Mexico Weekly Flash

Next week…

- **Monetary policy meeting minutes: arguments behind the change of tone**

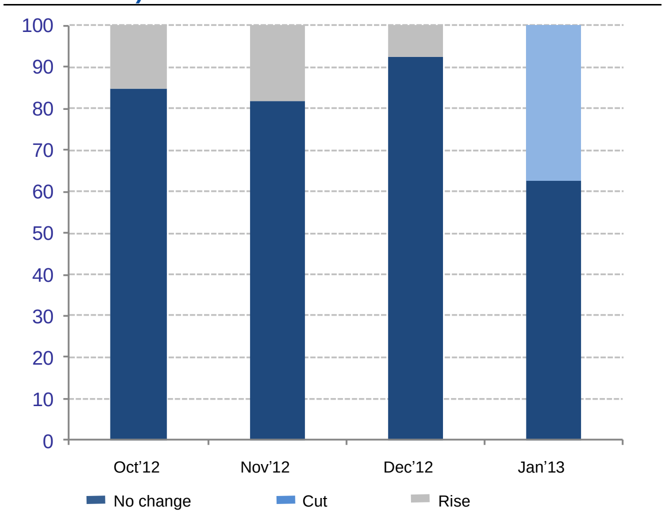
  Next Friday, the minutes of the monetary policy meeting held on January 18 will be released. Given that the tone is more accommodating than expected, we can expect board members to highlight the fall in general and core inflation at the end of 2012, influenced by the fading out of supply shocks, and also the outlook for consolidation of the downward trend in inflation during 2013. Furthermore, the fact that the statement mentions a possible cut to adjust the economy to a “situation of lower economic growth and lower inflation” means it is likely that the arguments set out in the minutes last March regarding the more favorable conditions for inflation arising from a prolonged implementation of appropriate monetary and fiscal policies will be taken up again.

  It will be necessary to pay close attention to the degree of discussion inside the board as to arguments put forward to sustain the outlook of lower inflation in the short and mid terms, which influenced the rapid change of tone in the statement. This is bearing in mind that only four of the five members took part in the most recent meeting; as the position of Deputy Governor left by José Sidaoui has not yet been filled.

MXN stands out against other LATAM currencies

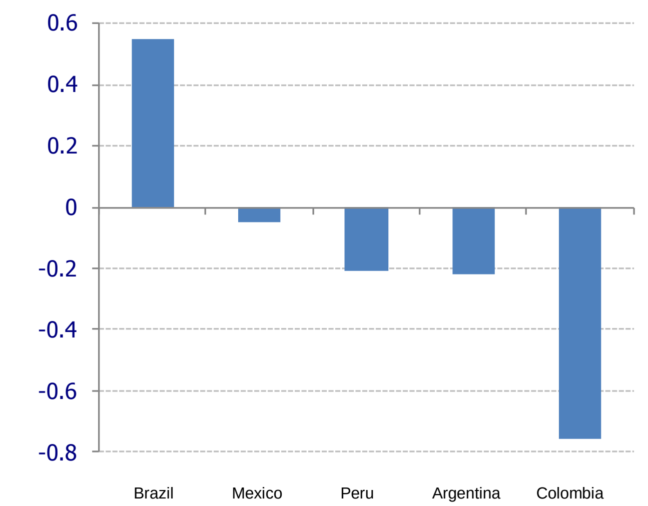
Although most Latin American currencies closed on Friday with losses against the previous week, the MXN remained practically stable, reporting a better performance than most of the other emerging currencies. Notably, the currency remains strong despite various factors which we have considered to be sufficient for profit-taking: 1) long MXN position at historic highs, 2) mixed economic data and corporate reports in the US, 3) increasingly accommodating outlook for the (continued on next page)

Chart 1
Analyst expectations regarding the next move in the lending rate over next six months (% analysts interviewed)



Source: BBVA Research with data from the Financial Market Analysts' Survey

Chart 2
Weekly change in Latin American exchange rates (%)



Source: BBVA Research and Bloomberg
NB: Negative numbers refer to a depreciation

MXN stands out against other LATAM currencies...

monetary position of the Bank of Mexico 4) uncertainty about budget cuts for the US in March, and 5) technical oscillating indicators show clear signs of overbuying. The market seems to maintain a certain degree of caution in the short term, although it has not been sufficient for a technical adjustment offering another opportunity to take long MXN positions. Therefore fixed income flows and outlook for structural reforms appear to be the main factors and limit the breaking of ranges.

Despite the upturn in the slope at the close of the week, the curve flattened significantly as the spread with USTs (10Y) reached lows since 2010 (trend in line with our target of 300bp). This week indicators in the US could act as catalysts; before GDP and non-farm payroll figures we expect the range to continue to be limited.

Technical Analysis

IPC

Source: BBVA, Bancomer, Bloomberg

Although we have been waiting for market adjustment for some weeks now, this has not happened, in fact, on the contrary, the IPC has continued to register further all-time highs. Our opinion is still that investing at these levels would pose a high risk in the short term. Although the RSI fell a few points at the end of the week, it is still operating at around 80pts and during the week it hit highs for the last 7 years. A reverse trend, which would be confirmed with the downward breakthrough of the 10-day rolling average (45,139pts) could initiate a return, at least, towards the range of 44,200/44,000pts. If the IPC rebounds again in the 10-day rolling average and breaks up through 45,500pts, we can consider the next level of resistance at 46,200pts.

Previous Rec. (1/21/13): We recommend favoring short-term liquidity and waiting for the market to show this natural adjustment in the upward trend. Possible supports at 43,000pts, 42,000pts and, in the worst case, 41,200pts.

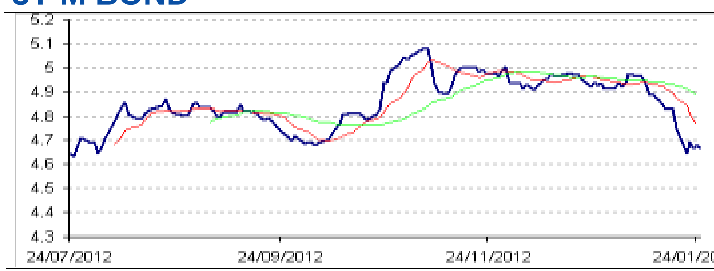
MXN

Source: BBVA, Bancomer, Bloomberg

The dollar found a floor and started a bounce from MXN12.55. During the week, it operated between MXN12.60 and MXN12.70. We believe that this upturn could find resistance levels at MXN 12.76 or even at MXN12.90, where 10-day and 30-day moving averages are trading.

Previous Recommendation (21/1/2013): we could expect to see a return to March levels at MXN12.55.

3Y M BOND

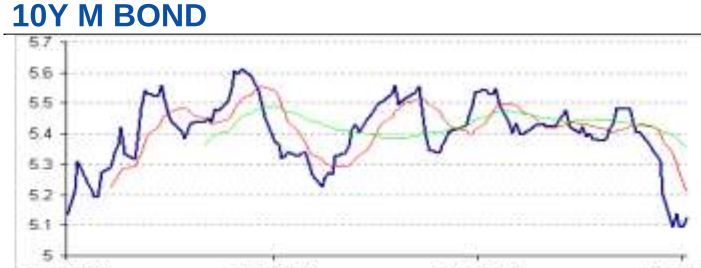


Source: BBVA, Bancomer, Bloomberg

3Y M BOND: (yield): The bond has been oversold in short term oscillating indicators. 1st support at 4.7% and second at 4.6%. We expect a rebound to 4.8%.

Previous Rec. (21/1/13). We could expect a new bounce toward 5% with a stop loss at 4.85%.

10Y M BOND



Source: BBVA, Bancomer, Bloomberg

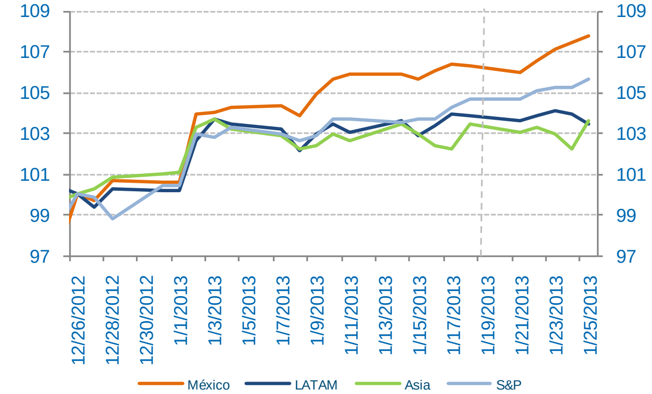
10Y M BOND (yield): In a buying zone near the floor of 5%. With the RSI showing buy, we expect a rebound towards 5.2% and subsequently 5.38%.

Previous Rec. (12/3/12). A purchase signal could come about if it breaks up through 5.57%.

Markets, activity and inflation

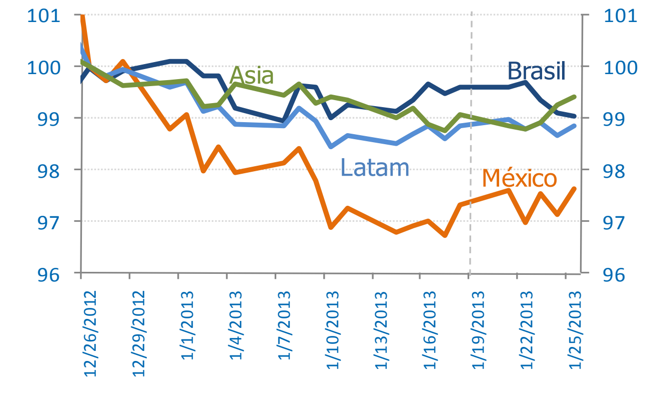
- **The temporary suspension of the US debt ceiling until next May, and better than expected US corporate reports, above all in technological companies, brings about gains in stock markets. At the end of the week, the exchange rate depreciated against the dollar and the euro, following the ECB's announcement that banks will pay a higher than expected amount of the emergency loans granted to them last year.**

Chart 7
Stock Markets: MSCI indices (December 26, 2012 = 100)



Source: Bloomberg & BBVA Research

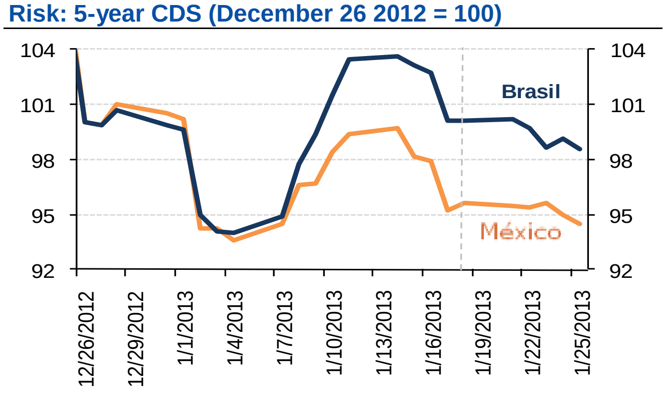
Chart 8
Foreign exchange: dollar exchange rates (December 26, 2012 = 100)



Source: Bloomberg and BBVA Research Note: LATAM includes Argentina, Brazil, Chile, Colombia and Peru. Asia includes the Philippines, South Korea, Taiwan, Singapore, Indonesia and Thailand.
Non-weighted averages

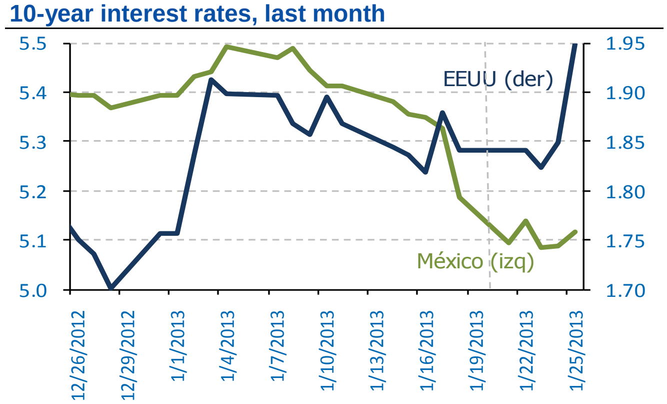
- **Fall in long term rates in Mexico to levels close to all-time lows influenced by lower than expected inflation, which increases the outlook of possible cut in the lending rate. The ECB's announcement influenced the fall in risk aversion and the rise in Treasury bonds.**

Chart 9
Risk: 5-year CDS (December 26 2012 = 100)



Source: Bloomberg & BBVA Research

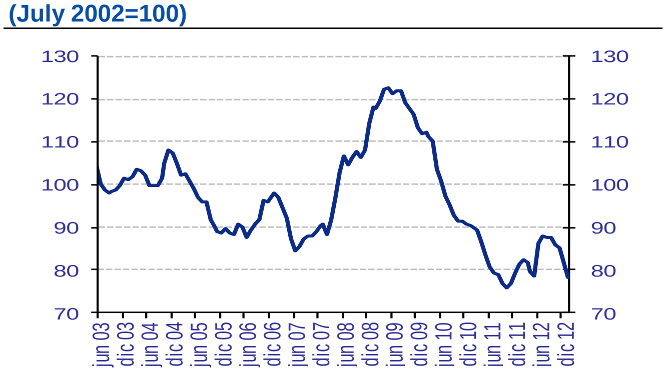
Chart 10
10-year interest rates, last month



Source: Bloomberg & BBVA Research

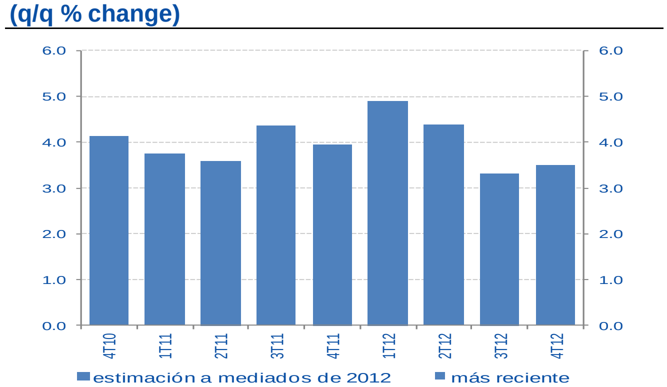
- **Downward surprises in inflation and mixed data in activity, suggesting slowdown**

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

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

Pedro Uriz
pedro.uriz2@bbva.com

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

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