 4.5% y/y

Consumer and producer confidence indicators will provide valuable information on the close of Q2 of the year in terms of expectations. Both indicators have seen opposing performances in recent quarters with producer confidence falling, mainly due to the trend aggregate or expected order volume, and consumer confidence improving, the possibility of acquiring a durable good in coming months standing out alongside the more optimistic stance on family and country situations in twelve months in comparison to present.

Job performance effects consumer confidence, with the formal private-sector component for June being released this week. Employment has increased by 0.4% with notable stability over the last 20 months. This growth has involved around 1.8 million workers joining the market since the lowest part of the employment cycle in June 2009. This variable, alongside that for growth in real wages, is key for consumer confidence and in the last analysis for maintaining growth in private consumption.

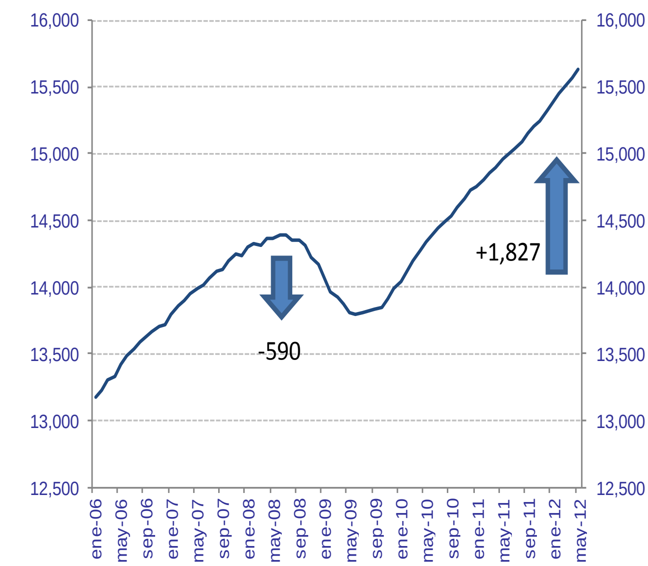
Monitoring the performance in indicators such as the ISM among US manufacturers will also be important this week, where a move tends to corroborate the slowdown outlook in coming months pointed to by domestic confidence indicators.

Chart 3
Confidence: consumer and producer (July 7=100)



Source: BBVA Research with INEGI data

Chart 3
Formal Private-sector Employment (IMSS, thousands of people)



Source: BBVA Research with STPS data

Markets

- **Domestic markets saw major gains in line with global risk appetite.**

The MXN rose around 2.2%, recovering much less lost ground than other emerging currencies. Nonetheless, the MXN broke with emerging currencies and those of the G10 over the week, strengthening over 4.1%. We believe that foreign inflows are the reason for these moves, especially the close of recent MXN fixed income hedging and the chance of more FDI. With regard to this, there was the announcement that Inbev will acquire the rest of Gmodelo for USD20.1bn in cash. This transaction would definitely favor a stronger MXN if inflows saw a brief lapse. Nevertheless, GModelo capital analysts believe the operation will not be closed before the end of the year. In turn, neither is there a clear correlation between the MXN and FDI/portfolio inflows. We therefore believe that the currency will continue to be more sensitive to news from overseas.

The curve saw a fairly volatile week, however Mbond and TIIE curves again close at lows, falling on average by over 10bp on Friday. Regarding flows recorded over the week (up to Thursday, June 28), we point out foreign flows saw a net sale of MXN 3.52bn. Mainly for the M2024, M2020 and M2042 maturities. The Siefores sold MXN 4.487bn (mainly M22, M24, M31). Investment companies also sold around MXN 1.446bn (short-term). Other domestic companies bought MXN 810mn

Technical Analysis

IPC (headline)

Source: BBVA, Bancomer, Bloomberg

The IPC weekly gain meant the market again tested the 40,000pts zone, for the third time since the end of March. Although the IPC traded above this level, it was not able to close the week there. We continue to see this level as a major resistance for a short-term move and, therefore, we have reduced our short-term positions anticipating a possible IPC adjustment given the readings of over-buying in several issuers, as well as the index itself (the RSI of the IPC already trades at 71pts). If it breaks 40,000pts, it would seek out the 41,200pts level

Previous Rec.: 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.

MXN

Source: BBVA, Bancomer, Bloomberg

Maintaining the short-term downward move and breaking the supports of MXN13.65 and MXN13.50. It ended the week slightly below the 200-day rolling average. We believe that it could hit MXN13.25 at the most before a bounce due to over-selling in the oscillating indicators.

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.

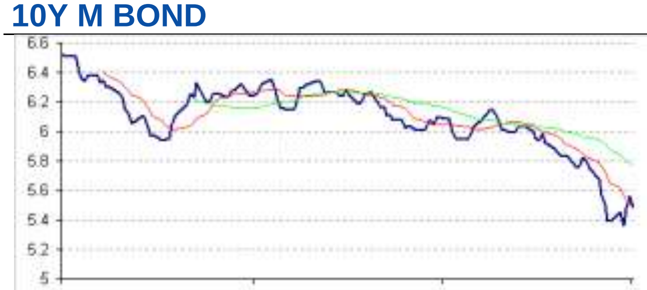
3Y M BOND

Source: BBVA, Bancomer, Bloomberg

3Y M BOND: (yield): It seems to have found a floor in the 4.65% zone. The weekly bounce puts it above the 10-day rolling average. This may continue, initially, toward MXN4.75% and, if the 30-day rolling average is breached, we could see a return to 4.9%.

Previous Rec.: The downward move may extend toward 4.7% and, without a bounce, to 4.55%.

10Y M BOND



Source: BBVA, Bancomer, Bloomberg

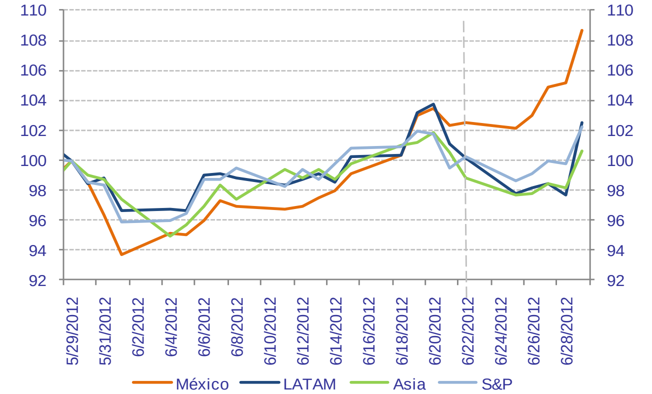
10Y M BOND (yield): Finding a floor at 5.4% and bouncing toward the 10-day rolling average. The opening of short-term rolling averages suggests a return to 5.8%.

Previous Rec.: It may continue the fall toward the 5.6% or 5.4% zone.

Markets

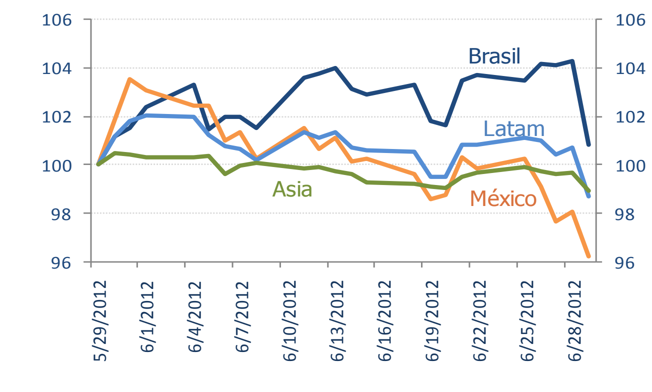
- **Rise on stock markets and stronger LatAm currencies after European leaders agreed on measures to directly fund the banking system, in addition to not demanding preference over other investors with regard to the loan to Spain for cleaning up its banking system.**

Chart 7
Stock Markets: MSCI Indices (May 29, 2012 index = 100)



Source: Bloomberg & BBVA Research

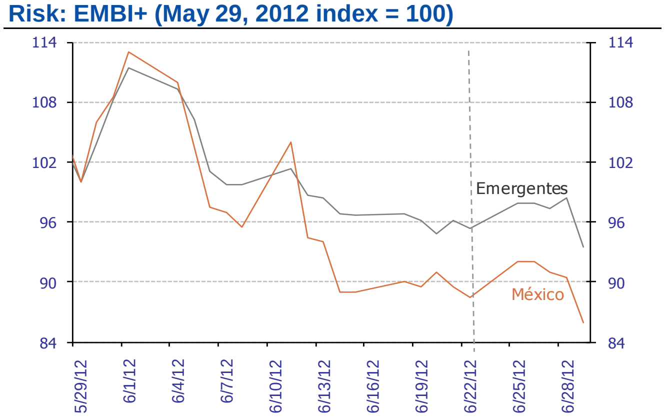
Chart 8
Foreign exchange: dollar exchange rates (May 29, 2012 index=100)



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

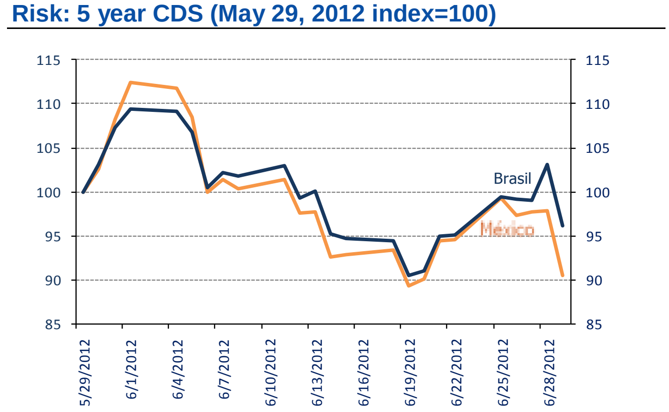
- **Fall in risk aversion thanks to agreements at the European summit, even with personal spending failing to see growth in the US and consumer confidence coming in below expectations.**

Chart 9
Risk: EMBI+ (May 29, 2012 index = 100)



Source: Bloomberg & BBVA Research

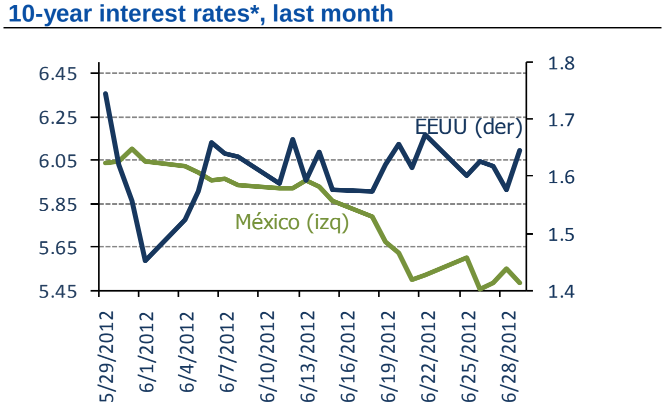
Chart 10
Risk: 5 year CDS (May 29, 2012 index=100)



Source: Bloomberg & BBVA Research

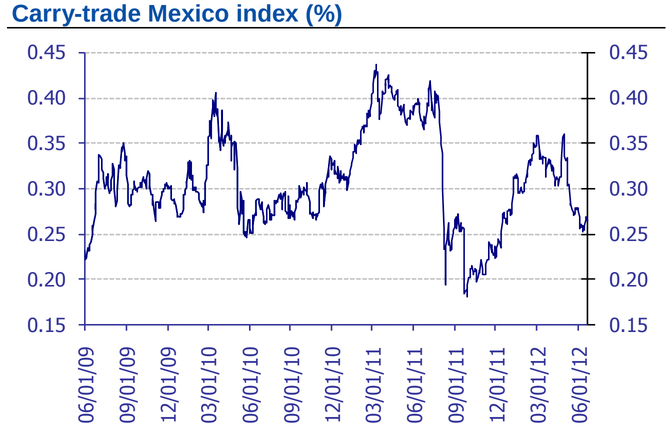
- **Rise in US interest rates due to greater appetite for risk. Rates in Mexico fall toward the end of the week.**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

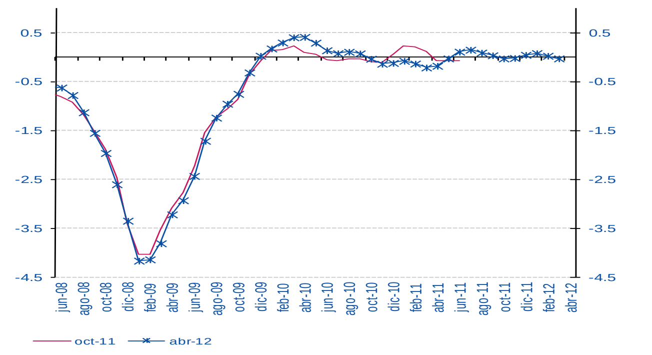


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

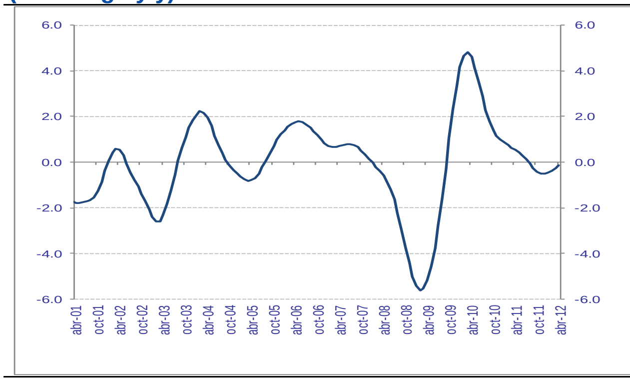
- **Output holds positive performance, situation indicators point to 2Q12 with quarterly rates around 0.7%.**

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.

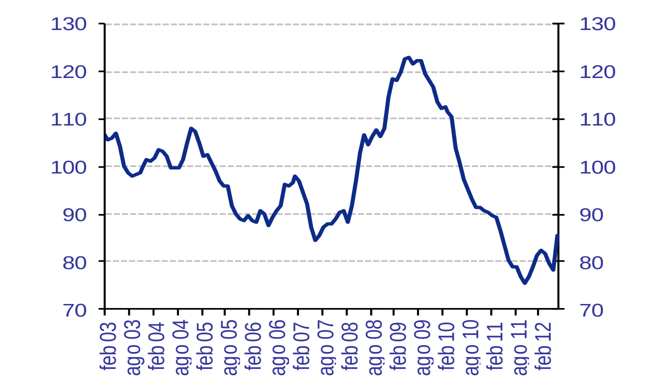
Chart 14
Advance Indicator of Activity, trend (% change y/y)



Source: INEGI

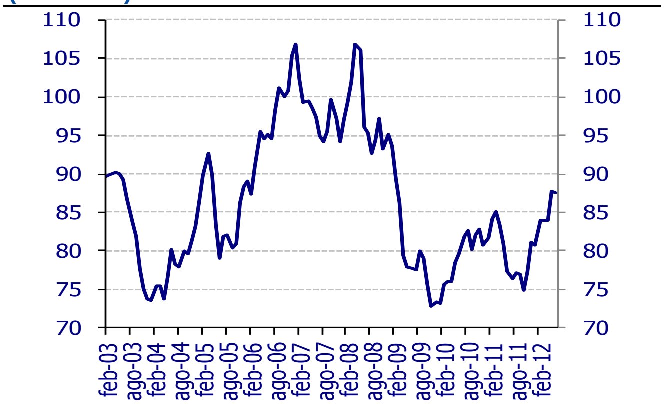
- **Inflation ceases downward surprises while output moved up.**

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.

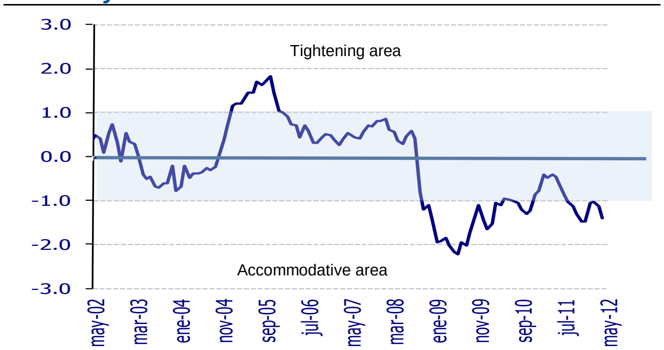
Chart 16
Activity Surprise Index (2002=100)



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.

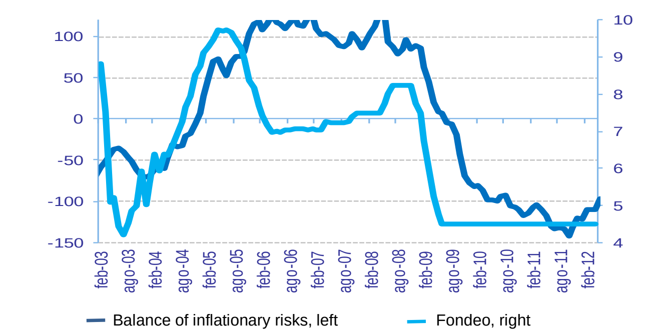
- **Monetary Conditions ease due to exchange rate depreciation in May and June**

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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