Mexico Weekly Flash

Next week…

- **Good output performance in second quarter, services key...**

  This week in addition to inflation for the first two weeks in August being published, retail and service sector performance for June will be released. It should be stated tertiary activities contributed 0.7 points to the 0.9% growth in 2Q12 GDP. The upswing in June for manufacturing was significantly better than expected and was the second highest change since March 2010. The good performance in services in retail and real estate (both seeing 1.5% growth q/q) will be seen this Wednesday 22, when retail sales and service sector revenue performance are released. Retail sales are particularly likely to have continued to contribute positively to the rise in wages and employment in the formal private sector. In turn, we will also see relevant data on the unemployment rate and addition measures such as underemployment in July. It should be recalled that, in this sense, downward resistance is important in both instances, still far from the levels seen pre-crisis.

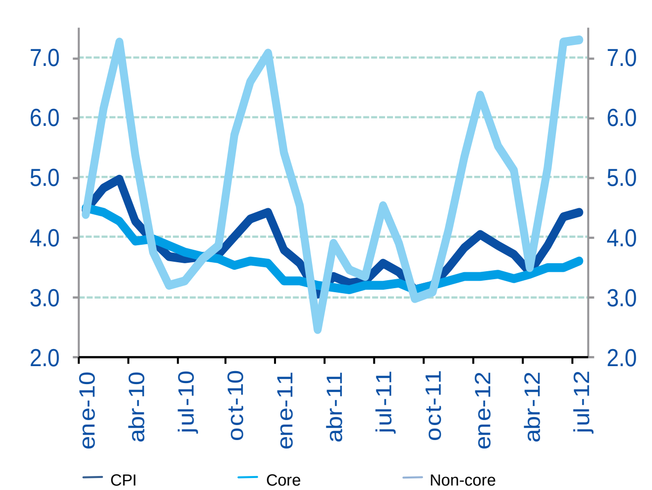
  In addition to output indicators, inflation for the first two weeks in August will be released which should continue to rise at an annual rate due to non-core pressure.

  (continued on next page...)

- **Local curve with no flow providing support over the week**

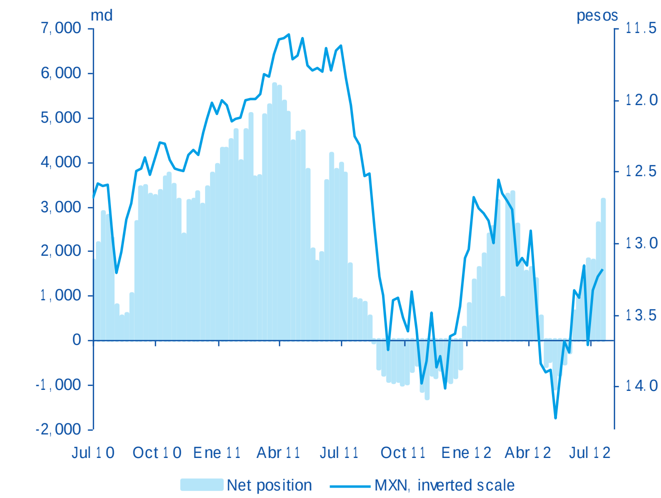
  The Mbond and TIIE curve rates continued their upward pattern in line with US T-bills, albeit with more intense gains due to no weekly flows toward domestic curves. In turn, the USDMXN kept in the 13.04-13.20 range over the week due to speculation surrounding major liquidity injections from the Fed.

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



Source: BBVA Research with INEGI data

Chart 2
CME: Long Non-Trading Positions in MXN (USD$mn)



Source: BBVA Research with Chicago Mercantile Exchange

Calendar: Indicators

Inflation for the first two weeks in August (August 23)

Forecast: 0.21% bi-weekly 4.52% y/y	Consensus: 0.17% bi-weekly	Previous: 0.56% m/m, 4.42% y/y

Next week see the release of inflation figures for the first two weeks of August. We expect inflation to continue to rise at an annual rate mainly due to non-core factors and to come in around 4.5%. The non-core components should continue to see pressure from livestock product prices, due to the outbreak of bird flu and high global grain prices, in addition to high energy prices around the world continuing to affect this element. Processed food prices in the core component should continue to see pressure from high grain prices although with remaining goods we are likely to see lower increases in annual inflation thanks to some effects of the weaker peso easing off. Meanwhile, services prices should remain fenced in, specifically the cost of housing and other services. Nonetheless, we will have to see if education prices remain stable or see some increase due to the continued economic recovery. We believe inflation will see its year-high in September and then fall back over the third quarter, coming in below 4% at the end of the year.

Aggregate Services Revenue Index in June (August 22)

Forecast: 1.3% m/m 7.1% y/y	Consensus: N.A.	Previous: 1.0% m/m 5.9% y/y

Retail Sales Indicator in June (August 22)

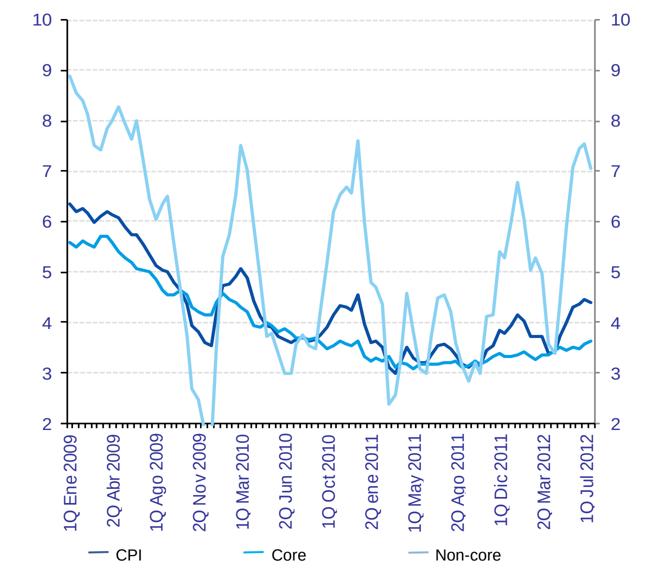
Forecast: 0.5% m/m 2.9% y/y	Consensus: N.A.	Previous: -0.2% m/m 4.4% y/y

Unemployment Rate in July (August 24)

Forecast: 4.9%	Consensus: N.A.	Previous: 5.0% y/y

Chart 3

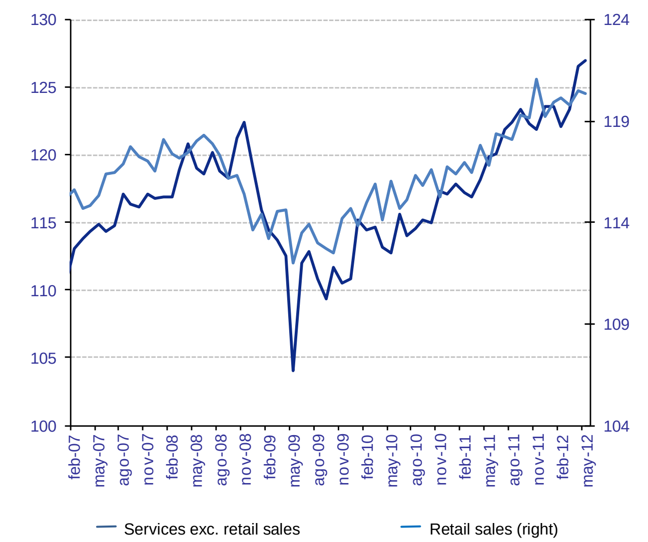
Headline inflation, core and non-core (% y/y)



Source: BBVA Research with INEGI data

Chart 4

Retail Sales and Services Indicator (2003 Index=100)



Source: BBVA Research with INEGI data

Mbond and TIIE curve rates maintained their upward pattern in tune with US T-bills.

Over the week, the strength seen in local rates was higher than in US rates. This is due to no weekly flows in domestic curves. The Siefores, in a portfolio reshuffle week, stayed away from the market while overseas investors reduced their flows in August, mainly this week. In fact, there were major outflows on Wednesday and Thursday (selling in the medium section and a major amount for 2036 [total sales over the two days of MXN5.134 bn), however, the aggregate flow for August remains positive. Attention with foreign portfolio rejigging: although we do not expect a massive outflow, we should watch out for some temporary flow decline as a leading indicator of curve performance.

MXN reflects cautious sentiment toward US data and the situation in the EMU

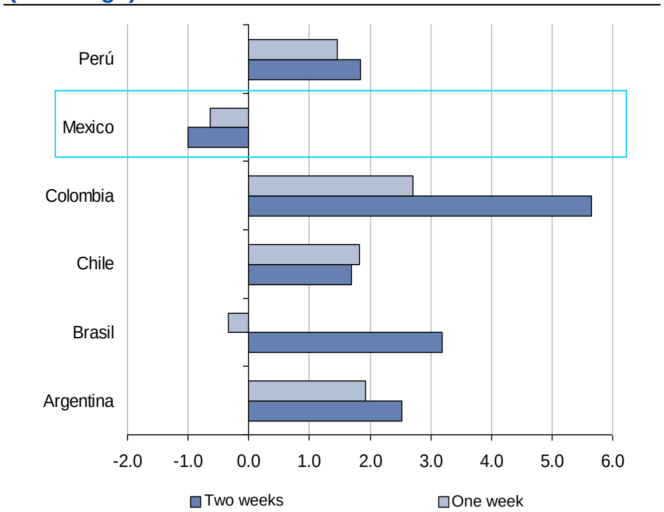
The USDMXN kept in the 13.04-13.20 range over the week, ending with a near 0.5% devaluation compared to the previous Friday. Performance was set by the series of economic data released in the US which if they continue to be mixed (positive for July but with negative bias for August) do not increase uncertainty regarding the economic cycle but neither do they restrain expectations of new liquidity injections. We believe that this should continue to be the trend over coming days in anticipation of the annual Fed meeting at Jackson Hole (end of month).

We believe that in the face of few key events in the EMU, markets will continue to respond to economic indicators which, next week, will be abundant in the US. In this way, the caution will remain in the short-term and the currency should remain in the 13.0-13.35 range.

In the current global scenario of higher risk appetite, the Mexican stock market saw a worse performance than its Latin American cousins.

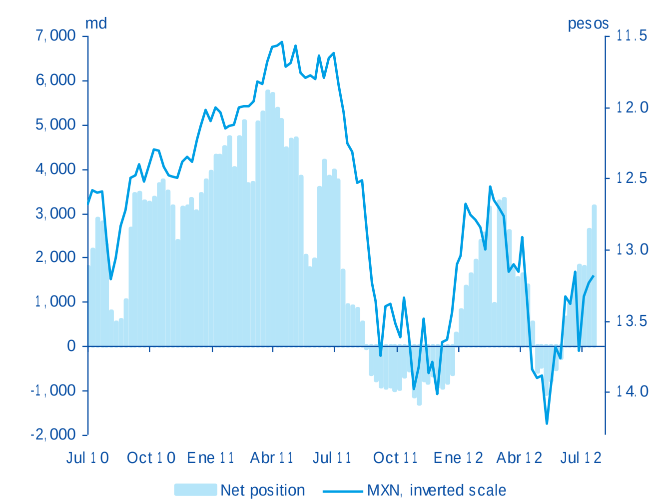
The IPC's performance in Mexico was affected by a 6% decline in Walmex and the BMV's announcement of changes in the IPC selection (to come in between September and August). Incoming businesses will account for 6.4% of the IPC and AMX will represent 25%. In turn, shares in MFrisco, Alfa, Gap, Chedraui and Bimbo could see sell pressure due to the stock market rebalancing effect.

Chart 5
LatAm: Stock Markets (% change)



Source: BBVA Research and Bloomberg

Chart 6
CME: Long Non-Trading Positions in MXN (USD$mn)



Source: BBVA Research and Bloomberg

IPC

Source: BBVA, Bancomer, Bloomberg

The IPC saw no major changes in the short-term outlook, continuing to trade laterally in the 40,400pts to 41,500pts range. We will therefore only see an exit signal when the lower limit of this range is broken. This break could come about if the US market, after 6 consecutive weeks of rising, starts to see profit-taking.

Previous Rec. (8/10/12). This lateral pattern occurred after a major upswing meaning the likelihood the break ends up positive is high.

MXN

Source: BBVA, Bancomer, Bloomberg

The dollar had a week with marginal trades, remaining in the MXN13.10/13.15 zone. Our short-term recommendation is to hold long positions in the expectation of a bounce to the MXN13.30 or even MXN13.50 zone, only applying a stop loss if it breaks down through MXN13.00.

Previous Rec. (8/10/12). We recommend taking positions awaiting a bounce with resistances at MXN13.30 and MXN13.50, maintaining a stop loss below MXN12.95.

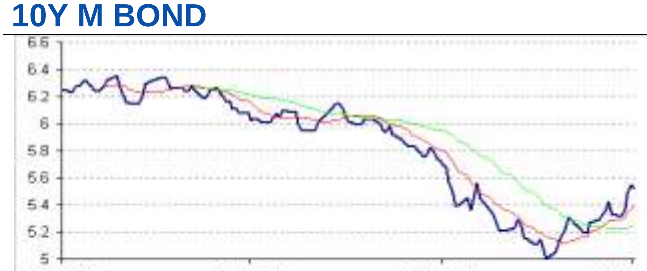
3Y M BOND

Source: BBVA, Bancomer, Bloomberg

3Y M BOND (yield): Again testing the 10-day rolling average, respecting the initial floor and the bounce move remaining in force. We maintain a target in the 4.9-4.95% range.

Previous Rec. (8/10/12). We can consider a short-term change in the trend. Our target is 4.95% and a support at 4.75%.

10Y M BOND



Source: BBVA, Bancomer, Bloomberg

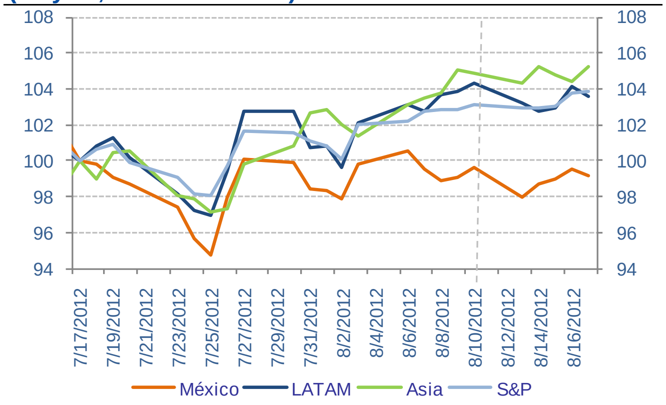
10 Y M BOND: (yield): Maintaining its upward move after a positive crossing for averages. We maintain an initial target of 5.6% and then 5.8%. Initial support level at 5.4%.

Previous Rec. (8/10/12). 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%.

Markets

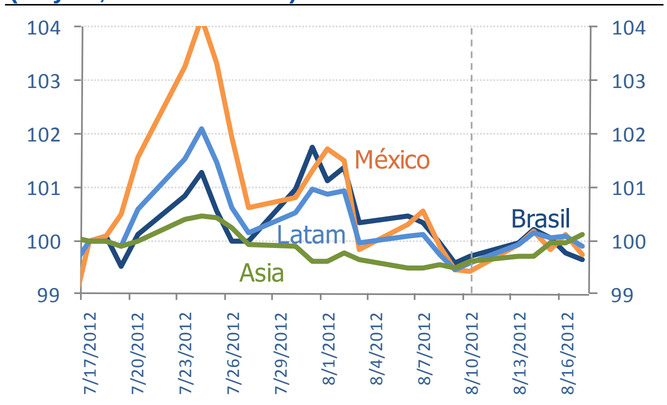
- **Upward moves on stock markets and marginal moves on currency markets after better-than-expected US economic figures were released on retail sales, industrial output and consumer confidence.**

Chart 7
Stock Markets: MSCI Indices (July 17, 2012 index=100)



Source: Bloomberg & BBVA Research

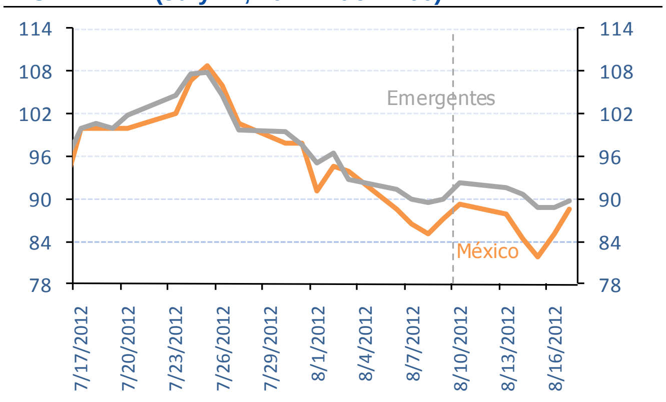
Chart 8
Foreign exchange: dollar exchange rates (July 17, 2012 index=100)



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

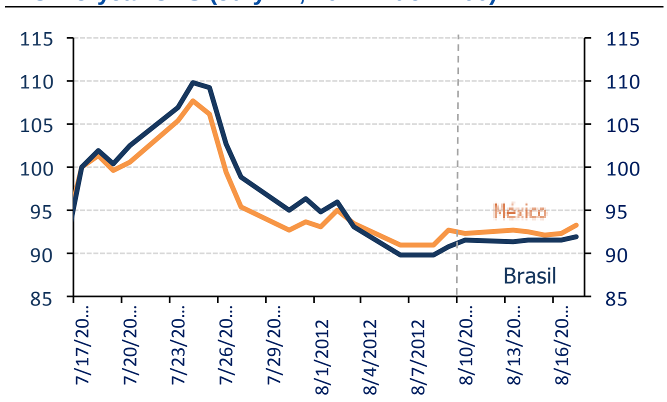
- **Global risk aversion indicators with no major changes in a week with low trading volumes.**

Chart 9
Risk: EMBI+ (July 17, 2012 index=100)



Source: Bloomberg & BBVA Research

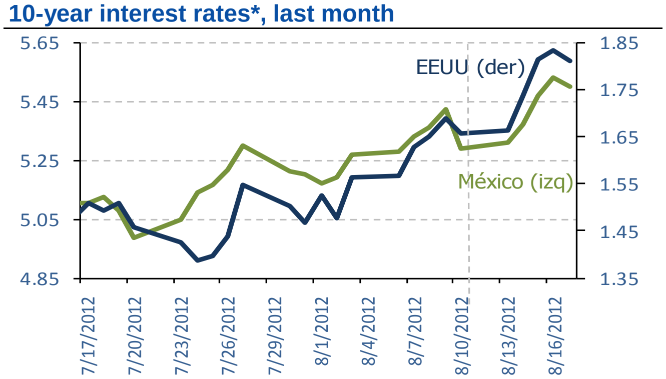
Chart 10
Risk: 5-year CDS (July 17, 2012 index=100)



Source: Bloomberg & BBVA Research

- **Continued upswing in US interest rates due to better-than-expected economic data and a European scenario with no major changes. Mexican rates increased due to high positive correlation with US rate.**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

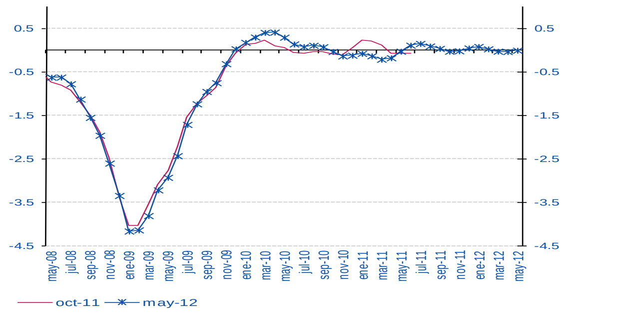
Chart 12
Carry-trade Mexico index (%)

Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

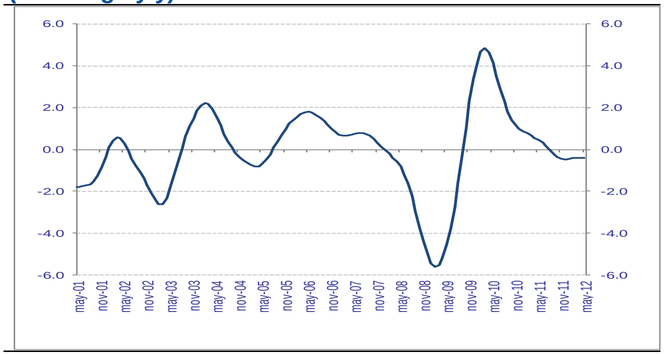
- **Output holds positive performance, situation indicators point to 3T12 with quarterly rates above 0.5%.**

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.

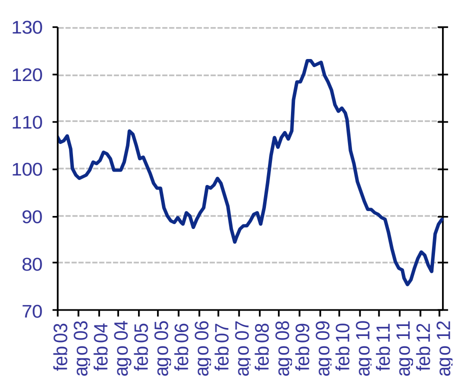
Chart 14
Advance Indicator of Activity, trend (% change y/y)



Source: INEGI

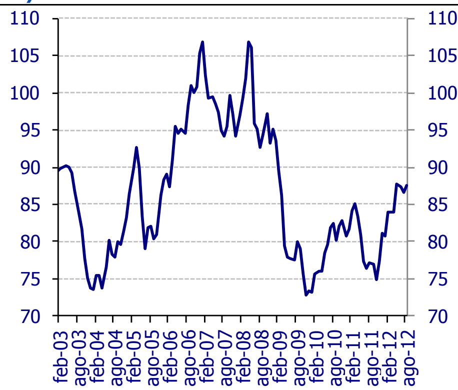
- **Inflation ceases downward surprises while output moved up.**

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.

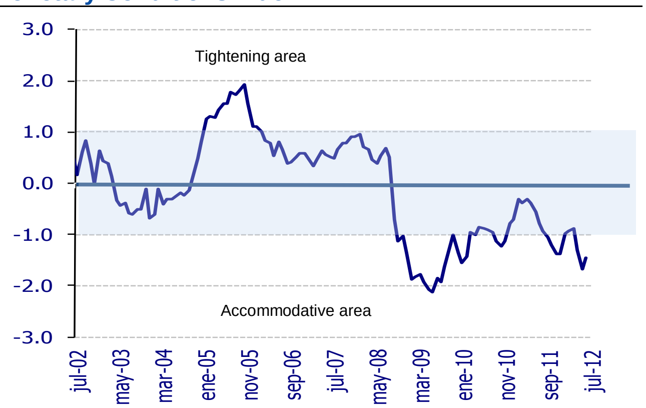
Chart 16
Activity Surprise Index (2002=100)



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.

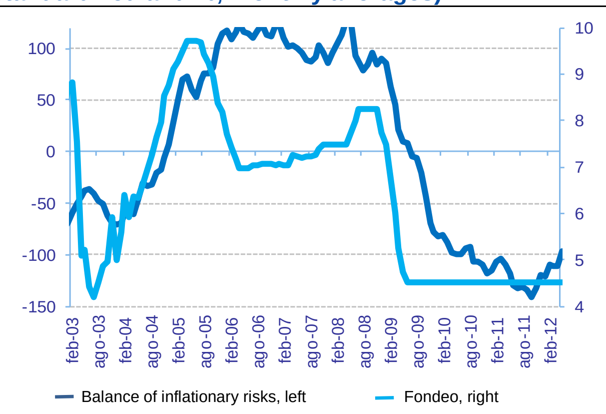
- **Monetary Conditions relax after higher inflation in June.**

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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