Mexico Weekly Flash

Next week…

- **The Bank of Mexico will release its monetary policy decision, leaving the target rate at the current 4.5%.**

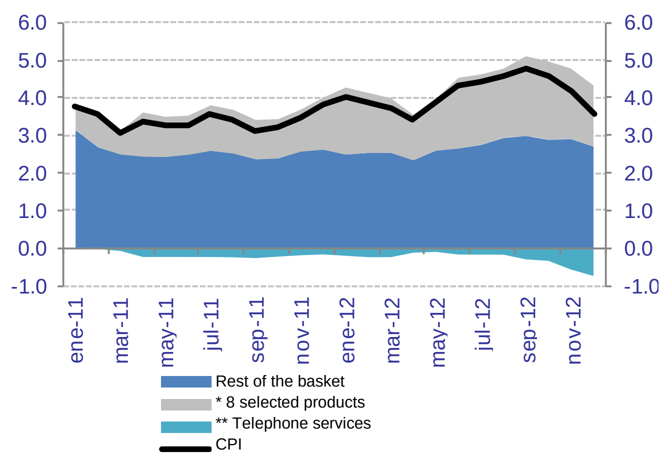
  Next Friday the Central Bank will keep the monetary policy rate unchanged. Banxico underlined in its statements over the last quarter of the year that its decision to maintain the monetary rate was linked to inflation continuing its downward trend. In the last part of the year, inflation continued to fall, hitting 3.57% in December thanks to supply shocks continuing to dissipate and lower telephone prices. With regard to output, uncertainty surrounding fiscal matters remains in the US after the partial agreement reached in recent weeks. Linked to the crisis in Europe which is far from being definitively resolved, this leads us to believe the worsening risk balance in this area will remain.

  In a scenario where inflation remains in the central bank target ranges and growth slows to around 3%, the outlook for a monetary pause this year remains.

- **The foreign-exchange market will be focused on corporate reports in the US and the monetary policy decision**

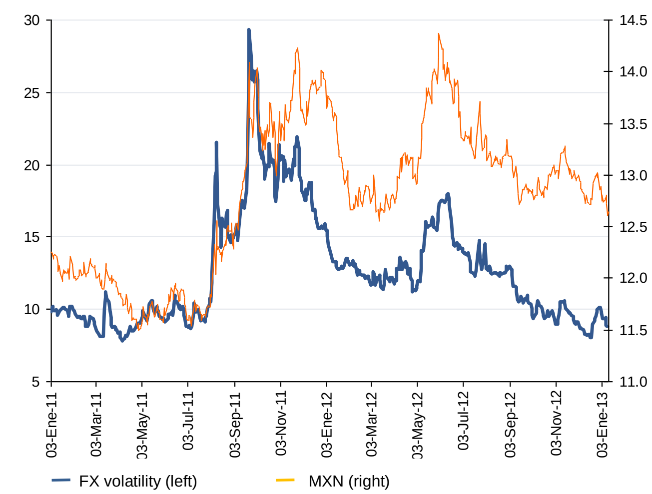
  The MXN saw some profit-taking on Friday which was in line with the pause in the recent rally on US stock markets. The currency reacted to economic data from China over the week as well as less negative outlooks for the EMU in Draghi's speech after the ECB meeting. Nonetheless, toward the close demand for the MXN slowed, closing slightly below technical resistance levels. In addition to the strong MXN positions on the CME, this leads us to remain cautious regarding the currency rally and, in any event, to expect profit-taking before again taking long positions. This week the market will again be focused on corporate reports in the US as well as any change in stance shown by Banxico in its monetary policy decision.

Chart 1
Inflation (% change y/y)



Source: BBVA Research with INEGI data. *Tortillas, chicken, beef, eggs, tomatoes, beans, gas and fuel (13.5% weight in the IPC basket of goods). ** **Telephone services include local, cell, national and international long distance services (3.26% weight in basket)

Chart 2
MXN and Implied Volatility 1m contracts (ppd and %)



Source: BBVA Research and Bloomberg

Technical Analysis

IPC

Source: BBVA, Bancomer, Bloomberg

After two months of major upswings, we are seeing highly advanced over-purchasing readings in technical short-term indicators. The RSI ended the week above 80pts, something not seen since November 2010. This move is part of the upward trend where the IPC has been trading since August 2011. The upper part of this channel sits right at 45,000pts. We saw major adjustments on the three previous occasions that the market reached the upper part of this channel (average: -8%). We recommend favoring short-term liquidity and waiting for the market to show this natural adjustment in the upward trend. Possible supports at 43,000pts, 42,000pts and, in the worst case, 41,200pts.

Previous Rec. (12/17/12): We believe the IPC is highly likely to seek out the second support level.

MXN

Source: BBVA, Bancomer, Bloomberg

The dollar broke through MXN12.70 over the week, a level where it has found support several times since September. With this break, and faced with a lack of over-selling on the RSI, we could expect to see a return to March levels at MXN12.55.

Previous Rec. (12/17/12): The 1st resistance level is MXN12.89 followed by MXN12.95 where the 10- and 30-day rolling averages sit.

3Y M BOND

Source: BBVA, Bancomer, Bloomberg

3Y M BOND (yield): The bond has traded between 4.9% and 5% since November without setting out a short-term trend. We could expect a new bounce toward 5% with a stop loss at 4.85%.

Previous Rec. (12/17/12). We recommend a target of 5.1% as long as it shows no downward break.

10Y M BOND

Source: BBVA, Bancomer, Bloomberg

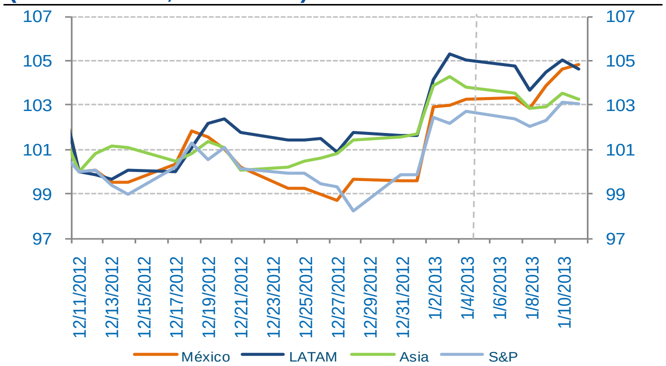
10Y M BOND (yield): The bond is trading in an upward triangle formation that could set off a buy signal with an upward break through 5.57%. We recommend waiting for this break.

Previous Rec. (12/3/12). Positions again to be taken when it hits 5.35%.

Markets, activity and inflation

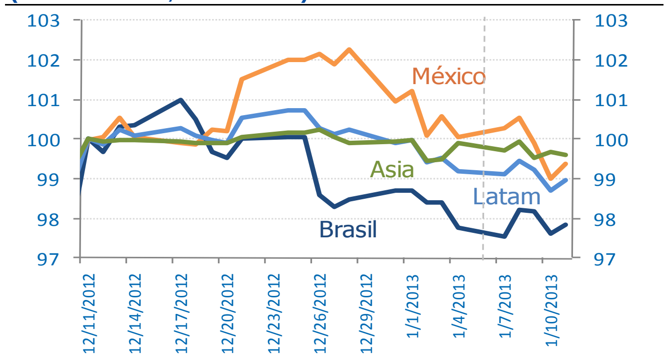
- **Better-than-expected growth data and lower-than-expected inflation figures in Mexico add to better-than-expected corporate reports in the US to influence a strengthening in LatAm currencies. Linked to this, a less negative outlook at the European Central Bank contributes to gains on stock markets.**

Chart 7
Stock Markets: MSCI indices (December 11, 2012 = 100)



Source: Bloomberg & BBVA Research

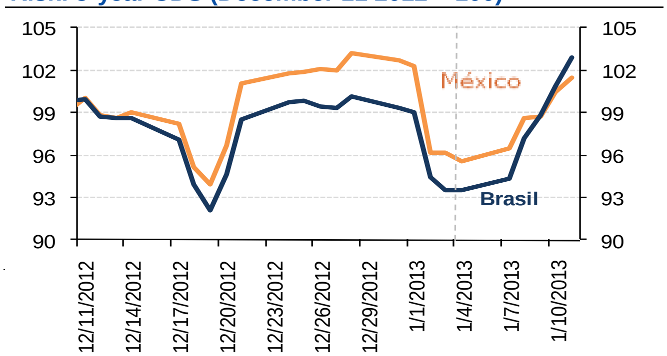
Chart 8
Foreign exchange: dollar exchange rates (December 11, 2012 = 100)



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

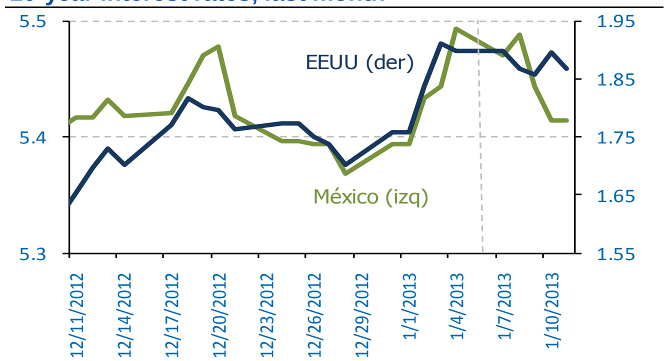
- **Slight increase in risk aversion toward the end of the week with the release of higher-than-expected inflation figures in China and lower-than-expected banking reports in the US. Rates in Mexico fall due to better-than-expected inflation figures.**

Chart 9
Risk: 5-year CDS (December 11 2012 = 100)



Source: Bloomberg & BBVA Research

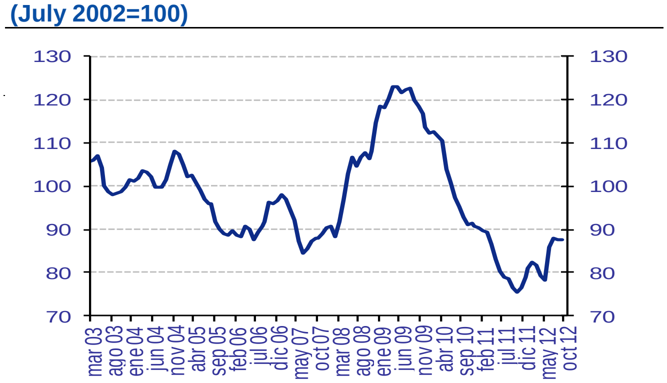
Chart 10
10-year interest rates, last month



Source: Bloomberg & BBVA Research

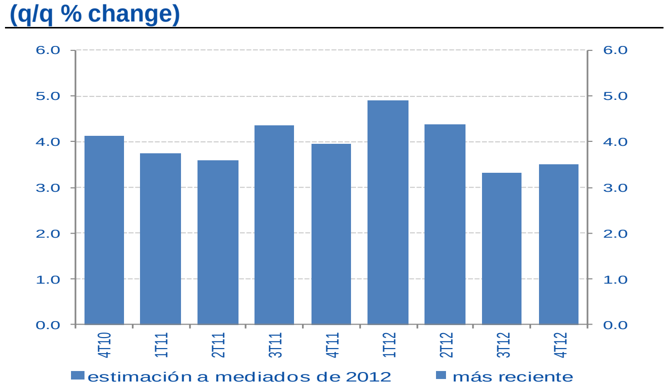
- **Recent situation indicators for economic output point to the last quarter having seen good growth meaning an annual average for 2012 slightly above 3.7%. In the meantime, inflation fell, coming in under 4% in December.**

Chart 11
Inflation Surprise Index (July 2002=100)



Source: Bloomberg & BBVA Research

Chart 12
Observed and estimated GDP (q/q % change)



Source: BBVA Research with data from Bloomberg

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