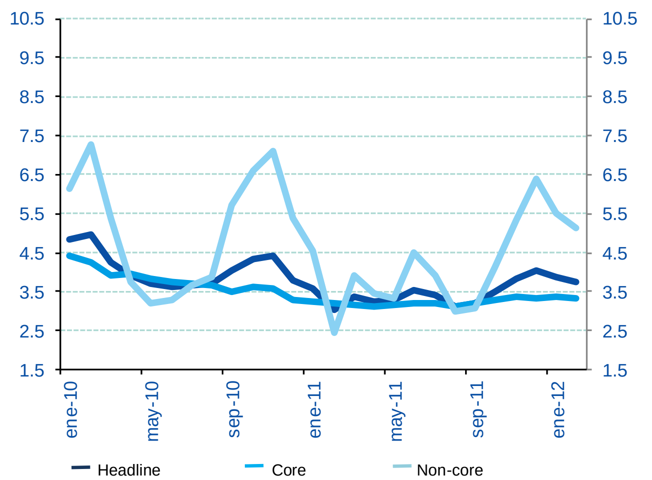
Mexico Weekly Flash

Next week…

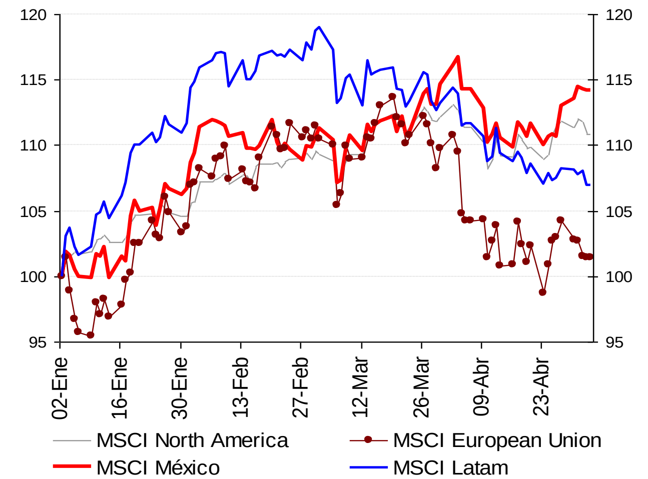
- **Monetary policy meeting minutes - debate remains**
  - This coming Friday 11 sees the release of the minutes from the monetary policy decision on April 27. After Banxico left the lending rate unchanged and showed a less accommodating tone than in the last release, we expect Board discussions to revolve around maintaining the monetary policy stance. In this regard, Board member stances on the appropriateness of cutting the interest rate after the lower-than-expected inflation figures from March and the first two weeks of April will be important.
  - The exchange of opinions resulting from an unchanged inflation risk balance with regard to the previous release will also be important to see. Especially after recent inflation figures support the arguments of most members which, according to the latest minutes, believe upward risks have decreased.
  - Lastly, attention will need to focus on the debate surrounding recent financial market performance and the way in which its influence on the risk balance is dealt with. This after the paragraph on the monetary stance after the last statement emphasized the role the markets have on future rate reductions. It should be stated that, with regard to this point, the last minutes set out that one of the board members attributed the postponement of a rate cut to uncertainty surrounding the global economic scenario.
- **Upswing in risk aversion on global markets. The favorable corporate reporting season comes to a close**
  - Weak global macro indicators and expectations on the ECB were the main drivers on markets last week. After starting the week at 12.9 ppd, the MXN saw falls toward 13.2 in response to US jobs data. In turn, corporate reports in Mexico support the IPC: leverage at historical lows and funding requirements covered for the year.

Chart 1
Headline inflation and components (% change y/y)



Source: BBVA Research with INEGI data

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



Source: BBVA Research, Banxico, Indeval

Calendar: Indicators

April Inflation (Wednesday, May 9)

Forecast: -0.31m/m 3.41% y/y	Consensus: -.36% m/m	Previous: 0.05

Next Wednesday sees the release of April's inflation figures, with a forecast fall mainly being due to non-core factors such as the continued reduction in livestock prices and the fall in electricity prices in different areas. We expect core inflation to rise by 0.11% m/m, kept in check due to lower price pressures for goods prices and a reduction in tourist services prices due to the start of the low season. April should be one of the best months of the year for inflation. Nonetheless, since many factors contributing to this good result are volatile, we should watch out for possible reversals, specifically in prices of agricultural products. Despite this, we believe the inflation outlook for the year has already improved considerably and inflation will likely come in below 4% for the year.

Revised March Trade Balance (Wednesday, May 9)

Appropriate: +1.575 bn USD	Consensus: N.A.	Previous: +458 md

According to the relevant trade balance data for March, Mexico recorded a trade surplus of 1.575 billion dollars with an oil surplus of 1.689 bn. Although the non-oil deficit for the period was just 123 md, the low growth rate in manufacturing exports (0.3% m/m real), lower than the monthly average over the last 12 months (0.6% m/m) stands out. This figure stands out due to the fact that imports for intermediate consumer goods in February, which boost manufacturing export growth, increased 3.9% m/m. In this way, manufacturing sales overseas were expected to see better growth. With this, the monthly growth rate in intermediate imports of -1.2% m/m real in March may be a sign of a slowdown in foreign demand.

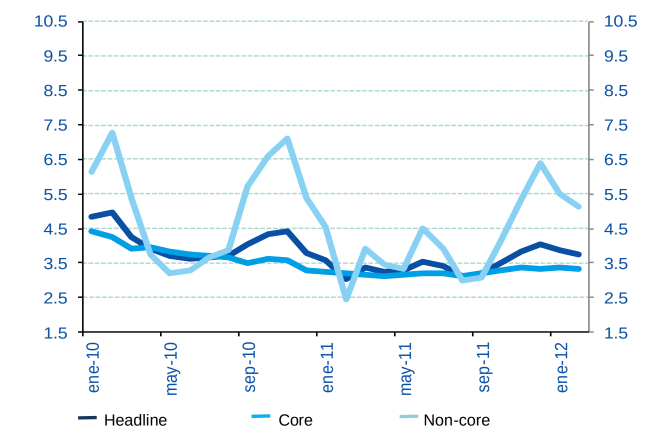
Total employment in 1Q12, unemployment rate (Friday, May 11)

Forecast: 5%	Consensus: N.A.	Previous: 5%

The National Occupation and Employment Survey (ENOE) indicators to be released on Thursday will provide a broader overview of employment in the first quarter. This will be very important since some moderation in private formal employment and distribution was seen in April (0.27% m/m vs. 0.43% m/m over the previous three months, on average) and growth in other employment (nearly 60%) will provide further clues for job market analysis. It should be stated that to 4Q11, 65.2% of workers received between 0 and 3x minimum wage. In turn, information on the unemployment rate will also be important which remained around 5% of the EAP, as well as complementary employment rates such as under-employment or employment in critical conditions.

Chart 3

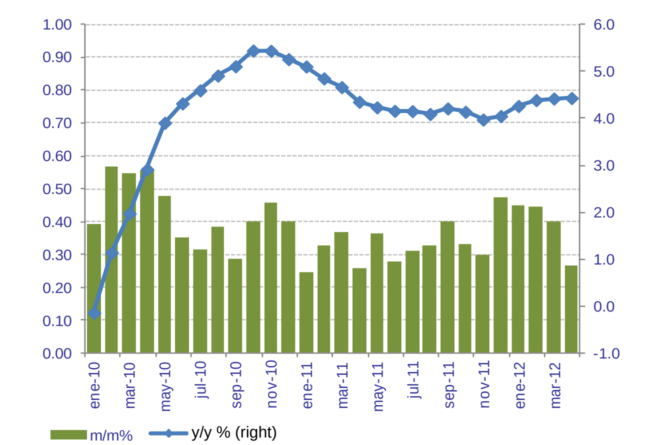
Headline inflation and components (% change y/y)



Source: BBVA Research with INEGI data

Chart 4

Formal Private-sector Employment (y/y% m/m%)



Source: BBVA Research with STPS data

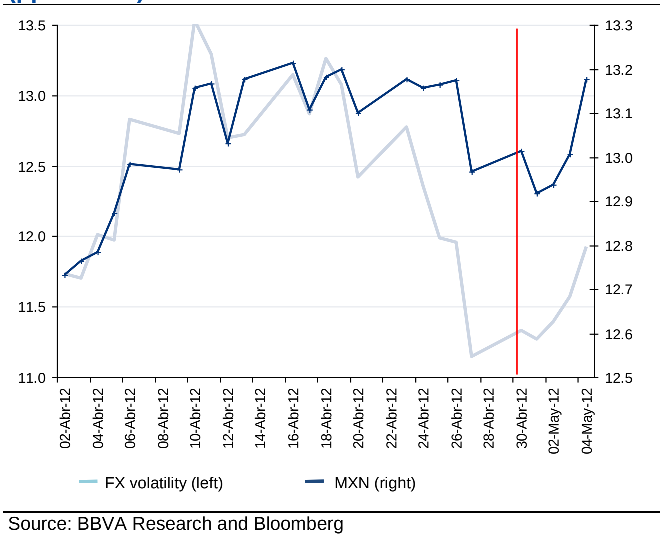
- **Risk aversion continues to dominate markets**
  - Negative economic indicators and focus on the European risk with the ECB's stance and Spanish debt issuances stood out last week. With a slight break in performance on developed and emerging country markets, the latter saw better performance despite the weakness of macroeconomic signals. In turn, Draghi's comments on the prudent use of sovereign bond purchases and interest rates remaining on hold stood out, tempering the rate cut the market seemed to start discounting. We continue to believe that market sentiment in the fact of economic signals and sovereign risk could continue to see a short-term negative bias, although we insist that adjustments would be moderate given high market liquidity.

- **Earnings season ends in Mexico, with figures supporting an IPC target of 42,100pts at the end of the year.**
  - Sales increased 17.2% annually (coming in 5pp above our estimates), EBITDA was in line with a near 12% increase, while net profits saw 19.1% annual growth. The balance continues to show clear strengths with historical Net Debt / EBITDA below 1.2x (excluding Cemex, it is below 1.0x). Furthermore, the basket of companies suffices to cover maturities until the end of 2013. Finally, in historical terms and ring-fencing market movement, the value of Mexican companies came in 3.6% cheaper in terms of EV/EBITDA (9.0x) and 7.6% in terms of net profits (19.2x) thanks to the slight deleveraging and increased earnings.

- **MXN highly sensitive to US cyclical data**
  - Last week flagged up the MXN's sensitivity to global news, specifically to events in the US (non-farm payroll on Friday) in a context where the Bank of Mexico kept its policy rate unchanged despite the fixed-income market starting to discount a cut. In this sense, the MXN traded in a wide range between 12.88 and 13.18 over the week. Maximum weekly levels were near 13.23, where the Banxico intervention mechanism would kick in. It should be said that in this context non-trading positions in Chicago increased by USD100mn to come in at a total USD1.6bn. The MXN's sensitivity will continue in the face of statements from Fed members and the chance of surprise inflation figures.

Chart 5

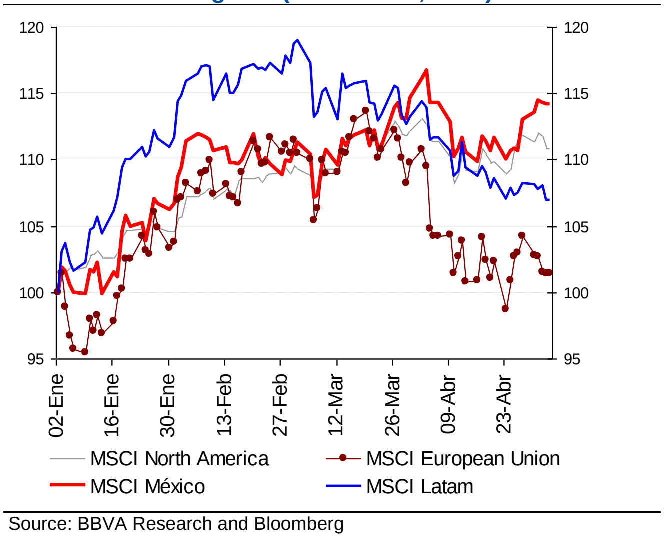
Mexico: MXN/USD and implied 1-month volatility (ppd and %)



Source: BBVA Research and Bloomberg

Chart 6

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



Source: BBVA Research and Bloomberg

Technical Analysis

IPC Stock Market Index

Source: BBVA, Bancomer, Bloomberg

The Amx bounce (16% in 2 weeks), the largest issuer on the IPC, helped the market see a positive weekly balance and stay above the 30-day rolling average (39,197pts). Over-buying in this issuer could lead to profit-taking placing the IPC below this support level and push it to the 38,000pts zone. We recommend maintaining a low investment level and expect a return to the floor or, otherwise, a break up through 40,000pts.

Previous Rec.: The spread between the rolling 10-day and 30-day averages closed and the market could retake an upward trend toward the 39,500 and 40,000 pts resistances.

MXN

Source: BBVA, Bancomer, Bloomberg

The dollar again tested the support zone over the week, marked by the 30- and 50-day rolling averages, bouncing off these. It will again seek out the MXN13.20 level which it was unable to break in previous weeks. If it manages the break, MXN13.40 would be the next target.

Previous Rec.: The 10-session run in this range continues to point to an upward break toward MXN13.40, as long as it does not return below MXN13.00.

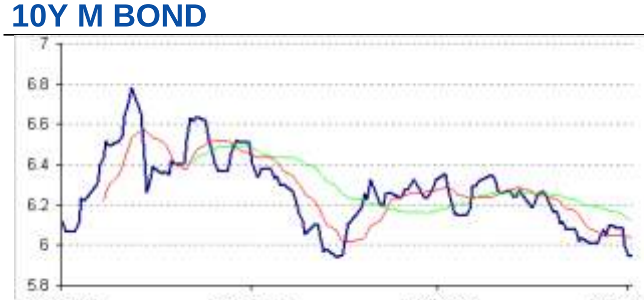
3Y M BOND

Source: BBVA, Bancomer, Bloomberg

3-YEAR M BOND: (yield): Hitting resistance at 4.9% and halting upswing. It may again test the 30-day moving average (4.75%). If it breaks this floor, the downward move may run to 4.7 or 4.6%.

Previous Rec.: Resistances at 4.9% and 5.05%, with support at 4.75%.

10Y M BOND



Source: BBVA, Bancomer, Bloomberg

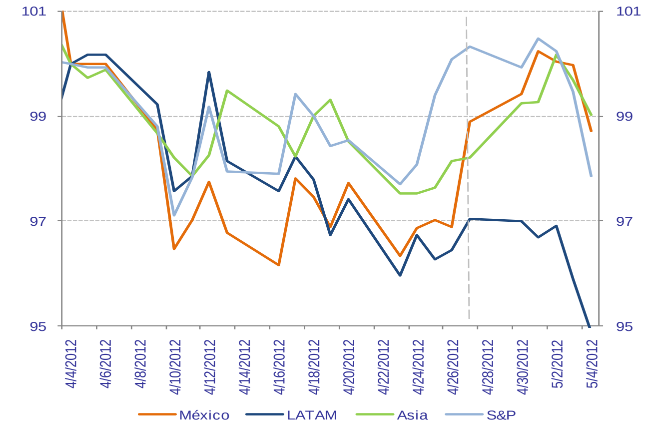
10Y M BOND (yield): Despite having started a bounce from 6%, it could not maintain the move. Below this floor, we continue to believe that over-selling is high. We continue to consider a bounce toward 6.15%.

Previous Rec.: It could keep bouncing to 6.4%, maintaining the floor at 6%.

Markets

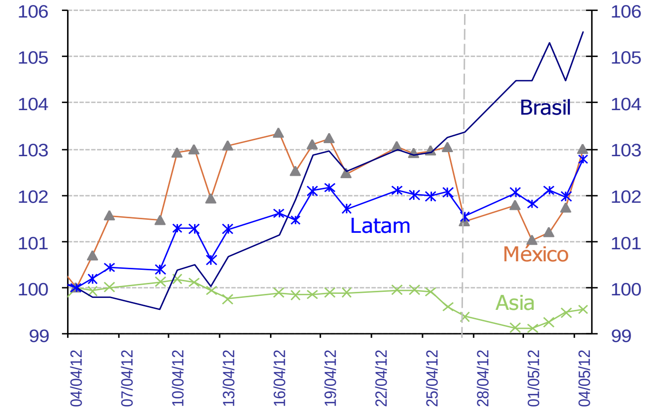
- **Fall on stock markets and general currency drops over the week after lower-than-expected US employment data and non-manufacturing output.**

Chart 7
Stock Markets: MSCI Indices (Apr 4, 2012 index = 100)



Source: Bloomberg & BBVA Research

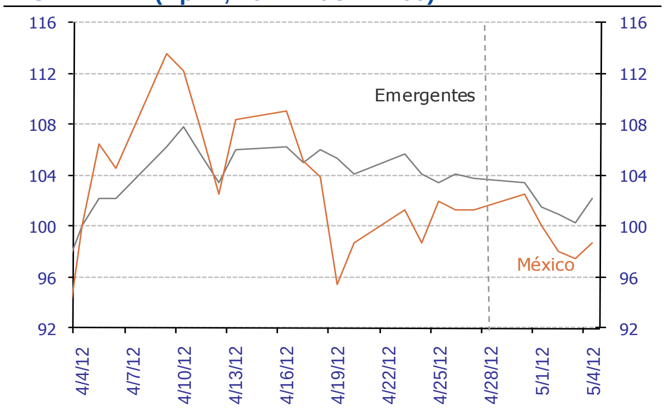
Chart 8
Foreign exchange: dollar exchange rates (Apr 4, 2012 index = 100)



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

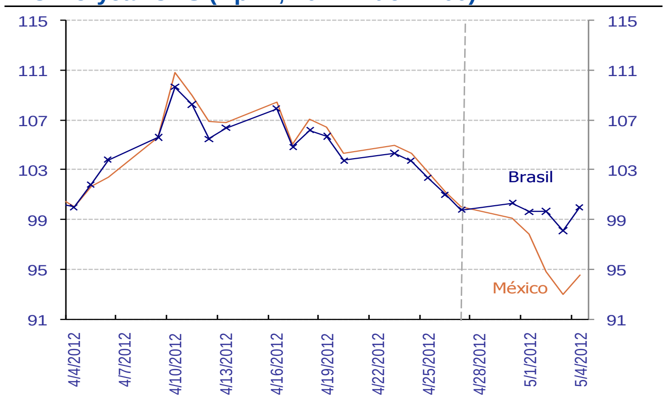
- **Slight increase in risk aversion at the end of the week due to US job data pointing to a slowdown in the recovery speed**

Chart 9
Risk: EMBI+ (Apr 4, 2012 index = 100)



Source: Bloomberg & BBVA Research

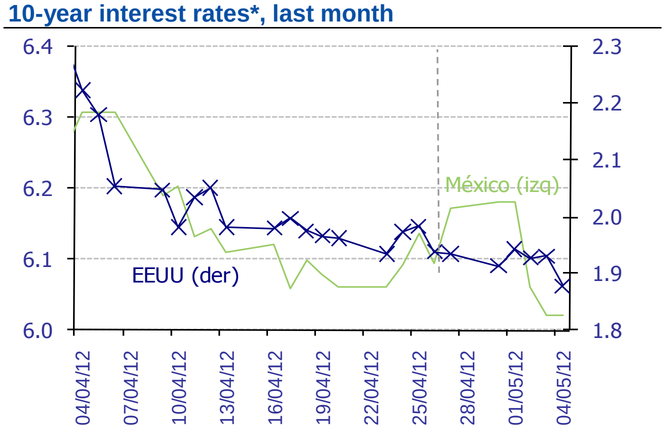
Chart 10
Risk: 5-year CDS (Apr 4, 2012 index=100)



Source: Bloomberg & BBVA Research

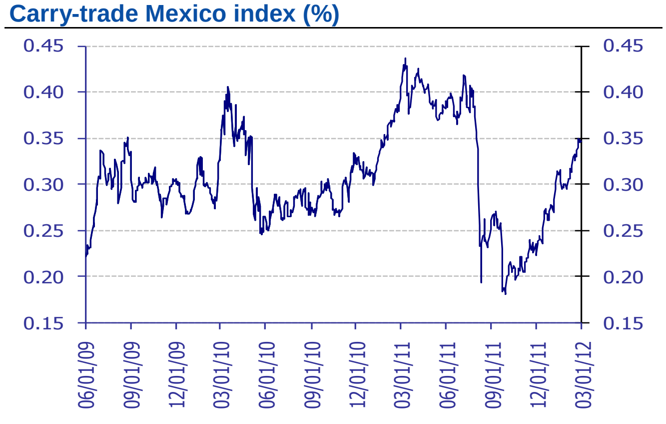
- **Long-term rates fall in Mexico and the US due to expected slowdown in US economic output**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

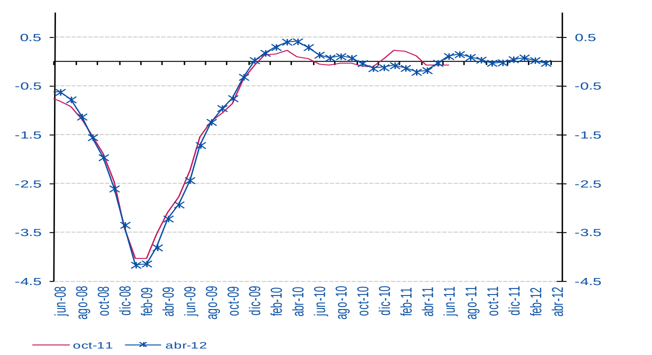


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

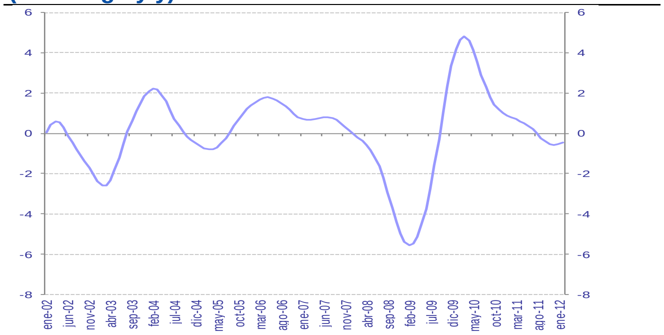
- **Output holds positive performance, situation indicators point to 1Q12 with quarterly rates around 0.5%.**

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.

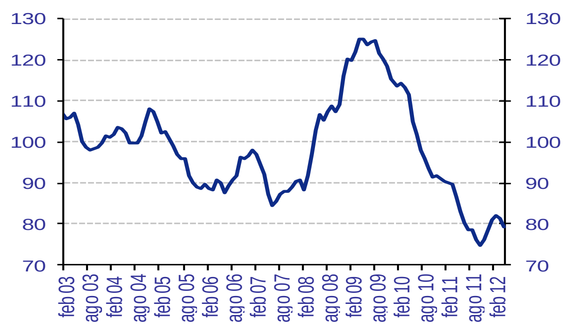
Chart 14
Advance Indicator of Activity (% change y/y)



Source: INEGI

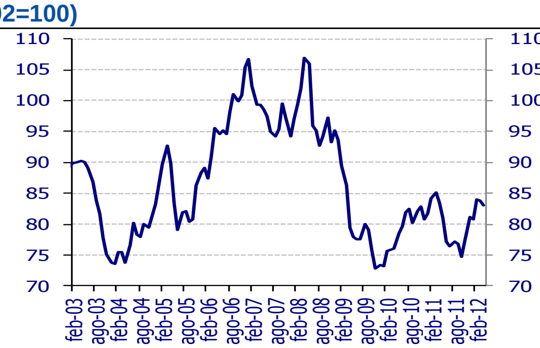
- **Both the recent inflation and output surprises were downward.**

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.

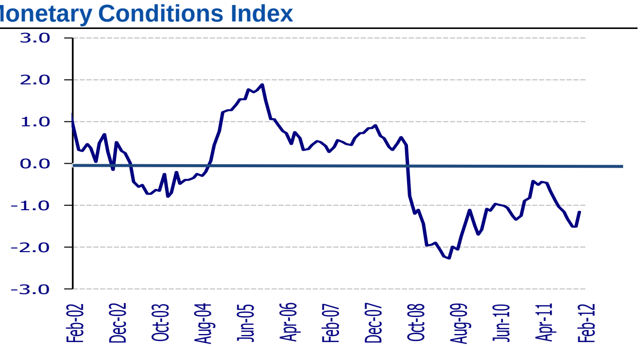
Chart 16
Activity Surprise Index (2002=100)



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.

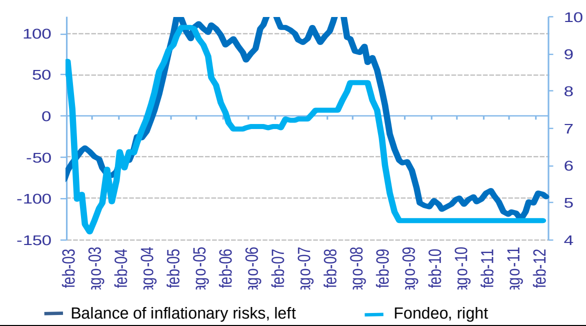
- **Monetary conditions slightly strained due to recent exchange rate appreciation.**

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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