Mexico Weekly Flash

Next week…

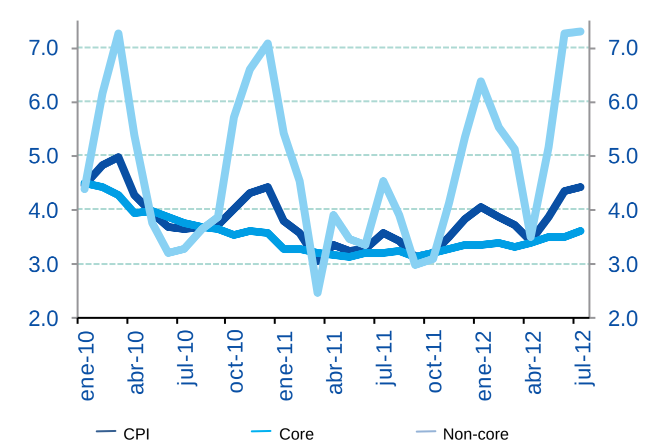
- **Banxico: Inflation report for the second quarter**

  The Bank of Mexico will publish its inflation report for the second quarter of the year next Wednesday. Highlights will include the central bank's inflation outlook, especially in the current scenario with inflation above 4% and after Banxico highlighted in its most recent statement that price risks have an upward bias in the short-term. In turn, the recent downturn in the domestic output risk balance and its effects on inflation in the medium-term are elements underlining the important of the central bank's growth forecasts, especially given the stronger downward risk for global growth. Additionally in terms of domestic output, the INEGI will release GDP growth figures for the second quarter and industrial output in June next Thursday 16. These should confirm the positive progress in output for the quarter although at a slightly lower rate than in the first months of the year.

- **Slightly stronger MXN with no global news and a slight climb in the MBond curve**

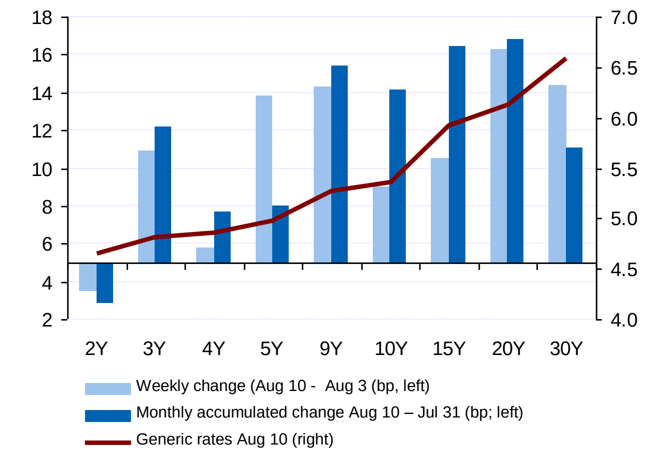
  With no major economic events, domestic market fluctuations were in line with those seen in LatAm and the US. The MXN mainly responded to technical factors while the yield curve reacted to the expected news of short-term inflationary pressures. The outlook for high liquidity, a prolonged monetary pause and a "respite" in EMU risk premiums led to a climb in the Mexican bond curve.

Chart 1
Headline inflation, core and non-core (% y/y)



Source: BBVA Research with INEGI data

Chart 2
Mexico: Yield curve (bp and %, generic)



Source: BBVA Research, Banxico, Indeval

Calendar: Indicators

Industrial Output in June (August 13)

Forecast: 0.7% m/m, 2.7% y/y	Consensus: 1.0% m/m sa	Previous: -0.9% m/m, 1.8% y/y

June IGAE (August 16)

Forecast: 0.4% m/m, 3.6% y/y	Consensus: N.A.	Previous: -0.4% m/m 3.0% y/y

GDP 2Q12 (August 16)

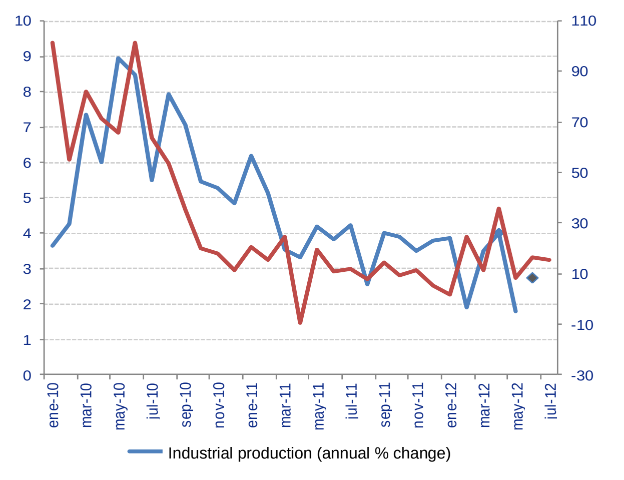
Forecast: 0.7% m/m, 2.7% y/y	Consensus: 4.2 a/a nsa	Previous: -0.9% m/m, 1.8% y/y

2Q12 GDP should have continued to see positive growth albeit slightly below that seen in the first months of the year. Based on the most recent estimates, we calculate growth in the region of 0.9% over the previous quarter (seasonally adjusted) giving an annual rate of around 4%.

It is worth recalling that based on the IGAE for May, average industrial growth was negative in April/May, affected by the contraction in US manufacturing ([-]0.7% % change m/m in May) and thus reflected in the lower number of automotive units produced (around 80% for export) of (-)0.5% m/m which, however, in yearly figures rose to 8.2%. In turn, the IGAE services indicator also points to a slight contraction in May for the sector after good growth in April. The albeit slight contraction in retail sales (-)0.2% m/m and other services such as transport (-)3.8% m/m and recreation services (-)4.7% m/m stands out for the sector. More timely output indicators in June however point to production generally recovering drive; for example, automotive output grew almost 10% in a month, US manufacturers recovered from the decline the previous month and consumer confidence also saw maintained strength before May.

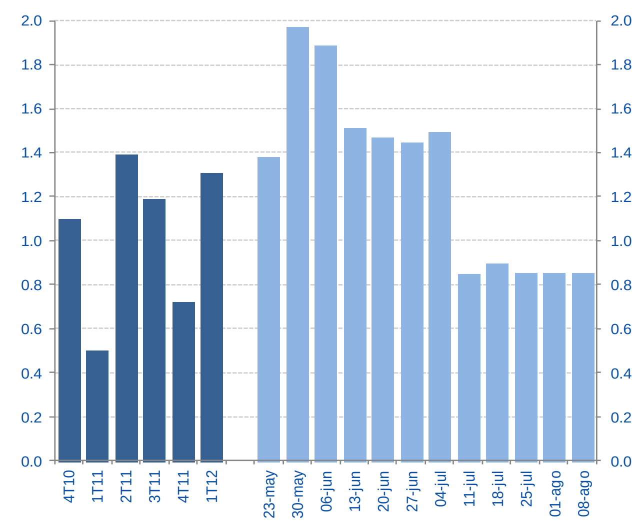
In short, we expect industrial output to have seen growth of around 0.7% for the month, 2.7% annual, with manufacturing being the strongest component due to the upswing in transport equipment. In marginal terms, the IGAE should expand by around 0.4% m/m in June, near to the 3.6% with regard to the same month last year.

Chart 3
Industrial and Automotive Output (% change m/m)



Source: BBVA Research with data from INEGI and AMIA

Chart 4
MICA BBVA Bancomer Model, estimate for 2Q12



Source: BBVA Research.

Markets

With no global economic news, the MXN saw a slight strengthening over the week. Markets awaiting

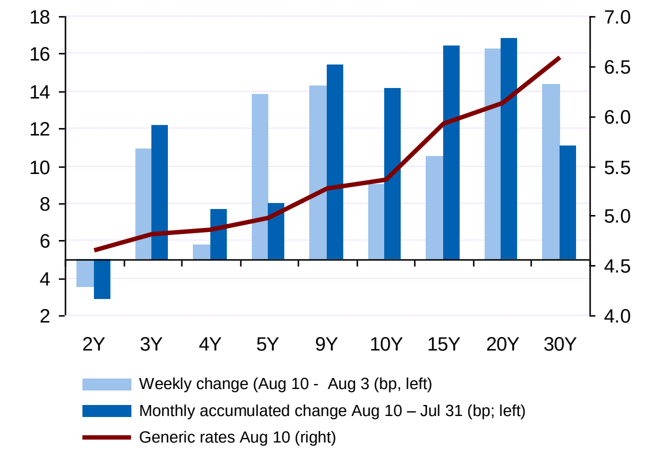
The lack of news on resolving the turmoil in Europe and US economic indicators meant the MXN followed technical factors awaiting directional elements which may arrive toward the end of the month with global monetary news. In this way, the MXN saw a slight weekly rise (0.19%), similar to other LatAm currencies. Fluctuations remained in a tight range between 13.28 and 13.05.

The stronger declines in the MXN were seen mid-week both due to technical factors and profit-taking in Europe. The MXN discreetly surpassed the performance of its peers with good unemployment figures in the US. In turn, the confirmation of upward inflationary pressure (above the Banxico target) had a marginal effect on the currency. Nonetheless, higher annual inflation favored the carry. Over the coming week, more US indicators to be released (retail sales and advances on August manufacturing) could have a greater impact on the MXN.

Upswing and weekly climb in the MBond curve in response to higher inflation and correlation with 10y US T-bills

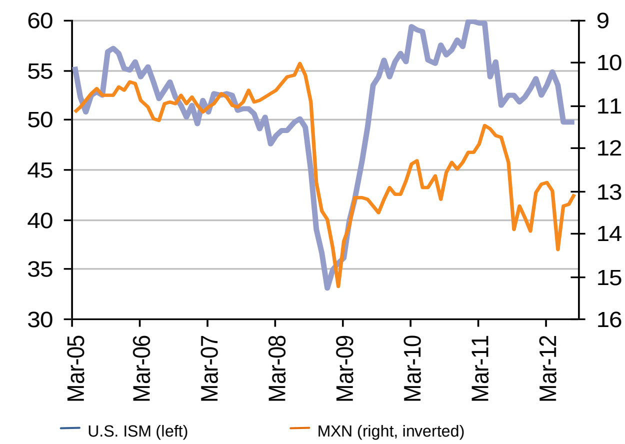
Domestic yield curves moved up over the week with more marked losses in longer maturities. This move was in line with US rates and higher inflation without creating a change in outlook for monetary policy. The high global liquidity meant the curve remained anchored.

Chart 5
Mexico: Yield curve (bp and %, generic)



Source: BBVA Research and Bloomberg

Chart 6
MXN (ppd; inverted axis) and US Output (ISM, index)



Source: BBVA Research and Bloomberg

Technical Analysis

IPC

Although the IPC has seen 2 consecutive weeks with declines, no short-term sale signal has taken root. Over 4 weeks the IPC has traded in a lateral range between 40,400 and 41,500pts. This week it again respected

this pattern, trading with a minimum of 40,546pts and a maximum of 41,383pts. This lateral pattern occurred after a major upswing meaning the likelihood the break ends up positive is high. If it breaks 41,500pts, we would have to forecast the 1,000pts in the lateral range upwards, meaning the next target would be 42,500/42,600pts.

Previous Rec. (8/3/12). In this way, we are keeping the resistance range between 42,000 and 42,200pts, where we would recommend taking profits in the face of the over-purchasing to be seen on short-term oscillating indicators

Source: BBVA, Bancomer, Bloomberg

MXN

The dollar remained trading near the MXN13.10 floor zone over the entire week. We believe that the range between MXN13.00 and MXN13.10 is a buy zone given the over-selling readings on oscillating indicators. We recommend taking positions awaiting a bounce with resistances at MXN13.30 and MXN13.50, maintaining a stop loss below MXN12.95.

Previous Rec. (8/3/12). The oscillating indicators are still not seeing high over-selling and so we cannot rue out a move toward MXN13.00, where we would again recommend taking short-term positions.

Source: BBVA, Bancomer, Bloomberg

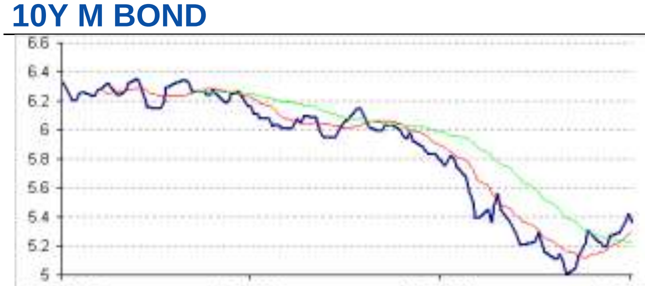
3Y M BOND

3Y MBOND (yield): Exceeding the previous maximum (4.75%) meaning we could be seeing a short-term trend change. Nuevo objetivo en 4.95% y soporte en 4.75%.

Previous Rec. (8/3/12). We maintain our forecast resistance at 4.75%. Above this level would mean a trend change.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND



10Y MBOND (yield): The 10-day rolling average has not broken up through the 30-day rolling average. We maintain our initial resistance at 5.6% and support zone at 5.3%.

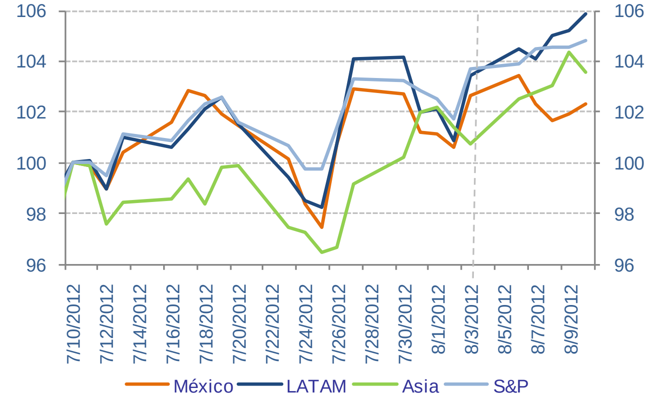
Previous Rec. (8/3/12). The 30-day average has changed trend and we can expect a bounce toward 5.6%. Oscillating indicators also support this bounce. Stop loss under 5.18%.

Source: BBVA, Bancomer, Bloomberg

Markets

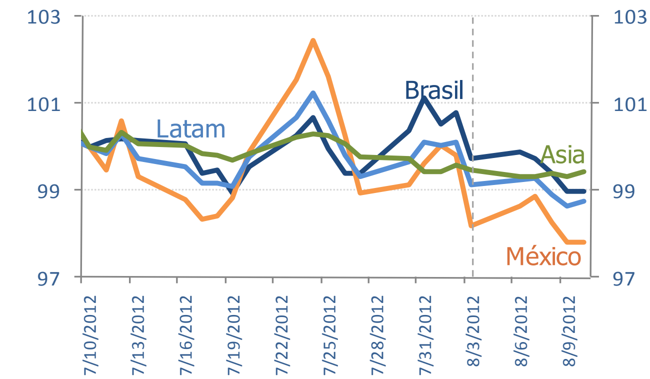
- **In a week with no major economic data, most stock markets saw gains influenced by statements from German politicians pointing to support for the ECB bond purchase plan. The Mexican stock market ended the week with no major changes while the peso strengthened over the week supported by the decline in unemployment welfare applications in the US.**

Chart 7
Stock Markets: MSCI Indices (Index, July 10, 2012=100)



Source: Bloomberg & BBVA Research

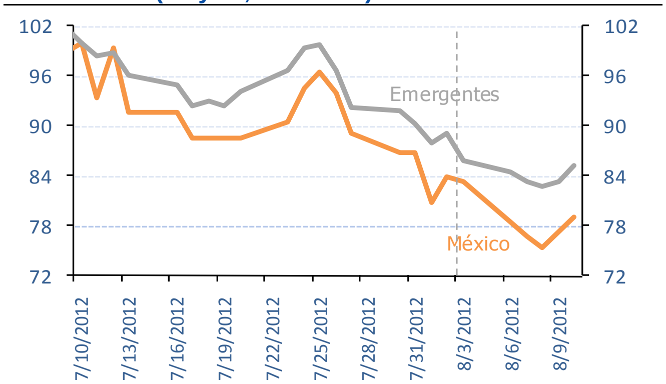
Chart 8
Foreign exchange: dollar exchange rates (Index, July 10, 2012=100)



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

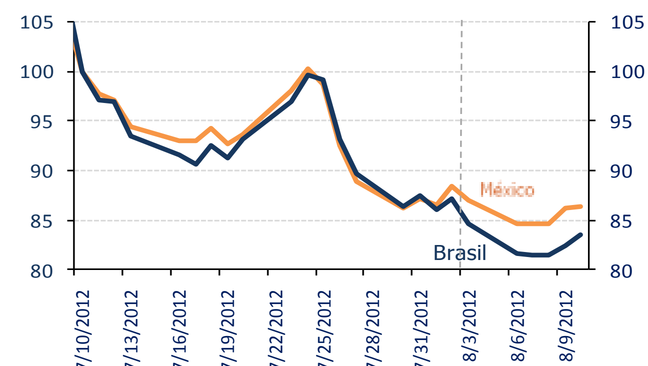
- **Fall in global risk aversion mid-week which minimized after the release of lower-than-expected inflation and industrial output data for the Chinese economy.**

Chart 9
Risk: EMBI+ (July 10, 2012=100)



Source: Bloomberg & BBVA Research

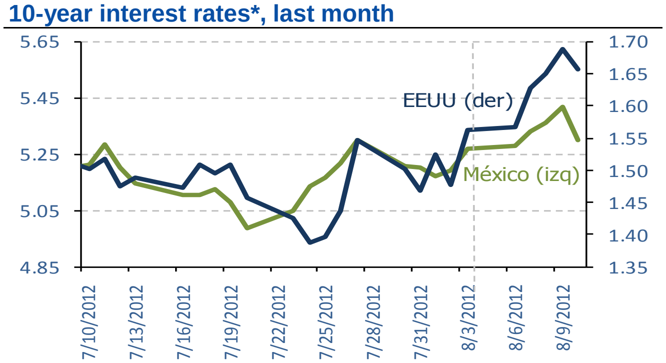
Chart 10
Risk: 5-year CDS (July 10, 2012=100)



Source: Bloomberg & BBVA Research

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

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

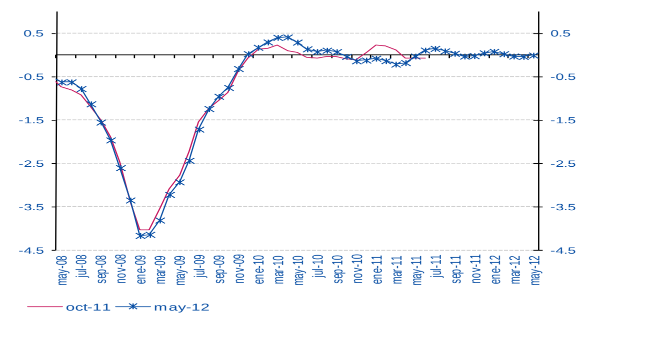
Chart 12
Carry-trade Mexico index (%)

Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

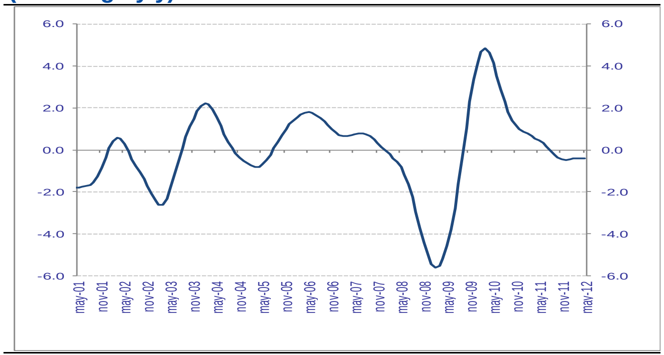
- **Output holds positive performance, situation indicators point to 2T12 with quarterly rates around 0.9%.**

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.

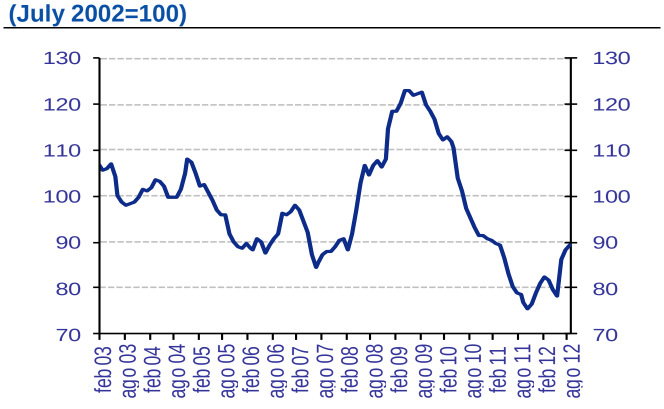
Chart 14
Advance Indicator of Activity, trend (% change y/y)



Source: INEGI

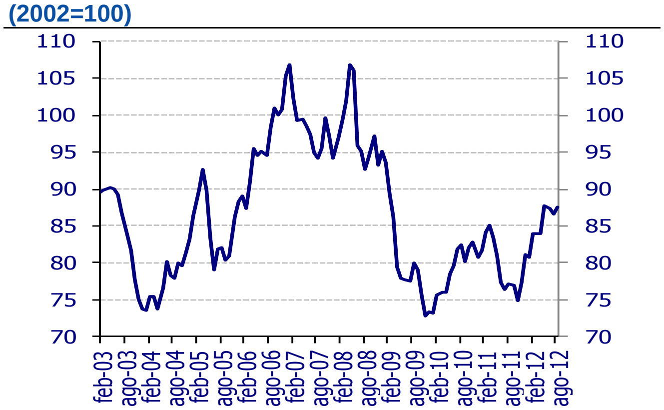
- **Inflation ceases downward surprises while output moved up.**

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.

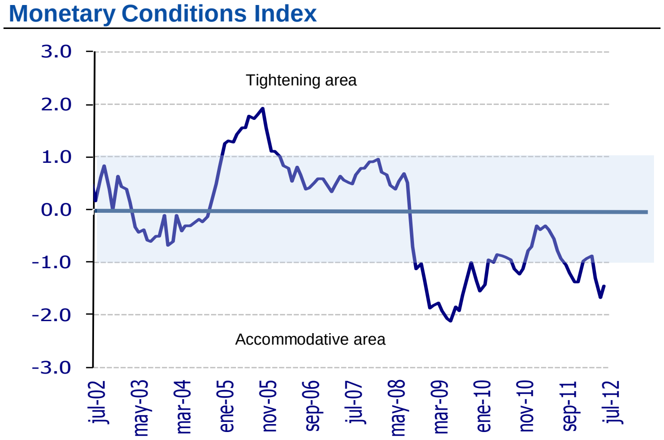
Chart 16
Activity Surprise Index (2002=100)



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.

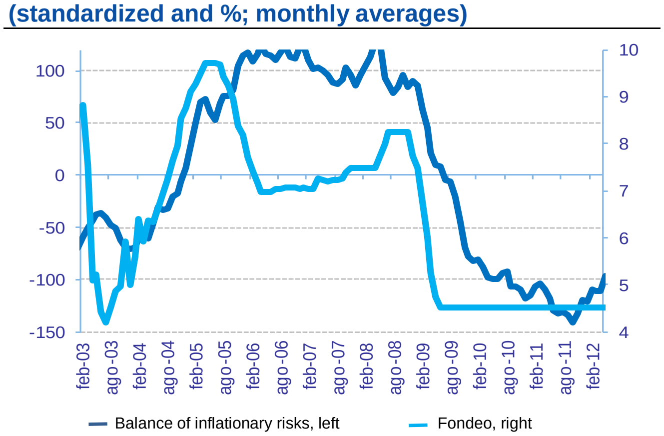
- **Monetary Conditions relax after higher inflation in June.**

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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