Mexico Weekly Flash

Next week…

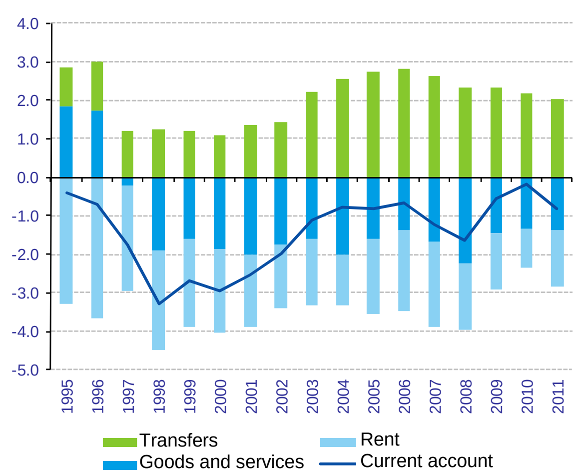
- **Balance of Payments for 2012 set to show economy has no imbalance in external accounts**

  Next Monday sees the release of the Balance of Payments for 2012. We forecast the current account should again show a very low deficit, as in the previous three years, of 0.6% of GDP. The exceptional 471 million dollar surplus recorded in the trade balance over the period has had a major impact on this good performance. This is due in part to weak domestic demand, favorable oil prices, the weak peso and the competitiveness of Mexican exports. The capital account balance will also be released. The country's foreign direct investment (FDI) will be an important component, as will portfolio investment. It should be stated that FDI to the third quarter was somewhat disappointing, running to 13.045 billion dollars - 18% lower than the same period for 2011. In turn, portfolio investment, especially public sector bonds to 3Q12, saw a very positive performance recording aggregate inflows of 45.753 billion dollars - 54% above the previous year. Mexico has no problems funding its current account thanks to it being largely financed with investment inflows and having a solid macroeconomic performance based on responsible fiscal and monetary policies.

- **Will the MXN break through its trading ranges?**

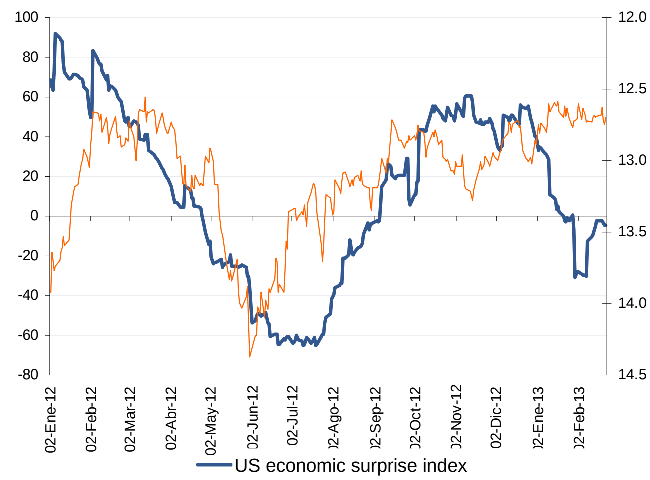
  Over the year, the exchange rate has mostly traded in the 12.60-12.80 range due to mixed news on both the foreign and domestic front. Nonetheless, uncertainty linked to the fiscal cliff in the US and forecasts of a lower bank lending rate at Banxico could take the rate above the 12.80 ceiling. This could open up opportunities for long positions in the MXN.

Chart 1
Current account balance and breakdown (% of GDP)



Source: BBVA Research with INEGI, STPS and Bloomberg data

Chart 2
Economic surprise index (US) and USDMXN (Positive/negative surprise index and ppd)



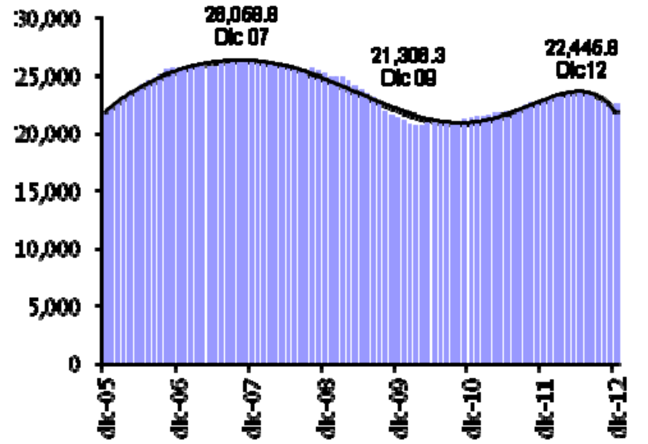
Source: BBVA Research and Bloomberg

How are remittances looking so far in 2013? (March 18)

Forecast: 1.483 bd	Consensus: 1.459 bd	Previous: 1.706 bd

On March 1, the Bank of Mexico will release figures on remittances received in Mexico for the first month of this year. January is generally a slow month for remittances in Mexico as some Mexican migrants are usually still in the country visiting family. January 2013 will be no exception and we estimate Mexico receiving around 220 million dollars less than in December 2012. We also believe remittances will likely come in below the 1.506 billion dollars seen in January last year meaning the annual rate could decline slightly. This is due to the continuing economic uncertainty in the US and a possible effect from the exchange rate (pesos per dollar) as January 2012 saw growth while recently there has been a declining trend. Although the decline in remittances has slowed in recent months, we could still see months without growth, depending largely on economic performance in the US and its effect on Mexican migrants.

Chart 3
Remittances



Source: BBVA Research with INEGI data

- ### Will the MXN break through its trading ranges?

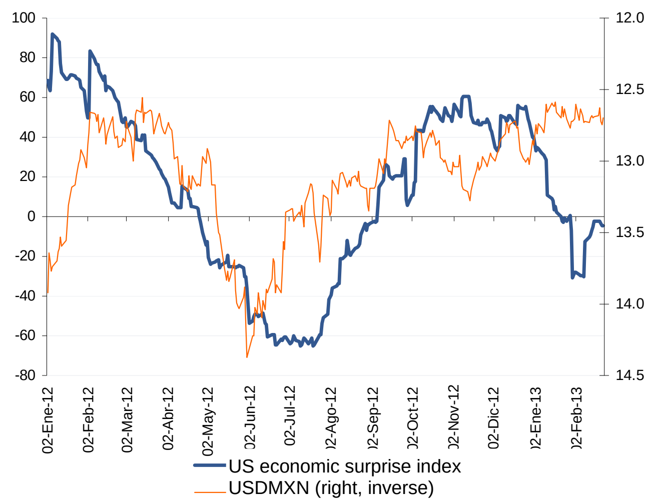
The USDMXN exchange rate has mostly traded in the 12.60-12.80 range over the year due to mixed news on both the foreign and domestic front. On the one hand, cyclical risks remain (e.g. ongoing fiscal debate in the US) linked to cautious investors in emerging markets. On the other, high global liquidity conditions continue to expand. Despite Fed minutes showing intense debate on when to limit quantitative easing (QE) in the US, the current economic climate continues to justify the Fed widening its balance sheet as has been seen at other central banks such as the Bank of Japan and the Bank of England.

In turn, several domestic factors have also had a mixed impacted on USDMXN ranges. On the one hand, it is highly likely that Banxico cuts its policy rate which would limit the *carry* appeal for the MXN. On the other, the fundamentals underpinning the Mexican economy continue to be relatively appealing with a chance of structural reforms supporting the growth potential in Mexico.

In all, the factors above have limited holding short-term MXN directional positions. Nevertheless, opportunities to take long MXN positions could open up if there are increases in risk premiums due to the fiscal debate in the US as well as FX markets tending to discount a lower Banxico lending rate at the next meeting (March 8), as seen on the fixed income securities market.

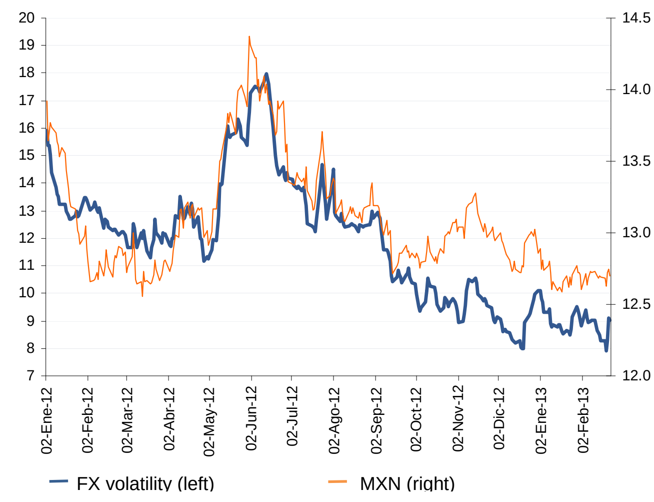
These factors combined could lead the USDMXN to break the upper 12.80 ceiling and, if this occurs, some positions would close. Despite this and the increase in inflation on Friday (considered as temporary), the medium-term appeal of the MXN remains meaning the adjustment we see could be short-lived.

Chart 5
Economic Surprise Index (US) and USDMXN (Positive/negative surprise index and ppd)



Source: BBVA Research and Bloomberg

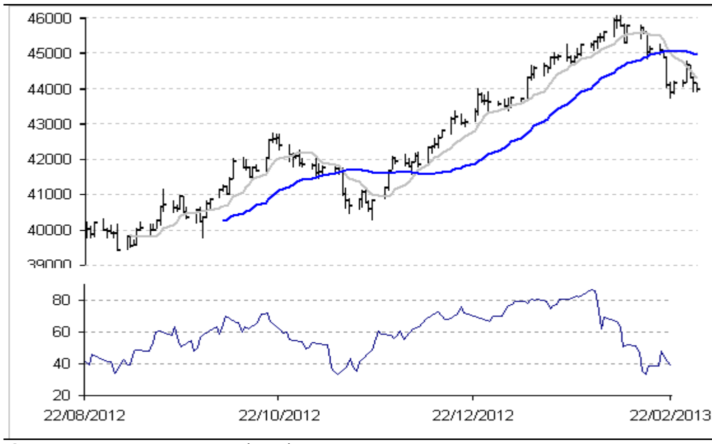
Chart 6
Mexico: MXN/USD and implied 1-month volatility (ppd and %)



Source: BBVA Research and Bloomberg

Technical Analysis

IPC



In spite of the weekly fall, the IPC managed to remain above the previous minimum and support of 43,500pts. This means we cannot rule out a double bottoming-out scenario. Even if this bounce occurs, we cannot consider an entry signal onto the market until the IPC again hits above the 30-day rolling average, i.e. above 45,000pts. If the market fails to strengthen above this resistance level, the next IPC floors are at 42,700pts (50% drop in the Fibonacci model) and 42,000pts which corresponds to the lower part of the upward channel the market has traded in since September 2011 for 17 months and which also coincides with the 68% drop in the Fibonacci model. This downward scenario produces declines of between -2.9% and -4.5% in current levels.

Previous Rec. (2/18/13): Given the possible volatility due to quarterly reports, we cannot rule out the market hitting below the 43,500pts floor.

Source: BBVA, Bancomer, Bloomberg

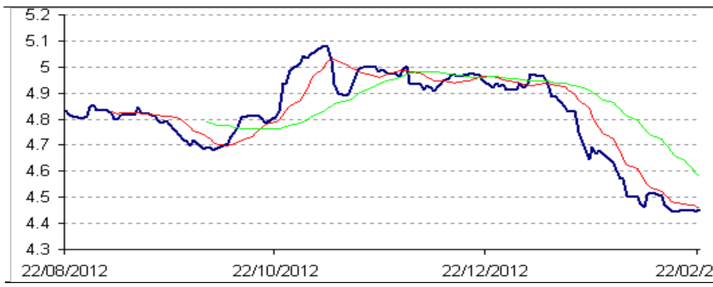
MXN

New test of the MXN12.80 resistance level over the week. There has still been no break through this resistance but it has started to trade above the negative trend level from the last few months and the 10-day rolling average continues to trade above the 30-day rolling average. This suggests a break of the current range will be upward.

Previous Rec. (2/18/13): It ended the week slightly below the 30-day rolling average

Source: BBVA, Bancomer, Bloomberg

3Y M BOND

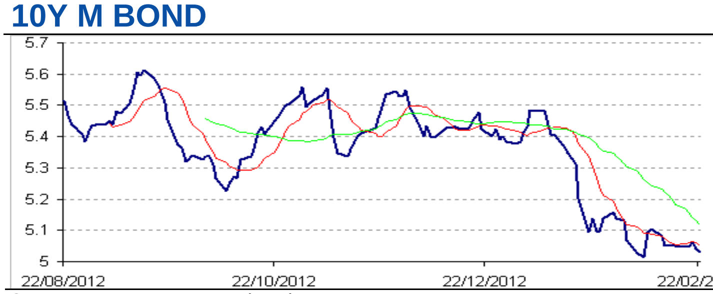


3Y M BOND (yield): The bond saw a sideward move over the week. Over-selling remains very high and we could see a bounce toward 4.6% in the 30-day rolling average.

Previous Rec. (2/18/13). The bond continued downward. The over-selling and opening up of averages points to an upturn toward 4.6%.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND



10Y M BOND (yield): The bond continues to trade down and the resistance level is not at 5.15% where the 30-day rolling average sits.

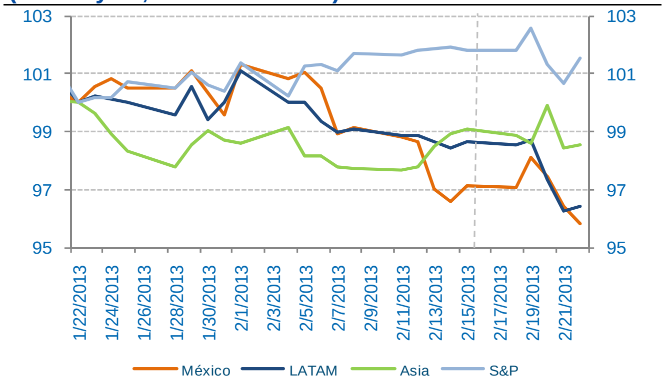
Previous Rec. (2/18/13). Given the spread at this level with the 30-day average, we continue to assume an upturn, now toward 5.2%.

Source: BBVA, Bancomer, Bloomberg

Markets, activity and inflation

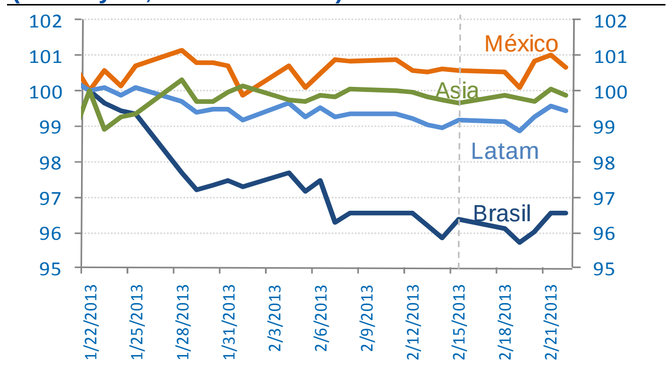
- **The debate on the Federal Reserve board surrounding a possible cut in the speed of purchases or even a suspension of purchasing Treasury bonds toward the middle of this year had an impact on the devaluation in currencies and losses on stock markets mid-week. This was exacerbated by lower-than-expected manufacturing and services output figures from Europe.**

Chart 7
Stock Markets: MSCI indices (January 22, 2013 index=100)



Source: Bloomberg & BBVA Research

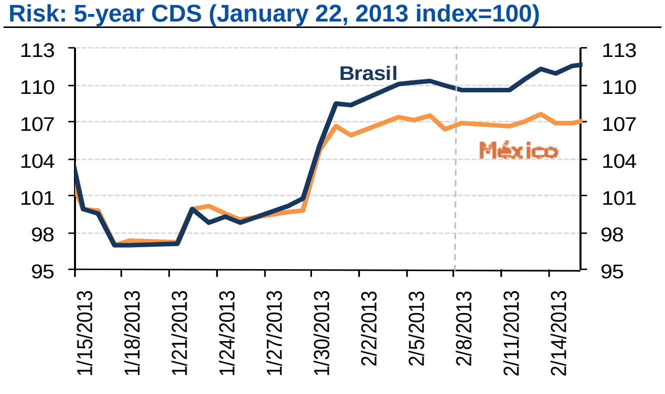
Chart 8
Foreign exchange: dollar exchange rates (January 22, 2013 index=100)



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

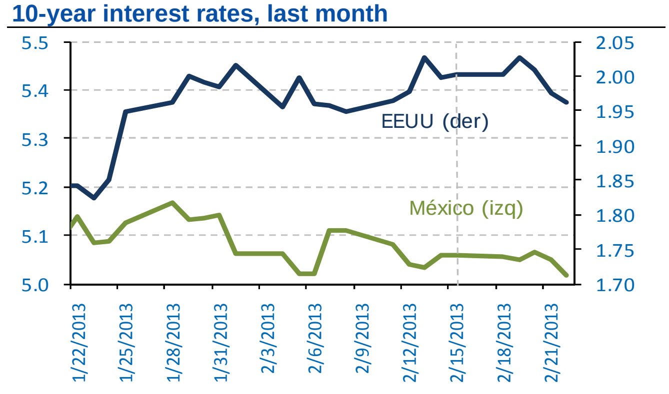
- **Rates in Mexico return to correlation with US Treasury rates and fall with the higher risk aversion due to lower-than-expected economic output figures from Europe.**

Chart 9
Risk: 5-year CDS (January 22, 2013 index=100)



Source: Bloomberg & BBVA Research

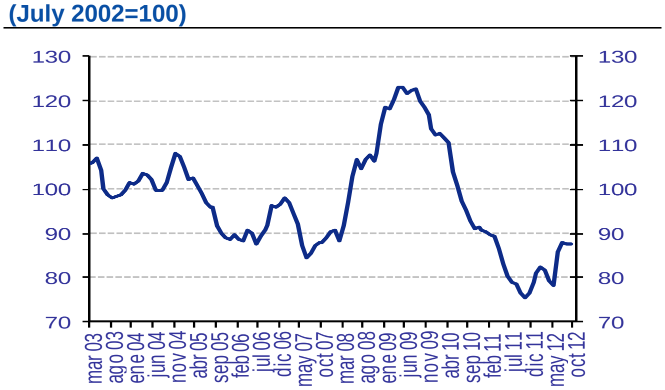
Chart 10
10-year interest rates, last month



Source: Bloomberg & BBVA Research

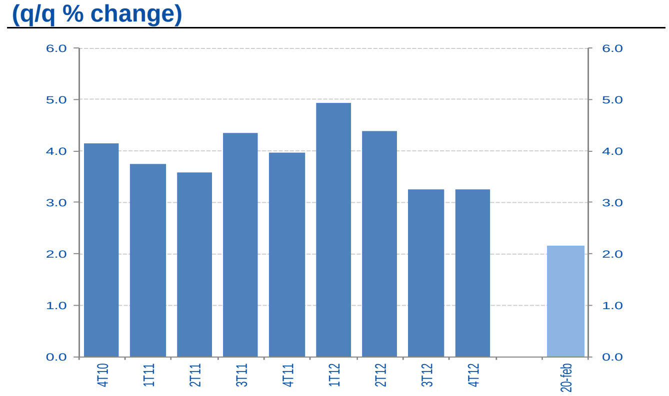
- **Recent situation indicators for economic output point to the start of 2013 continuing to see a slowdown in output. The BBVA MICA model points to annual growth of 2.5%. Meanwhile, inflation has slowed, coming in below 4% in December.**

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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