Mexico Weekly Flash

Next week…

- **... focus falls on the first output indicators for July in Mexico and the US**

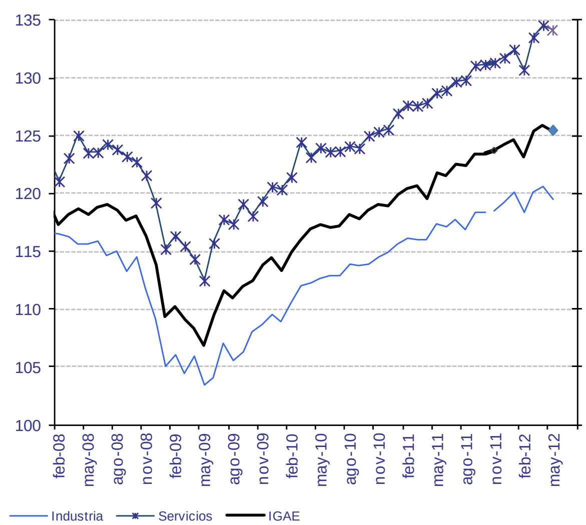
  This last week was a good example of how global volatility is setting the short-term performance of the Mexican peso, without major impact from domestic variables which show no major surprises. Inflation for the first two weeks of July was 0.1pp higher than expected due to higher poultry prices; the IGAE saw a -0.4% change in May (BBVA Research forecast: -0.5%) and the trade balance in June was in surplus by 601 million dollars (BBVA Research forecast: +339 million; consensus: -100 million). With no important news on the domestic front, the euro crisis continues to be the driving factor in the peso rate with the currency being used as a risk hedge for emerging markets.

  Neither do we expect to see domestic economic indicators changing the panorama for the Mexican economy this coming week. Public finances in June (released: Monday, July 30) will continue to show sustained oil and non-oil revenue growth given the way the cycle is going. Consumer confidence and manufacturing output for July will be more important (Friday, August 3) which in June saw consistent declines with the US cycle running out of steam. In this way, we will see if the cyclical situation is confirmed from July's ISM figures (Wednesday, August 1) and non-farm payroll (Friday, August 3). On the domestic front, the minutes from the latest Banxico monetary policy meeting will need to looked at closely (Friday, August 3) to see the Board's level of concern about the slowdown in global output and its impact on domestic output and inflation.

- **The MXN and MBonds diverged at the end of the week, with the currency closing with gains and fixed income assets falling**

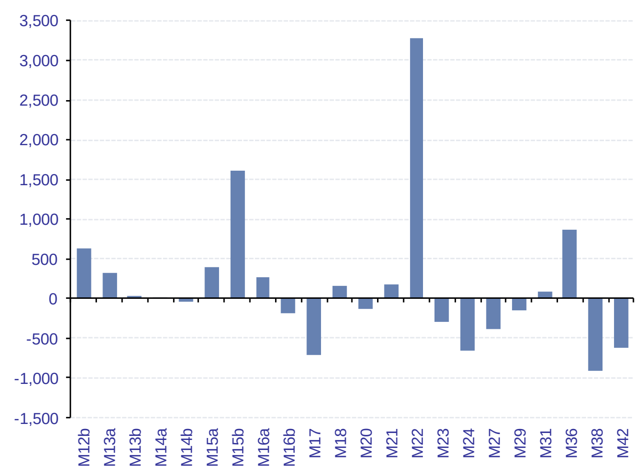
  Domestic curves and the MXN again showed divergence at the end of last week. Meanwhile, the currency ended up 1% over the week and the Reference 10-year MBond yield moved up by 30bp

Chart 1
IGAE, 2003=100



Source: BBVA Research

Chart 2
Net Foreign Inflows to MBOND curve (millions of MXN) - July 26, 2012



Source: BBVA Research, Banxico, Indeval

Calendar: Indicators

Public Finances in 2Q2012 (July 30)

The second quarterly public finance report is released next week. We believe one of the most important aspects will be the performance in budget revenues. Total revenues tally annual growth to May of 7.4%, a much higher rate than estimates after the budget approval of 4.0% (4.5% if we take out the effect of the elimination of the federal tenure). However, this growth is due to a 17% rise in oil revenue and a 10.7% rise from non-oil institutions and companies. Nonetheless, tax revenue, which was expected to increase 2.8% y/y (3.8% without tenure) accumulated a growth rate of 0.8% y/y to May due to VAT receipts only increasing 2.1% while IETU business tax fell -17.4%, in addition to the aforementioned vehicle tenure cancelation. In this way, although public revenue is higher than expected with the main items increasing over the last 12 months (Chart 4) even higher than expected, these increases are mainly based on oil.

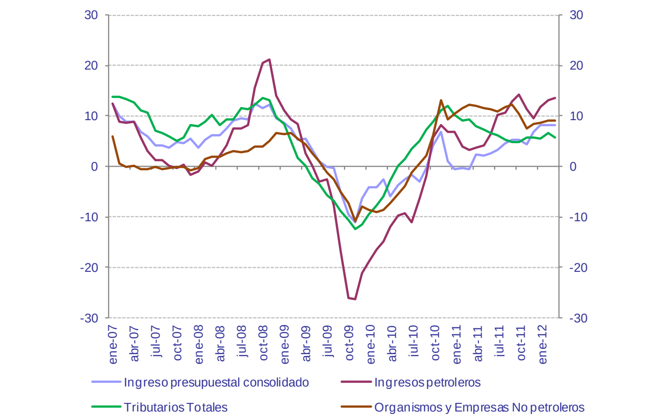
Consumer and producer confidence in July (August 3)

Forecast: Consumer: 0.4% m/m, 95.6 pts Producer: 0% m/m, 52.7 pts	Consensus: N.A.	Previous: -1.3% m/m, 95.2 pts Previous: 0% m/m 52.7 pts

The producer and consumer confidence figures for July are set to be released this week. Consumer confidence benefitted from the consistent increase in the IMSS which grew at a rate of nearly 0.4% monthly in the last 18 months and recently even increased to 0.5% m/m. In short, the confidence level continues to be below what is was before the 2009 recession which could be linked to low real wages growth. Finally, growth, albeit modest, in consumer confidence is a support for private consumption alongside access to finance.

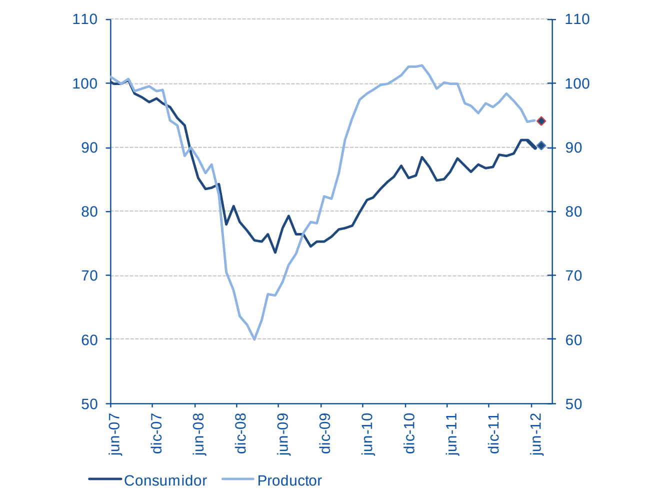
In turn, we forecast manufacturing producer confidence to have remained stable in July within a framework of a continual slowdown since mid-2010, in line with the slowdown in industrial output. Several indicators linked to industrial activity such as US industrial output and the ISM there point to a slowdown toward the third quarter. This would be in line with contracted foreign demand for manufacturers.

Chart 3
Budget revenues and components (% change y/y)



Source: BBVA Research with SHCP data

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



Source: BBVA Research with data from INEGI and SNIIM

The MXN and MBonds diverged at the end of the week, with the currency closing with gains and fixed income assets falling

Domestic curves and the MXN again showed divergence at the end of last week. Meanwhile, the currency ended up 1% over the week and the Reference 10-year MBond yield moved up by 30bp. Initially, losses on the curve were due to a more marked risk aversion scenario in the face of concerns that Spain would need a bailout (beyond the financial support approved for the banking system). Nevertheless, as the days went by, higher investor spirits (leading to a 3% rise in the peso from its weekly high of 13.78) did not spread to fixed income assets. MBonds, however, correlated again with USTs although, in our opinion, the reasons for this were not the same. We believe the move in the curve was led more by technical strategies among domestic investors than a negative view from overseas.

In fact, it should be highlighted that while most losses were concentrated in the medium term, foreigners invested in the MBond 2022. Indeed, our estimate for net purchases shows that from Monday to Thursday foreign capital inflows for this bond were MX 3.8 bn while the Siefores had a net flow of MX 843 mn for that product. On balance, foreign inflows were positive (MX 3.778 bn) but exit moves were seen in longer maturities (the 2038 and 2042 bonds saw an exit of MX 1.541 bn). Meanwhile, the Siefores went for MBonds with only investment companies seeing exits from the curve (MX 404 mn). In our opinion this shows that trading over the week comes from technical adjustments and that range dynamics should prevail.

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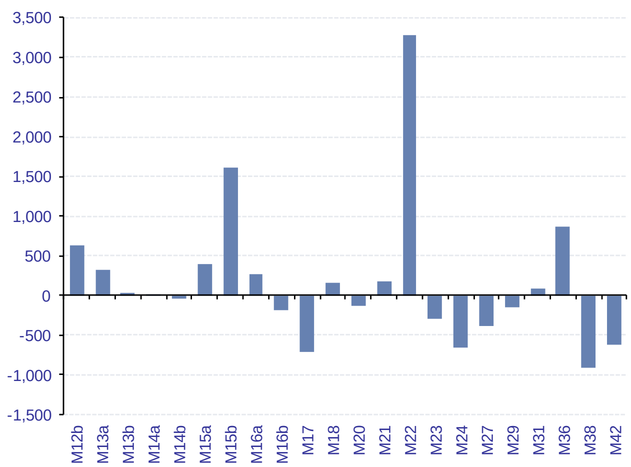
Chart 5

Net Foreign Inflows to MBOND curve (millions of MXN) - July 26, 2012



Source: BBVA Research, Banxico, Indeval

Technical Analysis

IPC

The week ended with a weekly balance above the 41,000pts resistance level. The next ceiling level could be at 41,500pts while the important short-term floor now sits at 40,000pts where the 30-day rolling average comes in. It should be recalled that there has been not major adjustment since the bounce started at 37,000pts. While there is not trend change on the daily chart, we will hold positions.

Previous Rec. (23/7/12). Due to the over-buying we may see at this 2nd resistance, we believe an appropriate level for profit-taking sits at 42,000pts.

Source: BBVA, Bancomer, Bloomberg

MXN

The dollar started the week moving up, breaking MXN13.50 and hitting the 50-day rolling average at MXN13.72. A downward move then began from this point. We believe the floor for this adjustment should be in the MXN13.25 zone, where we would recommend taking long positions with a stop loss at MXN13.22. If it breaks down through these levels, it could again hit levels near MXN13.00.

Previous Rec. (July 23, 2012). With the return to levels below MXN13.40, the door is open for a new return to the MXN13.25 level.

Source: BBVA, Bancomer, Bloomberg

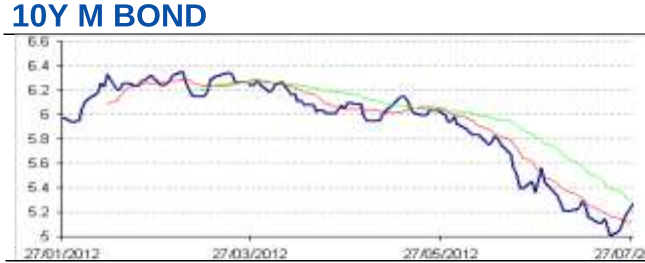
3Y M BOND

3Y M BOND (yield): A reaction began at the end of the week. We believe it could hit 4.75% and only breaking up through this level would point to a trend change.

Previous Rec. (July 23, 2012). Next floor up to 4.55%.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND



10Y M BOND (yield): Start of a bounce from the 5% support level. It already hit above the 10-day moving average, but still not over the 30-day average. Given the position of oscillating indicators, this break could be seen, seeking out 5.6%.

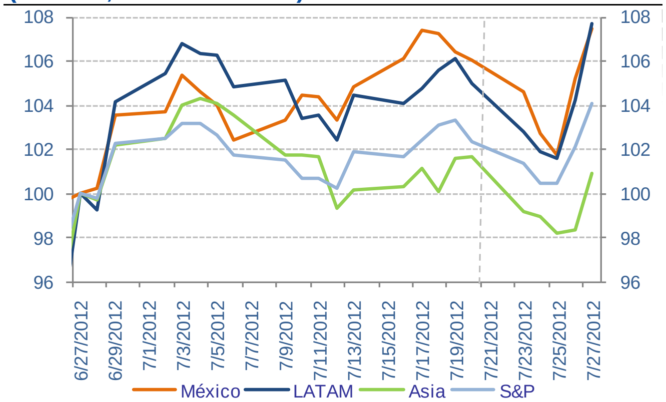
Previous Rec. (July 23, 2012). Next floor at the psychological level of 5% and, if broken, up to 4.8%.

Source: BBVA, Bancomer, Bloomberg

Markets

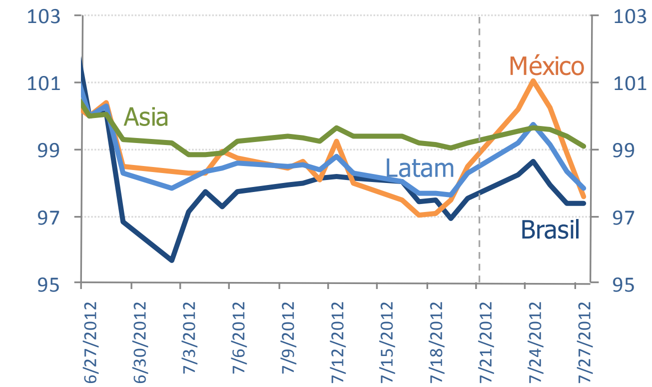
- **Gains on stock markets over the week and a rise in emerging currencies after the ECB chair stated that all necessary measures would be taken to safeguard the euro. This statement was understood as a sign of a new round of bond purchases contributing to stable access to markets for peripheral nations in the euro zone.**

Chart 7
Stock Markets: MSCI Indices (June 27, 2012 index=100)



Source: Bloomberg & BBVA Research

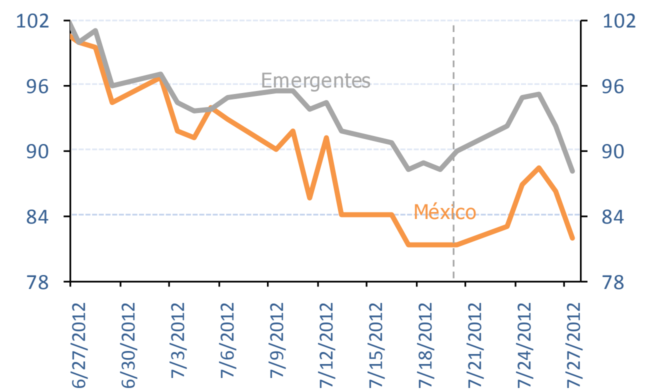
Chart 8
Foreign exchange: dollar exchange rates (June 27 2012 index=100)



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

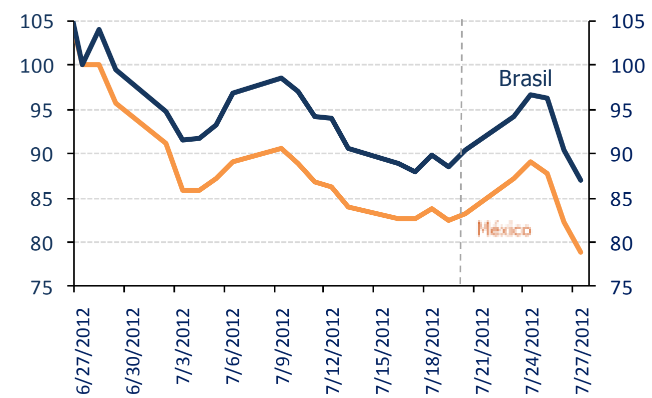
- **Fall in risk aversion due to a possible ECB intervention in coming weeks**

Chart 9
Risk: EMBI+ (June 27 2012 index=100)



Source: Bloomberg & BBVA Research

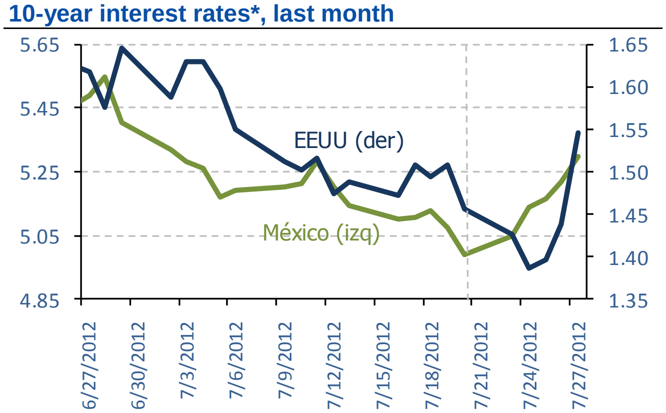
Chart 10
Risk: 5-year CDS (June 27 2012 index=100)



Source: Bloomberg & BBVA Research

- **Increase in Mexican interest rates over the week mainly due to lower global risk aversion and higher US rates.**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

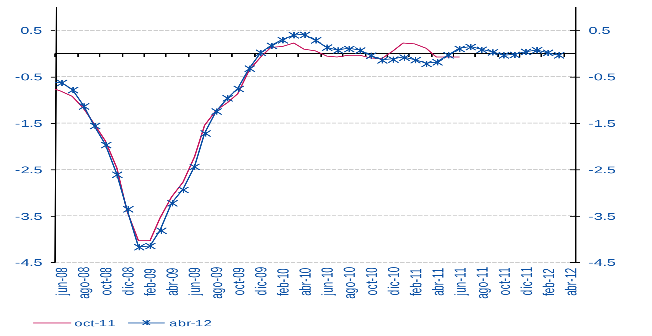
Chart 12
Carry-trade Mexico index (%)

Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

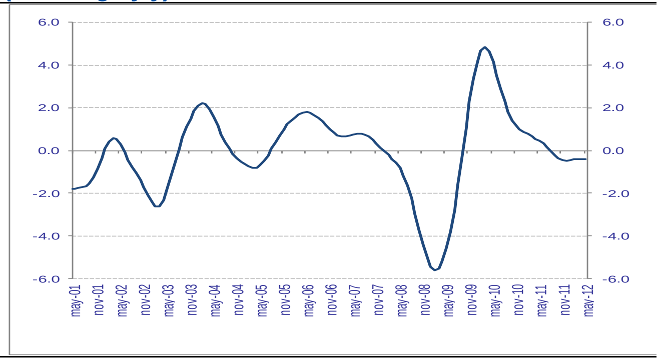
- **Output holds positive performance, situation indicators point to 2Q12 with quarterly rates around 0.7%.**

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.

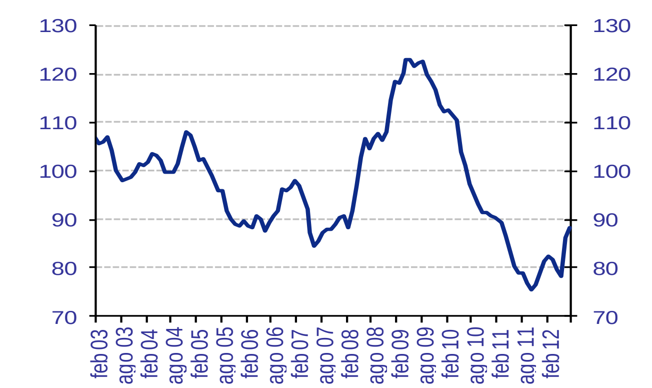
Chart 14
Advance Indicator of Activity, trend (% change y/y)



Source: INEGI

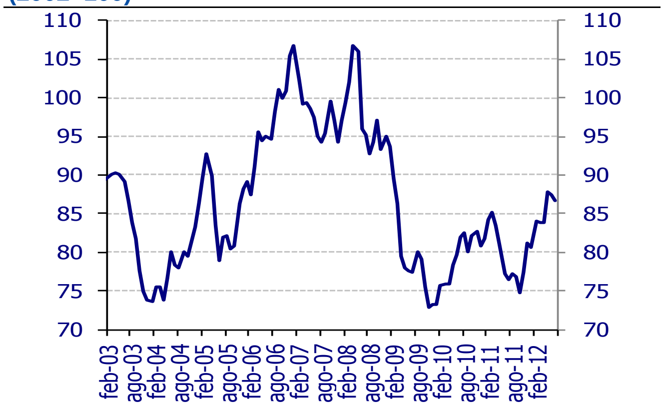
- **Inflation ceases downward surprises while output moved up.**

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.

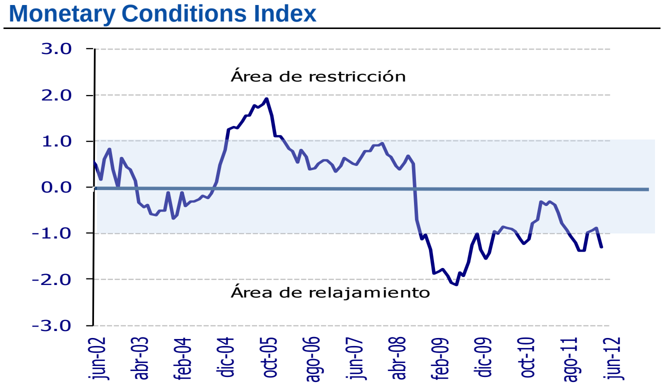
Chart 16
Activity Surprise Index (2002=100)



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.

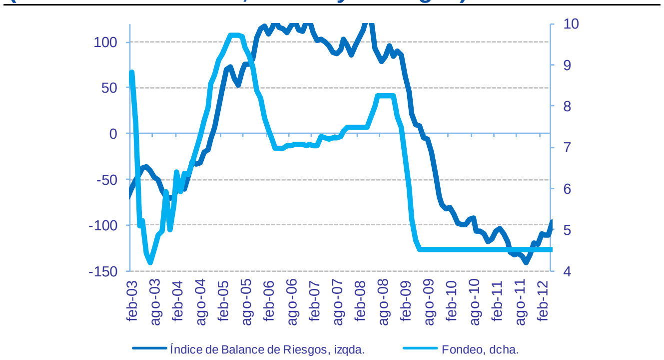
- **Monetary Conditions relax after higher inflation in June.**

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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