BBVA | RESEARCH

Weekly Flash

Mexico

February 24, 2012

Economic Analysis

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Market Analysis

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Next week...

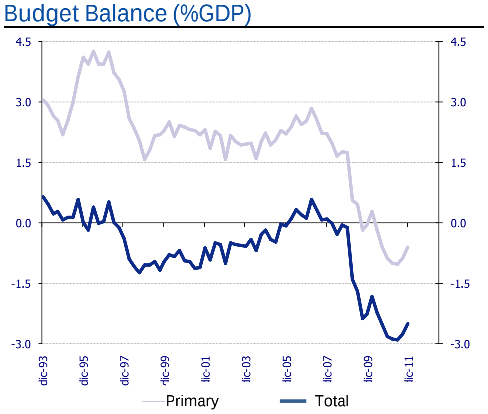
Public finances provide certainty and have room to improve their action ability

Next week sees the release of the first monthly data for 2012 on the federal budget balance. It is likely to continue to see a trend to reduce the public deficit in Mexico. Budget revenue only began to recover its pre-crisis levels at the end of 2011. This highlights the importance of prudent handling of Mexican public finances since, despite revenue recovering slowly, the deficit in terms of PSBR has fallen from 3.5% of GDP in 2010 to 2.8% in 2011. In addition, the wider measure of financial liabilities in the federal public sector (historic PSBR) is 38% of GDP, with a highly favorable time structure (the average maturity for issuances by the federal government is 7.6 years) and a low foreign debt level (28% of the total). This is an enviable position in comparison to other economies and provides certainty for the markets. Nonetheless, the recent crisis also highlighted that the low level of budget revenue with regard to GDP (23%) and the high dependence on oil revenue (34% of the total) are a limitation for implementing public investment programs or ambitious social spending with a long-term outlook.

Markets discount Greek bailout, local factors lead to differences

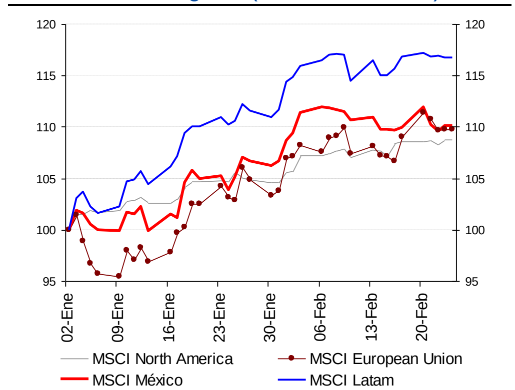
In a discounted statement, the new bailout package for the Greek economy was approved, albeit with doubts surrounding implementation, This led to ups-and-downs on markets. Locally, the MXN weakened over the week which may be due to investor speculation on the rate difference between the US and Mexico. Corporate reports continue to offer favorable surprises.

Chart 1
Budget Balance (%GDP)



Source: BBVA Research and SHCP

Chart 2
MSCI: Selected regions (100=Jan 01, 2012)



Source: BBVA Research with data from Bloomberg

Calendar: Indicators

Economic Analysis

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Producer confidence in February (Friday, March 2)

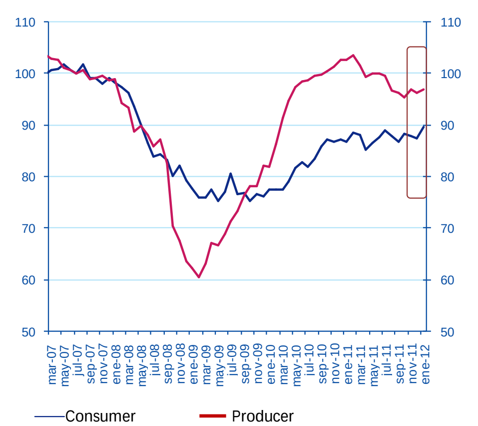
Forecast: 1.0% m/m 54.8 pts Consensus: N.A. Previous: 0.6% m/m 54.3 pts

Manufacturing confidence indicators to be released this week will offer clues as to the perception of supply in economic performance in the first months of the year. It should be stated that until present, producer confidence had seen few improvements. In fact, in terms of year-on-year comparison, since last August it had been below last year's levels. This is despite the good performance in industrial output which has been positive - as seen in the positive surprise in December for manufacturers. In turn, and unlike the manufacturer confidence indicator, other producer confidence sub-indices such as "a good time to invest" have seen a relatively better performance than in previous months. In the last part of the year, manufacturers mentioned current economic conditions made this a good time to invest. Further, sub-indices such as manufacturing orders continue to point to caution among manufactures regarding future economic performance. In all, business opinion on future industrial conditions will be important. We expect it to have improved in February by 1% m/m.

Construction Company Survey in December (Wednesday, February 29, for December)

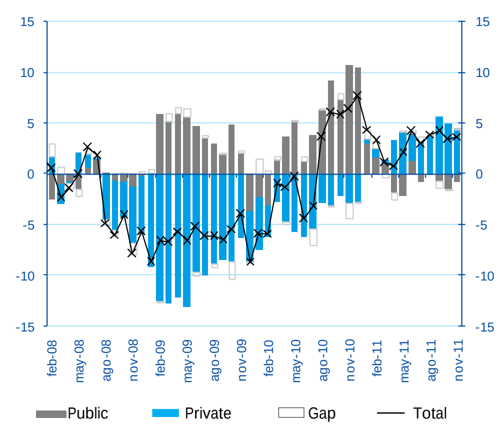
This survey from the end of last year will be important for information on construction industry performance and particularly for the public and private components. It should be stated that until now and throughout 2011, the private sector (especially in the residential components) has made the highest contribution to the industry, unlike in 2010. We expect this trend to continue to explain a large part of the near 4.3% expansion in construction in annual terms for the last quarter of last year.

Chart 3
Confidence: Consumer and Producer (July 07 = 100)



Source: BBVA Research with INEGI data

Chart 4
Construction Companies (% change y/y and contributions)



Source: BBVA Research with INEGI data

Markets

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Greek bailout: discounted but still uncertain implementation

The week began with approval for the Greek bailout although with uncertainty on investor participation. This led to erratic moves on markets which ended the week with marginal changes except in Asia - this was supported by lower reserve requirements for Chinese banks. Locally, markets focused on lower-than-expected inflation in Mexico supported by non-core factors. Meanwhile, retail sales disappointed with a downturn.

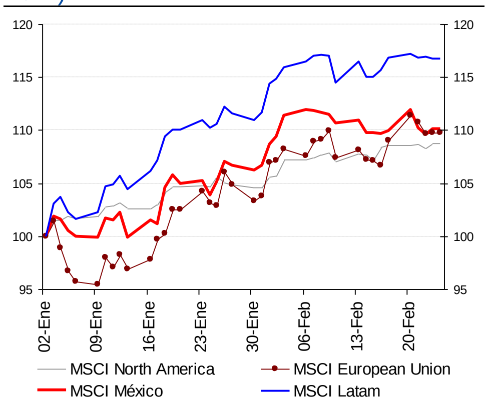
A lower MXN in the face of speculation surrounding the rate differences in Mexico and the US

The MXN fell again on Friday making a weekly devaluation of 1.1% (12.89 ppd). This performance should be highlighted since it shows worse relative performance to emerging market currencies and those in the G10 which strengthened. The currency again saw a decoupling with the EUR and moved only in line with the JPY and CAD. We believe this is due partly to local indicators released during the week which (although not in line with our forecast) led to speculation on the market concerned with a lower rate differential with the US. We believe the MXN could move toward the 12.50-60 range in the short-term due to: (1) favorable cyclical US data for capital markets (S&P), (2) high liquidity expectations and (3) an outlook of acceptable demand in exchanging Greek debt with private investors

Corporate reports offer positive surprises.

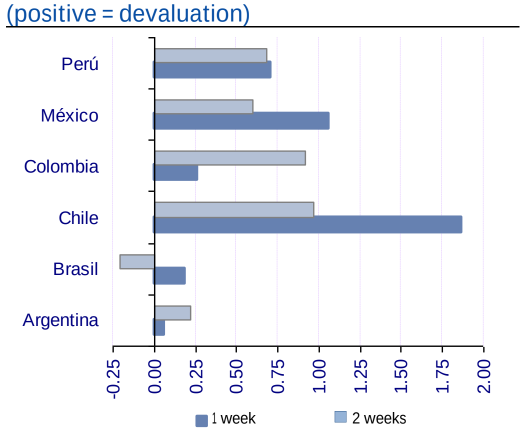
Twenty-one companies on the IPC have reported earnings. Sales rose 19.2%, EBITDA 12% and net profits 18.8%. Although positive, the high pressure scenario on margins for goods is confirmed. The liquidity scenario and global macroeconomic news do not point to a positive outlook for the IPC (target 42,100pts in 2012). Despite this, and taking into account the market rally since December 2011 (explained by the lower systemic risk premium), we believe it will be difficult to see major upward breaks on the IPC while not new catalysts appear (see EMU fiscal compact chart).

Chart 5
MSCI: Selected regions (100=Jan 01, 2012)



Source: BBVA Research and Bloomberg

Chart 6
LatAm FX: aggregate % change (positive = devaluation)



Source: BBVA Research and Bloomberg

Market Analysis
Equities

Technical Analysis
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Technical Analysis

IPC Stock Market Index

Source: BBVA, Bancomer, Bloomberg

The IPC continues it move around 38,000pts for the third week. Only a close below 37,500pts would set the end of the positive short-term trend and we would recommend an exit if there is a downward break through this floor. Resistance continues set around 38,700pts on the upside. We believe it will be difficult to break this since it is an historic maximum for the market. We recommend reducing positions toward this level.

Previous Rec.: Amx could drive the market in coming days. We recommend taking advantage of the possible upswing in coming sessions to take profits.

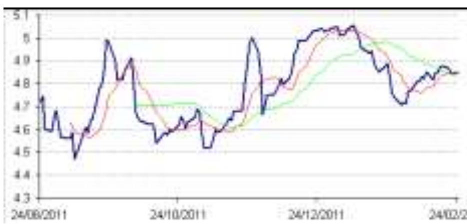
MXN

Source: BBVA, Bancomer, Bloomberg

The dollar continues lateral stance from recent weeks. Only an upswing through MXN12.95 and, therefore, through the 30-day rolling average would set a short-term upward trend toward MXN13.30. We recommend waiting for this sign to take long positions.

Previous Rec.: At this time, the MXN12.74 level is the short-term support and a downward break could set the floor at MXN12.60/12.50

3Y M BOND

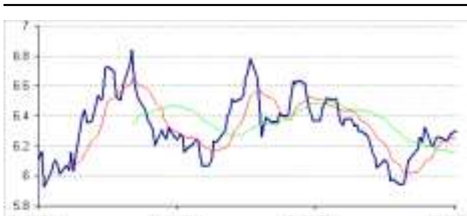


Source: BBVA, Bancomer, Bloomberg

3-YEAR M BOND: (yield): Maintained resistance at 5% until it comes in below the 30-day rolling average and respects the 4.8% level. Over-buying on some oscillating indicators.

Previous Rec.: The position on oscillating indicators points to a move toward 5% where the 200-day rolling average sits.

10 YEAR M BOND



Source: BBVA Bancomer, Bloomberg

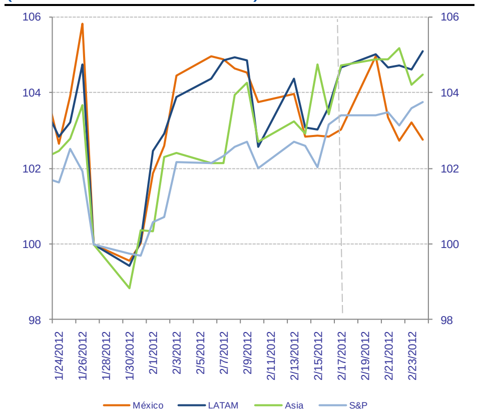
10Y M BOND (yield): Maintains trading above the 10- and 30-day rolling averages. Resistance at 6.46% for the 200-day rolling average. Oscillating indicators support a move toward this level.

Previous Rec.: We believe it could continue this trend toward 6.5% at the 200-day rolling average.

Markets

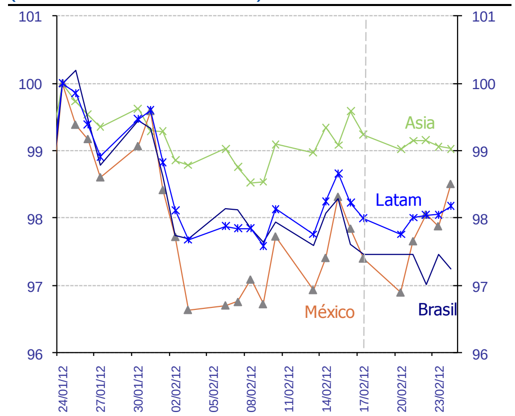
Marginal fall on the stock market and devaluation in the exchange rate over the week in a scenario of better-than-expected data from the US, doubts surrounding the crisis in Europe and higher oil prices

Chart 7
Stock Markets: MSCI Indices (Jan 24, 2012 index=100)



Source: Bloomberg & BBVA Research

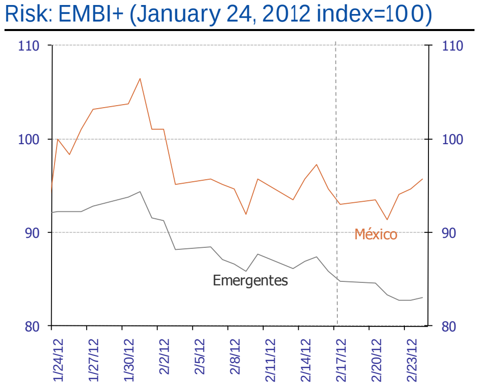
Chart 8
Foreign exchange: dollar exchange rates (Jan 24, 2012 index=100)



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

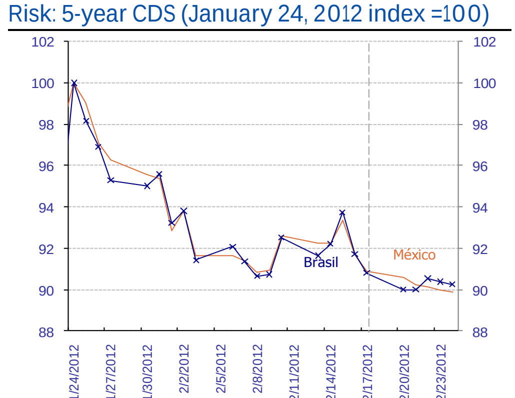
Slight fall in risk aversion over the week after the second Greek bailout is approved

Chart 9
Risk: EMBI+ (January 24, 2012 index=100)



Source: Bloomberg & BBVA Research

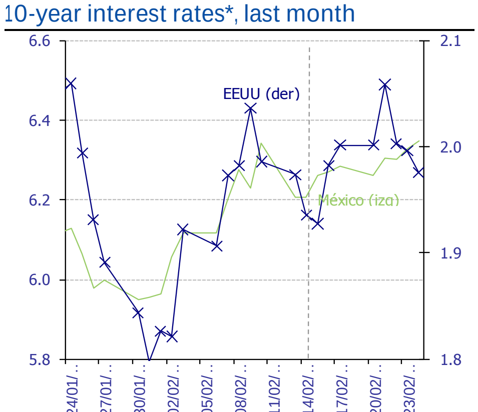
Chart 10
Risk: 5-year CDS (January 24, 2012 index =100)



Source: Bloomberg & BBVA Research

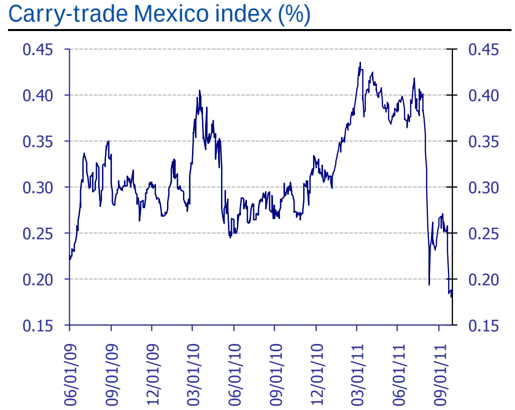
Rise in Mexican and US interest rates over the week due to greater appetite for risk.

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

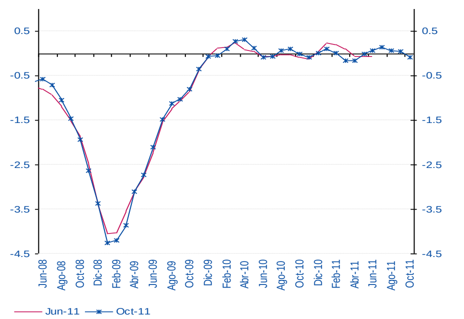


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

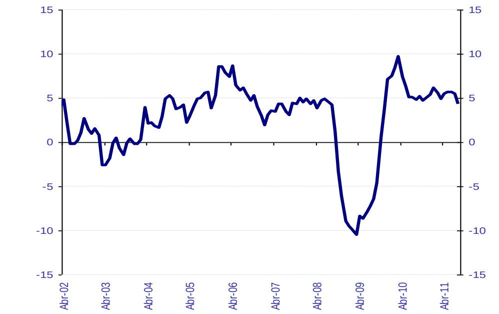
Output holds positive performance, situation indicators point to 1T12 with quarterly rates around 0.4%

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.

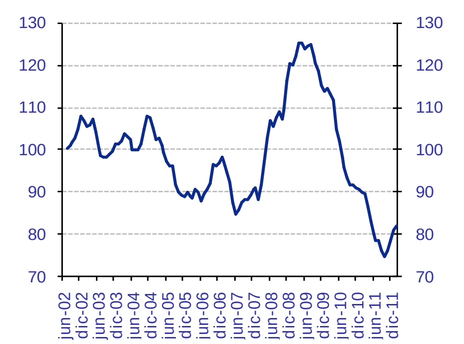
Chart 14
Advance Indicator of Activity (% change y/y)



Source: INEGI

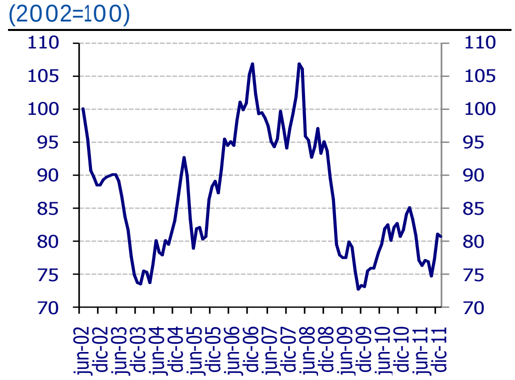
Monetary Conditions remain relaxed although halt their downward trend.

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.

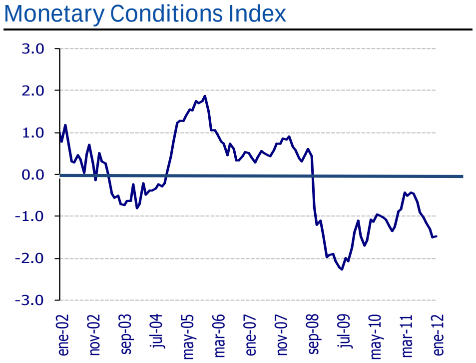
Chart 16
Activity Surprise Index (2002=100)



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.

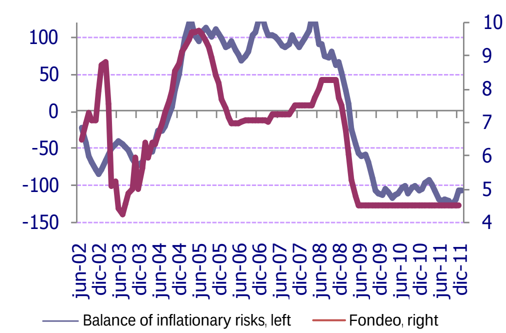
Both the recent inflation and output surprises continue to rise

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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