Mexico Weekly Flash

- **Policy rate cut in September once inflation is in the target variability range**

In a setting where central banks continue to relax their monetary stance, the tone of the minutes from Banxico's last monetary policy meeting and recent output and inflation data lead us to expect a 50 basis point cut in the lending rate at the September meeting. This decision is based on the following factors. First, the minutes show that most of the board believe that core inflation remaining around 3% is proof that convergence with the inflation target has been maintained despite headline inflation coming in above 4% as a result of supply shocks. Specifically, most argue that "once the shocks are separated into those [products] where monetary policy has direct or indirect effect, convergence at 3% is occurring".

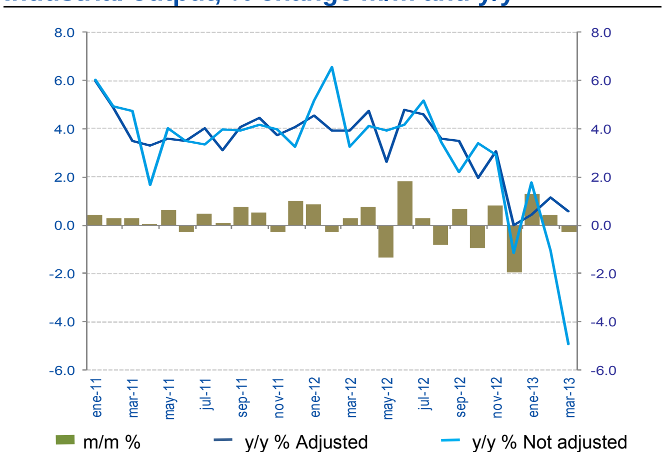
In this sense, the latest inflation figures point to supply shocks seemingly falling quicker-than-expected meaning inflation is expected to possibly come in below 4% from July on.

Second, even with Banxico not changing its growth forecasts in its most recent inflation report, most of the board have a pessimistic take on domestic output as well as agreeing that downward risks remain. This argument is in line with industrial output figures for March which were released today, seeing a 0.3% decline.

Third, the minutes contain several paragraphs on the revision of monetary easing measures around the globe and some members directly associate it with a tightening of monetary conditions in emerging economies - a point Banxico highlighted in its latest statement as a determining factor behind its stance. In addition, most members agree that these measures will be maintained and could even increase, which have come about since different central banks have cut their policy rates in the last months.

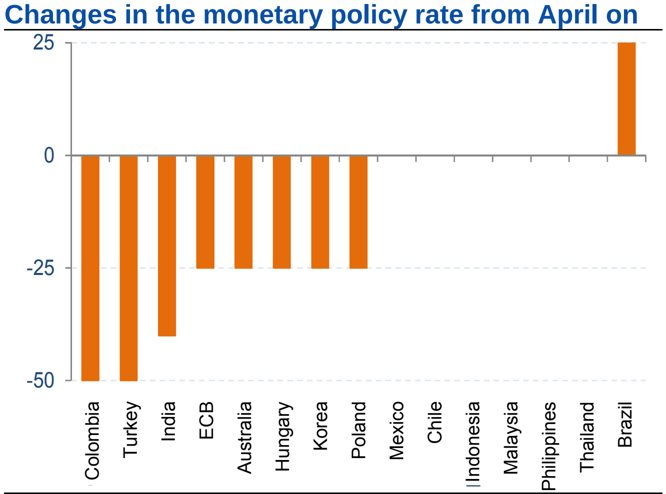
Based on the above, we believe that the conditions will be in place for a 50 basis points cut in the policy rate in September once inflation is in the range around the inflation target. It should be stated that the time of a cut is strongly influenced by when inflation is on a sustained downward trend and below 4%.

Chart 1
Industrial output, % change m/m and y/y



Source: BBVA Research with INEGI data

Chart 2
Changes in the monetary policy rate from April on



Source: Bloomberg

GDP at constant prices for 1Q13 (May 17)

Forecast: 0.3% q/q 2.2% y/y CSV	Consensus: 0.1% q/q CSV	Previous: 0.8% q/q, 3.3% y/y CSV

This week sees the publication of output growth in 1Q13. Based on available data, we believe that it will have expanded at 0.3% for the quarter, measured on the data corrected for seasonal variation, equivalent to 2.2% y/y also corrected for seasonal variation. Growth in the service sector will stand out in the first quarter, coming in around 2.8%, compared to manufacturing growth of around 1%.

Job market indicators for the first quarter show that the growth rate for those in employment came in at 1.3% in 1Q13, with tertiary sector additions standing out in the professional services, transport, logistics and restaurant and hotel sectors. The performance in the labor force is especially important, adding variation in employment with variation in wages in real terms. This measurement expanded in 1Q13 by 2.7% y/y since the second quarter in a row increase in real income of those in employment (also 1.3%) is added to the increase in employment.

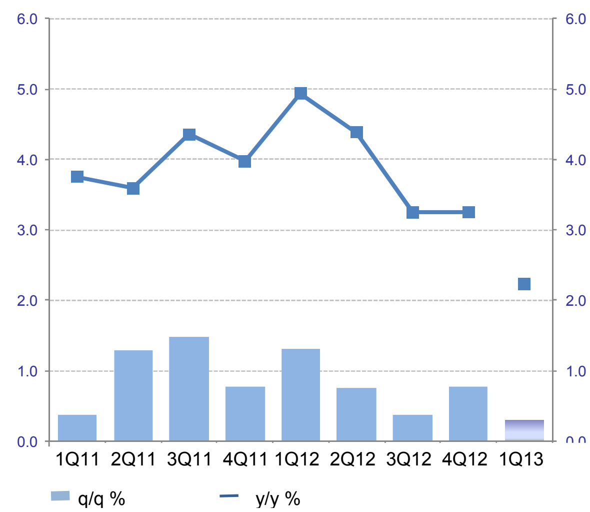
Despite expected growth coming in far below forecast from the start of the year, the expected performance for domestic demand as well as stability in job creation, alongside the gradual increase in real income, will mean better output in coming quarters. We therefore expect growth in 2013 to come in at 3.1%.

Industrial performance in May was released this week. This came in far below expectations from March (forecast: 0.6%, real: -0.3%). In annual terms, growth rose to 0.6% y/y corrected for seasonal variation (CSV) and -4.9% y/y non-CSV. It should be highlighted that both construction and manufacturing reported respective monthly growth of 0.8% and 0.2%. This is in contrast to mining and electricity, and water and gas supply at (-)2.1% and (-)0.8% respectively. With these figures, manufacturing output remains stable at around 1% annual growth in the first quarter of the year.

Available figures in April point to automotive output having improved, offsetting the negative numbers for March. In turn, producer confidence indicators showed improvement in some items such as likely to invest and the future situation in the country. Further, US industrial output as well as consumer spending indicators there remain stable with growth rates - a good sign for Mexican manufacturing.

Chart 3

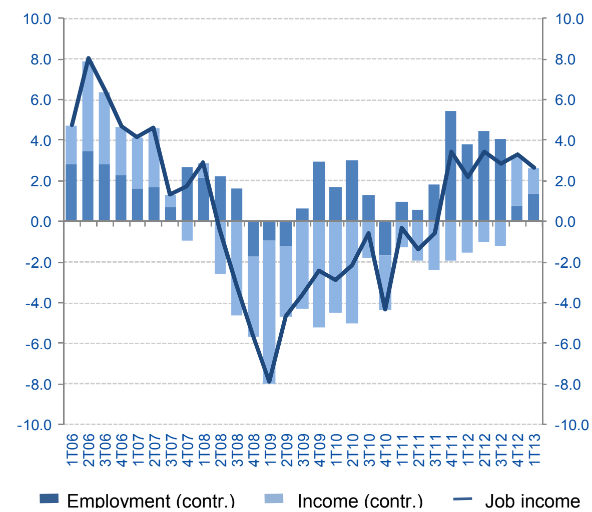
Mexico GDP, % change y/y and q/q



Source: BBVA Research with INEGI data

Chart 4

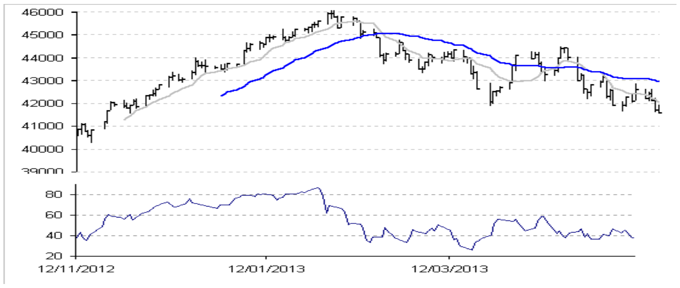
Job Income
(% change y/y and contribution to growth)



Source: BBVA Research with INEGI data

The MBonds curve reacted more to the global outlook, especially to statements by Bernanke as we stated in the Strategic Vision. These set out the risk linked to creating bubbles given the liquidity setting and low rates (which could again lead to market expectations of a reduction in short-term Fed purchases). In this way, the MBonds curve sustained its high correlation with T-bills and moved up for most maturities. Nevertheless, we do not expect the move to become a sustained trend. On the one hand, there are still no signs of a recovery in the US that point to exit strategies. On the other, the domestic market is more focused on the likelihood of Banxico cutting rates. This is such that even the MXN closed with losses, coming after the higher Fitch rating, which could be followed by S&P that already made an outlook change, and especially Moody's (already at Fitch levels) stating that there could be chances of a rating rise. We would not, therefore, expect to see a reversal of flows. We continue to see downward room in the short section of the curve given the Banxico situation and maintain out outlook for a stronger MXN.

IPC



Source: BBVA, Bancomer, Bloomberg

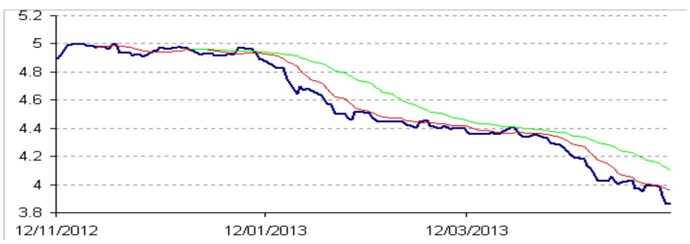
The negative weekly balance has again moved the IPC to a critical support level. It closed the week trading below 42,000pts, although still without confirmation of a break, i.e. 1% below the floor. Confirmation of a break would come at 41,859pts and introduce a higher adjustment signal with new targets at 40,500pts (-3% below the current level) and 39,500pts (-5% below the current level). On April 26, the market already tested this floor level and managed to stay above it. However, this time around, the US market is not at a resistance level. The weekly gains on the Dow Jones and the S&P practically took them to the high end of their respective short-term channels meaning we are highly likely to see profit-taking on the market. If these markets test the low end of the short-term channels, we would be seeing a return of around 3%, in line with the first IPC floor. **Previous Rec.** (05/06/13): Given the position on the oscillating indicators, we believe this ceiling level should be broken without any problems and the market may sustain this bounce to at least 43,000pts.

MXN

Source: BBVA, Bancomer, Bloomberg

The dollar traded below MXN12.00 over the week but never hit our stop loss at MXN11.90. It bounced over the last two sessions of the week and returned to the resistance level set by the high end of the channel and the 30-day rolling average. We closed positions and expect and return to the MXN12.00 level or, failing this, an upward break through MXN12.20 to take new long positions. **Previous Rec.** (05/06/13): We think the MXN12.00 level should again be a major support for short-term moves.

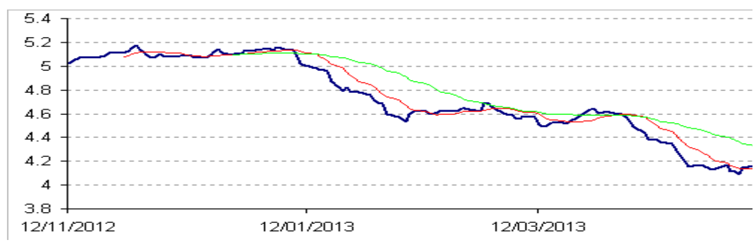
3Y M BOND



Source: BBVA, Bancomer, Bloomberg

3Y M BOND: (yield): The 3Y bond remained down, below the 10-day rolling average. No entry signal until it hits above 3.96%. **Previous Rec.** (05/06/13): Entry signal until it hits above the 10-day rolling average (4.01%) with a target at 4.19%.

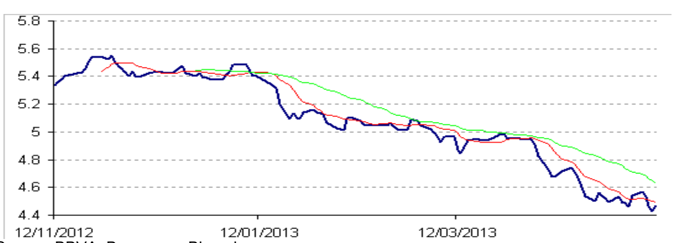
5Y M BOND



Source: BBVA, Bancomer, Bloomberg

5Y M BOND (yield): The 10Y bond could not realize the upward break of the 10-day rolling average. Only if it hits above 4.1% could we consider an entry with an initial target at 4.3%. **Previous Rec.** (05/0613): Still not hitting above the 10-day rolling average (4.14%). We need to wait for it to cross over to consider an entry.

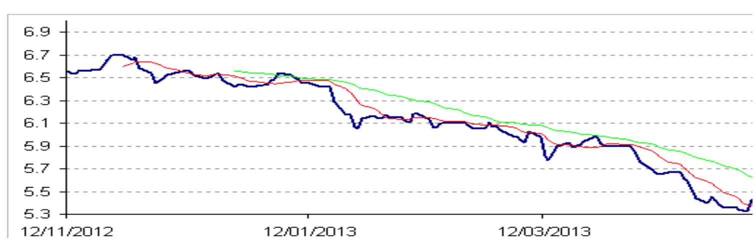
10Y M BOND



Source: BBVA, Bancomer, Bloomberg

10Y M BOND (yield): The 10Y bond failed to remain above the 10-day rolling average. Near resistance at 4.5% and 4.5%. We need to wait for it to cross averages for an entry. **Previous Rec.** (05/06/2013). It is about the cross up though the 10-day rolling average (4.51%). Above this level sets off purchases toward 4.72%.

30Y M BOND



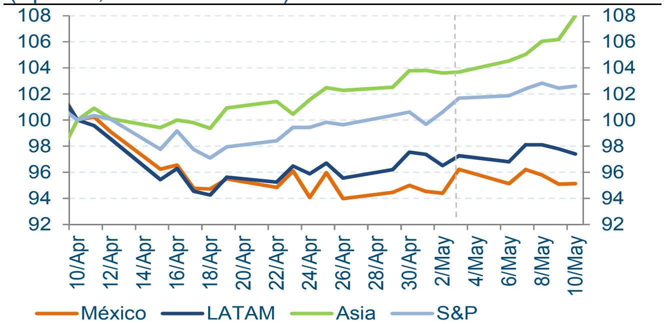
Source: BBVA, Bancomer, Bloomberg

30Y M BOND (yield): The 30Y bond complied with the entry signal. It is approaching a second resistance level at the 30-day rolling average at 5.6%. With the RSI at 46pts, it could sustain the bounce. If it breaks through the resistance level, it could remain up to 5.85%. **Previous Rec.** (05/06/2013). Entry started by closing the week above the 10-day rolling average (5.39%). Target at 5.65% with stop loss at 5.3%.

Markets, activity and inflation

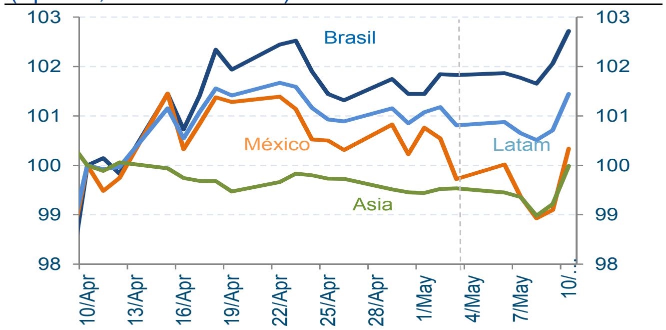
- **The stronger peso after the higher credit rating for Mexican sovereign debt from Fitch dissipated after the expectations at the end of the week of a better recovery rate for the US economy led to the dollar making gains against more emerging currencies.**

Chart 7
Stock Markets: MSCI indices
(April 10, 2013 index=100)



Source: BBVA Research with data from Bloomberg

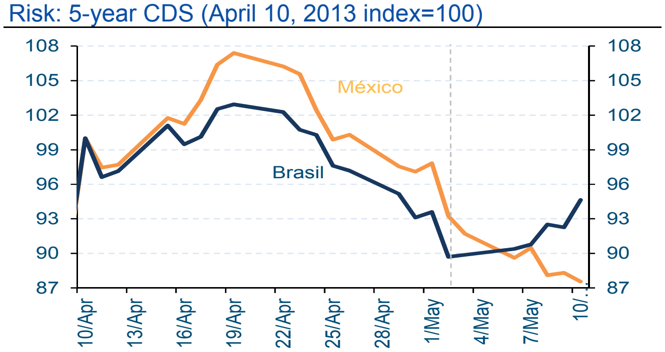
Chart 8
Foreign exchange: dollar exchange rates
(April 10, 2013 index=100)



Source: BBVA Research with Bloomberg data NB: LATAM includes Argentina, Brazil, Chile, Colombia and Peru. Asia includes the Philippines, South Korea, Taiwan, Singapore, Indonesia and Thailand.

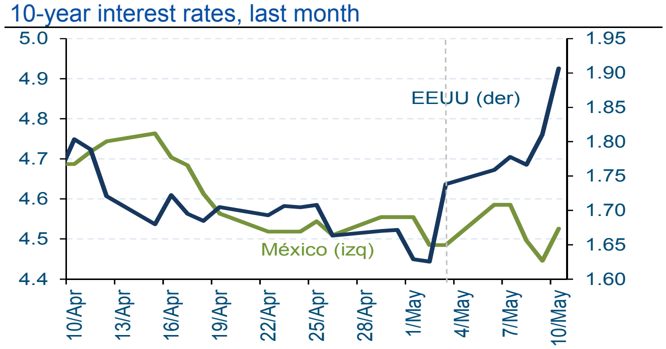
- **Higher US interest rates in the face of lower risk aversion due to better forecasts for the US cycle and the speech by Federal Reserve Bank of Philadelphia chairman regarding early easing of bond purchases. Rates in Mexico moved in line with U.S. Treasury bonds. The Mexican CDS spread hit levels not seen since 2008 after the higher credit rating.**

Chart 9
Risk: 5-year CDS (April 10, 2013 index=100)



Source: BBVA Research with data from Bloomberg

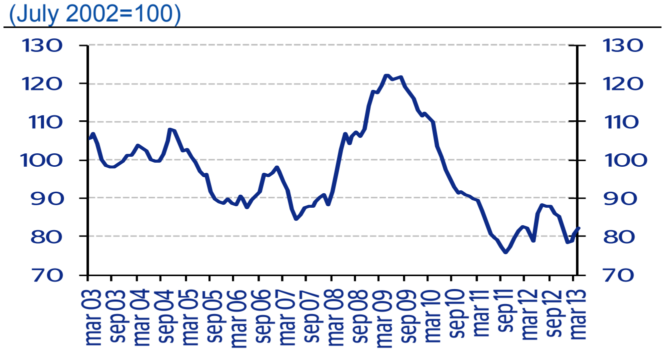
Chart 10
10-year interest rates, last month



Source: BBVA Research with data from Bloomberg

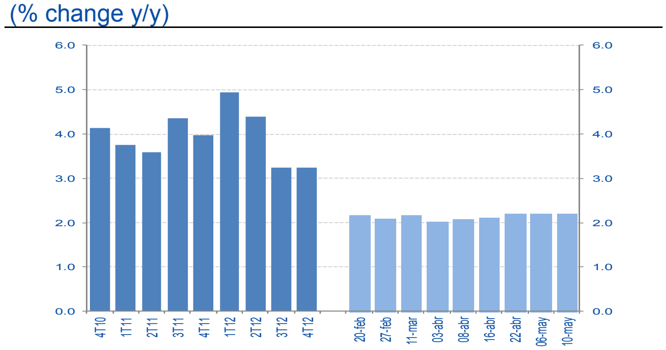
- **Inflation moved up in the first two weeks of March above expectations. Nonetheless, we believe the bounce will be temporary and have hit a high in April.**

Chart 11
*Inflation Surprise Index
(July 2002=100)



Source: Bloomberg and BBVA Research
*This measures the deviations in inflation in comparison to market-forecast figures, adjusting for inflation volatility. When it trends down, this implies a lower-than-expected inflationary surprise; when it trends up, this indicates a higher-than-expected inflationary surprise.

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



Source: BBVA Research

Arnoldo López Marmolejo
arnoldo.lopez@bbva.com

Cecilia Posadas
c.posadas@bbva.com

Alejandro Fuentes Pérez
a.fuentes@bbva.com

Octavio Gutiérrez Engelmann
o.gutierrez3@bbva.com

Javier Amador
javier.amadord@bbva.com

Pedro Uriz Borrás
pedro.uriz2@bbva.com

Iván Martínez
ivan.martinez.2@bbva.com

Rodrigo Ortega
r.ortega@bbva.com

BBVA | RESEARCH | Av. Universidad 1200, Col. Xoco, Mexico 03339 D.F. | researchmexico@bbva.bancomer.com | www.bbvaresearch.com

IMPORTANT DISCLOSURES

The BBVA Group companies identified by the research analysts' names included on page 4 of this report have participated in or contributed to its preparation, including the information, opinions, estimates, forecasts and recommendations therein.

For recipients in the European Union, this document is distributed by Banco Bilbao Vizcaya Argentaria, S.A. (hereinafter called "BBVA"). BBVA is a bank supervised by the Bank of Spain and by Spain's Stock Exchange Commission (CNMV), registered with the Bank of Spain with number 0182.

For recipients in Mexico, this document is distributed by BBVA Bancomer, S.A. Institución de Banca Múltiple, Grupo Financiero BBVA Bancomer (hereinafter called "BBVA Bancomer"). BBVA Bancomer is a bank supervised by the Comisión Nacional Bancaria y de Valores de México.

For recipients in USA, this document is being distributed by BBVA Securities Inc. (hereinafter called "BBVA Securities"), a subsidiary of Banco Bilbao Vizcaya Argentaria, S.A. ("BBVA") registered with and supervised by the U.S. Securities and Exchange Commission and a member of the Financial Industry Regulatory Authority ("FINRA") and the Securities Investor Protection Corporation. U.S. persons wishing to execute any transactions should do so only by contacting a representative of BBVA Securities in the U.S. Unless local regulations provide otherwise, non-U.S. persons should contact and execute transactions through a BBVA branch or affiliate in their home jurisdiction.

BBVA and BBVA Group companies or affiliates (art. 42 of the Royal Decree of 22 August 1885 Code of Commerce), are subject to the BBVA Group Policy on Conduct for Security Market Operations which establishes common standards for activity in these entities' markets, but also specifically for analysis and analysts. This BBVA policy is available for reference at the following web site: www.bbva.com.

Analysts residing outside the U.S. who have contributed to this report are not registered with or qualified as research analysts by FINRA or the New York Stock Exchange and may not be considered "associated persons" of BBVA Securities (as such term is construed by the rules of FINRA). As such, they are not subject to NASD Rule 2711 restrictions on communications with subject companies, public appearances and trading of securities held in research analysts' accounts.

BBVA is subject to a Code of Conduct for Security Market Operations, which details the standards of the above-mentioned overall policy for the EU. Among other regulations, it includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. This Code of Conduct for Security Market Operations is available for reference at the following web site: www.bbva.com / Corporate Governance.

BBVA Bancomer is subject to a Code of Conduct and to Internal Standards of Conduct for Security Market Operations, which details the standards of the above-mentioned overall policy for Mexico. Among other regulations, it includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers. These Code and the Internal Standards is available for reference at the following web site: www.bancomer.com/GrupoBBVABancomer/Conócenos.

BBVA Securities is subject to a Capital Markets Code of Conduct, which details the standards of the above-mentioned overall policy for USA. Among other regulations, it includes rules to prevent and avoid conflicts of interests with the ratings given, including information barriers.

EXCLUSIVELY FOR RECIPIENTS RESIDENT IN MEXICO

In the past twelve months, BBVA Bancomer has granted banking credits to the following companies covered in this report: **ALFA, AXTEL, CONSTRUCCION Y SERVICIOS INTEGRALES SIGMA, CORPORACION GEO, DAIMLER MEXICO, FACILEASING, GENOMMA LAB INTERNACIONAL, GEO EDIFICACIONES, GRUPO CARSO, GRUPO CASA SABA, GRUPO CEMENTOS DE CHIHUAHUA, GRUPO COMERCIAL CHEDRAUI, GRUPO PALACIO DE HIERRO, IMPULSORA DEL DESARROLLO Y EL EMPLEO EN AMERICA LATINA, INDUSTRIAS BACHOCO, INMOBILIARIA RUBA, PEMEX CORPORATIVO, TIENDAS CHEDRAUI, URBI DESARROLLOS URBANOS, VOLKSWAGEN LEASING.**

In the past twelve months, BBVA Bancomer has granted *Representación Común* services to the following companies covered in this report: **N/A**

BBVA or one or more of its affiliates makes a market/provides liquidity in the securities of the following companies covered in this report: Casa de Bolsa BBVA Bancomer, MexDer Contrato de Futuros (Dólar de Estados Unidos de América (DEUA), TIIE de 28 días (TE28), Swap de TIIE, CETES de 91 días (CE91)), Bonos M, Bonos M3, Bonos M10, Indice de Precios y Cotizaciones de la BMV (IPC), Contrato de Opciones (IPC, Acciones América Móvil, Cemex, CPO, Femsa UBD, Gcarso A1, Telmex L), Udibonos.

As far as it is known, a Director, Executive Manager or Manager reporting directly to the BBVA Bancomer General Manager has the same position in the following companies that may be covered in this report: **Alfa, Alsea, America Movil, AMX, Asur, CMR, Coca-Cola Femsa, Consorcio Hogar, Dine, El Puerto de Liverpool, Fomento Economico Mexicano, Grupo Aeroportuario del Pacifico, Grupo Aeroportuario del Sureste, Grupo Bimbo, Grupo Carso, Grupo Financiero Inbursa, Grupo Kuo, Grupo Maseca, Grupo Modelo, Grupo Posadas, Grupo Televisa, Industrias Peñoles, Invex Controladora, KOF, México, Grupo Aeroportuario del Centro Norte, Sanborns Hermanos, Sears Roebuck de México, Telecom, Telefonos de México, Tenaris, Urbi Desarrollos Urbanos, Vitro.**

BBVA Bancomer, and, as applicable, its affiliates within BBVA Bancomer Financial Group, may hold from time to time investments in the securities or derivatives financial instruments with underlying securities covered in this report, which represents 10% or more of its securities or investment portfolio, or 10% or more of the issue or underlying of the securities covered.

DISCLAIMER

This document and the information, opinions, estimates, forecasts and recommendations expressed herein have been prepared to provide BBVA Group's customers with general information and are current as of the date hereof and subject to changes without prior notice. Neither BBVA nor any of its affiliates is responsible for giving notice of such changes or for updating the contents hereof.

This document and its contents do not constitute an offer, invitation or solicitation to purchase or subscribe to any securities or other instruments, to undertake or divest investments, or to participate in any trading strategy. Neither shall this document nor its contents form the basis of any contract, commitment or decision of any kind.

Investors who have access to this document should be aware that the securities, instruments or investments to which it refers may not be appropriate for them due to their specific investment goals, financial positions or risk profiles, as these have not been taken into account to prepare this report. Therefore, investors should make their own investment decisions considering the said circumstances and obtaining such specialized advice as may be necessary. Other than the disclosures relating to BBVA Group, the contents of this document are based upon information available to the public that has been obtained from sources considered to be reliable. However, such information has not been independently verified by BBVA or any of its affiliates and therefore no warranty, either express or implicit, is given regarding its accuracy, integrity or correctness. To the extent permitted by law, **BBVA and its affiliates accept no liability of any type for any direct or indirect losses or damages arising from the use of this document or its contents. Investors should note that the past performance of securities or instruments or the historical results of investments do not guarantee future performance.**

The market prices of securities or instruments or the results of investments could fluctuate against the interests of investors. Investors should be aware that they could even face a loss of their investment. Transactions in futures, derivatives, options on securities or high-yield securities can involve high risks and are not appropriate for every investor. Indeed, in the case of some investments, the potential losses may exceed the amount of initial investment and, in such circumstances; investors may be required to pay more money to support those losses. Thus, before undertaking any transaction with these instruments, investors should be aware of their operation, as well as the rights, liabilities and risks implied by the same and the underlying securities. Investors should also be aware that secondary markets for the said instruments may not exist.

BBVA or any of its affiliates´ salespeople, traders, and other professionals may provide oral or written market commentary or trading strategies to its clients that reflect opinions that are contrary to the opinions expressed herein. Furthermore, BBVA or any of its affiliates' proprietary trading and investing businesses may make investment decisions that are inconsistent with the recommendations expressed herein. No part of this document may be (i) copied, photocopied or duplicated by any other form or means (ii) redistributed or (iii) quoted, without the prior written consent of BBVA. No part of this report may be copied, conveyed, distributed or furnished to any person or entity in any country (or persons or entities in the same) in which its distribution is prohibited by law. More specifically, this document is in no way intended for, or to be distributed or used by an entity or person resident or located in a jurisdiction in which the said distribution, publication, use of or access to the document contravenes the law which requires BBVA or any of its affiliates to obtain a licence or be registered. Failure to comply with these restrictions may breach the laws of the relevant jurisdiction.

The remuneration system concerning the analysts responsible for the preparation of this report is based on multiple criteria, including the revenues obtained by BBVA and, indirectly, the results of BBVA Group in the fiscal year, which, in turn, include the results generated by the investment banking business; nevertheless, they do not receive any remuneration based on revenues from any specific transaction in investment banking.

In the United Kingdom, this document is directed only at persons who (i) have professional experience in matters relating to investments falling within article 19(5) of the financial services and markets act 2000 (financial promotion) order 2005 (as amended, the "financial promotion order"), (ii) are persons falling within article 49(2) (a) to (d) ("high net worth companies, unincorporated associations, etc.") of the financial promotion order, or (iii) are persons to whom an invitation or inducement to engage in investment activity (within the meaning of section 21 of the financial services and markets act 2000) may otherwise lawfully be communicated (all such persons together being referred to as "relevant persons"). This document is directed only at relevant persons and must not be acted on or relied on by persons who are not relevant persons. Any investment or investment activity to which this document relates is available only to relevant persons and will be engaged in only with relevant persons.

BBVA Hong Kong Branch (CE number AFR194) is regulated by the Hong Kong Monetary Authority and the Securities and Futures Commission of Hong Kong.

This document is distributed in Singapore by the BBVA's office in this country for general information purposes and it is generally accessible. In this respect, this document does not take into account the specific investment goals, the financial situation or the need of any particular person and it is exempted from Regulation 34 of the Financial Advisors Regulation ("FAR") (as required in Section 27 of the Financial Advisors Act (Chapter 110) of Singapore ("FAA"))

BBVA, BBVA Bancomer or BBVA Securities are not authorised deposit institutions in accordance with the definition of the Banking Act 1959 nor are they regulated by the Australian Prudential Regulatory Authority (APRA)

GENERAL DISCLAIMER FOR THE EVENT THAT THE READERS HAVE ACCESSED TO THE REPORT THROUGH THE INTERNET

Internet Access

In the event that this document has been accessed via the internet or via any other electronic means which allows its contents to be viewed, the following information should be read carefully:

The information contained in this document should be taken only a general guide on matters that may be of interest. The application and impact of the laws may vary substantially depending on specific circumstances. BBVA does not warrant that this report and/or its contents published on the Internet are appropriate for use in all geographic areas, or that the financial instruments, securities, products or services that can be referenced on it are available or appropriate for sale or use in all jurisdictions or to all investors or counterparties. Recipients of this report acceding to it through the Internet are acceding on their own initiative and are responsible for compliance with local regulations applicable to them.

Changes in regulations and the risks inherent in electronic communications may cause delays, omissions, or inaccuracy in the information contained in this site. Accordingly, the information contained in the site is supplied on the understanding that the authors and editors do not hereby intend to supply any form of consulting, legal, accounting or other advice.