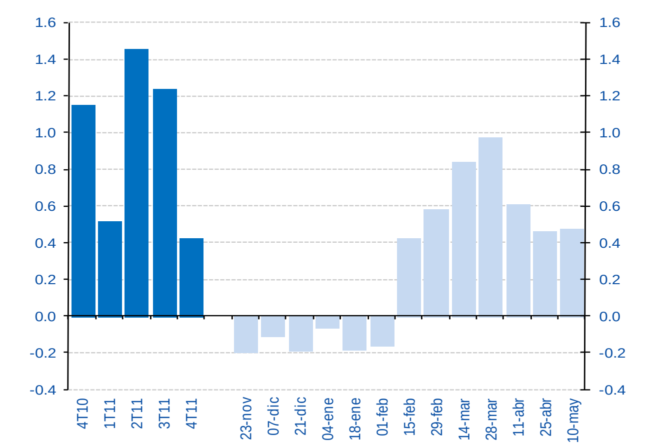
Mexico Weekly Flash

Next week…

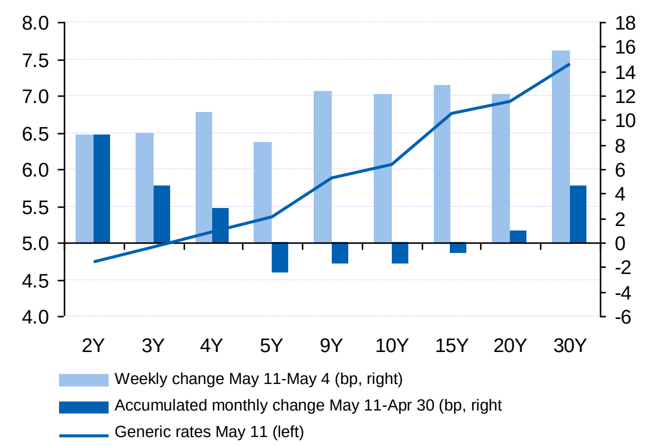
- **Looking back with 1Q12 GDP (0.5% q/q vs. 0.4% in 4Q11) and forward with the Banxico Inflation Report**
    - This week will show what happened in 1Q12 in terms of Mexican economic growth (INEGI, Thursday 17) which, alongside available information to day, we predict to have come in at 0.5% per quarter, slightly above that recorded in 4Q11, 0.4%. This estimate has moderated in recent weeks with the arrival of new information for February. We believe this is due more to a statistical effect for the leap year adjustment than to an underlying slowdown in the growth rate. In all, attention will need to be paid to the performance in relevant US data (industrial output in April will come out next Wednesday 16) which seem to show some stabilization in growth and moderate job increases.
    - Looking ahead, the 1Q12 Banxico Inflation Report (Wednesday 16) will set out the economic scenario and the inflation and risk balance forecasts will be especially important. Taking into account what was seen in the minutes released today from the last Board meeting, it is highly likely that the risk balance remains neutral on inflation given the signaled improvement in the risk balance for economic growth and lower-than-expected consumer price increases, especially in the non-core component.
- **Global risk aversion and prolonged pause outlook dominate local asset performance**
    - The upswing in global risk premiums (sovereign and financial fears in Europe and slowdown rate in China), alongside forecasts of a prolonged monetary pause in Mexico, were the main drivers behind local markets over the last week. MXN will continue to be volatile. Meanwhile, defensive investments make 2- and 3-year interest rates more attractive.

Chart 1
Bi-weekly GDP forecast for 1Q12, % q/q
Forecasts in line with the MICA BBVA Research model



Source: BBVA Research

Chart 2
Mexico: Interest rates and changes (generic in % and bp)



Source: BBVA Research and Bloomberg

Calendar: Indicators

Real GDP 1Q12 (Thursday, May 17)

Forecast: 0.5 q/q 3.6% y/y	Consensus: 1% q/q	Previous: 0.4% q/q 3.7%

Industrial Output in March (Monday, May 14)

Appropriate: 0.8 m/m 2.5 y/y SA	Consensus: 1.9% q/q	Previous: 1.7% m/m 1.7 y/y SA

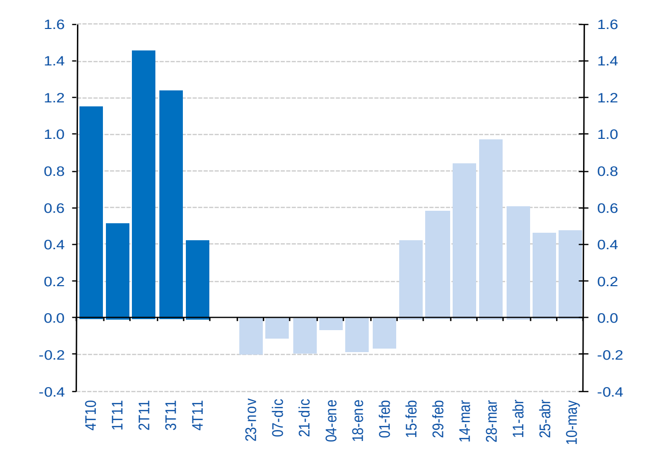
IGAE in March (Thursday, May 17)

Appropriate: 0.5 m/m 2.5 y/y SA	Consensus: N.A.	Previous: 0.8% m/m 2.3 y/y SA

In terms of industrial output, due to the leap year, information to day is distorted and we expect this to have diluted in March. The level of fading for the negative effect on manufacturers and construction will be significant to see, both seeing major declines in the previous month. In any case, other recently released indicators point to a slight slowdown in economic output, especially in manufacturing. The adjustment in services, meanwhile, was lower. In this sense, retail sales continue to rise (0.5% per month on average in the first two months of the year), supported by job creation of around 0.4% per month (up to April) which has, in turn, driven consumer confidence. The latter increased 0.9% on average, more than in the last quarter of last year (0.3%).

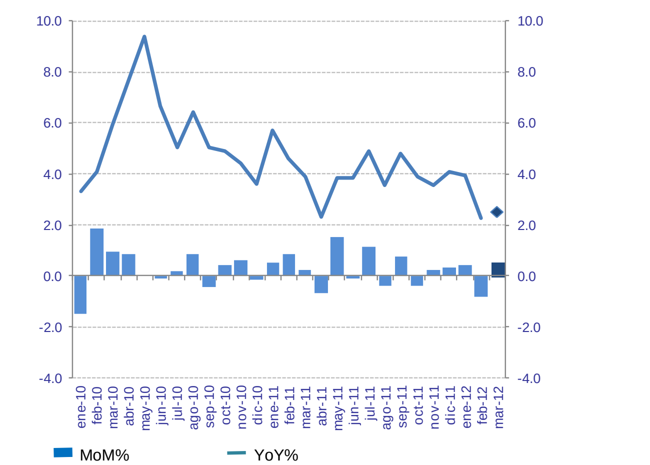
In all, the real time MICA BBVA Research indicator for economic growth, incorporating output, forecast, spending, job market and financial market data, points to GDP quarterly growth possibly coming in at 0.5% for 1Q12, slightly above the previous quarter.

Chart 3
Bi-weekly GDP forecast for 1Q12, % q/q
Forecasts in line with the MICA BBVA Research model



Source: BBVA Research with INEGI data

Chart 4
IGAE (y/y% and m/m%)



Source: BBVA Research with INEGI data

Markets

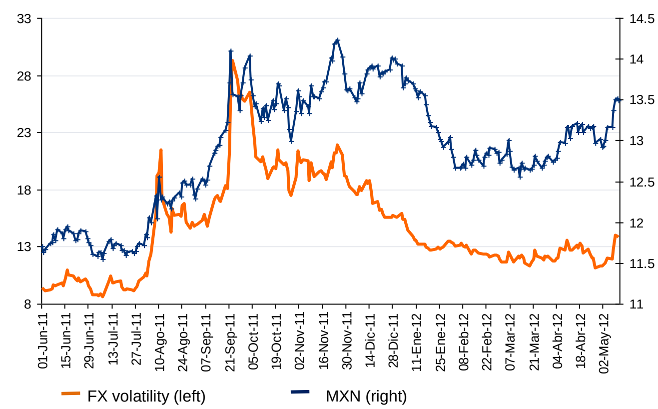
Global risk aversion and prolonged pause outlook dominate local asset performance

- The upswing in global risk premiums (sovereign and financial fears in Europe and slowdown rate in China), alongside forecasts of a prolonged monetary pause in Mexico, were the main drivers behind local markets over the last week.
- Banxico minutes (released May 11) showed a more moderate debate around a quick cut to the policy rate, as well as the increase in global risk due to the situation in Europe. This is one of the main threats for the Mexican economy. Despite this, debate around a possible rate cut continues and it is likely to run across coming meetings given the current risk balance. In these circumstances, defensive investments in fixed income with 2- and 3-year bond interest rates are recommended in expectation of a possible moderation in risk allowing long positions in higher maturity tranches in the final part of the curve. This situation may become active toward summer depending on events in Europe.
- Global risk premiums continue to be the main determining factor for the MXN. Meanwhile, the domestic monetary debate is in the background. Over the week, the MXN fell around 3%, trading between 13.14 and 13.57. In turn, implied volatility for one month hit highs from the start of the year. Currency volatility is therefore likely to continue and MXN carry-trade will not settle until the global outlook improves.

Capital markets fall back due to global scenario and domestic corporate news

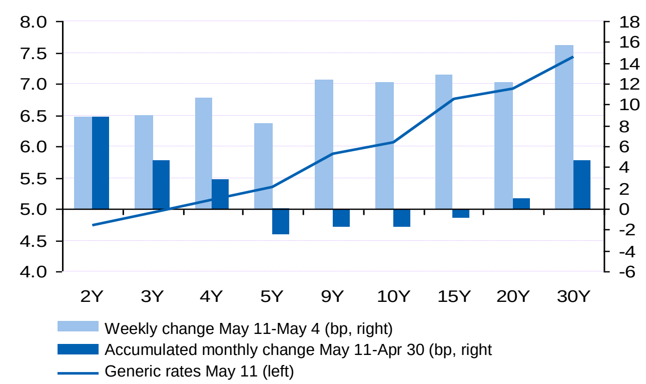
- In response to a more volatile global scenario (upswing in sovereign and financial risks in Greece and Spain), capital markets in Mexico saw a negative performance also due to Amx corporate output statements (acquisition of 28% of KPN and Simple Mobile). In the face of high global risk aversion, consumer companies (food, drinks and retail) saw the best performance in comparison to other cyclical businesses such as the mining sector - affected by the up to 6% drop in metal prices.

Chart 5
Mexico: MXN/USD and implied 1-month volatility (ppd and %)



Source: BBVA Research and Bloomberg

Chart 6
Mexico: Interest rates and changes (generic in % and bp)



Source: BBVA Research and Bloomberg

Technical Analysis

IPC

Source: BBVA, Bancomer, Bloomberg

The IPC may see a positive correlation with a possible bounce in the US market and again try a move to the 40,000pts mark, albeit this time not driven by Amx. We believe a triple A issuer reaction may begin which have remained with weak moves in recent sessions, such as Walmex, Cemex and Gmexico. The first step for the IPC is to hit above the 30-day rolling average, i.e. above 39,300pts.

Previous Rec.: We recommend maintaining a low investment level and expect a return to the floor or, otherwise, a break up through 40,000pts.

MXN

Source: BBVA, Bancomer, Bloomberg

The dollar recorded a strong gain over the week, finally breaking through the MXN13.20 mark and hitting MXN13.50, where it seems to be hitting short-term resistance. The over-purchasing in oscillating indicators does not suggest that it should return to MXN13.20 zone in the next few sessions.

Previous Rec.: 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.

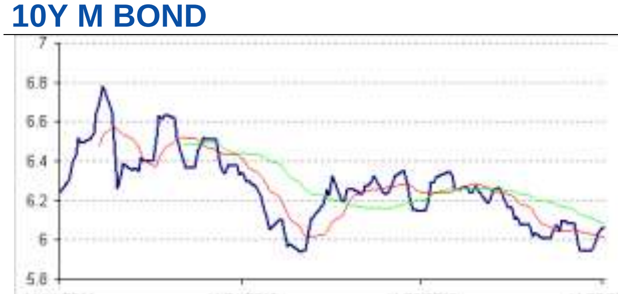
3Y M BOND

Source: BBVA, Bancomer, Bloomberg

3Y M BOND: (yield): No halt in move at 4.9% and aims to test the 5% - 5.05% zone. Given the over-purchasing in oscillating indicators, we see it breaking through this zone as difficult.

Previous Rec.: It may again test the 30-day moving average (4.75%)

10Y M BOND



Source: BBVA, Bancomer, Bloomberg

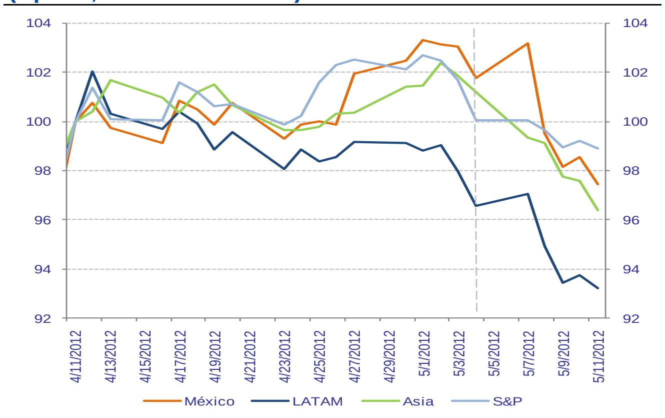
10Y M BOND (yield): Respecting the short-term over-selling, it started a reaction from 6%. It should at least seek out the 6.15% - 6.2% zone in the short-term. It should find resistance there at the 30- and 200-day rolling averages.

Previous Rec.: considering a bounce toward the 6.15% zone.

Markets

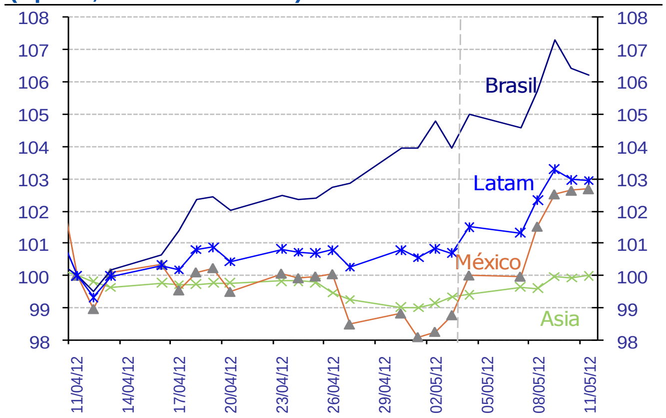
- **General decline on stock markets and currency devaluations over the week after increased risk aversion due to political tensions in Greece that place compliance with austerity measures agreed with the Troika in exchange for bailouts in doubt.**

Chart 7
Stock Markets: MSCI Indices (Apr 11, 2012 index = 100)



Source: Bloomberg & BBVA Research

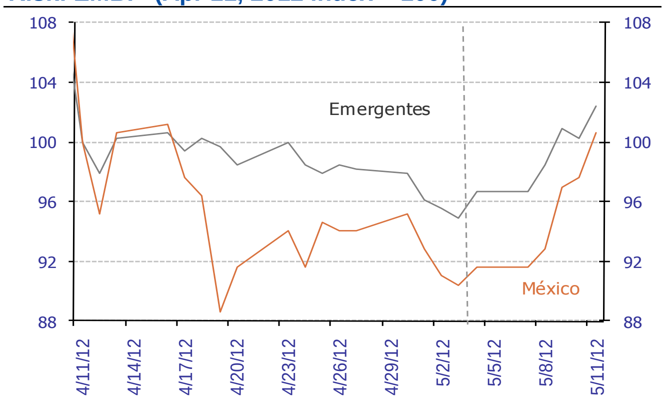
Chart 8
Foreign exchange: dollar exchange rates (Apr 11, 2012 index = 100)



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

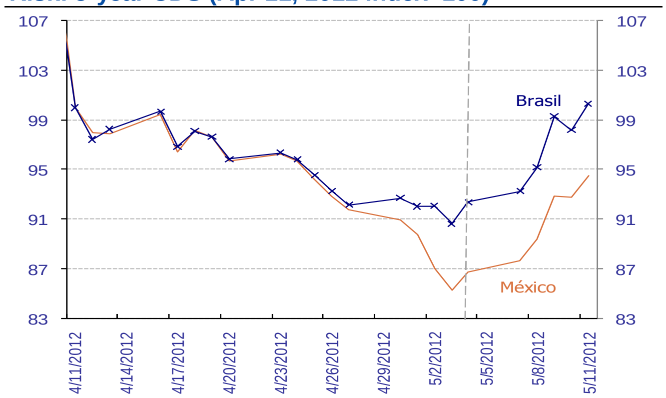
- **Increase in risk aversion in the face of renewed fears over a lack of resources to face up to financial commitments in Greece after the initial attempt to form a coalition government fails**

Chart 9
Risk: EMBI+ (Apr 11, 2012 index = 100)



Source: Bloomberg & BBVA Research

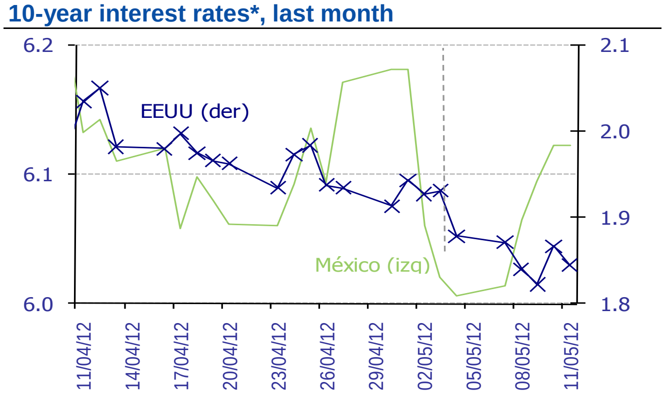
Chart 10
Risk: 5-year CDS (Apr 11, 2012 index=100)



Source: Bloomberg & BBVA Research

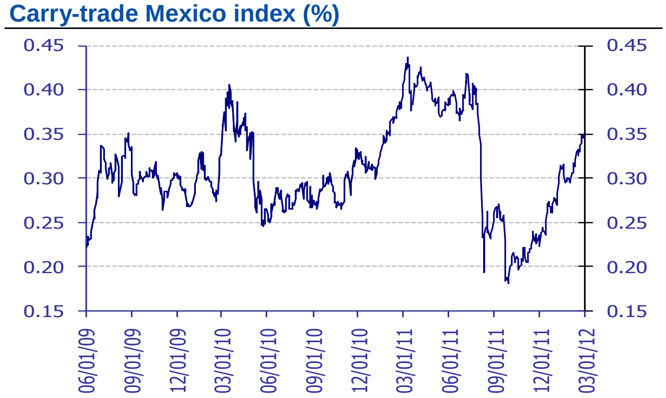
- **Rise in Mexican interest rates and a fall in US rates over the week due to investors searching for safe haven assets**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

Chart 12
Carry-trade Mexico index (%)

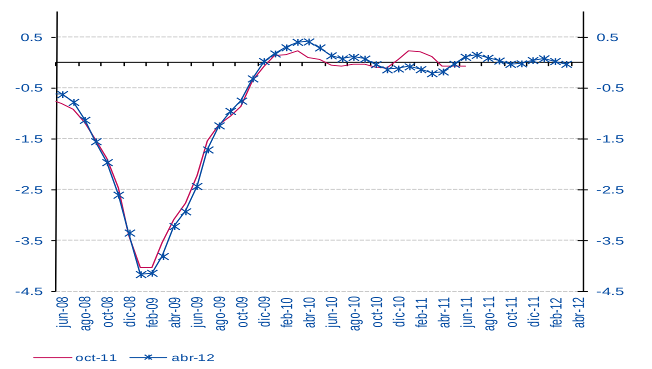


Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

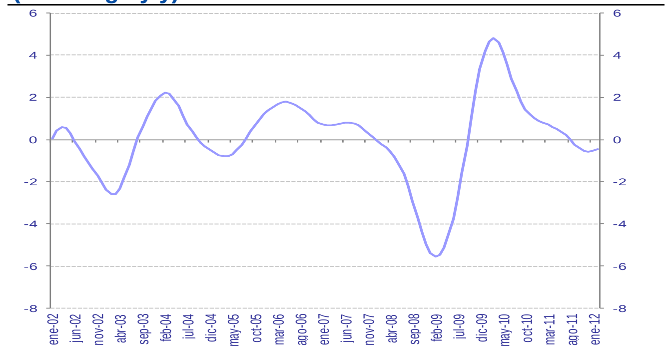
- **Output holds positive performance, situation indicators point to 1Q12 with quarterly rates around 0.5%.**

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.

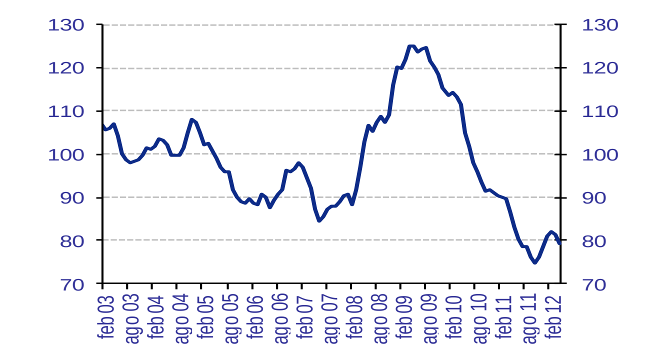
Chart 14
Advance Indicator of Activity (% change y/y)



Source: INEGI

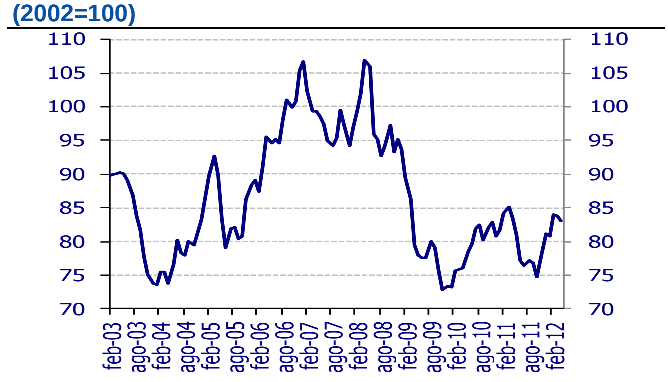
- **Both the recent inflation and output surprises were downward.**

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.

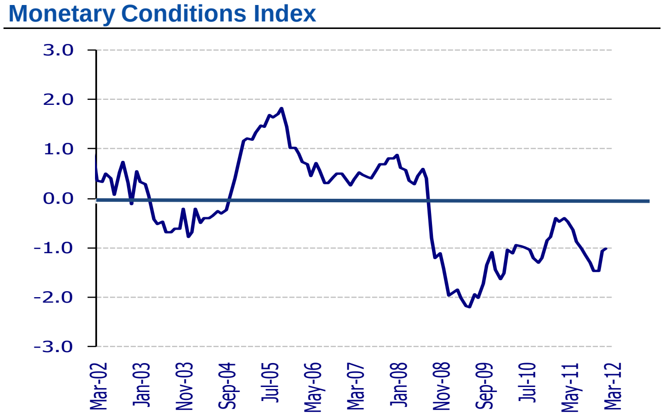
Chart 16
Activity Surprise Index (2002=100)



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.

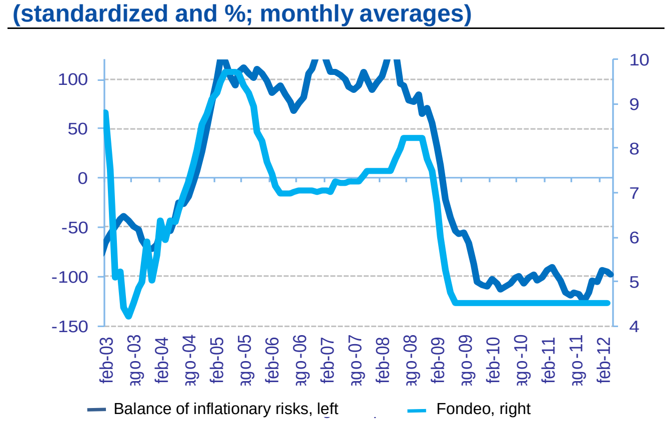
- **Monetary conditions near neutral zone**

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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