

Weekly Watch

Mexico

July 22, 2011

Economic Analysis

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Market Analysis

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Next week...

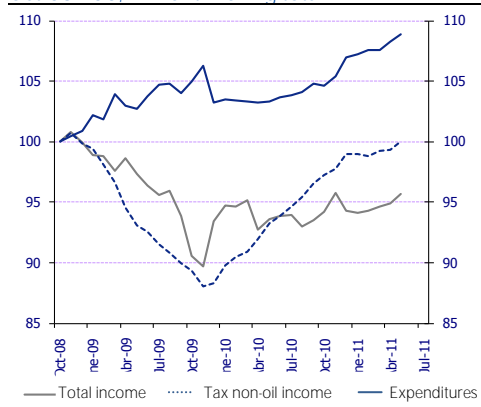
...Mexico also has public finance

The extraordinary meeting of the Heads of State and Governments of the Eurozone on Thursday provided positive news although aspects remain to be hammered out in resolving Greece's solvency problems and eliminating any spread to other countries in the zone which will remain under market scrutiny with regard to payment of some European sovereign debt. In the US, meanwhile, negotiations continue to raise the public debt threshold and avoid default from the beginning of August and, in this event, the downgrading already announced by ratings agencies. In Mexico, budget data, information for June coming next week, show a consistent improvement in revenues with growth in output and higher tax rates from 2010. As for expenses, there were also increases linked to investment and with other expenses, highly inertial, and more so with the higher oil price - the reference for transfers to states. As can be seen in the chart below, the increase in the former is lower than in the latter giving budget levels as a percentage of GDP at 2.9% in 1Q11 (1% deficit without debt interest payments). These figures are much better than for other economies and mean no risk of an increase in public debt with present financing costs. Nonetheless, the deficit not falling after two years of growth at an average 5% does highlight the weaknesses in Mexican public finances pointed out often in the past: upward inertia in expenses and a low income base, as well as volatility due to double exposition to the economic cycle, output and oil.

Relief in risk premiums thanks to EU agreements, the fiscal situation in the US will come into the spotlight while domestic inflation sees surprise upswing

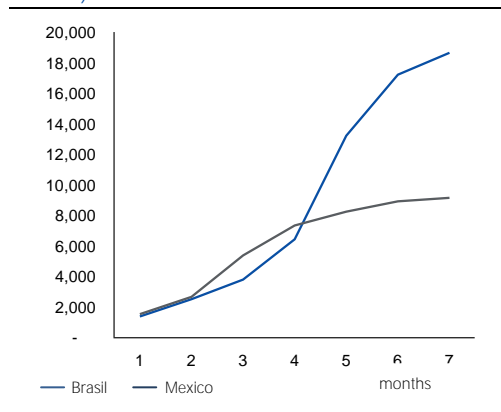
The major advances in solving the sovereign debt crisis in Europe (June 21) contributed to relief in risk tensions. In addition, real estate and manufacturing output data for the US supported the MXN. Fixed income saw lower demand due to safe-haven assets meaning the yield curve in the US and Mexico moved up. Despite the surprise upswing in total inflation, core inflation remains stable and, therefore, no change is seen in the interest rate stability scenario. Volatility will continue due to the still unresolved agreement to increase the US debt threshold.

Chart 1
Mexico, budget figures
 Oct-08=100, 12 month rolling total



Source: BBVA Research with SHCP data

Chart 2
Placement in domestic credit market (in USD million)



Source: BBVA Research with data from Bloomberg

Calendar: Indicators

Economic Activity Index (IGAE) (May, July 27)

Forecast: 0.3% m/m (3.2% y/y) Consensus: N.A. Prev: 0.4% m/m (3.4% y/y)

Economic Analysis

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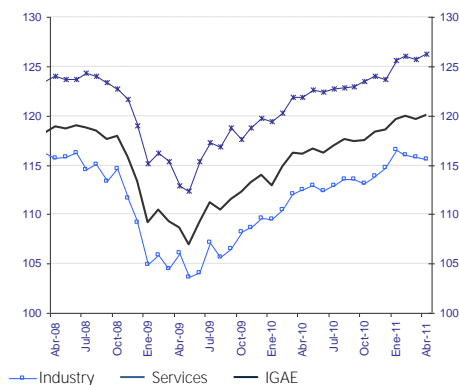
We believe that there are reasons for the IGAE to remain relatively stable for May. On the one hand, manufacturing saw good growth (a positive +1.1% m/m upswing) which ended the run of falls. Although growth is concentrated in certain manufacturing sectors and there are still major lags in sectors such as construction, the aggregate dynamic was good. On the other, available services data showed contrasting results: on the one hand, services (aggregate income index for non-financial private services) saw a good performance (0.9% m/m, 0.7% on average in the first four months of the year) while sales saw major contractions (-2.1% m/m, 0.4% on average in the first four months). In all, we estimate growth will have remained at a similar rate to the previous month, continuing the temporary moderation outlook linked to overseas downturns.

Trade Balance (June, July 26)

Forecast: 252 md. Consensus: N.A. Previous: 555 md

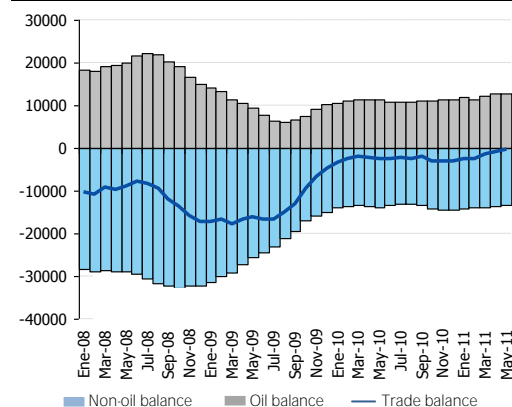
The Trade Balance for June will continue to show a surplus thanks to higher exports, contrasting with domestic demand. However, this surplus will slowly recede as the oil price moves down thanks to the gradual easing of tension in the Middle East and high inventory levels in OECD countries. In terms of trade levels, the coming months will be important to see the effects that the lower output rate in the US may have on Mexico.

Chart 1
IGAE, index (2003=100)



Source: BBVA Research with Banxico data

Chart 4
Trade balance (md) 12-month rolling average



Source: BBVA Research and INEGI

Markets

Relief in risk premiums thanks to EU agreements, the fiscal situation in the US will come into the spotlight

In addition to positive data and corporate reporting in the US, attention was focused on the extraordinary EU summit (Thursday 21) where a new rescue package for Greece was spelled out, with private participation and flexibility in regional fund policies (EFSF) and from the ECB. The latter favored a reduction in risk aversion translating into weekly gains in the Euro and MXN. In this way, the MXN saw one of the best performances in the LatAm region, rising 0.7% against the greenback. Looking forward, the debate on the US debt threshold will become more important on the markets, especially with the proposal from a group of Senators which could see volatility continue in the short-term. Over the week, the MXN could trade between 11.60 and 11.85.

Market Analysis

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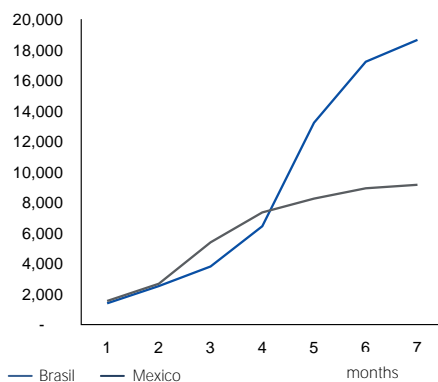
Less appetite for safe-haven assets moves the yield curves upward

In this global scenario, there was lower demand for safe-haven assets and, in turn, yields on UST bills saw upward pressure. In line with the movement in USTs, the domestic yield curve also moved up. However, volatility remains due to the lack of agreement to increase the US debt threshold. At the end of the week, inflation data were released which although seeing a surprise upswing, core data continue to be moderate implying no change to the interest rate stability scenario.

Quarterly reports supported stock market levels, while corporate debt placement is in line with the economic cycle

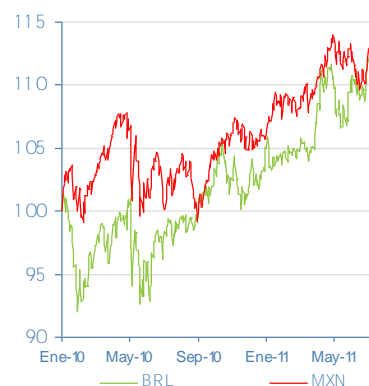
In the U.S. sales results were 0.3% higher and EPS were up 7.5%. In Mexico, reports were in line with estimate to date: sales were 1.5% up, EBITDA down 1.9%, but net profits remained at 1.5%. Despite this, the key factor is the global risk premium meaning the performance of capital markets has been relatively better in developed economies. In turn, the domestic debt market maintains a slow rate in line with growth in the economy. The domestic market has placed MXN 105.294 billion (+5% y/y) so far this year.

Chart 5
Placement in domestic credit market (in USD million)



Source: BBVA Research with data from Bloomberg

Chart 6
Relative performance of Latin American currencies (Jan 1=100)



Source: BBVA Research with data from Bloomberg

Market Analysis
Equities

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Technical Analysis IPC Stock Market Index



IPC: . We believe that after the -1500pts fall since July 4, the market is ready to see a short-term bounce. The spread between the 10 and 30-day rolling averages has practically closed and, although the RSI did not hit the 30pts zone (overselling), it started to bounce at 36pts. For the market to ease the short-term pressure more, it needs to close above 36,000pts and, therefore, above the 10 and 30-day rolling averages. This would allow it to look for a return to the 200-day rolling average (36,534pts). In order to again consider short-term risk, the IPC would have to come in below the intra-day minimum it hit in the week (35,100pts), opening up a pathway toward June's minimum ranges between 34,600 and 34,800pts.

Previous Rec.: We believe these floor zones should be respected and we could start to see a technical bounce.

Source: BBVA, Bancomer, Bloomberg

MXN

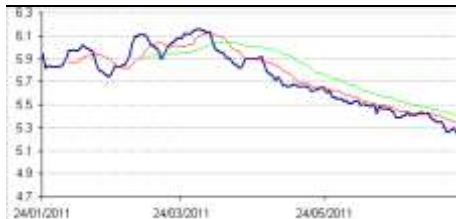


Dollar sees downward trend throughout the week. The support level hits between P\$11.60 and P\$11.55 which we could expect due to lack of overselling on oscillating indicators. We cannot see this floor being broken and should expect a bounce toward the P\$11.70 / P\$11.75 level.

Previous rec.: we could see the P\$11.80 resistance level being broken moving toward P\$12.00. This will continue as long as it does not break downward through P\$11.66.

Source: BBVA, Bancomer, Bloomberg

3Y M BOND



3Y M BOND: (yield): Although oscillating indicators are in oversell, it has not managed to come out of the downward trend it has traded in since April. Resistance at 5.31% and 5.39%. Support in the lower part of the negative range at 5.2% and 5.1%.

Previous rec.: It may carry this decline toward 5.26%.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND



10Y M BOND (yield): Maintaining trading in the negative range. Resistances at 6.8%, 6.93% and 7.01%. Only above the latter can we consider a change in the trend. Downward, the next support is 6.66%.

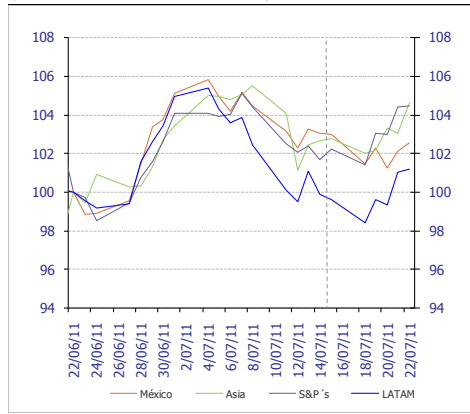
Previous rec.: new yearly minimum with chances of still seeking the 6.74% zone.

Source: BBVA, Bancomer, Bloomberg

Markets

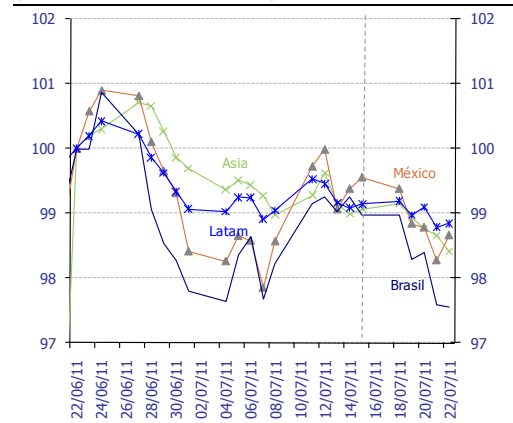
A packet of additional measure to deal with the debt crisis in Europe and bargain purchases created a rise on stock markets while the peso fell at the end of the week due to the strength of the dollar against other currencies.

Chart 7
Stock Markets: MSCI Indices
(June 22, 2011 index=100)



Source: Bloomberg & BBVA Research

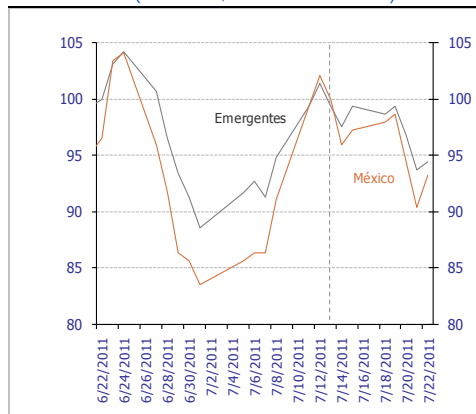
Chart 8
Foreign exchange: dollar exchange rates
(June 22, 2011 index=100)



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

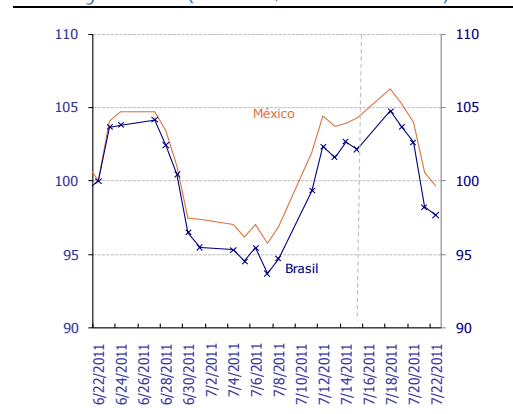
Fall in risk aversion after the release of measures to deal with the European debt crisis

Chart 9
Risk: EMBI+ (June 22, 2011 index=100)



Source: Bloomberg & BBVA Research

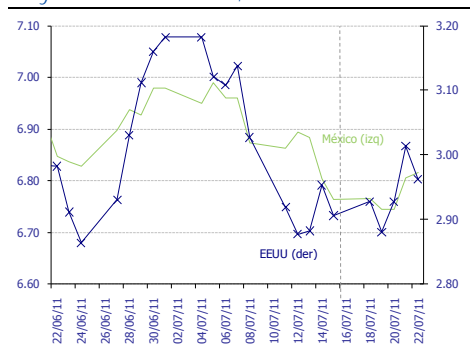
Chart 10
Risk: 5-year CDS (June 22, 2011 index=100)



Source: Bloomberg & BBVA Research

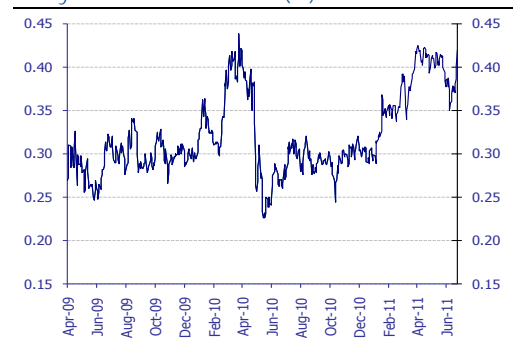
US rates fall due to expectations that an agreement on the US threshold is near. Rates in Mexico rise over the week influenced by US T-Bills.

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

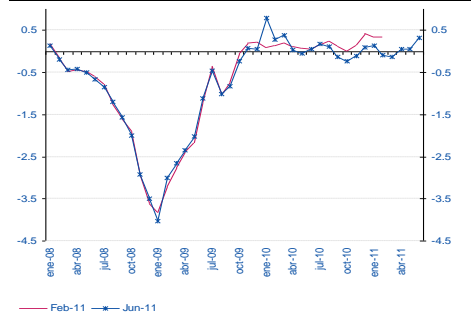


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

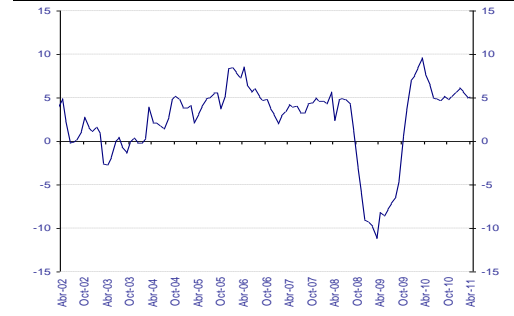
For the time being, recent output data point to moderation in April being temporary and linked to industrial output

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.

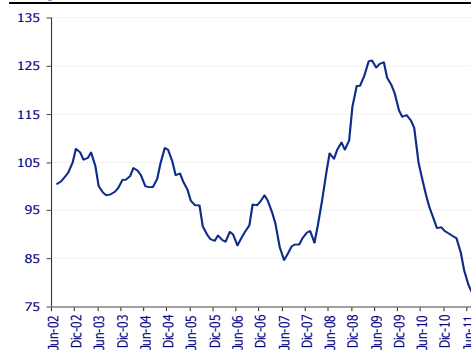
Chart 14
Advance Indicator of Activity (% change y/y)



Source: INEGI

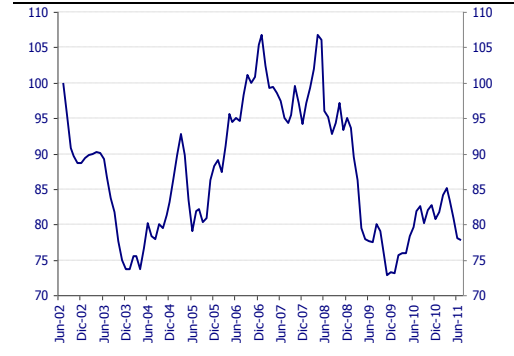
Recent inflationary surprises have been downward, while those concerning economic activity have been mixed.

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.

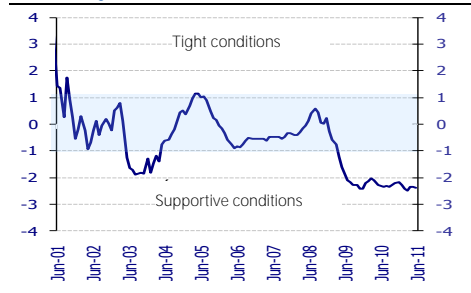
Chart 16
Activity Surprise Index (2002=100)



Source: BBVA Research with Bloomberg data. Difference between recorded data and the Bloomberg consensus for seven activity variables in Mexico. Standardized index. Rises (falls): positive (negative) surprises.

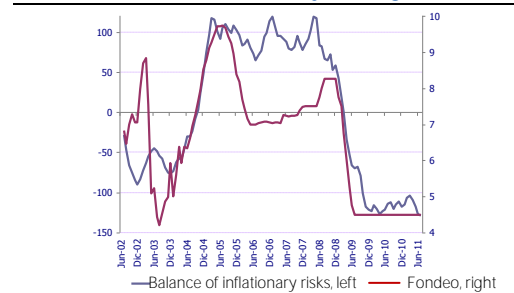
The monetary conditions have not changed and continue to be loose, with this loosening in fact increasing slightly in recent days.

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, weighted index (between inflation and economic growth); uses economic indicators for activity and inflation. A rise in the index points to a greater weight of inflationary risks over growth risks and thus a greater likelihood of monetary restriction

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