Mexico Weekly Flash

Next week…

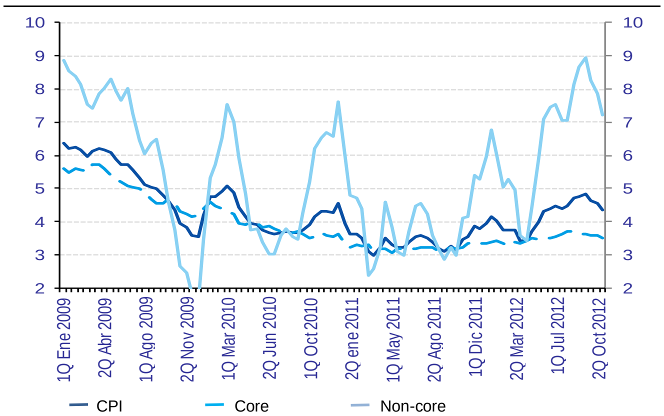
- **Banxico will release its last monetary policy decision of the year.**

  Next week we will hear the last monetary policy decision released by the governing board of Banxico. We expect the lending rate to remain the same, given that inflation has begun to fall (as the central bank expected). However, we also expect the statement to maintain the tone of warning against inflation, because even though inflation has fallen, the most important risks mentioned by the Central Bank remain: further supply shocks affecting basic products, higher than expected increases in public prices, a distortion in the wage fixing process or a higher devaluation of the peso. In terms of output, we believe that the main factors will be external weakness and the potential risks implied for Mexico and the world, and uncertainties in economic policy prevailing in both the US and Europe. Consequently, we believe that the monetary pause will continue for a certain length of time, although there could be new supply shocks which could again put inflation off course, or if there is a knock-on effect from the most volatile prices to those most linked to activity performance, Banxico might take a tougher line and even begin to withdraw the monetary stimulus.

- **Local markets shaped by MXN in ranges and heavy inflows of foreign investment.**

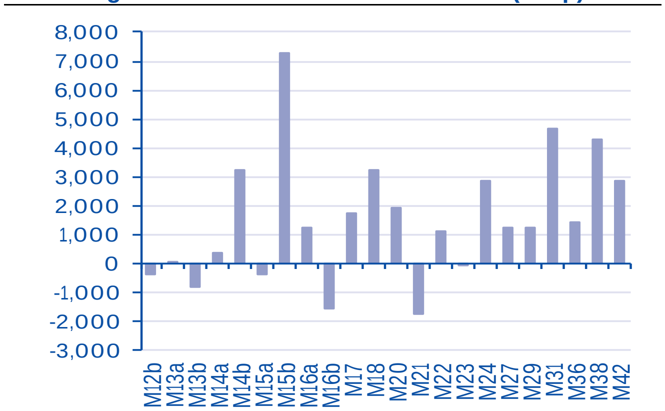
  A week of higher appetite for global risk leads to 1.26% rise in MXN, increases of around 2.7% in the IPC and a slight increase in the level of the Mbono curve (10bp); although the medium part has been hit hardest (see flow comment below). This behavior was focused on the last two days, with very little liquidity due to the markets being closed in the US on Thursday (and partly open on Friday, and also that markets in Japan did not open that day either). The impulse stems from signs suggesting that an agreement to provide Eur44bn is to be reached, and also from the good business confidence figure in Germany. Although budget negotiations in the European Union have fallen through, markets still have a constructive outlook compared to the "fiscal cliff" in the US, and have omitted any news from Europe which does not offer a realistic or favorable financial outlook.

Chart 1
Inflation breakdown



Source: BBVA Research with INEGI data

Chart 3
Net foreign inflows to MBONO in November (bn. p)



Source: BBVA Research, Banxico, Indeval

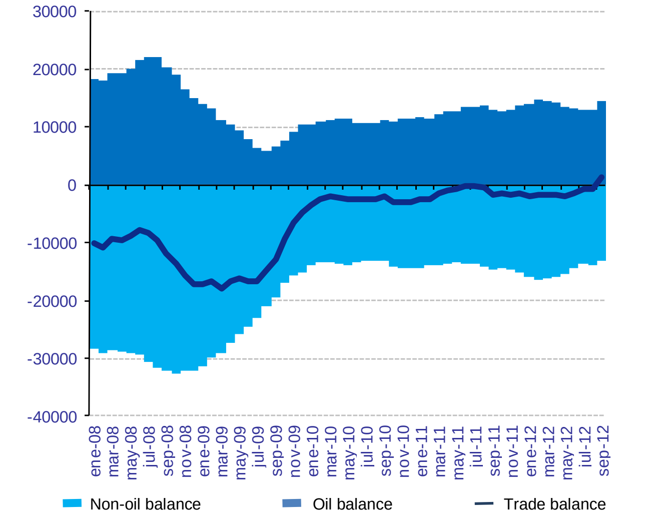
Calendar: Indicators

October Trade Balance

Forecast: -755 md	Consensus: -555 md	Previous: 233 md

We will be informed next week of the trade balance for October, which, according to our estimates, will present a 755 md deficit, typical bearing in mind the seasonal nature of this indicator in the last quarter of the year. The trade balance should once again - as in September - show the slowdown in output both outside and inside Mexico, so that in our opinion there is a possibility that the year end trade balance could be close to zero or might even show a slight surplus. Mexico's foreign trade balance shows a surplus of 1363 md up to 3Q12, although traditionally the 4Q12 balance is the most deficit prone, so that at year end we believe the figure will be equally balanced.

Chart 2
Trade balance and components (MD, 12-month rolling total)



Source: BBVA Research with INEGI data

- **Local markets shaped by MXN in ranges and heavy inflows of foreign investment**

A week of higher appetite for global risk leads to 1.26% rise in MXN, increases of around 2.7% in the IPC and a slight increase in the level of the Mbono curve (10bp); although the medium part has been hit hardest (see flow comment below). This behavior was focused on the last two days, with very little liquidity due to the markets being closed in the US on Thursday (and partly open on Friday, and also that markets in Japan did not open that day either). The impulse has come from the signs suggesting that an agreement to provide Eur44bn is to be reached, and also from the good business confidence figure in Germany. Although budget negotiations in the European Union have fallen through, markets still have a constructive outlook compared to the "fiscal cliff" in the US, and have omitted any news from Europe which does not offer a realistic or favorable financial outlook.

On the domestic front, the inflation figure for the first fortnight revealed a continuing downward trend, though it had little impact on the markets. Inflation for the first fortnight of November was published on Thursday, and was slightly above market consensus (0.79% vs. 0.72%); although the downward trend in the annual rate continued (to 4.36% from 4.60%). According to the BBVA Research Economics team (see Flash Inflation Mexico), supply shocks continued to dilute, while core inflation continued its downward trend. There were two important aspects of core inflation: 1) in goods, foods were better than expected, while the figure was somewhat worse for the rest of goods, but very much in line in the aggregate figure; 2) other services, again much lower than expected, due to higher competition in the telecommunications market. In non-core inflation, electricity was higher than expected, though the downward trend continued; and agricultural components continued to fall (although there might be pressures in coming months).

Regardless of yesterday's figure, which confirms slowing in the annual inflation rate, we expect that Banxico will bear in mind the inflation breakdown a few months ago — particularly of the main components affected by wage negotiations and second round effects on the recent supply shocks seen — before defining a different monetary policy. In 2013, there will be more details of these risk elements, plus new ones if the new government implements a change in its energy subsidy policy and/ore a change in the Income Act (taxes). We thus do not expect changes in the lending rate in 2013 and in any case the first few months of the year will have to pass before Banxico has enough information to implement a change in its position. Generally speaking, before having new catalysts, we expect that assets in both MXN and local curves, will continue to respond to range strategies.

Mexico's construction story, plus the global interest rate scenario, continues to be materialized in foreign flows to the Mbono curve. According to estimates, up to November 22, there is an accumulated inflow of USD 2.5bn in foreign investments. In contrast to October, foreign investors have exploited the fly, with heavy buys from 2031 to 2042, and December 2015. Our current open recommendation in the Mbono curve is to be long in this bond of 2015, in the Mbono 2042 and short on the 10-year bond. The Siefores meanwhile continue selling the nominal curve. In the same period, they have sold USD 1.2bn. As we predicted, this means that the inflow of funds during the year will be very similar to 2011, in fact it might even be higher. The trigger for adjustment in foreign investors' portfolios will not be a catalyst such as the "fiscal cliff" and/or greater aversion stemming from events in Europe, but when the Fed changes its monetary policy and the market considers a clear cycle of increases in interest rates.

This Monday, PEMEX will issue MXN 25.0bn in issues of fixed-rate, inflation-indexed and floating rate Bonds. On Tuesday the 1-year Mbono will be auctioned. After the PEMEX issue, with the interest payments close at hand, and further details of global risks ("fiscal cliff" and Europe), locals can take advantage of these levels to return to the market.

Technical Analysis

IPC (headline)

The weekly rise in the IPC was not strong enough to take the market back above 41,500pts and 30-day rolling averages. With these resistances broken upward, the market would not have a short term ceiling until the zone between 42,500 and 42,700pts. The RSI, at 58pts and without yet reaching an overselling zone, suggests that the rebound movement may be maintained in the following sessions. The notch of 41,500pts becomes a new base in the short-term. The lack of correlation between IPC and Amx has been evident in recent weeks. The short term oscillating indicators of the issuer have begun to rebound from very high oversell levels; and still have a lot of upside potential.

Previous Recommendation (12/11/12). The doji candlestick with which the IPC ended the week suggests a major bounce. Nonetheless, it has to combine with a positive candlestick to complete the upswing pattern

Source: BBVA, Bancomer, Bloomberg

MXN

The dollar ended the week slightly below the level of MXN13.00. Although it attempted a rebound from this level midweek, it was unable to consolidate it and there is still risk of a downward break of this floor to place targets of between MXN12.90 and MXN12.70. Any upturn would be limited to between MXN13.15 and MXN13.20. Previous Recommendation (12/11/2012): Once above MXN13.10, expectations are maintained to seek out the MXN13.30/13.40 zone. MXN13.00 continues to be our major support.

Source: BBVA, Bancomer, Bloomberg

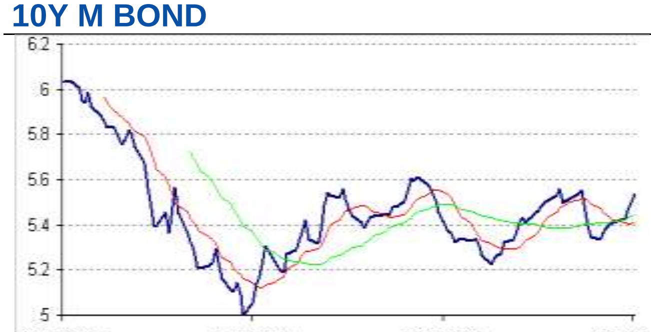
3Y M BOND

3Y M BOND: (yield): The bond adjusts towards 30-day rolling average from which to begin a new rebound. The 4.95% zone is a good support, where 10- and 30-day rolling averages sit. We think it might try the 5.1% range in the short term.

Previous Rec. (12/11/12). The 4.85% level should provide support to attempt an upswing.

Source: BBVA, Bancomer, Bloomberg

10Y M BOND



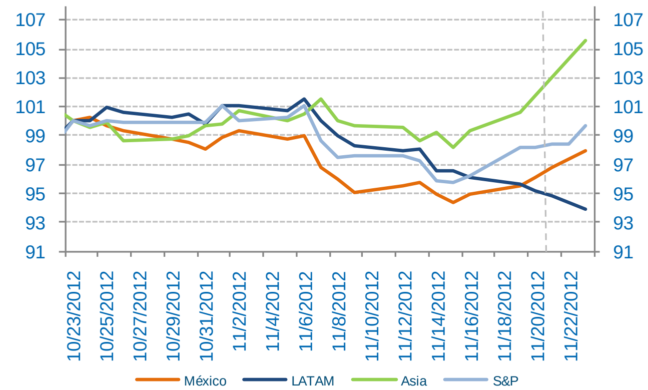
10Y M BOND (yield): The bond has operated in a lateral range of between 5.2% and 5.6% since August. Close to the high part of this channel, we recommend waiting for an upward break to consider a move toward 6%.
Previous Rec. (12/11/12). The bond came in below the 30-day rolling average opening the door back to the previous minimum at 5.25% levels.

Source: BBVA, Bancomer, Bloomberg

Markets

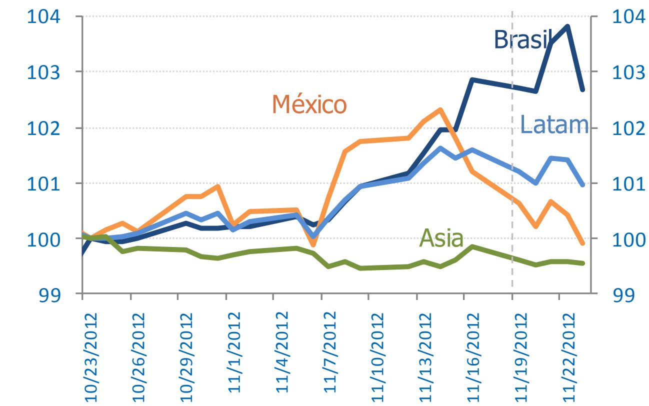
- **A week of optimism on the markets after President Obama said he was hopeful of reaching an agreement with Congress, and due to positive figures in China and Germany.**

Chart 7
Stock Markets: MSCI Indices (October 16, 2012 index=100)



Source: Bloomberg & BBVA Research

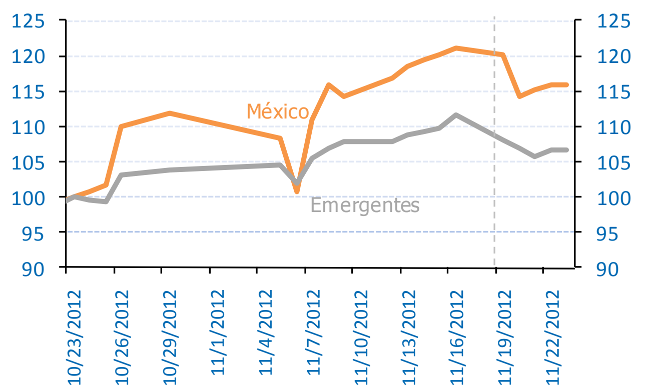
Chart 8
Foreign exchange: dollar exchange rates (October 16, 2012 index=100)



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

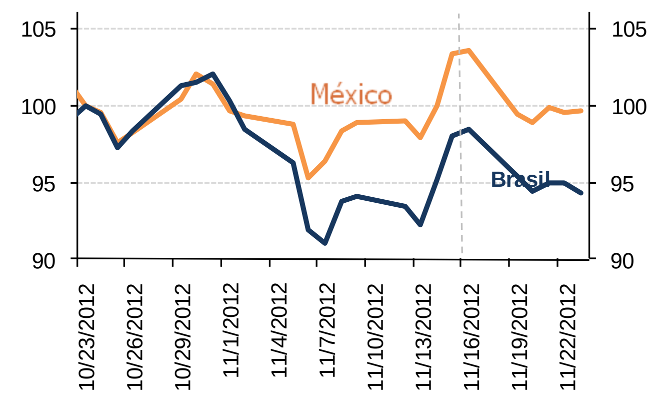
- **Given the above, generally speaking risk aversion slowed slightly this week.**

Chart 9
Risk: EMBI+ (October 16, 2012 index=100)



Source: Bloomberg & BBVA Research

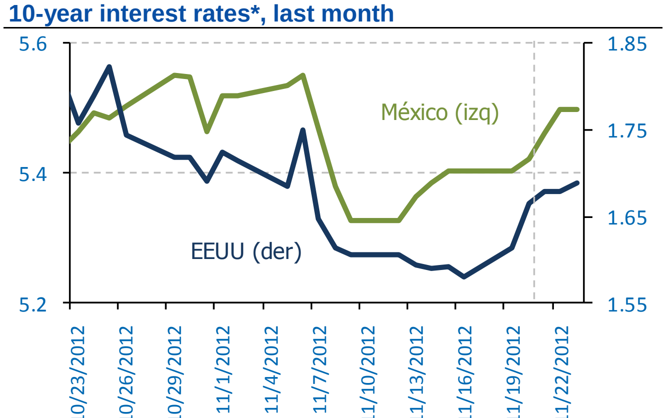
Chart 10
Risk: 5-year CDS (October 16, 2012 index=100)



Source: Bloomberg & BBVA Research

- **The positive correlation between interest rates in Mexico and the US continues.**

Chart 11
10-year interest rates*, last month



Source: Bloomberg & BBVA Research

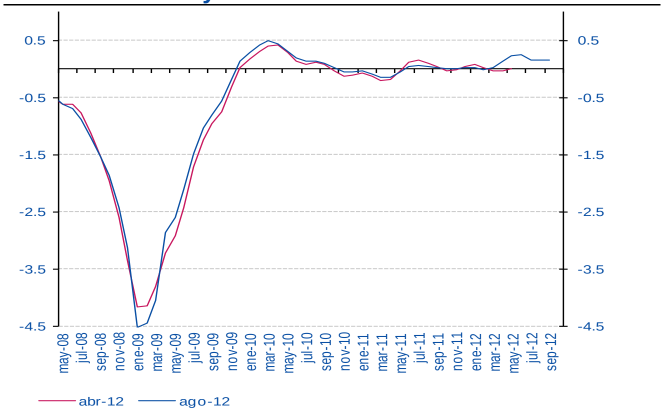
Chart 12
Carry-trade Mexico index (%)

Source: BBVA Research with data from Bloomberg

Activity, inflation, monetary conditions

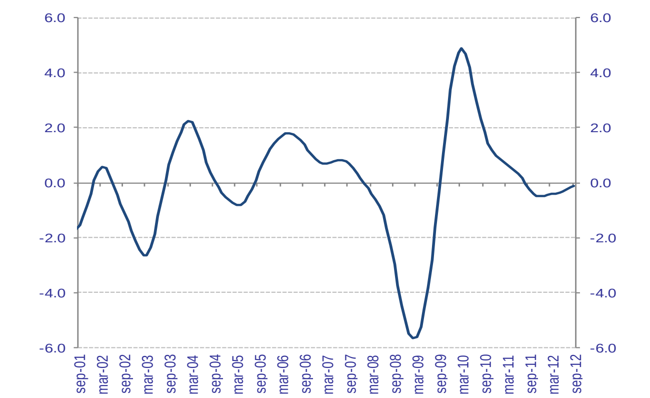
- **Output slowed in the third quarter, indicators from the third quarter point to this continuing to see a soft slowdown**

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.

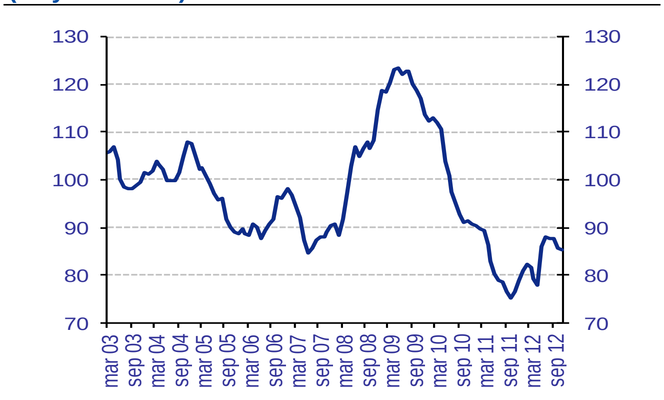
Chart 14
Advance Indicator of Activity, trend (% change y/y)



Source: INEGI

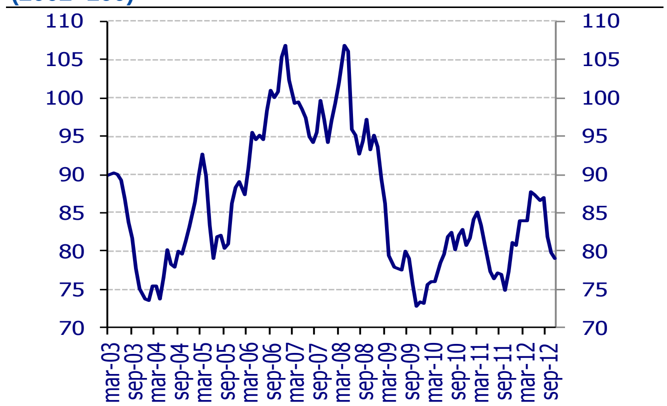
- **Inflation ceases upward surprises while output slowed.**

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.

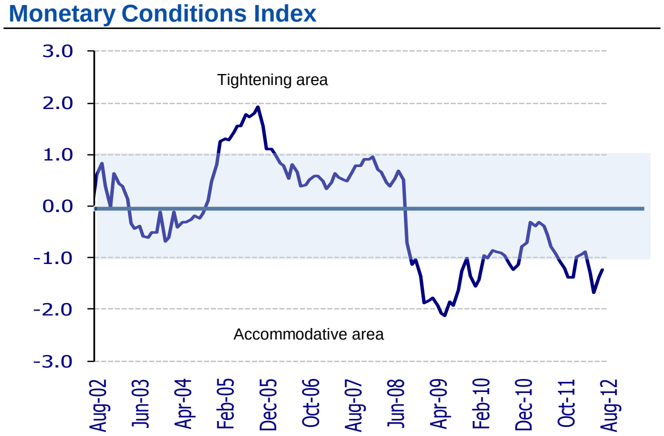
Chart 16
Activity Surprise Index (2002=100)



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.

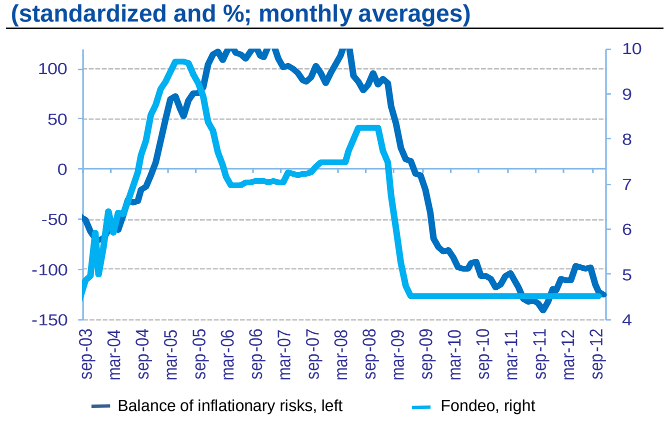
- **Monetary conditions slightly reduced their looseness after currency appreciation.**

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 IBR signals greater weight of inflationary risks over those of growth and, therefore, more likelihood of monetary restriction

Claudia Ceja
claudia.ceja@bbva.bancomer.com

Cecilia Posadas
c.posadas@bbva.com

Alejandro Fuentes Pérez
a.fuentes@bbva.bancomer.com

Octavio Gutiérrez Engelmann
o.gutierrez3@bbva.bancomer.com

Ociel Hernández
o.hernandez@bbva.bancomer.com

Arnoldo López
arnoldo.lopez@bbva.com

Iván Martínez
ivan.martinez.2@bbva.com

Rodrigo Ortega
r.ortega@bbva.bancomer.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, AMX, 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 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.