Mexico Weekly Flash

Next week…

- ### Inflation above 4% but the risk balance shows a downward bias for global activity

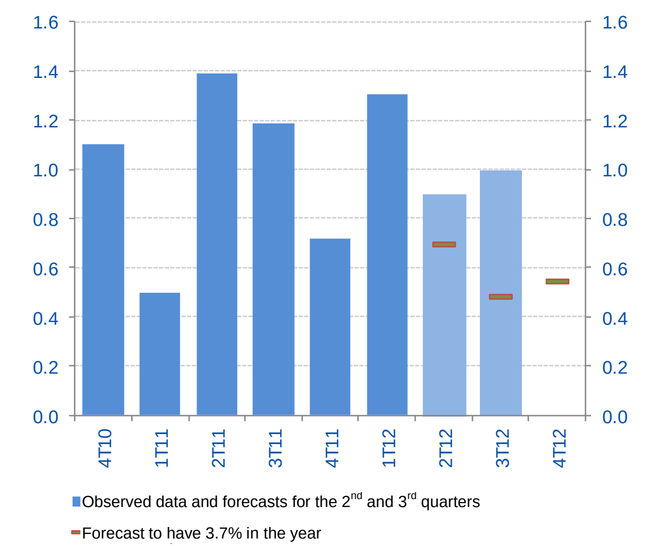
The week ended with Banxico's monetary decision to maintain the lending rate at 4.5%, as expected, although there was a more uncertain tone regarding global activity risk balance which the Central Bank believes also means a downward bias for the medium-term domestic inflation outlook. This will not avoid short-term upward pressure due to supply problems with some food products maintaining price growth above 4%, as shall be seen with inflation from the 1st two weeks of July (Tuesday 24: 4.29% annual). In any case, the central bank's tone will avoid this hitting domestic yield rates if a somewhat higher result is seen.

In terms of output, the impact already seen on manufacturing due to the current slowdown in the US will be clear in the IGAE for May (Wednesday 25: -0.5% monthly). In short, domestic support elements and upward surprises recorded in different output indicators in the first part of the year point to a growth forecast for Mexico of 3.7% in 2012 being more reasonable given the second half is likely to see less dynamism. As seen in the attached chart, forecast growth in the second and third quarter of the year in line with recent information is more than enough to hit 3.7% in 2012.

- ### Foreign capital inflows and global risk balance set the standard for fixed income assets and the MXN

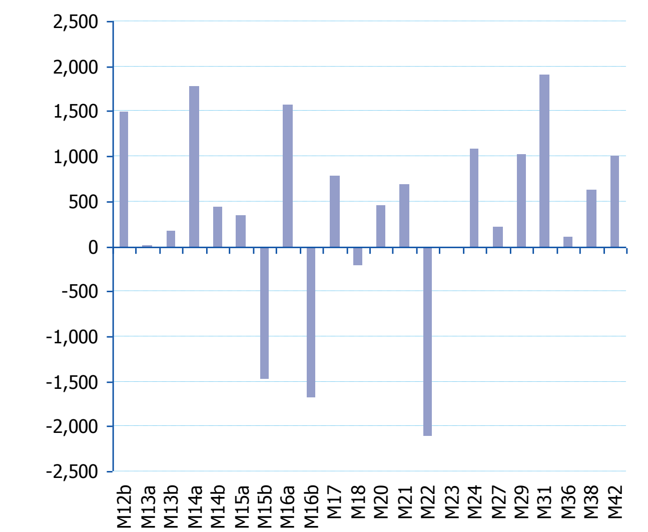
Overseas appetite for domestic curves continues. This higher demand, in a monetary scenario confirming an expansive monetary posture for a longer time continues to support the long sections on nominal curves. In turn, the upswing in inflation in the short-term leaves the door open for short-term Udibonos. The MXN should remain in ranges in the face of higher cyclical risks and appetite for domestic curves.

Chart 1
Mexico, quarterly GDP growth, %



Source: BBVA Research

Chart 2
Net foreign inflows to Mbond over the week of July 16-19 (millions of MXN)



Source: BBVA Research, Banxico, Indeval

Calendar: Indicators

Economic Activity Index (IGAE) May (July 25)

Forecast: -0.5% m/m, 3.1% y/y	Consensus: N.A.	Previous: 0.3% m/m, 5.3% y/y

With figures for industrial output in May already released on July 12, the services sector should also have recorded a slight contraction in the Month. We estimate the decline to have been around (-)0.3% which contrasts with the 0.7% growth in the previous month. Nonetheless, this is in line with recent figures for retail sales (-0.2%) and the even bigger fall in the service sector revenue indicator (-1.2%), making for the biggest decline since October 2010. It should also be stated that industrial output in May fell (-)0.9% vs. the (-)0.2% expected - mainly a result of the decline in manufacturing of (-)1.4%. The branches mainly linked to foreign demand such as transport equipment, furniture manufacturing, non-metal minerals saw slight declines in May compared to the previous month.

In this way, we expect a slight contraction in the IGAE for May, in line with slightly lower growth in the second quarter compared to the first and the expected mid-year slowdown. We forecast GDP growth in 2Q12 of around 0.7% (q/q).

Inflation in the first two weeks of July (July 24)

Forecast: 0.24% bi-weekly, 4.29% y/y	Consensus: 0.29% bi-weekly	Previous: 0.46% m/m, 4.34% y/y

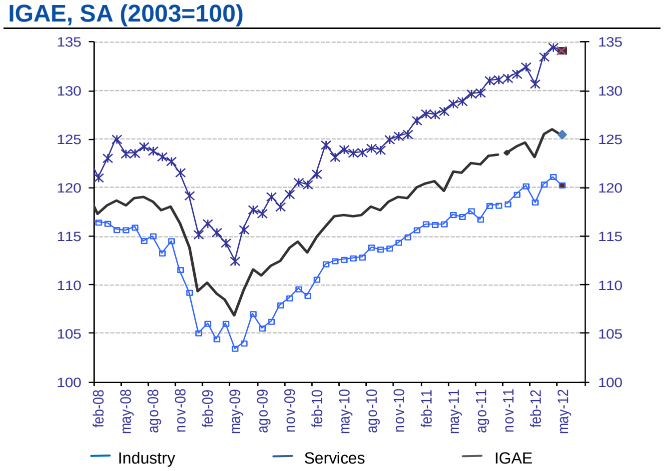
Inflation for the first half of July will be released next Tuesday, set to remain around 4.3% y/y. Inflation came in above 4% thanks to shock on grain and oil markets, as well as the recent increase in fruit and vegetable prices. Linked to these factors, inflation in July will be affected by the higher egg prices due to the outbreak of bird flu in Jalisco. Core inflation will continue around 3.5% thanks to the absence of supply pressures seen in low services inflation levels is enough to contain goods price pressures caused by high maize prices and lower peso. We maintain that the recent increase in inflation will last a few months and come in below 4% in December.

Trade balance in June (July 29)

Forecast: 338.9 md	Consensus: -100 md	Previous: 362 md

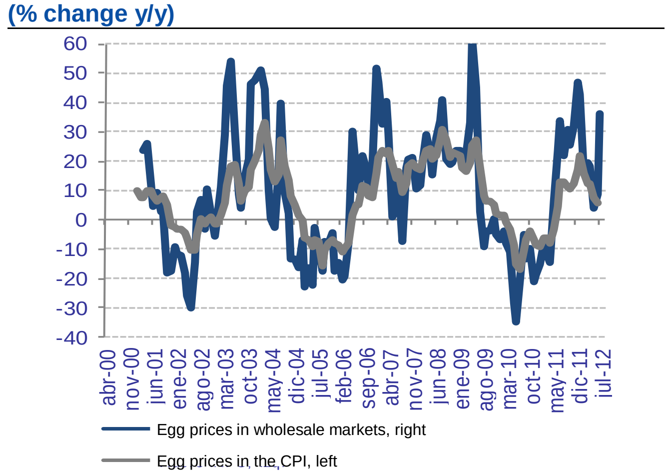
The trade balance in June is released next week, although we believe it will continue to be near balanced. It is important to see the performance of manufacturing exports and imports of intermediate goods in the country - both indicators being closely linked to US output. This year's average nominal monthly growth rates are 1.27% and 0.6% respectively which, although positive, do show high volatility in the year to date. The trade balance will again remain near balanced at the end of the year, although it will be the first to be affected if a new global recession hits.

Chart 3
IGAE, SA (2003=100)



Source: BBVA Research with INEGI and Bloomberg data

Chart 4
Egg prices in the CPI and wholesale markets (% change y/y)



Source: BBVA Research with data from INEGI and SNIIM

There is still a margin for long positions in the long part of the curve

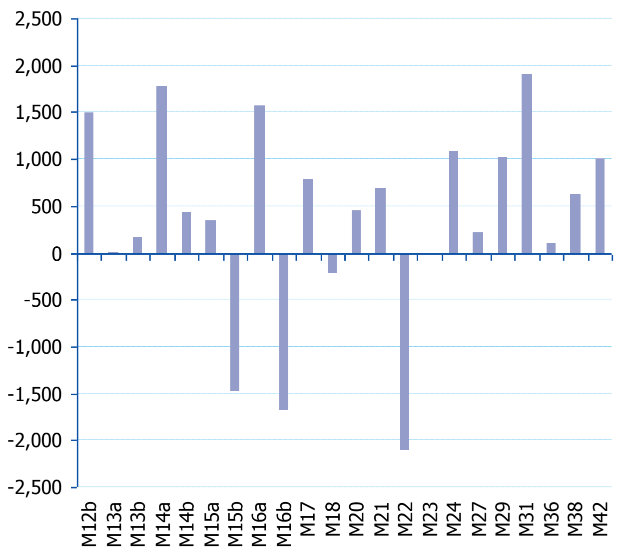
Economic risks will not dissipate in coming months and the current rate of the economy, despite the slowdown, will not see a quick marked change. Since we do not expect Banxico to cut the rate this year, we believe the short section of the curve will not offer relative value. Nevertheless, as we stated in our note "Surfing on the MX rocketed curves", the current risk/profit analysis suggests holding long positions in the 3Y zone since, in the short-term, the appetite for the short section of the curve will not reduce. In addition, it is clear that the low international yields are here to stay. If we also consider the curve being fairly flat in the medium section, it offers negative carry for domestic investors in the short part and includes minimal or zero risk premiums once monetary policy expectations are taken into account (not the mention the domestic constructive scenario, expected economic reforms and persistent foreign capital inflows). It is more than likely that domestic curves remain anchored and foreign inflows maintain their dynamism. All this means that the long part of the curve will continue to dominate due to the convex effect at these levels and the risk premiums will continue low due to the domestic constructive outlook.

Based on this, we recommended a strategy of extremes (butterfly) with a neutral effect and duration: go long in the extremes (3Y and 30Y) and short in the medium. It avoids the lack of curvature in the medium section of the curve and provides protection against any steep climb due to an unexpected rate cut. It also takes advantage of the domestic constructive vision and the convex effect in the long section. We expect the gap between the 10Y and 30Y to close at 80-85bp and that the section between the 3Y and 10Y climbs around 100bp in the next 6 months. In this way, the butterfly would go from -0.72pp currently to 0.0-0.1pp. In turn, we maintain our long position open in the 3Y Udibono. Since May, the rally here has been over 117bp although we believe it will maintain its safe-haven asset quality since we expect inflation to increase above expectations at the end of the year. Our real target rate is zero.

Insignificant impact on the USDMXN - set to remain in ranges

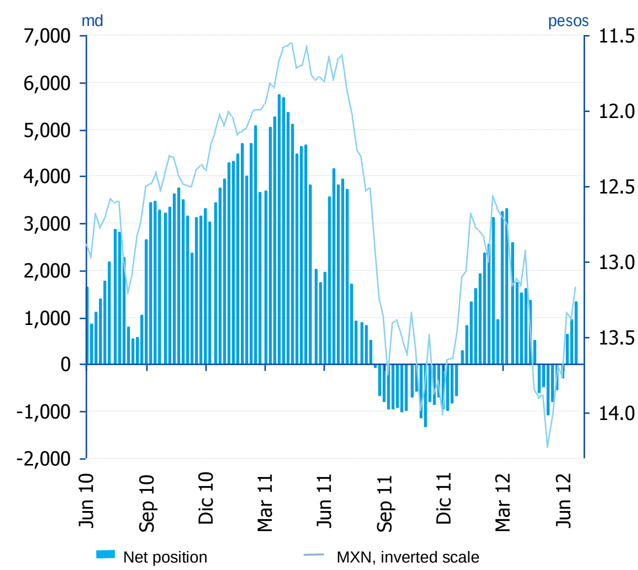
Banxico restated that, if financial market uncertainty fell back, the MXN will continue to fluctuate in line with fundamentals, as seen in recent weeks. The outlook of a stronger MXN has been the basic forecast for most analysts for some time, including ourselves. Despite the fact that we maintain this positive outlook, we believe the USDMXN rate will remain in ranges for the time being and respond to technical levels since the determining factors in coming months will remain mixed. On the one hand, foreign capital inflows and quantitative easing expectations will likely continue to support most risk assets. On the other, pessimistic news on the EMU, high concern over the cycle and key political events in the US will add more volatility to global markets. If Banxico adopts a looser stance, the low differential between interest rates will weigh the currency down. Since this seem impossible right now, we do not believe the MXN will react to monetary policy expectations in the short-term.

Chart 5
Net foreign inflows to Mbond over the week of July 16-19 (millions of MXN)



Source: BBVA Research, Banxico, Indeval

Chart 6
Share Indices: changes (%)



Source: BBVA Research and Bloomberg

Technical Analysis

IPC

The week saw a new all-time high for the IPC (41,273pts), maintaining the short-term upward trend. Despite the break on the market from mid-week, the 10-day rolling average saw no trend change. This technical level, at 40,400pts, is our 1st support reference for the short-term. A downward break through this level would mean a return to the 39,500pts zone where of the 30 day rolling average sits. In turn, the upward move marks resistance levels at 42,000 and then 43,000pts. Due to the over-buying we may see at this 2nd resistance, we believe an appropriate level for profit-taking sits at 42,000pts.

Previous Rec. (16/7/12). With the weekly close at a new all-time high above 40,500pts, we can consider targets at 41,000 and 41,500pts

Source: BBVA, Bancomer, Bloomberg

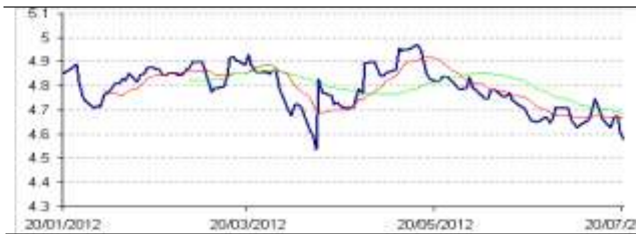
MXN

The dollar had a volatile week, starting with a downward move to a minimum of MXN13.09 (very near the important MXN13.00 floor) from where it started an upswing. Now above MXN13.25 (previous floor), it could maintain an upswing to MXN13.50.

Previous Rec. (July 16, 2012). With the return to levels below MXN13.40, the door is open for a new return to the MXN13.25 level. We believe it may again respect this floor.

Source: BBVA, Bancomer, Bloomberg

3Y M BOND

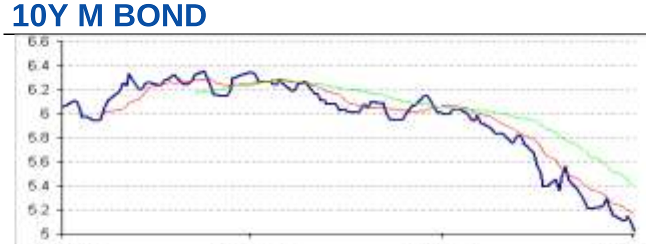


3-YEAR M BOND (yield): It again attempted a bounce over the week but was unable to hit above 10- and 30-day rolling averages while, on the contrary, breaking the previous minimum. Next floor up to 4.55%.

Previous Rec. (16/7/12). We believe it has marked a good floor at 4.65%.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND



10-YEAR M BOND (yield): Unable to go above the 10-day rolling average, the bond hit a new all-time low. Next floor at the psychological level of 5% and, if broken, up to 4.8%.

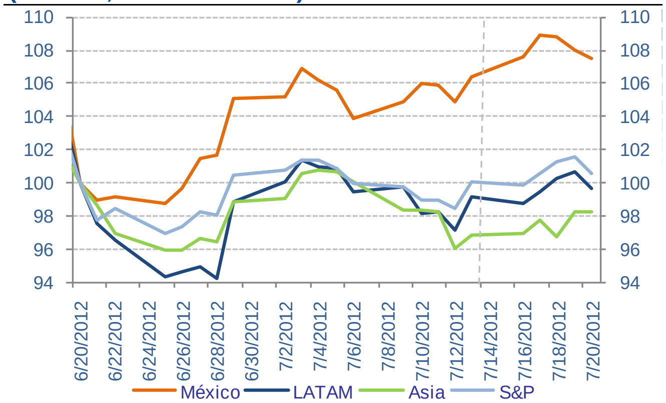
Previous Rec. (16/7/12). in order to be validated, any upswing attempt has to place it above the 10-day rolling average (5.3%).

Source: BBVA, Bancomer, Bloomberg

Markets

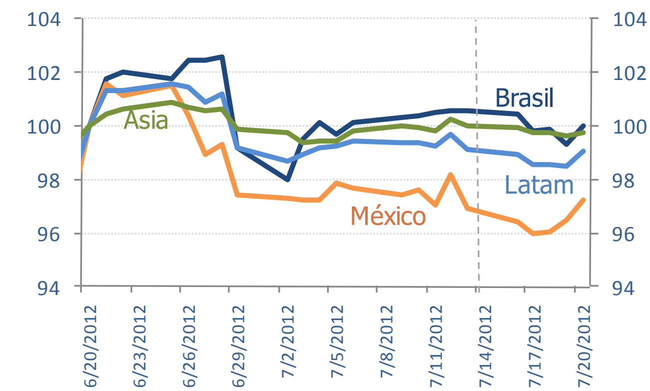
- **Gains on stock markets over the week after the Fed chairman clearly stated before the US Senate banking committee that, if needed, they were ready to take action. The peso fell toward the end of the week after the release of lower-than-expected figures for US manufacturing output and house sales.**

Chart 7
Stock Markets: MSCI Indices (June 20, 2012 index=100)



Source: Bloomberg & BBVA Research

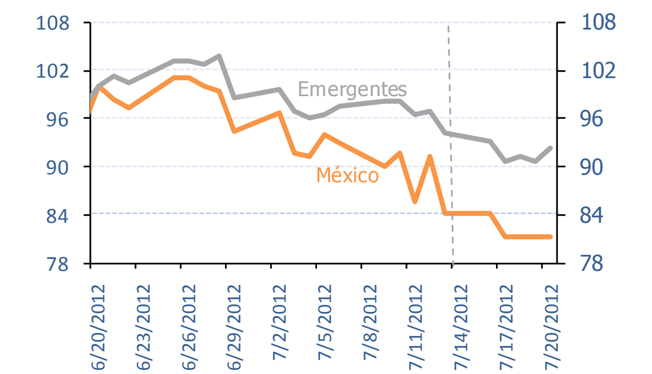
Chart 8
Foreign exchange: dollar exchange rates (June 20, 2012 index=100)



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

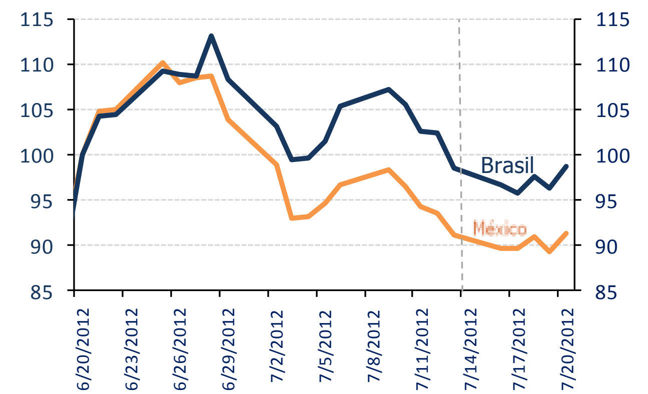
- **Slight upswing in risk aversion over the week after the signing of a Memorandum of understanding on the bailout package for the Spanish banking system was delayed, as well as continuing doubts on markets on how it will work.**

Chart 9
Risk: EMBI+ (June 20, 2012 index=100)



Source: Bloomberg & BBVA Research

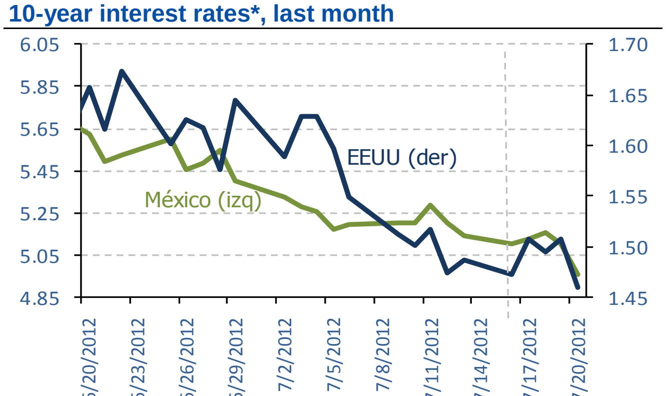
Chart 10
Risk: 5-year CDS (June 20, 2012 index=100)



Source: Bloomberg & BBVA Research

- **US rates fall over the week. Rates in Mexico fell, influenced by the performance of Treasury bonds and foreign investment inflows.**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

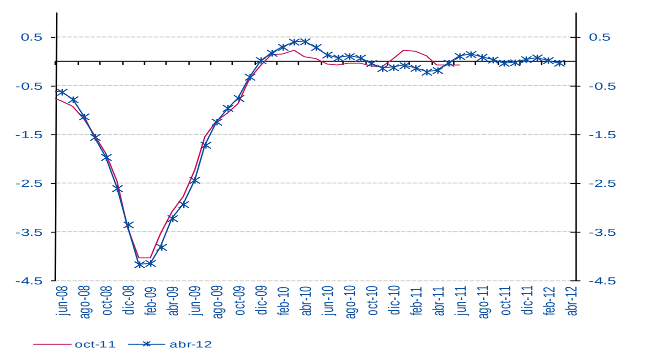
Chart 12
Carry-trade Mexico index (%)

Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

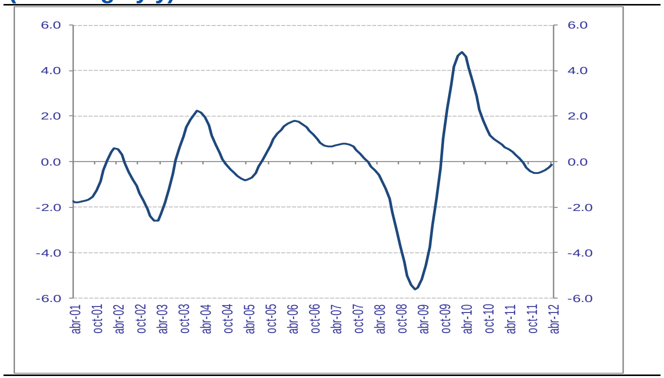
- **Output holds positive performance, situation indicators point to 2Q12 with quarterly rates around 0.7%.**

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.

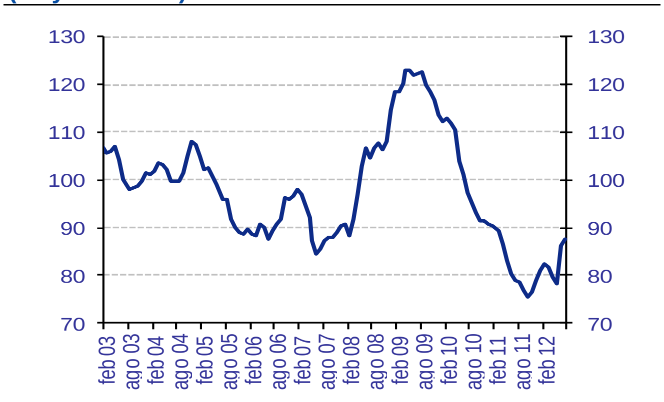
Chart 14
Advance Indicator of Activity, trend (% change y/y)



Source: INEGI

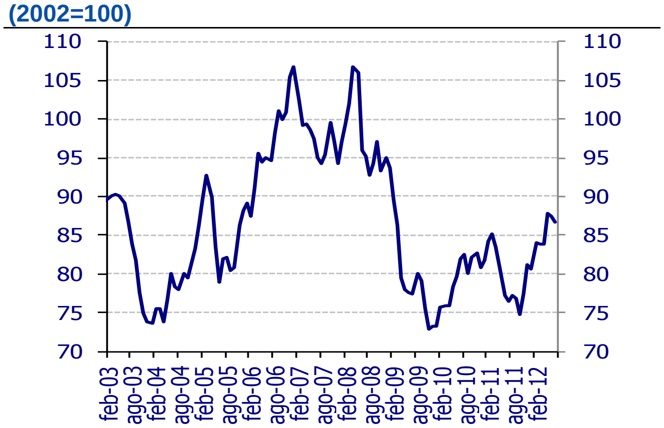
- **Inflation ceases downward surprises while output moved up.**

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.

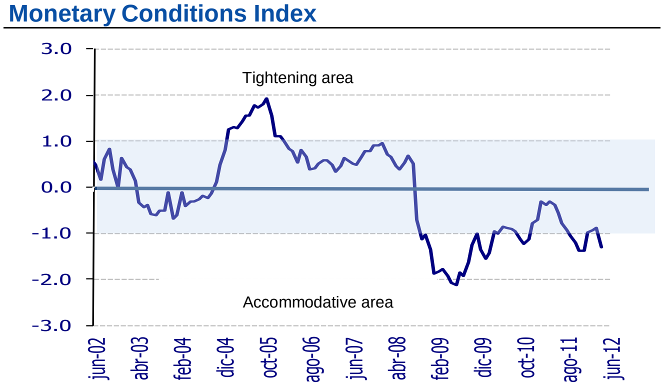
Chart 16
Activity Surprise Index (2002=100)



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.

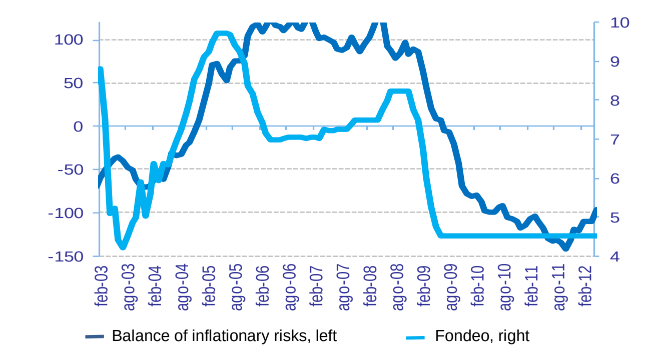
- **Monetary Conditions relax after higher inflation in June.**

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

Claudia Ceja
claudia.ceja@bbva.bancomer.com
+5255 5621 9715
Octavio Gutiérrez Engelmann
o.gutierrez3@bbva.bancomer.com
+5255 5621 9245
Iván Martínez
ivan.martinez.2@bbva.com

Pedro Uriz
pedro.uriz2@bbva.com

Julian Cubero
juan.cubero@bbva..com

Ociel Hernández
o.hernandez@bbva.bancomer.com
+5255 5621 9616
Rodrigo Ortega
r.ortega@bbva.bancomer.com
+52 55 5621 9701

Alejandro Fuentes Pérez
a.fuentes@bbva.bancomer.com
+52 55 5621 9705
Arnoldo López
arnoldo.lopez@bbva.com

Cecilia Posadas
c.posadas@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 7 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, 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: 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, Asur, CMR, Coca-Cola Femsa, Consorcio Hogar, Dine, El Puerto de Liverpool, Fomento Economico Mexicano, Gruma, Grupo Aeroportuario del Pacifico, Grupo Aeroportuario del Sureste, Grupo Bimbo, Grupo Carso, Grupo Financiero Inbursa, Grupo Kuo, Grupo Modelo, Grupo Posadas, Grupo Televisa, Industrias Peñoles, Invex Controladora, 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.