Mexico Weekly Flash

Next week…

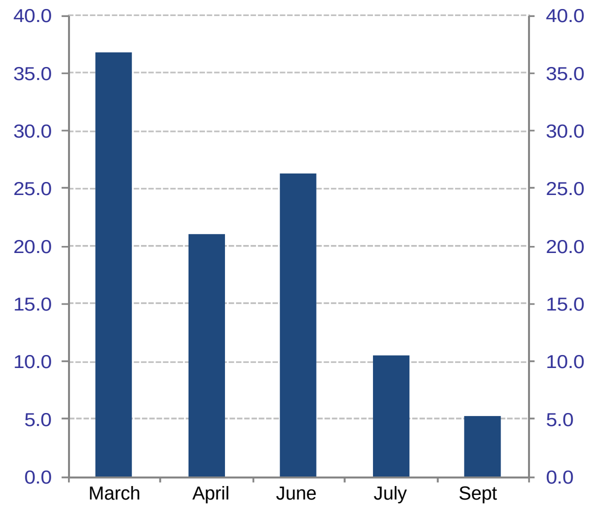
- **Recent upward inflation risks could delay the monetary policy rate cut**

  This coming Friday Banxico will release its monetary policy decision which comes in the light of an unexpected change in tone in recent statements that stressed a looser position. We believe Banxico is more likely to keep the rate unchanged and opt for a 50 basis points cut at the April meeting based on the following factors. Firstly, several more weeks are needed to clearer weigh up how much the recent bird flu outbreak has affected inflation. Secondly, more inflation data are required to see if the favorable telephone prices are set to continue. Especially since inflation in February came in above analyst expectations. Thirdly, external events such as the US fiscal talks and the new Italian political scenario could lead to unstable financial markets in coming weeks. Lastly, there will be more output data at the April meeting for both Mexico and the US, providing output performance for 1Q13 and the chance to assess the future outlook. In short, given the prudence shown by Banxico on previous occasions where the tone has relaxed, there is evidence to believe that the decision to cut the lending rate will be delayed. Nonetheless, the repeated looser tone suggests a rate cut at the March meeting cannot be ruled out.

- **Volatility continues to favor domestic curves**

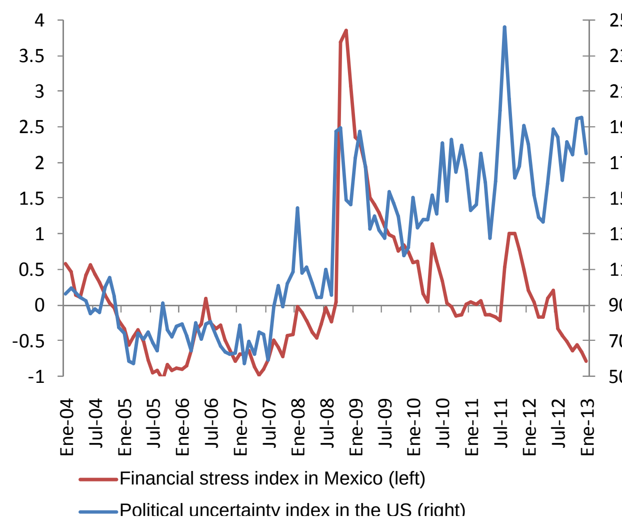
  Yields in the long section of the curve continue to positively respond to the global scenario (liquidity and low growth) as well as to a more relaxed tone at the Bank of Mexico.

Chart 1
Date of the next monetary policy cut (% analysts)



Source: BBVA and Financial Market Analysts' Survey
NB: 19 out of 20 analysts who responded to the date and size of the next move expected a cut.

Chart 2
Political uncertainty index in US and Financial stress indicator in Mexico (Indices)



Source: BBVA Research with Backer, Bloom and Davids (2013)

Calendar: Indicators

February inflation (March 7)

Forecast: 0.58% m/m (3.65% y/y)	Consensus: 0.51% m/m	Previous: 0.40 m/m (3.25% y/y)

Next Thursday sees the release of inflation figures for February which are expected to rise 0.58% m/m for headline and 0.53% for core inflation meaning annual inflation is set to come in at 3.65% and 2.98% respectively. These relatively high inflation rises in February are due to the strong revision in cell phone rates after the aggressive promotions and discounts seen between November and the first two weeks of January, higher public prices such as water and, to a lesser extent, some price pressures in agricultural and livestock products. Although inflation will rise due to these factors and a base effect compared to 2012, many factors that support a decline in inflation between October and January remain current such as the stronger peso, stable global commodity prices and slack in the economy. With this, sub-indices such as goods which saw major pressure last year will continue to see inflation drop back and others that escaped any pressure such as housing prices and education are set to to see ongoing stable inflation. In turn, and despite the new outbreak of bird flu in Guanajuato and part of Jalisco, no major price hikes such as those seen last year have been recorded. In this way, although inflation may rise toward April, the favorable basis inflation has seen remains in place meaning no major inflationary pressure is expected in the second and third quarter of the year. Inflation is therefore highly likely to end the year below 4%.

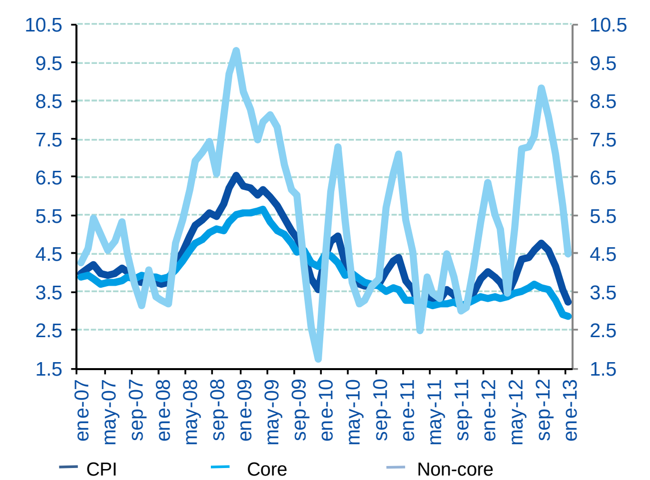
Consumer and producer confidence in February (March 5)

Forecast: Consumer -0.2% m/m (98.1 pts)	Consensus: N.A.	Previous: -0.8% m/m (98.3 pts)
Forecast: Producer 0.0% m/m (56.6 pts)	Consensus: N.A.	Previous: 0.7% m/m (56.6 pts)

Confidence indicators for February will reflect the more optimistic tone in output at the end of 2012 and start of 2013. Performance was mixed in producer confidence since, on the one hand, the aggregate trend indicator contracted (-)3.7% in monthly terms in January. Other sub-indices were in negative terrain such as output and domestic and foreign demand for goods. On the other hand, producer confidence increased slightly and, more importantly, the right moment to invest indicator saw a higher upturn in the last 12 months. For February, we believe industrial output should have increased, especially for manufacturing. It should be stated in this sense that the US ISM indicator remains in growth territory showing a third consecutive month of recovery.

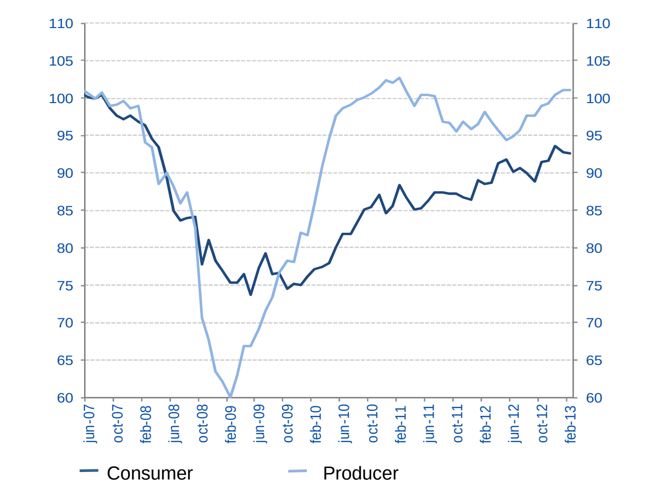
The ability to acquire durable goods indicator will need to be monitored in consumer confidence since it contracted for the second month in a row in January. We forecast the aggregate indicator to see a slight decline. It should be stated that confidence is still below pre-crisis levels.

Chart 3
Inflation breakdown (% change y/y)



Source: BBVA Research with INEGI data

Chart 4
Confidence: Consumer and Producer (July 07 = 100)



Source: BBVA Research with INEGI data

Markets

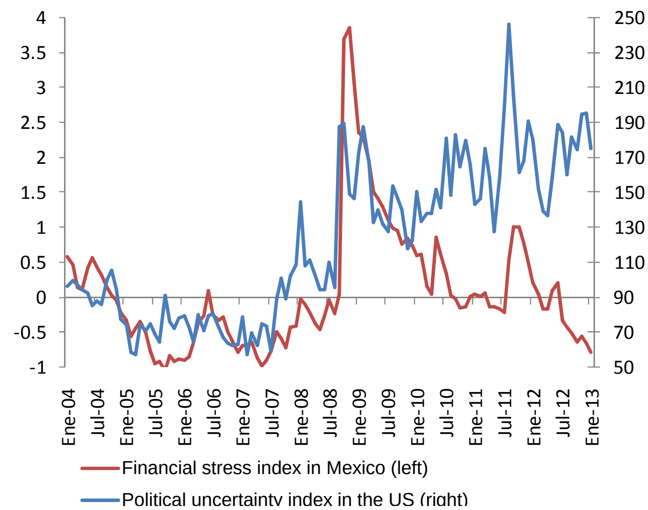
- **Volatility continues to favor domestic curves**

In line with our forecast, yields in the long section of the curve continue to positively respond to the global scenario (liquidity and low growth) as well as to a more relaxed tone at the Bank of Mexico. The 2042 Mbond hit all-time lows while the slope between the M2042 and M2022 closed toward 97bp (our target is 85bp - open at 122bp). In turn, our long M2015 (Dec) strategy vs Mbond 2022 is heading toward our target (100bp - open at 42bp); the difference is currently 65bp.

If Banxico cuts the lending rate next Friday, as stated the likelihood is not low, we have no doubt that the exit will continue to move against the middle section. The Bank of Mexico being inclined toward easing, the global scenario continuing to support the curves and a constructive domestic outlook sustain our forecast. Along these lines, the MXN saw a fair amount of volatility, closing unchanged. We could see a wider trading range before the Bank of Mexico decision this week.

Chart 5

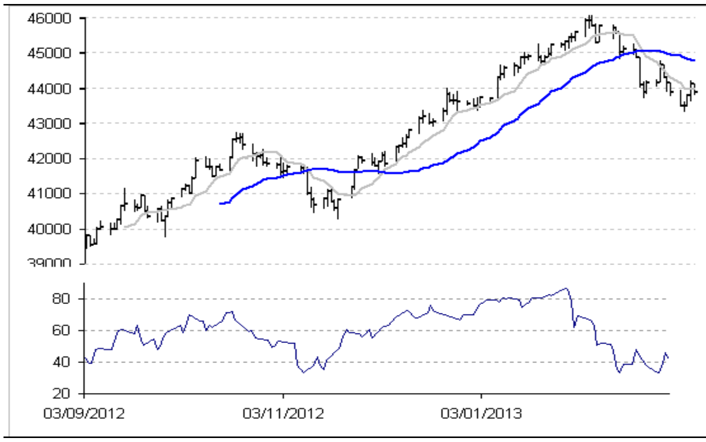
Political uncertainty index in US and Financial stress indicator in Mexico (Indices)



Source: BBVA Research with Backer, Bloom and Davids (2013)

Technical Analysis

IPC



The IPC tested the 43,500pts level over the week which we have signaled in recent weeks as a major support point standing for the 38.2% pushback in the Fibonacci model. From this floor, the IPC saw a bounce to maintain a neutral balance, although this it not enough to take it above the 1st resistance level set by the 10-day rolling average (44,000pts). Above this level there is a second resistance at 44,850pts where the 30-day rolling average is already trading. Therefore, and thanks to the RSI level, we can only consider a return to these resistances and a trend change could be considered once there is an upward break through the 30-day rolling average.

Previous Rec. (2/25/13): We cannot consider an entry signal onto the market until the IPC again hits above the 30-day rolling average, i.e. above 45,000pts

Source: BBVA, Bancomer, Bloomberg

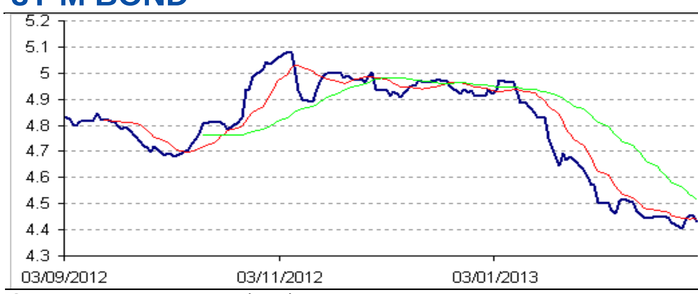
MXN

Volatile week with the dollar hitting a high of MXN12.90. After the upward break through MXN12.80, this level is now the short-term support. Oscillating indicators continue to point to an upturn through MXN13.00 while it remains above MXN12.75. We maintain long positions.

Previous Rec. (2/25/13): Continuing to trade above the 30-day rolling average. This suggests a break of the current range will be upward

Source: BBVA, Bancomer, Bloomberg

3Y M BOND

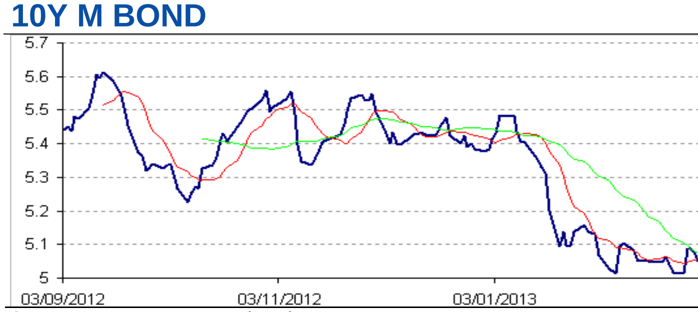


3Y M BOND (yield): The bond continues to show no short-term upturn but we continue to consider a move to at least the 30-day rolling average at 4.5%. Positive signal if it breaks this resistance level.

Previous Rec. (2/25/13). Over-selling remains very high and we could see a bounce toward 4.6% in the 30-day rolling average

Source: BBVA, Bancomer, Bloomberg

10Y M BOND



10Y M BOND (yield): The bond maintained the move between 5% and 5.1%. The 10-day rolling average is about to cross up through the 30-day. We therefore believe we could see an upward move in coming days with resistances at 5.1 and 5.15%.

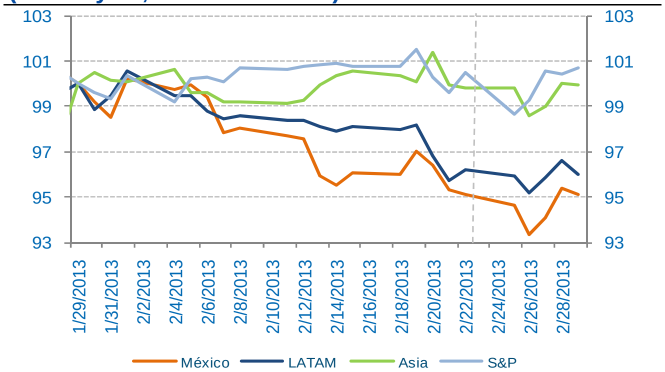
Previous Rec. (2/25/13). Given the spread at this level with the 30-day average, we continue to assume an upturn, now toward 5.2%

Source: BBVA, Bancomer, Bloomberg

Markets, activity and inflation

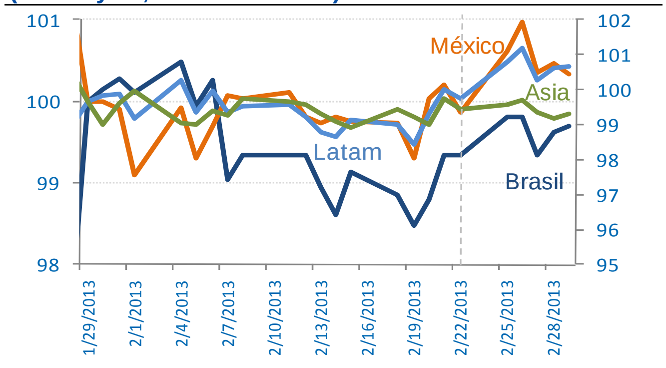
- **The results of the Italian elections where no party won a majority in the chambers to form a government led to doubts about ongoing austerity measures in the country and losses on stock markets and declines in LatAm currencies. The peso strengthened at the end of the week after US manufacturing output and consumer data prevailed against uncertainty surrounding spending cuts coming into effect in the US and lower-than-expected manufacturing data in China and Europe.**

Chart 7
Stock Markets: MSCI indices (January 29, 2013 index=100)



Source: Bloomberg & BBVA Research

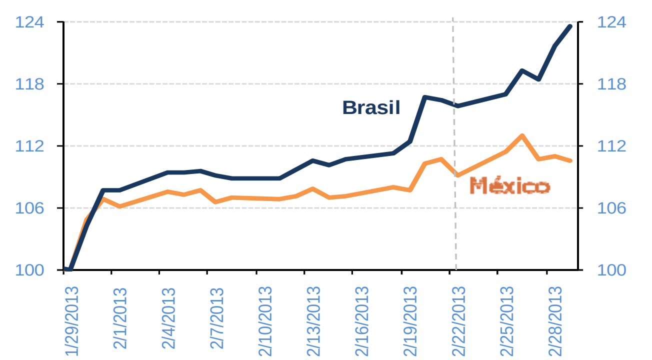
Chart 8
Foreign exchange: dollar exchange rates (January 29, 2013 index=100)



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.

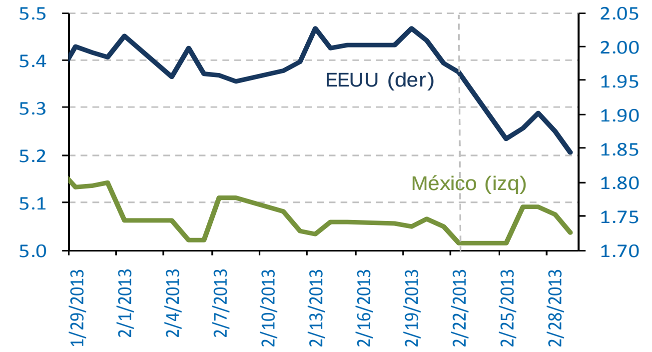
- **US rates fall and Mexican rates rise over the week due to higher risk aversion and in anticipation of the monetary policy decision.**

Chart 9
Risk: 5-year CDS (January 29, 2013 index=100)



Source: Bloomberg & BBVA Research

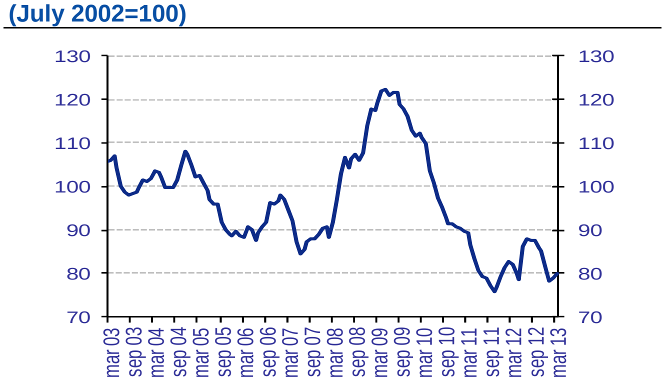
Chart 10
10-year interest rates, last month



Source: Bloomberg & BBVA Research

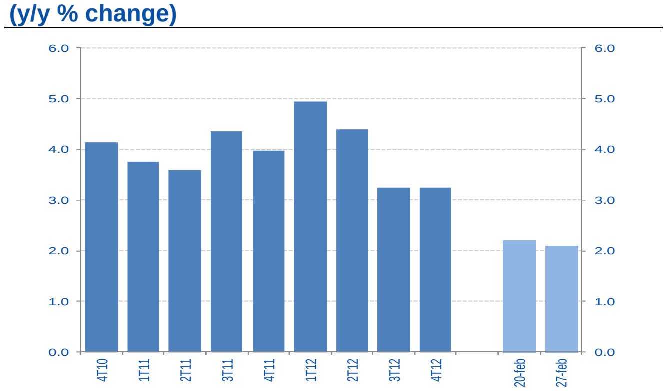
- **Recent situation indicators for economic output point to the start of 2013 continuing to see a slowdown in output. The BBVA MICA model points to annual growth of 2.5% or slightly lower. Meanwhile, inflation has slowed, coming in below 4% in December.**

Chart 11
Inflation Surprise Index (July 2002=100)



Source: Bloomberg & BBVA Research

Chart 12
Observed and estimated GDP (y/y % change)



Source: BBVA Research with data from Bloomberg

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