

Weekly Flash

Mexico

Next week...

March 2, 2012

Economic Analysis

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Market Analysis

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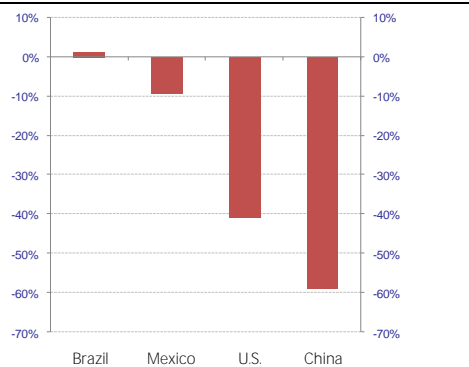
The impact of higher oil prices on the Mexican economy depends on the effective use of the additional resources

Oil prices in dollars are hitting maximums for recent years due to the uncertainty surrounding supply as a result of geopolitical tensions in the Middle East. The scenario also includes output in some areas coming in better-than-expected. More expensive oil means higher production costs for consumer nations and a transfer of income to producers. In any event, it seems reasonable to think that the direct negative impact of an oil shock on net importer country demand would be lower than in past decades simply due to the intense use of this product being below what it was before. As shown in the attached chart, the required amount of oil to deal with a real GDP increase has fallen 40% in the US and almost 60% in China. Nonetheless, absolute consumption is increasing, especially in China, due to its GDP having taken off in the last three decades. It is difficult to mark out the net impact of this situation in higher oil prices and lower demand for other products at least in our main customer, the US, for Mexico. On the one hand, the higher price of one of its main export products adds to the fact that consumers, unlike in other countries, remain insulated from the higher oil prices. On the other hand, there is the effect of lower available income at our foreign clients, even when this means the net effect in terms of income is positive for Mexico. We also need to take into account where this higher income at the federal public sector is going: an implicit fuel subsidy. In this way, there is a scant response from consumers to the price increase in a non-renewable resource (see chart) and a redistribution to other public administrations to deal with public spending and providing funds for stabilization and emergencies in the face of disasters (more the first than the second). (see next page...)

The MXN saw weekly gains with slight gains on the stock market.

The MXN saw one of the best relative performances among emerging currencies, even with the falls seen in main risk assets. This responded to liquidity factors with positive surprises in US economic data.

Chart 1
 Intensity in oil use, barrels/GDP % Change from 1980-85 to 2006-10



Source: BBVA Research with IMF and BP data

Chart 2
 Mexico: MXN/USD and implied 1-month volatility (ppd and %)



Source: BBVA Research with data from Bloomberg

(From the first page) The multiplying effect of public spending on growth would be higher if spent on investment instead of current spending and the indiscriminate regressive subsidy in terms of income distribution.

Calendar: Indicators

Economic Analysis

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February Inflation (Friday, March 2)

Forecast: 0.31% m/m 3.98% y/y Consensus: 0.33% m/m Previous: 0.71% m/m (4.05% y/y)

Inflation in February saw a slight break to its upward move seen in annual terms from October due to major reductions in the prices for different fruits and vegetables and lower pressures on livestock products (eggs, chicken, pork and beef). We estimate core inflation at a monthly rate of 0.48% meaning it should come in at 3.48% y/y. In this way, the core component continues to move up in annual terms. Food prices continue to see upward pressure in grain both domestically and globally. Further, there were additional pressures in February due to upward adjustments in cigarette prices. In turn, services continue to see very low annual inflation thanks to the good performance seen in housing prices and other services since last year. We expect inflation to again rise above 4% in coming months, mainly due to a base effect. Nonetheless, we estimate it will close the year well below this level. However, attention will need to be paid to upward pressure oil and grain prices may have in coming months.

Consumer Confidence, January (Monday, March 5)

Forecast: 1.2% m/m 2.5% y/y Consensus: N.A. Previous: 2.6% m/m (3.2% y/y)

Formal Employment in the private sector, January (during the week)

Forecast: 0.45% m/m 4.4% y/y Consensus: N.A. Previous: 0.47% m/m (4.3% y/y)

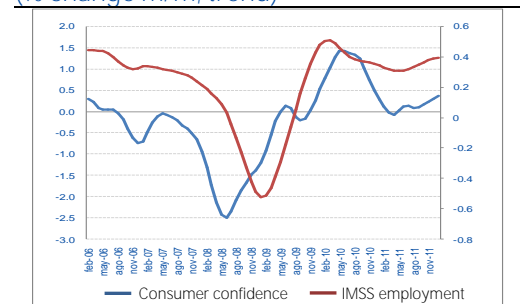
Consumer confidence could have remained at very similar levels to those last month. It should be stated that consumer confidence saw a slight upward trend again due to the marginal improvement in formal employment in the private sector. In recent months, it has risen from a monthly average change of 0.3 in October and November to 0.5% in December and January, taking into account seasonal effects. The chance to purchase a durable good has significantly improved from an average contraction of (-)5.2% in October and November 2011 to 12.7% in December and January on average. This could be seen in growth in private consumption in the first quarter of the year.

Chart 3
Inflation forecast breakdown (% change y/y and m/m)

	Weight (%)	Monthly change (%)			Annual change (%)		
		dic-11	ene-12	feb-12	dic-11	ene-12	feb-12
CPI-Mix	100.0	0.82	0.71	0.31	3.82	4.05	3.38
Core-Mix	74.6	0.51	0.45	0.48	3.35	3.34	3.42
Goods	37.0	0.67	0.35	0.68	4.52	4.64	4.79
Food products	14.7	0.99	1.28	0.91	7.32	7.18	7.32
Other Goods	22.4	0.42	0.51	0.58	2.39	2.72	2.87
Services	37.7	0.37	0.11	0.32	2.40	2.28	2.31
Rent	17.9	0.14	0.18	0.25	2.04	1.99	2.04
Education	5.2	0.00	0.43	0.25	4.19	4.32	4.43
Other serv.	14.7	0.72	-0.04	0.41	2.27	2.01	1.99
Non-CPI-Mix	25.2	1.56	1.55	-2.27	5.34	6.38	8.02
Farm products	8.1	4.29	3.23	-1.29	3.73	7.37	6.00
Fruits/Vegetables	3.3	6.85	3.79	-3.96	-4.37	0.07	-3.06
Meats/Eggs	4.8	2.70	2.87	0.73	9.76	12.71	12.86
Public managed	17.2	0.57	0.63	0.33	6.19	5.82	5.69
Energy	7.8	0.81	0.61	0.58	8.30	7.98	7.99
Controlled prices	9.4	0.13	0.65	-0.13	2.39	1.93	1.56

Source: BBVA Research with INEGI data

Chart 4
Consumer Confidence and Employment (% change m/m, trend)



Source: BBVA Research with INEGI data

Markets

Market Analysis

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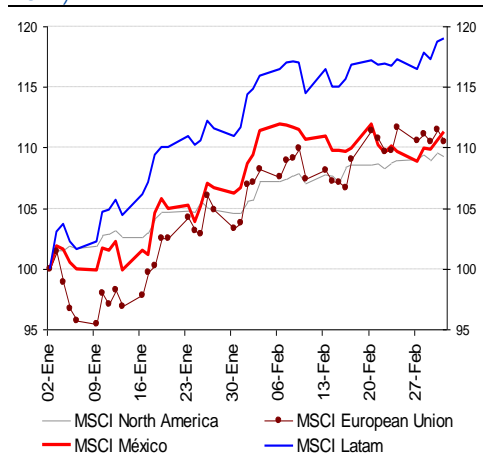
The MXN closed down around 0.2% on Friday. Nonetheless, it saw aggregate gains of around 1.2% over the week.

The MXN saw one of the best relative performances among emerging and G10 currencies, which ran to the end of the week, even with the falls seen in main risk assets. This was in response to a combination of liquidity factors with favorable surprises in US economic data. As we expected, the currency decoupled from the EUR. Although we see room for the MXN to continue with a positive bias over coming months, we see support levels around the corner and cannot rule out technical corrections due to the events and indicators to be released this week. In this way, our estimate range remains at 12.60-12.90.

Liquidity vs. profits: Global stock markets again benefit from the lower risk premium but trades are ever more fenced in.

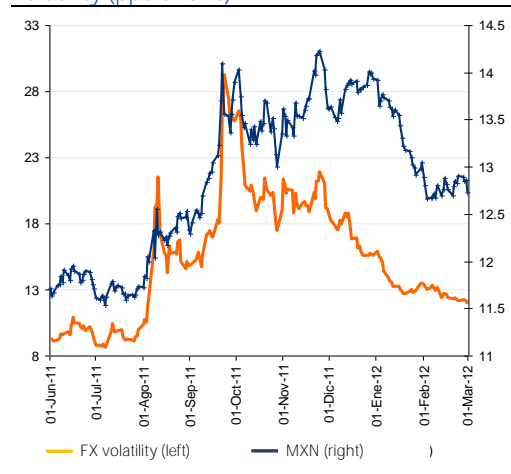
Mexico saw a discreet performance in the face of doubts set out by Bernanke on the strength of the US recovery and fewer positive surprises in corporate earnings. The corporate earnings season in Mexico concluded with 18.8% growth in sales, 13.6% in EBITDA and 16% in Net Profits. These figures are above our expectations by 3.2%, 2.3% and 7.1% (the surprise is due to the Elektra equity swap). There were positive surprises in EBITDA, food and construction while housing and some industries saw negative moves. In short, a positive season meaning we maintain our IPC value of 42,100pts. Stock markets may see lateral trading alongside a gradual relaxation in global risks after the ECB pumped liquidity in, thus increasing confidence in the interbank lending market (40% cost reduction over the year) and reducing the cost of corporate financing to 6-month lows.

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



Source: BBVA Research and Bloomberg

Chart 6
Mexico: MXN/USD and implied 1-month volatility (ppd and %)



Source: BBVA Research and Bloomberg

Market Analysis
Equities

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Technical Analysis

IPC Stock Market Index



The IPC is now at 20 sessions trading around 38,000pts. Although it has not broken up through 38,400pts, it has always respected the important 37,500pts floor. We recommend watching this floor since a downward break would set off an adjustment signal which we believe could find a floor of 36,500pts, -4% below current levels. We would only consider a short-term entry in the case of an upward break through 37,400pts.

Previous Rec.: 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.

Source: BBVA, Bancomer, Bloomberg

MXN



New failed attempt over the week to break the resistance level. It again found a short-term ceiling at MXN13.00. With a major floor at MXN12.60, we do not recommend taking long positions unless it manages to hit above the resistance.

Previous Rec.: Only an upswing through MXN12.95 and, therefore, through the 30-day rolling average would set a short-term upward trend toward MXN13.30.

Source: BBVA, Bancomer, Bloomberg

3Y M BOND

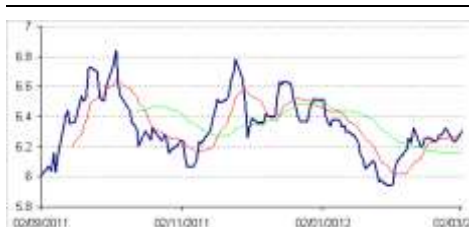


3-YEAR M BOND (yield): Although it attempted short-term floor levels over the week, it respected 10- and 30-day rolling averages. We maintain a target 5% and a floor at 4.8%.

Previous Rec.: We maintain resistance at 5% while it remains above the 30-day rolling average

Source: BBVA, Bancomer, Bloomberg

10 YEAR M BOND



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.

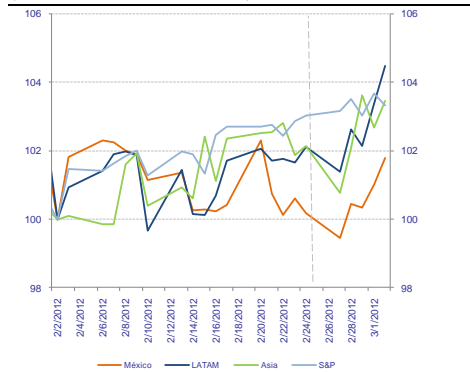
Previous Rec.: Resistance at 6.46% in the 200-day rolling average. Oscillating indicators support a move toward this level.

Source: BBVA Bancomer, Bloomberg

Markets

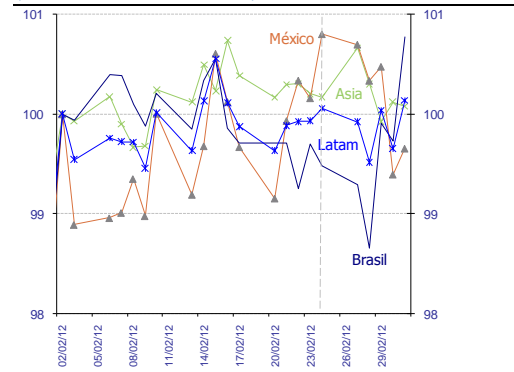
Better-than-expected data in US employment and consumer confidence lead to upswings on stock markets and strengthening currencies. All this despite the lack of announcements concerning a new monetary stimulus package at the FED

Chart 7
Stock Markets: MSCI Indices (Feb 2, 2012 index=100)



Source: Bloomberg & BBVA Research

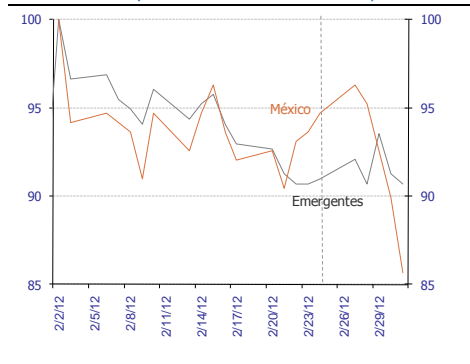
Chart 8
Foreign exchange: dollar exchange rates (Feb 2, 2012 index=100)



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

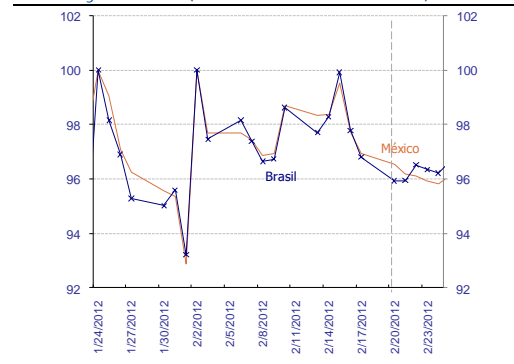
Downward move in risk aversion in light of data supporting an upswing in US output

Chart 9
Risk: EMBI+ (Feb 2, 2012 index=100)



Source: Bloomberg & BBVA Research

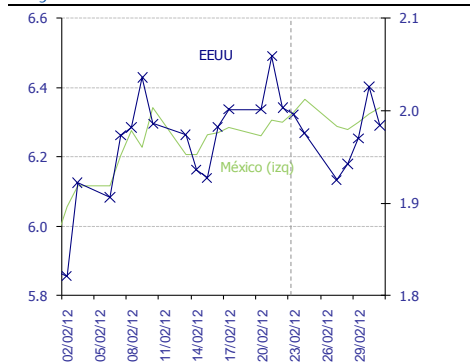
Chart 10
Risk: 5-year CDS (Feb 2, 2012 index=100)



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 (%)

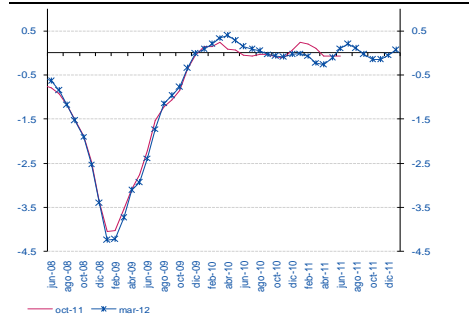


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

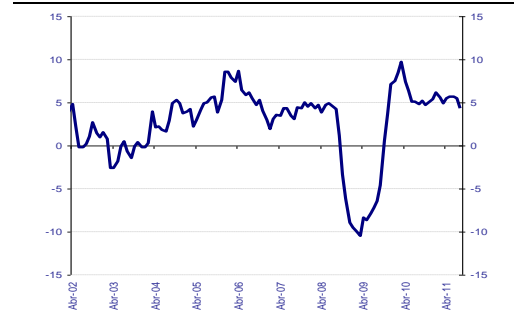
Output holds positive performance, situation indicators point to 1T12 with quarterly rates around 0.6%

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)



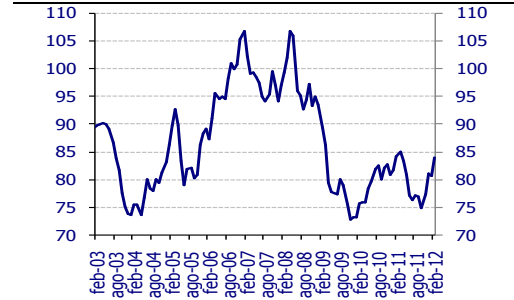
Source: INEGI

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.

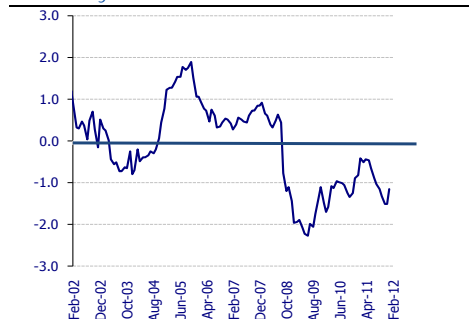
Chart 16
Activity Surprise Index (2002=100)



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.

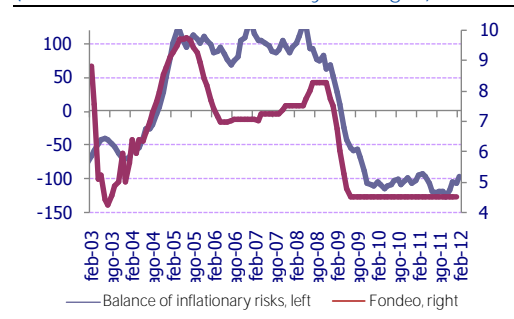
Both the recent inflation and output surprises continue to rise

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

Monetary conditions slightly strained due to recent exchange rate appreciation

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