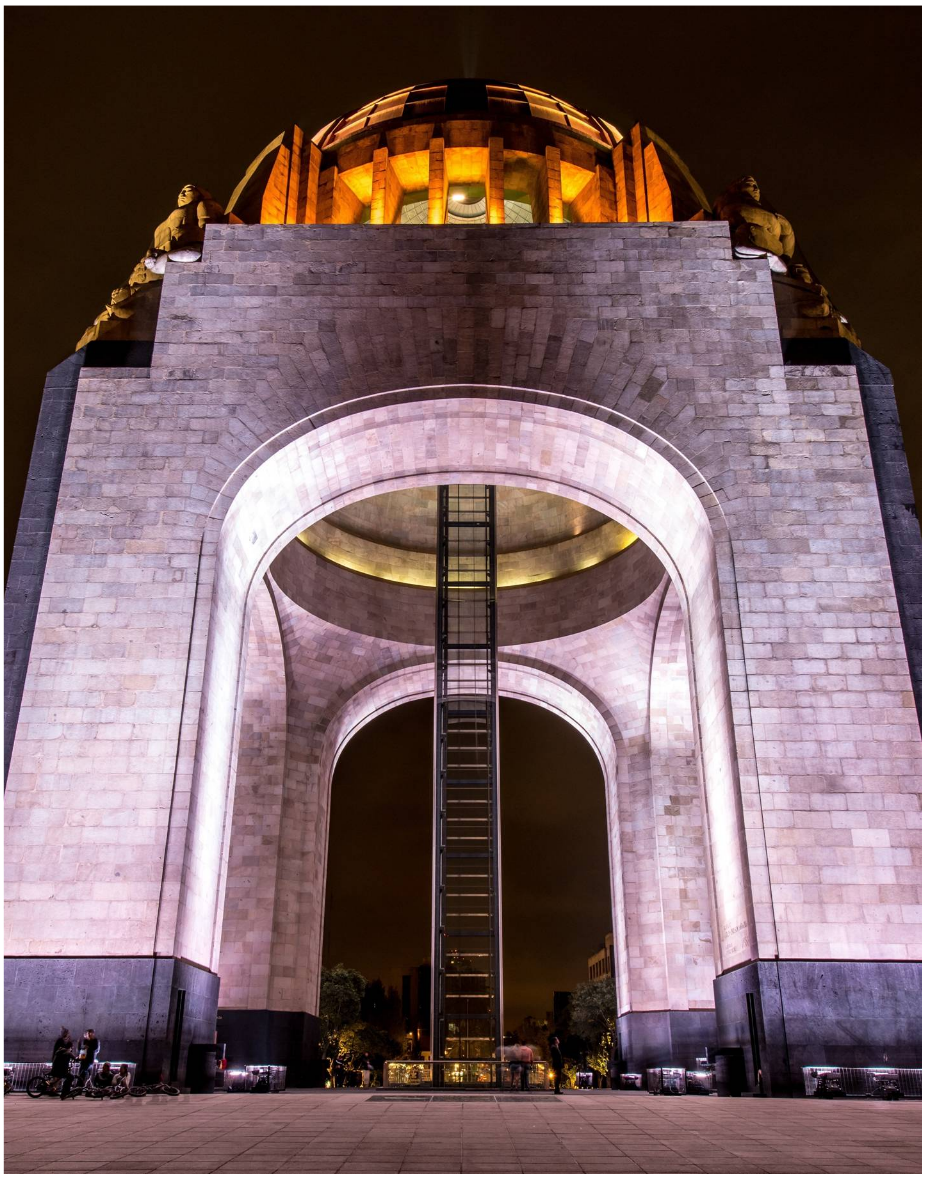
J.P.Morgan

Mexico 101

The 2014 Country Handbook

In your hands is the fourth edition of our Mexico 101 Handbook. Down the years we have enriched our report, and this time we are proud to present the most thorough analysis on Mexico so far. It should serve as a roadmap for all those looking at Mexico for the first time, providing a useful guide on everything from geography, demographics and politics to economics and financial markets. And for those well versed in Mexico, it includes thorough descriptions of the country's main sectors and latest key developments, including an update on our Mexico Structural Reforms Primer.



Monumento a la Revolución, Mexico City.

Mexico Equity Strategy

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Link to our 2014 Colombia 101 here.

Link to our 2013 Brazil 101 here.

Link to our 2012 Chile 101 here.

See page 144 for analyst certification and important disclosures, including non-US analyst disclosures.

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Table of Contents

Pricing as of April 8, 2013, unless otherwise indicated.

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Mexico 101

We hope this 146-page handbook serves as a useful primer and reference guide for all those looking to better understand and invest in Mexico.

Nur Cristiani & Gabriel Lozano

Key Macro Forecasts

We expect the economy to expand 3.1%oya in 2014 driven mainly by the expansionary policies implemented at the end of last year. Public spending and investment are expected to take the lead as private domestic demand and external appetite remain subdued in the first half of the year. However, we do expect a broad-based expansion in the second half of the year, once the US economy fully accelerates and consumer confidence gains traction after the tax-hikes implemented early in the year.

With respect to economic policy, we continue to expect fiscal and monetary tools to remain growth-supportive throughout the year. Regarding fiscal policy, we are expecting a fiscal deficit of 3.5% of GDP as approved by Congress last year. With respect to monetary policy, the Central Bank is expected to keep its reference rate unchanged throughout the year at 3.5%, after having implemented a 100-basis point easing cycle in 2013.

We anticipate the MXN to end the year at 12.80. The ongoing implementation of the exit strategy in the US (i.e., unwind of the quantitative-easing strategy) and a positive reform outlook that is expected to cement better growth dynamics in the medium term should keep the peso relatively range-bound. However, as long as the MXN remains a favorite hedging vehicle in the FX market, it will remain subject to risk – on/risk-off episodes.

Table 1: Macro Summary

	2012	2013	2014E
GDP Growth (%oya)	3.9	1.1	3.1
Consumer Inflation (%oya)	3.6	4.0	4.1
Current Account Balance (%GDP)	-1.2	-1.8	-1.8
Fiscal Balance (% GDP)	-2.6	-2.3	-3.5

Source: J.P. Morgan Economics.

Equity Strategy View

We are N Mexico in our LatAm and EM portfolios. We recently downgraded Mexico to N from its long-standing OW in February. Our downgrade was based on lack of conviction on Mexico's economic recovery after 2013's disappointment. Furthermore, EPS expectations were high considering the outlook for economic activity. The prospects of more realistic earnings growth meant further pressure on already expensive valuations, likely leading to a significant de-rating of the market.

Recent economic data make us more constructive on Mexico. Our economists' main concerns on the attainability of our 3.1% GDP growth forecast laid on perceived weakness in the manufacturing and consumer sectors. Manufacturing was impacted by inventory accumulation in the US, while an already weak consumer was further hit by tax increases early in the year. For manufacturing, both PMIs and exports point towards stronger activity after January's trough. For the consumer, consumer confidence up from January's multi-year low provides support to our expectation that weakness was a matter of perception on tax increases and that the real impact on disposable income was meager.

EPS expectations have come down to a more realistic level, lowering de-rating risk for Mexico's'multiples. After reaching over 15%, EPS growth expectations for 2014 have come down to a more realistic 10%. This provides support to current valuations. As economic data continue to support an improving outlook for the economy, companies should be able to recover from last year's meager growth. Thus, the focus for investors when looking at Mexico turns back to healthy fundamentals and long-term prospects of potential GDP growth expansion on the back of the recently approved reforms.

We remain optimistic on Mexico's long-term outlook. Reforms approved last year should drive potential GDP growth from our current estimate of 3.3% to 5%. Furthermore, opening up of the telecom and energy sectors should also open significant new business opportunities for Mexican companies, either because they are direct participants or because they provide services related to companies in such industries. A significant increase in FDI should also foster job creation, in turn positive for the consumer environment. All this, together with a disciplined fiscal stance by the government and controlled inflation, provides support to a positive long-term view in the Mexican market.

In the Mexico portion of our LatAm model portfolio. we continue to focus on industrial sectors, where we see attractive long- and short-term potential. In this category we include **Cemex, OMA, Pinfra, Alfa** and **Fibra Terrafina**. However, to get exposure to a recovery in the consumer, we continue to favor **Femsa** and **Liverpool.** (For further details, see our latest Key Trades and Risks here).

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Things to Know

Mexico's total area is nearly 2 million square kilometers (772 thousand square miles), making it the 14th-largest country in the world.

In the 2010 population census Mexico had around 112.3 million people, the 11th-largest population in the world. CONAPO estimates that by the end of 2014, Mexico will have 118.6 million people.

Mexico is the second-largest economy in Latin America and 14th in the world with a real GDP of $1 trillion.

The country has an old dependency ratio of around 1/3 that of developed economies. Around 48% of the population is under 25.

Mexico City and its surroundings add 26% of the total Economic Activity Participation. They house 21% of the total population.

After 12 years governed by right-wing party PAN, on December 2012 centrist-party PRI came back to power with President Peña Nieto. The PRI had previously governed Mexico from 1929 to 2000.

Services and other tertiary activities account for 65% of the total GDP. Industrial production accounts for 30% of the total GDP.

With 13 free-trade agreements signed, Mexico has been able to trade with partners that make up 60% of the world's GDP. Mexico is ranked 54 out of 75 in the ICC's Open Market Index.

~80% of Mexican exports go to the U.S, 8% go to Latin America and 4% go to EU. Non-oil major exports to the U.S are electrical machinery (20%) and car/auto parts (19%).

Oil accounts for about 33% of fiscal revenues, 15% of exports and about 7% of GDP.

Pemex is the world´s ninth-largest oil company by production.

Remittances are the second-largest source of FX after exports. On average, $292 was sent in each remittance during 2013, the same as in the first two months of 2014.

In terms of wealth distribution, Mexico has a Gini coefficient of 45.3, making it one of the highest in the OECD, just below that of Peru, Chile and Brazil.

The informal sector is estimated at 64% of the economically active population.

Credit penetration in Mexico is low by both global and regional standards at around 18% of the GDP versus over 57% in Brazil and over 38% in Colombia.

The financial system is dominated by foreign-controlled banks (72% of total system's loans). BBVA (Bancomer) and Citigroup (Banamex) are Mexico's two largest banks.

Mexico has a mandatory-contribution private pension fund system, with individual capitalization accounts. It was established in 1997 and now has AUMs of $158bn.

The Central Bank became independent in 1994 and officially set a 3% inflation-targeting regime in 2001.

Mexico is the most popular international tourist destination in the Americas, by arrivals.

Bank credit to the housing sector has grown 91% from 2006 to 2013.

The total market cap of all listed companies in the Mexican Stock Exchange is c. $535bn, or 42% of GDP.

Only 5 companies make up more than 52% of the IPC, and 45% is comprised of domestic defensive stocks.

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Overview

Area

Mexico's total area is almost 2 million km^2 (772k sq. miles), making it the **14th-largest country in the world.** Mexico is the fifth-largest country in the Americas, after Canada, the US, Brazil and Argentina. Mexico is composed of 31 states and one Federal District (Mexico City), which is the capital of the country.

Table 2: Top 5 Countries in the Americas by Total Area

Country	km² million	miles² million
Canada	9.98	3.85
US	9.63	3.72
Brazil	8.51	3.28
Argentina	2.77	1.06
Mexico	1.97	0.76

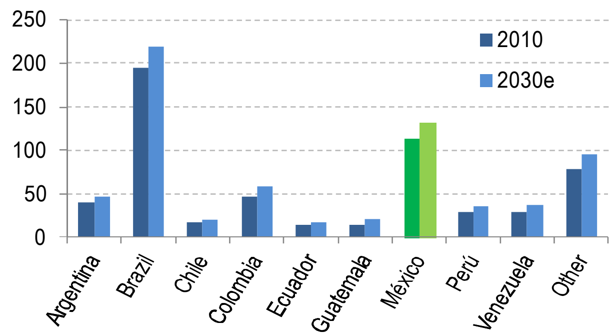
Source: INEGI and CIA World Factbook.

Population

Mexico has approximately 116 million people, making it the country with the 11th-largest population in the world. Brazil is 5th with 197 million, and China is 1st with 1.3 billion.

Figure 1: LatAm Population

million

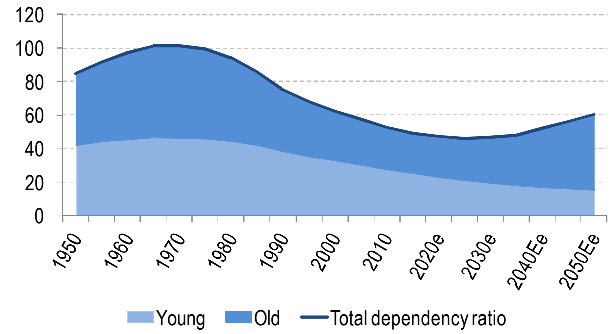


Source: CELADE.

Mexico is a young country. Around 48% of its population is under 25, the average age is currently 26. Mexico will reach its lowest total dependency ratio in a century within 10-20 years. Despite further shrinkage of young dependency, it will remain as one of the highest in the world. In contrast, the old-age dependency ratio, despite rising, will be only around one-third of the projected average in developed markets.

Figure 2: Dependency Ratio

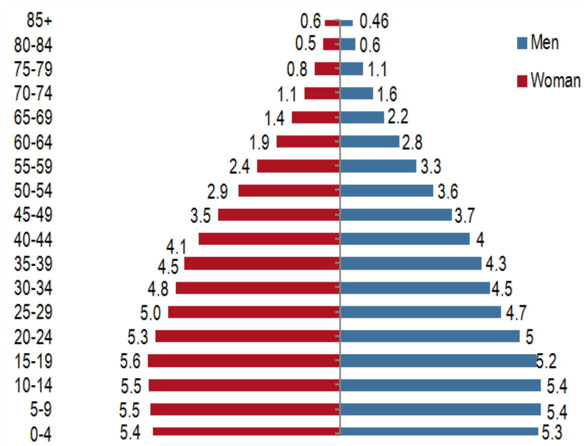
%



Source: CELADE. Note: Dependency ratio= (population aged 0-14 + population aged 65 and over) / population aged 15-64).

Figure 3: Public Pyramid 2013

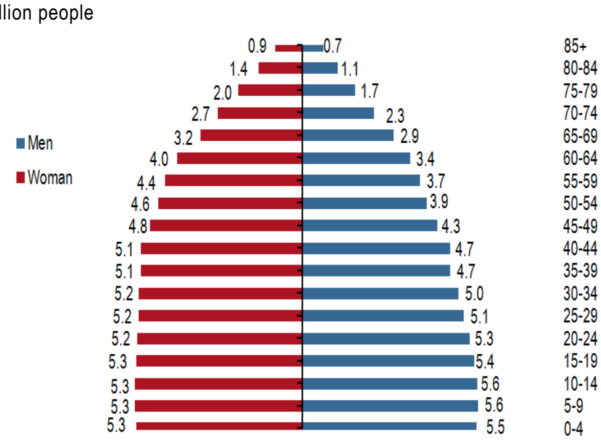
million people



Source: CONAPO.

Figure 4: Population Pyramid 2050

million people



Source: CONAPO.

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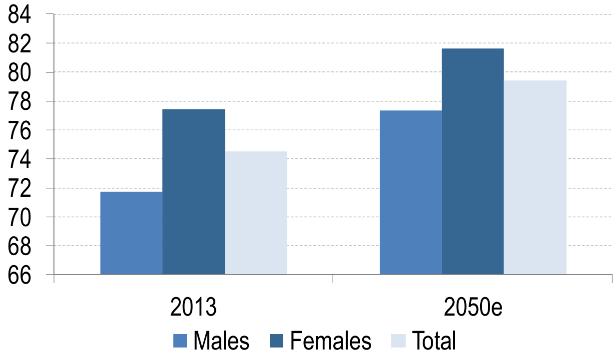
Figure 5: Life Expectancy in Mexico

years

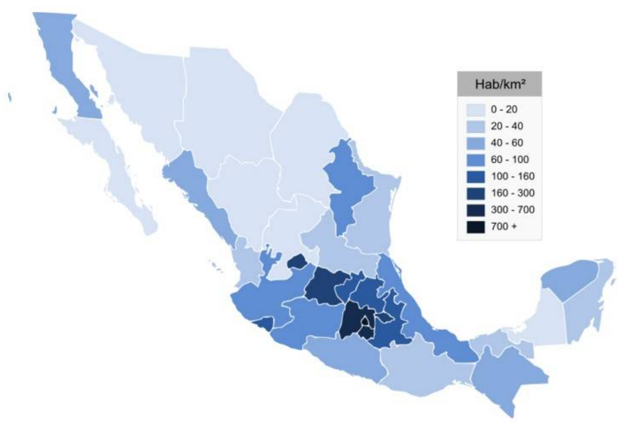


Source: CELADE.

Population is concentrated in central Mexico, in and around Mexico City. Northern Mexico is the most sparsely populated area, where one-quarter of the population lives but generates around 25% of GDP. Mid-Mexico, including Mexico City, has about 60% of the population and is responsible for 60% of GDP. Finally, the southeast generates 15% of the country's GDP.

Figure 6: Population Density by Region

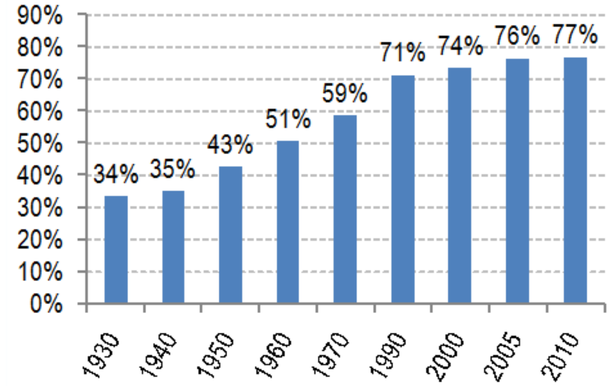
population per km²



Source: INEGI.

Mexico's urbanized area has increased significantly since 1940, with the **urbanization rate rising from 35% to over 77% in 2010.** Urbanization is already high by developing country standards. Increased urbanization has been spurred by migration to the northern border states, attracted by the rapid growth of the *maquila* (offshore assembly for re-export) industry, and to tourist centers on the Caribbean and Atlantic coasts.

Figure 7: Urban Population as % of Total

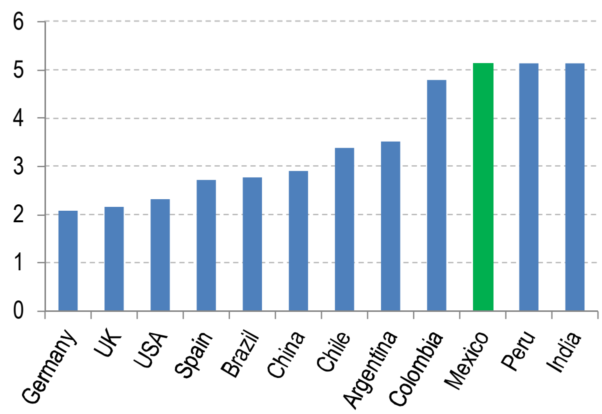


Source: INEGI.

The Mexican average home has 5.1 members, one of the largest in LatAm and the world. Brazilian homes have on average 2.7 members while German households have on average 2 members.

Figure 8: Number of Members in Average Home

no. of people



Source: INEGI.

Politics

Enrique Peña Nieto (EPN), of the centrist Revolutionary Institutional Party (PRI), is the current president of Mexico, serving a six-year term that began on December 1, 2012, and will end on **October 1, 2018**. The transition period between elections (July) and the swearing-in (previously on December 1) was narrowed in the political reform of 2013. Presidential re-election is explicitly forbidden in Mexico, although the reform enacted this year allows for the reelection of law-makers elected for the first time in 2015 mid-term elections. Presidents have served six-year terms since 1934. Before that, the president's term in office lasted 4 years. In the 70 years from 1929 to 2000, the country was governed by the PRI, which only yielded the presidency during the twelve years through 2012, when the right-wing PAN governed.

Mexico has 7 recognized political parties, though three are the most important: the centrist PRI; the right-wing PAN; and the left-wing PRD. The other political parties are the PT (Labor Party, left), PVEM (Green Party, right), Movimiento Ciudadano (previously Convergencia, left), and Nueva Alianza (centrist).

Mexico is a Federal Republic, in which there are 31 state governors and a government head of the Federal District (Mexico City). Currently 21 governors (68%) are from the PRI, 4 are from the PAN (13%) and 4 are from the PRD (13%). The remaining states of Oaxaca, Sinaloa, and Puebla are ruled by a political coalition of the PAN and the PRD.

Table 3: Mexico's Political, Demographic and Economic Composition

State	Ruling Party	% of population	% of GDP
Mexico	PRI	13.5	9.4
Distrito Federal	PRD	7.9	17.3
Veracruz	PRI	6.8	4.7
Jalisco	PRI	6.5	6.3
Puebla	PAN/PRD	5.1	3.4
Guanajuato	PAN	4.9	3.9
Chiapas	PRI	4.3	1.8
Nuevo León	PRI	4.1	7.5
Michoacán	PRI	3.9	2.4
Oaxaca	PAN/PRD	3.4	1.6
Chihuahua	PRI	3.0	3.0
Guerrero	PRD	3.0	1.5
Tamaulipas	PRI	2.9	3.1
Baja California	PAN	2.8	2.7
Sinaloa	PAN/PRD	2.5	2.1
Coahuila	PRI	2.4	3.1
Hidalgo	PRI	2.4	1.6
Sonora	PAN	2.4	2.6
San Luis Potosí	PRI	2.3	1.9
Tabasco	PRD	2.0	3.7
Yucatán	PRI	1.7	1.4
Querétaro	PRI	1.6	1.9
Morelos	PRD	1.6	1.1
Durango	PRI	1.5	1.3
Zacatecas	PRI	1.3	0.9
Quintana Roo	PRI	1.2	1.4
Aguascalientes	PRI	1.1	1.1
Tlaxcala	PRI	1.0	0.5
Nayarit	PRI	1.0	0.6
Campeche	PRI	0.7	5.2
Colima	PRI	0.6	0.6
Baja California Sur	PAN	0.6	0.6

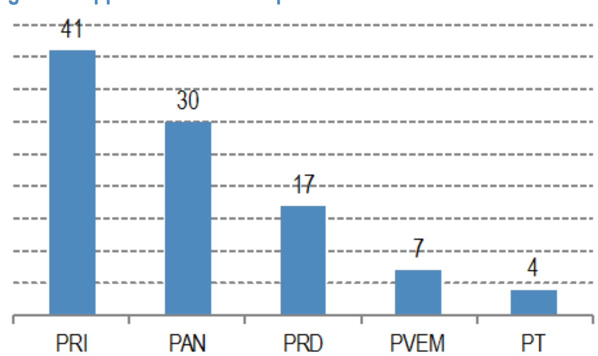
Source: Source: INEGI and IFE.

Besides holding the majority of governorships, states ruled by the PRI account for around 60% of both total GDP and total population. On the other hand, states governed by the PAN account for 10% of GDP and 19% of population, while the four states governed by the left-wing PRD represent 24% of GDP and 15% of the total population. The high percentage of GDP accounted for by PRD-governed states is due to the fact that among these is the Federal District, which by itself represents 17% of GDP. Lastly, there are three states governed by a coalition formed by PAN and PRD, which account for 11% of the population and 7% of GDP.

Government composition. Mexico is a federal republic and its government is divided into three branches: (1) the executive branch, formed by the president, state governors and municipal heads; (2) the legislative branch, consisting of local and federal law-makers; and (3) the judicial power, consisting of the judiciary and the Supreme Court of Justice.

The legislature consists of a bicameral Congress formed by senators (Upper chamber) and deputies (Lower chamber). Senators are elected for a six-year term, and there are 128 seats. Each state (including the Federal District) has two senators who are elected by direct vote. For the remaining 64 seats, each state is assigned a senator under the principle of first minority, adding 32 senators. Finally, the last 32 seats are distributed across political parties based on the proportion of the national vote obtained in the general election. The resulting seats are assigned directly by each corresponding party.

Figure 9: Upper Chamber Composition



Source: Cámara de Senadores' website (The Mexican Senate).

The lower chamber has 500 deputies. Three hundred are elected from single-member districts on a first-past-the-post basis. The remaining 200 law-makers are elected by proportional representation from among large 'plurinominal districts.' Lower chamber elections take place every three years.

The PRI is the largest political force in the lower chamber, with 48% of the 500 seats, followed by the

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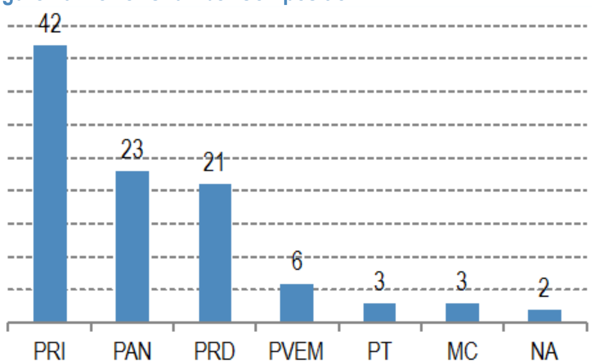
PAN with 28% and the PRD with 14% of the total number of seats (from 25% before).

Figure 10: Lower Chamber Composition



Source: Cámara de Diputados (Lower House).

The legislature holds two ordinary sessions per year. The first runs from August 1st until November 15th. The second runs from February 1st to April 30th. A Permanent Commission – formed by 18 senators and 19 deputies – holds legislative responsibilities in between ordinary sessions.

The judicial branch. The judicial branch is composed of the Supreme Court of Justice and the Electoral Tribunal, as well as several collegiate and unitary circuit tribunals, district tribunals, the Citizenship Council of the Federal Judiciary and the Federal Judiciary Council.

The Supreme Court is the head of the judicial power. It is formed by 11 ministers, each elected by the Senate from a three-candidate pool suggested by the president. They are elected for 15-year terms. The Supreme Court's duties are to defend the Constitution, maintain the equilibrium between the executive power and the legislature or any other entities at the state level and to solve any major relevant judicial affairs. Its decisions are final.

The Electoral Tribunal of the Judiciary is the institution in charge of all electoral affairs. This Tribunal has one supreme group (7 *magistrados*) and 5 regional groups (3 *magistrados* in each group); the *magistrados* that compose the supreme group are elected by the Senate, taking into account the Supreme Court's suggestions. The supreme group *magistrados* are elected for 10-year terms, while the regional *magistrados* are elected for 8-year terms.

The *Tribunales Colegiados* and the *Tribunales Unitarios* are divided geographically across the country. It is worth noting that there are 31 tribunals. The unitary circuit tribunals have 1 *magistrado*. They resolve *juicios de amparo* (formal accusations against the government for not following legal procedures) promoted against other unitary circuit tribunals and resolve the appeals process, among other responsibilities.

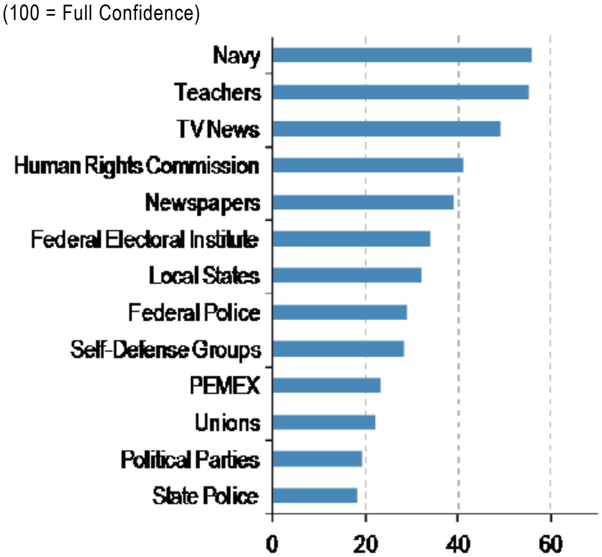
The collegiate circuit tribunals have 3 *magistrados* and are entitled to resolve the *juicios de amparo* that end a legal suit and to extradite a person by request of the president or a foreign government, to name but a few examples. These tribunals specialize in different legal affairs such as corporative, administrative and labor, among others.

The district tribunals are composed of one judge. This is the first legal phase and might be specialized by different affairs, while the Citizenship Council of the Federal Judiciary is formed by 7 regular citizens to resolve any issue that a district tribunal judge may impose.

The Federal Judiciary Council is the institution in charge of the administration, control and development of the judicial career, with the exemption of the Supreme Court and the Electoral Tribunal. This institution is obliged to protect the independence and good functioning of all the judicial institutions.

Overall confidence in institutions remains low. The most trusted institutions in Mexico are the navy, teachers and TV News programs, while unions, political parties and the state police are the least trusted.

Figure 11: Confidence Level in Institutions
(100 = Full Confidence)



Source: Parametría, January 2014.

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Reforms and the Pact for Mexico

(For a detailed description of the structural reforms approved in Mexico please refer to The Reforms in Mexico section, an update of our last year's Mexico Structural Reforms Primer).

The outlook for meaningful reforms improved significantly since the end of 2012 and even more considering the **fast-track approval of the Energy Bill** in December. For starters, the **Labor Reform** was approved in November of 2012, still under President Felipe Calderón's administration, and only after less than three months of its submission to Congress as a **Preferential Initiative** (*Iniciativa Preferente*).

The *Iniciativa Preferente* is the status under which the executive branch may submit to Congress two bills per ordinary session of Congress (as long as they are submitted on the very first day of proceedings). These bills should be discussed and voted in the Chamber to which the initiative was first submitted (Originating Chamber, which could be either the Lower or the Upper Chamber) in the following 30 calendar days. Once approved by the originating chamber, the initiative – which should not require constitutional amendments to be considered preferential – will be turned to the other Chamber (Reviewing Chamber) for its discussion and subsequent voting in 30 days.

The labor reform is intended to **boost labor flexibility and to create the incentives to increase the pool of workers in the formal sector**, while increasing transparency and accountability of unions.

Table 4: The Labor Reform in Mexico: Still submitted under President Felipe Calderón

Objective	Changes
Labor flexibility	Trial and training periods are introduced; hourly wages and reduction of hiring via outsourcing.
Reduction of market frictions	Capping the restitution of wages lost during strike periods ("salarios caídos").
Union reform	A worker has now the right to leave a union without been fired by the company.
	Transparency: Union-linked workers have now the right to vote freely to elect their leaders and to request further info regarding the use of worker's contributions to the union.
Organizational flexibility	Productivity and "multi-tasking" will be favored as the main criteria for reaching new/vacant jobs
	Productivity will be promoted with the certification of labor competitiveness, and job quality amongst others.
Increased protection and security of workers	A more broad definition of discrimination is now included in the Law; sexual harassment is now punishable and vulnerable groups (e.g. child labor; disabled workers; miners) will be further protected

Source: STPS and Banco de México.

A second key development that improved the outlook for structural reforms was the **Pact for Mexico**. The Pact was signed by President Enrique Peña Nieto and the leaders of the three main political forces (PAN, PRD and PRI), which now account for 419 lawmakers in the Lower House (out of 500), and 114 out of 128 senators. All together, they represent 86% of the total seats in the former, and 89% in the Senate.

The Pact was a multi-partisan agreement envisaged to strengthen the Mexican State, the democratization of politics and of the economy, the correct instrumentation of social rights, and the participation of citizens as key executioners and monitors of public policies. More broadly, the Pact was intended to reach through socio-political and economic accords ranging from social security and education, to employment, competitiveness and security.

Table 5: The Pact for Mexico: The 2012 reforms initiative at a glance

	Discussion	Expected by
Social security		
Universal health scheme*	- -	2013
Pension for the Elder*	2H13	**1H14**
Unemployment insurance*	1H14	**2H14**
Education		
National Evaluation System*	4Q12	2H13
Full-time schools*	4Q12	1H13
Broader access to higher education	- -	1H13
The Economy		
Strengthening of the antitrust body	1H13	2H13
State telecom network*	- -	1H13
Higher competition in the telecom market	1H13	2H13
Transform Pemex into an efficient company*	1H13	2H13
New Law for Mining Production and Royalties*	1H13	2H13
Competition in the oil and gas industries	1H13	2H13
States public accountability law	2H13	2H13
Fiscal Reform	**2H13**	**1H14**
Revision of government subsidies	2H13	**1H14**
Security		
State Coordination/National Gendarmerie*	1H13	2H13
Transparency and accountability		
Accountability of Public Accounts	- -	1H13
Anticorruption Law; National Ethics Council	- -	1H13
Politics		
Coalition governments	1H13	2H13
Political parties regulation	2H13	**1H14**

Source: http://pactopormexico.org. *Requires the approval of the Fiscal Reform.

The already approved **Education Reform** (February, 2013) was submitted to Congress with the support of the **Pact** (i.e., the executive branch and the three main political parties), and its approval among rank-and-file lawmakers was relatively straight forward.

In March 2013, the **Telecommunication Reform** was submitted to Congress, and its secondary legislation was still debated 12 months after the president signed it into

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law. Through constitutional amendments, the reform aims to boost competitiveness by strengthening antitrust bodies, limiting market share in the industry and auctioning two new free-to-air TV channels.

The **political reform** was approved on December 13 of 2013, and enacted on January 22 of 2014. Among the most important amendments are: The Federal Electoral Institute becomes the **National Electoral Institute**; **Senators are now eligible to be reelected for two consecutive periods** (each term lasts for six years), while **deputies could be eligible for four consecutive periods** (each term lasts three years); the president has the right to opt at any given time to shape a **coalition government** with one or more opposition parties represented in congress. Parties now require at least the support of 3% of the electorate to maintain its registration as political parties with full rights (including the allocation of proportional-participation legislators). Finally, **the next presidential term** (2018-24) will start on **October 1st** instead of December 1st, while the first ordinary session of Congress that corresponds to the next presidential term will start on August 1st, instead of September 1st.

Overall, the results obtained in such a short period of time continue to reflect **the strong commitment of the current administration to implement the long overdue structural changes aimed at boosting productivity and competitiveness in the long term**.

Health

Health & Primary education constitute the 9th out of 12 pillars the World Economic Forum (WEF) uses to assess competitiveness among countries, highlighting the importance of healthy workers with basic education for higher productivity. WEF takes into account the number of malaria and tuberculosis cases per 100k people, HIV prevalence among adult population, infant mortality, life expectancy, and enrollment and quality of primary education. With a **score of 6.1 Mexico is ranked 95th out of 148 countries**.

Table 6: Health & Primary Education Competitive Index

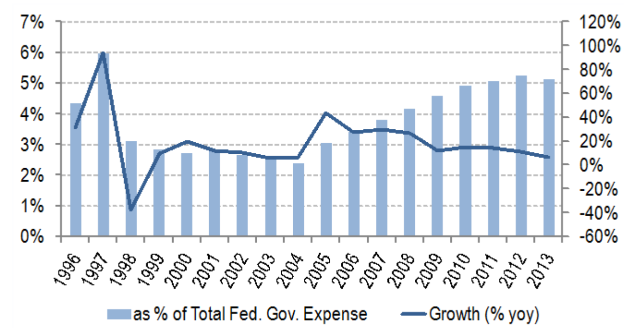
score 1-7

Country	Score
Mexico	6.1
Argentina	5.9
Chile	5.7
Brazil	5.4
Colombia	5.3
Peru	5.3
Bolivia	5.0

Source: WEF.

The Mexican Congress approved a public health expenditure budget for 2014 of Mx$130bn, 7% larger than in 2013. Private health spending has remained stable since 2005 at an average of 3.2% of GDP. Despite the increased health budget, Mexico moves at a slower pace than other OECD countries. **Mexico's public health expenditure at 2.9% of GDP is below the average of the OECD countries of 7%**.

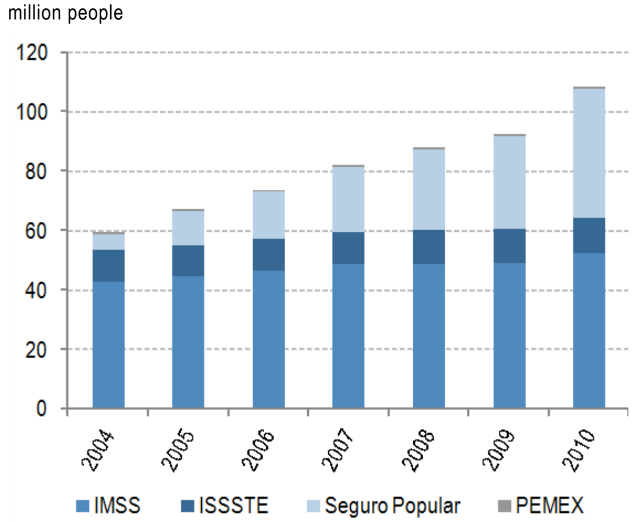
Figure 12: Federal Government Expenditures in Health



Source: SHCP.

The health system in Mexico is divided into different vertically integrated units that incorporate financing, insurance, and provision. The state-owned social security institutes cover salaried workers in the formal sector, while the 'popular health insurance' scheme (*Seguro Popular*) covers population working in the informal sector as well population in general that otherwise wouldn't have access. The *Seguro Popular* has expanded its coverage in the past years to cover almost 50% of the Mexican population.

Figure 13: Social Security Coverage in Mexico



Source: IMSS, ISSSTE, Secretaría de Salud, Pemex.

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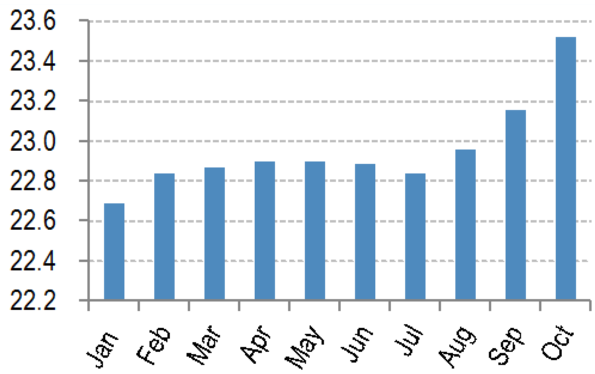
Affiliates to the IMSS at the end of October 2013 were 4% higher than in 2012 at 23.5mn including social security system workers.

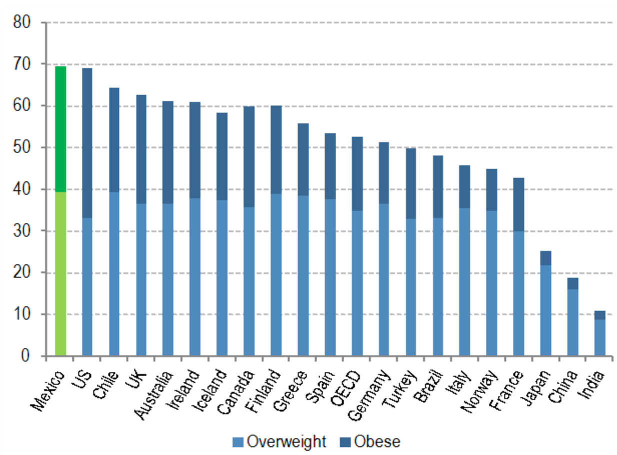
Figure 14: Number of IMSS Affiliates in 2013
millions



Source: IMSS.

According to the OECD, Mexico is still number one in overweight population worldwide. Around 40% of Mexicans are overweight and 30% are obese. Obesity is a source of concern as many people develop serious diseases such as diabetes or heart conditions. With a proper nutritional education, this could be reduced in the long term.

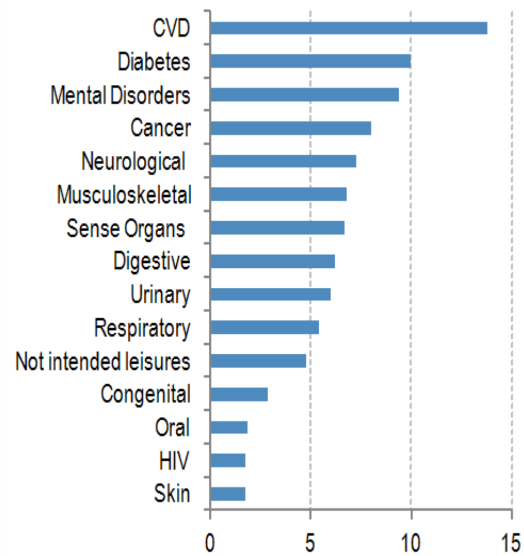
Figure 15: Overweight and Obese Population – Selected Countries
% of total population



Source: OECD Factbook 2012.

Diabetes and cardiovascular diseases (CVD) are the main health issues among the Mexican population. Causes of death have changed along the years. During the 1930s most of the causes of death in Mexico were related to digestive and/or respiratory contagious diseases. As of 2011 the **main causes of death among Mexicans are: (1) heart diseases, (2) diabetes, and (3) malignant tumors.**

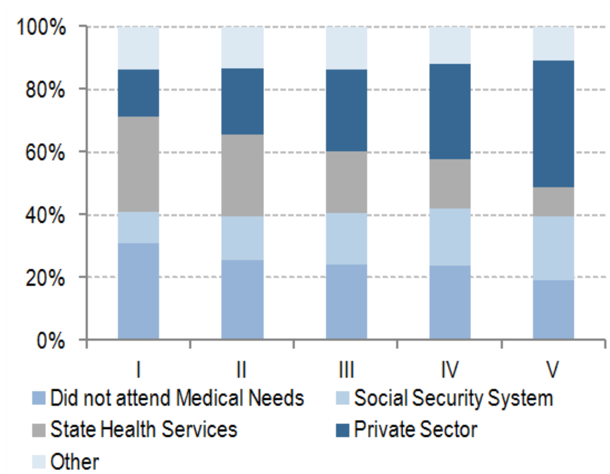
Figure 16: Main Health Issues among Mexicans
% of healthy lived years



Source: IMSS.

27% of the total Mexican population is unable to cover for necessary education and health expenses. 40% of the population in the highest income quintile uses private services to tend to their medical needs while c.30% uses a public health service. Only 15% of the people in the bottom quintile uses private health services, while 40% taps public services. 31% of the lowest-income quintile does not tend to their medical needs at all.

Figure 17: Place of Medical Attention by Household Quintile
% of total quintle



Source: INSP.

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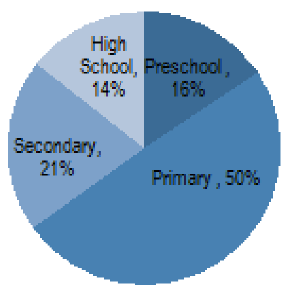
Education

Mexico classifies its education system into basic, upper secondary and higher education. Children attend preschool between the ages of 3 and 5, primary school between 6 and 11, lower secondary education between 12 and 14, and upper secondary between 15 and 18. In Mexico, secondary is divided into lower secondary and upper secondary, each one lasts 3 years. Before 2012, basic education only included preschool, primary and lower secondary. In 2012 the Congress approved a reform to make upper secondary education mandatory. Approximately 25.7 million students are enrolled in basic education, 4.3 million in upper secondary and 3.2 million in higher education.

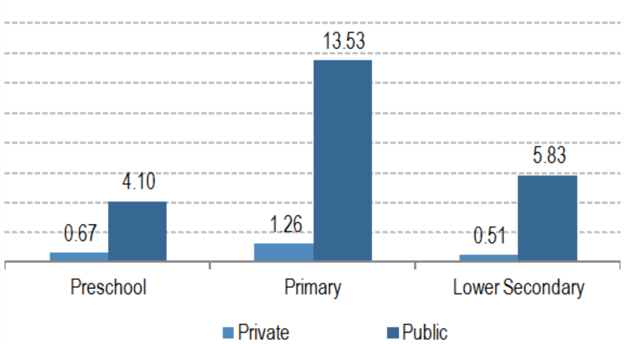
Figure 18: Public System Enrollment Distribution



Source: INEE. Data as of 2012.

About 90% of all students in Mexico (excluding university) attend public schools. Only 9% of the enrolled primary students attend private institutions.

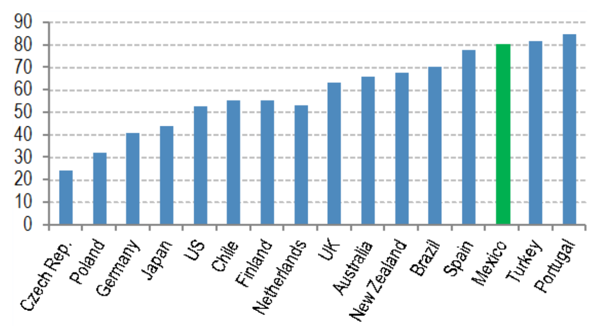
Figure 19: Private vs. Public Basic Education Enrollment
million students



Source: INEE. Dataas of 2013.

Mexico still has very low penetration of education, implying significant opportunity for improvement. Only 20% of the population have education above elementary, significantly below the OECD's average of 44%. In LatAm, Brazil and Chile are better ranked with 45% and 55%, respectively. Furthermore, of the 27.7 million students enrolled annually in basic education, only 4.3 million enroll to secondary and 3.2 million to higher education.

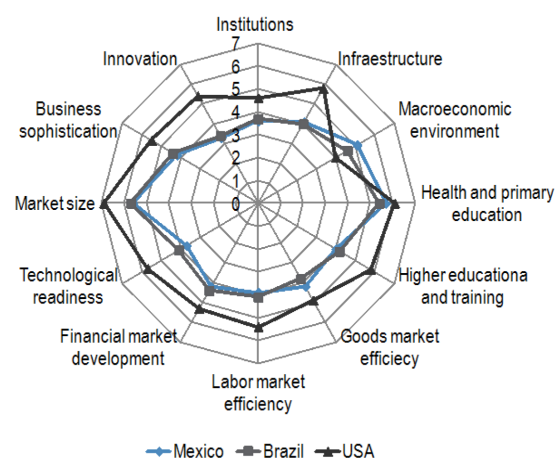
Figure 20: Population Aged 25-64 with Only Elementary Education or Less



Source: OECD.

According to the World Economic Forum, primary and higher education are two of the 12 pillars under which it evaluates countries to calculate their Global Competitiveness Index. Mexico is currently ranked 55 out of 148 economies evaluated in the overall index, losing two spots vs. 2012-13 ranking. Despite Mexico being ranked at number 37 and 67 for Primary and Secondary Education enrollment, it is ranked at 119 out of 148 countries when it comes to the quality of the educational system and 131 regarding the quality of math and science education.

Figure 21: Global Competitive Index Components



Source: Global Competitiveness Report 20013-2014, World Economic Forum. Maximum Rank = 7.

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Per capita GDP spend per student in Mexico at 18% is lower than in Brazil and Chile at 19% and 22%, respectively. During 2011-12 the average annual expense per student in public institutions for the school year was ~$1,520. During 2012, the OECD average total expenditure in private education as percentage of GDP was c.6%, while Mexico came in at 1.4%.

Table 7: Expenditure per Student in Public Schools

$ per student

Level	2009/2010	2010/2011	2011/2012	2012/2013e
Preschool	1,082.4	1,018.1	1,158.9	1,213.6
Primary	985.5	924.9	1,050.0	1,132.7
Secondary	1,510.5	1,419.6	1,610.0	1,779.9
High school	2,075.9	1,935.8	2,263.3	2,427.2
University	4,652.7	4,337.6	5,063.4	5,501.6

Source: INEGI, J.P. Morgan.

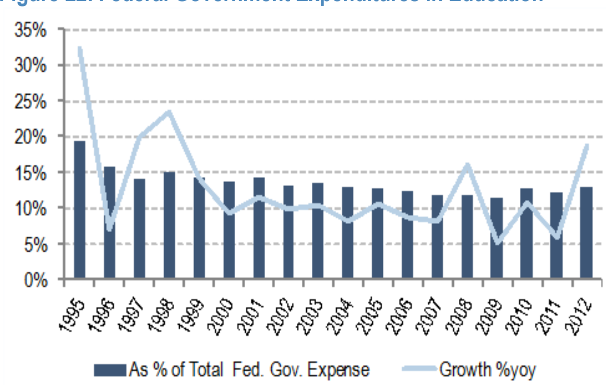
Table 8: Public & Private Expenditures in Education as % of GDP

School Year	Public Sector	Private Sector
2005/2006	5	1.4
2006/2007	4.9	1.4
2007/2008	4.9	1.3
2008/2009	5	1.3
2009/2010	5.4	1.5
2010/2011	5.3	1.4
2011/2012	5.3	1.4
2012/2013e	5	1

Source: INEGI, Presidencia de la República.

The 2013 federal government budget expenditure in Education was Mx$273bn, 19% higher than in the previous year. The 2014 public education budget was approved at Mx$292bn, a 12% increase from 2013.

Figure 22: Federal Government Expenditures in Education

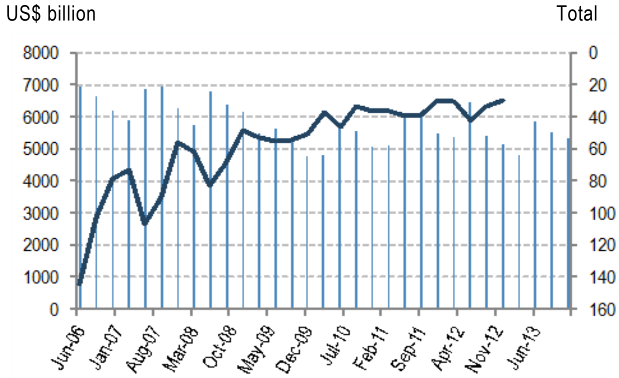


Source: SHCP.

Migration and Remittances

Remittances are the second-largest source of FX for Mexico, after exports. These grew dramatically, from under $2bn/qtr in 2000, on average, to a peak of $6.5bn/qtr in 2007. The US great recession brought a reduction in remittances since 2008, and they currently stand at $5.4billion/qtr. The reduction in remittances has mainly followed a reversal in migratory flows. While this might reflect stricter US migration controls, we believe a large part of the decline is explained by the economic cycle in the US. We expect remittances to expand again once the US economy fully recovers. We expect remittances to reach $23.9 billion (~2% of GDP) in 2014 from $21.5 billion last year.

Figure 23: Quarterly Remittances and Immigration



Source: Banxico, INEGI.

Remittances are especially important for certain regions of Mexico with high rates of emigration and for many low-income households where they constitute a sizable share of total income. By state, Michoacán stands as the largest beneficiary of remittances, accounting for 10% of total remittances inflows in 2013.

According to recent polls, nearly 1 out of 3 Mexicans have a close relative currently living in the US. This ratio is the highest in the North of Mexico, where 1 out of 2 Mexicans are reported to have a relative living in the US.

Studies have shown some evidence that **remittances to Mexico respond positively to deteriorating economic conditions back home,** providing some buffer to shocks from the US. Also, there is some sign that remittances respond positively to a depreciation of the peso and so could help to cushion or mitigate adverse external events.

On average, **$300 is sent in each remittance.** This has remained broadly stable over time, though impacted by factors such as the MXN/USD exchange rate, the US construction sector, and employment conditions on both sides of the border.

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Almost 100% of remittances inflows come from the United States while 60% of outflows go to this country, 13% go to Spain and 7% to Guatemala.

The US is the major source of remittances, accounting for 98% of them. Mexicans are the largest minority in most US states. The Pew Hispanic Center has estimated that around 12 million Mexican born people live in the US; nearly 60% are illegal immigrants. In the last US Census Mexican was the number one immigrant population in 32 US states. In Arizona and Texas, Mexican immigrants account for 58% of settlers; in New Mexico, they are about 70% of total foreigners.

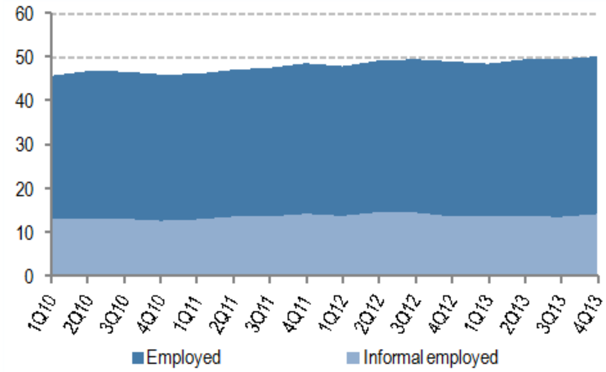
Figure 24: US States Where Mexicans Are Among Top 5 Minorities

Source: CONAPO.

Labor

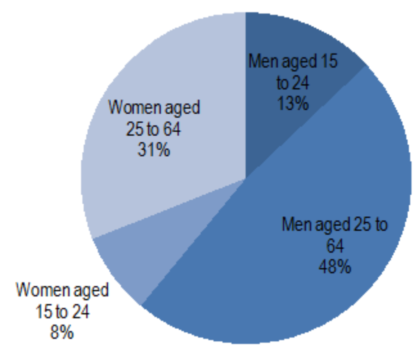
Employment is a major challenge as Mexico reaches its demographic bonus. Total economically active population (EAP) in Mexico is around 52.7 million, implying a participation rate of close to 60%. The Unemployment rate shifted up drastically after the 2008-09 crisis and currently stands at ~5%. According to INEGI's latest data, it is estimated that around 6 out of 10 Mexicans belong to the informal sector; excluding formal workers without adequate social security benefits and household workers, core informality ascends to 30% of the employed population. Around 73% of the not economic active population is women, while 62% of Mexican labor force is concentrated in men.

Figure 25: Employed Population
millions



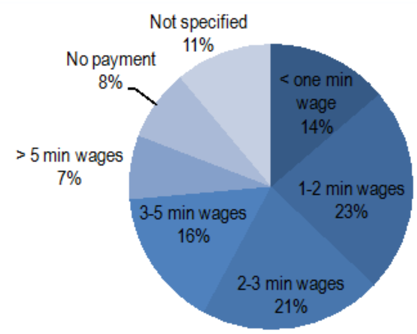
Source: INEGI.

Figure 26: Labor Force Breakdown
% of total labor force



Source: OECD.

Figure 27: Labor by Income
& of total labor force



Source: INEGI.

The increase in informality after the 2008-09 economic crisis, coupled with the stagnant growth in labor productivity, led to deterioration in the composition of labor by income. The share of workers earning more than 5 minimum wages declined to 7.3% in

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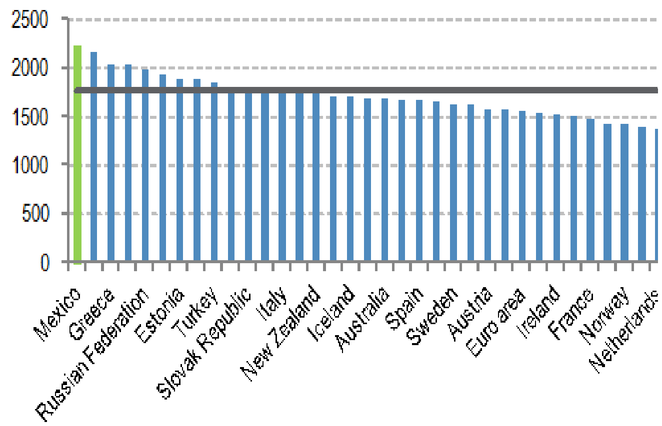
2013 from 8.7% in 2010. Workers earning less than 1 minimum wage increased to 6.9% of the total from 6% in the same period.

In late 2012 outgoing President Calderon sent a Labor Reform proposal to the Congress, the first since 1940. The bill was approved and made effective as of January 1, 2013. The outcome should be positive and seen in a longer-term context, as the main changes include the simplification of hiring and firing terms and linking salaries and promotions to productivity. This should eventually lead to a reduction in informality and an increase in productivity. The World Bank classifies Mexico as one of the 20 most rigid economies out of 144. However, assuming changes related only to facilitating hiring and firing terms are implemented, Mexico's ranking in terms of Employment Rigidity, according to World Banks Doing Business, would improve by an estimated 68 places, slightly ahead of even Chile.

Figure 28: Average Hours Worked per Person



Source: OECD. *Line indicates OECD's average.

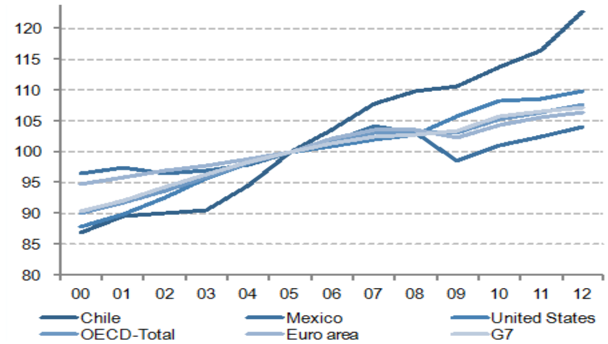
Mexico is the country that works more hours per employee within OECD countries while it has the lowest productivity of all. Mexicans work 2,226 hours every year, the OECD average is 1,769. In one hour of work Mexicans produce 30% of what Americans produce and 70% of what Chileans produce. While unit labor costs have been falling in Mexico, productivity has remained virtually flat. Mexico is lagging the rest of the OECD countries in terms of labor productivity. However, the ambitious reform agenda currently brought forward by the government has as its main goal increasing productivity across the board.

Table 9: Labor Productivity

	Average hours worked per person	GDP per hour worked as % of USA (USA=100)
Mexico	2226	29.9
Korea	2163	45
Chile	2029	42.5
Russia	1982	37.4
USA	1790	100
OECD avg.	1769	72.9
Japan	1745	62.5
Canada	1711	73.8
Spain	1666	78
Sweden	1621	85.3
Germany	1393	90.9
Netherlands	1384	93.8

Source: OECD.

Figure 29: Labor Productivity Index
index, 2005=100

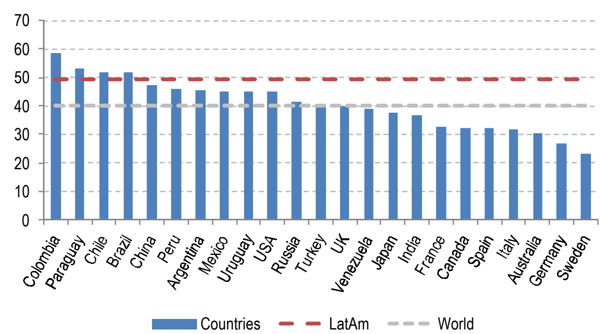


Source: OECD. Data as of 2012.

Wealth Distribution

Mexico has a Gini coefficient of 45.3, below some of its LatAm peers like Colombia, Chile and Brazil. Namibia has the highest (worst) at 70.7 while Sweden the lowest (best) with 23. This index measures the degree of inequality of family income. Perfectly distributed income would gather a score of 0.

Figure 30: Gini Coefficient (Selected Countries



Source: CIA Fact Book, INEGI.

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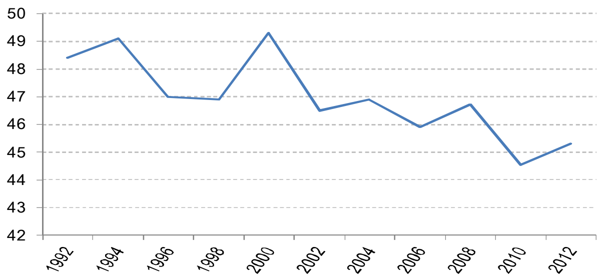
Figure 31: Historical Gini Coefficient



Source: ENIGH, INEGI.

Wealth distribution has improved with household Gini coefficient going from 48.4 in 1992 to 45.3 in 2012. Mexico used to have a Gini coefficient of 53 in 1998. Coupled to this, Labor Poverty Index (measured as the proportion of the population that can´t afford the basic basket with their current labor income) shows growth deceleration from 12.56% yoy in 1Q09 to 2.7% yoy in 4Q13.

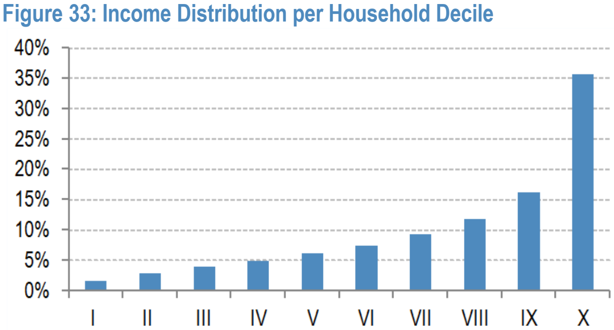
Figure 32: Labor Poverty Index

index points | % yoy

Source: CONEVAL. The index measures the proportion of the population that cannot afford the basic basket with their current labor income.

The tenth decile (wealthiest 10%) holds 35% of total national income while the lowest 10% of population has ~1.6% of Mexico's total income.

Figure 33: Income Distribution per Household Decile



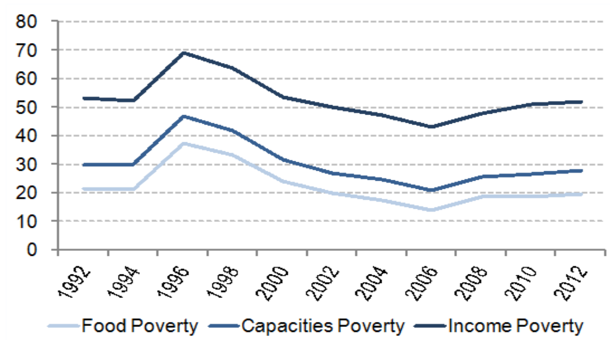
Source: INEGI, ENIGH. Data as of 2012.

INEGI has 3 definitions of poverty: (1) 'Income Poverty,' which is people below the poverty line, (2) 'Capacities Poverty,' which is a subset of the latter and means insufficiency of income to pay for necessary education and health expenses (27% of population), and (3) 'Food Poverty,' which is a subset of capacities poverty and includes people who can't afford the basic shopping basket of food (20% of Mexicans).

Around half of Mexicans live below the national poverty line. **The level of poverty has improved but remains high; during the tequila crisis (1995) poverty levels almost reached 70% of the population.** 60% of the rural population lives in poverty conditions, while 45% of urban Mexicans do so.

Figure 34: Poverty Levels

% of population

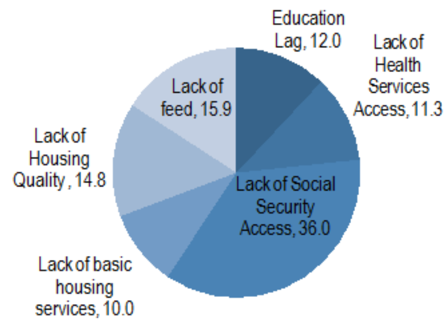


Source: CONEVAL.

According to CONEVAL the **main contributor to poverty intensity is the lack of access to social security**. This agency classifies indicators that cause poverty such as education lag, lack of social security access, lack of feed, etc.

Figure 35: Poverty Measurement: Contribution of Each Social Lacking Indicator

Weight in Lacking Indicator



Source: CONEVAL.

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Protection of the poorest has improved substantially since the 1995 crisis. Gov't spending on social programs (*Desarrollo Social* budget category) is currently more than double in real terms than it was in 1995 at the onset of the 'tequila' crisis. The targeting of poverty-reduction programs has also improved, which has contributed to an improvement in economic conditions.

The **main poverty reduction programs as of 2014 are**:

- The *Oportunidades* program provides means-tested cash transfers to lower-income families conditional on children's regular school attendance and comes with a basic health coverage package.

- The *Apoyo Alimentario* serves as a transition to the Oportunidades program. The program includes food support.

- The *Desarrollo de Zonas Prioritarias* program focuses on the improving living housing conditions in outcast municipalities. The program includes transfers to address basic services infrastructure development.

- The *Procampo* program, which was introduced in 1993 to compensate farmers with cash subsidies for the elimination of input subsidies, was shifted to the *Proagro* program under Peña Nieto's administration. The program intends to foster physical, human and technological investment, post harvest management, efficient use of energy, and sustainable use of natural resources.

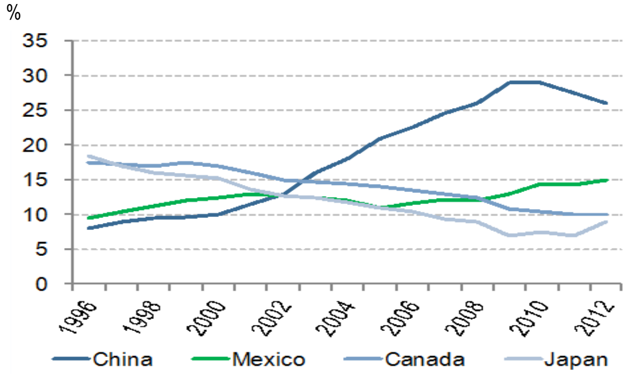
Despite federal programs targeted at reducing poverty, safety nets for the moderately poor remain limited. On March 18 the Lower House approved an amendment to the Social Security Law to create unemployment insurance (originally presented in Sept. 2013). The insurance will be funded from mandatory contributions the employer makes to the workers' Housing Credit & Retirement Account, currently at 5%. The insurance will cover for 6 months of unemployment activity at 50% of the base salary for the first month, 50% for the second month and 40% for the subsequent months.

Competitiveness

Mexico ranks 55th out of 148 countries in the 2013-14 World Economic Forum (WEF) Global Competitiveness Index, dropping from 53rd place last year and improving from 66th in 2011. WEF measures competitiveness among countries using 12 pillars or indicators such as competitiveness in institutions, infrastructure, goods market efficiency, and financial market development.

Stable wage growth has been one of the main drivers behind Mexico's sustained improvement in competitiveness rankings, particularly wages in the manufacturing sector. Manufacturing is one of the main drivers for the Mexican economy, representing c.75% of FDI as of 4Q13 and c.80% of total exports. China is the Mexico's main competitor in the manufacturing industry, mostly for market share in USA's manufacturing imports.

Figure 36: Share of US Manufacturing Imports by Origin

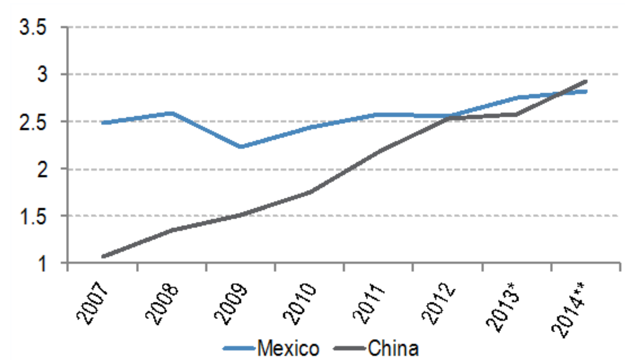


Source: IMF.

The gap between Mexico and China's manufacturing wages is closing. Higher wages in China have led to lower inequality (measured by Gini coefficient); therefore, down revisions in China's manufacturing wages are unlikely to happen. This should further foster Mexico's competitiveness in the sector.

Figure 37: Wages in the Manufacturing Sector

US$ per hour



Source: INEGI, J.P.Morgan. Data for China is adjusted to 50 work hours per week. *2013 data for China is preliminary, based on the 3Q13 annualized data. **J.P.Morgan estimates based on average wage annualized growth rates.

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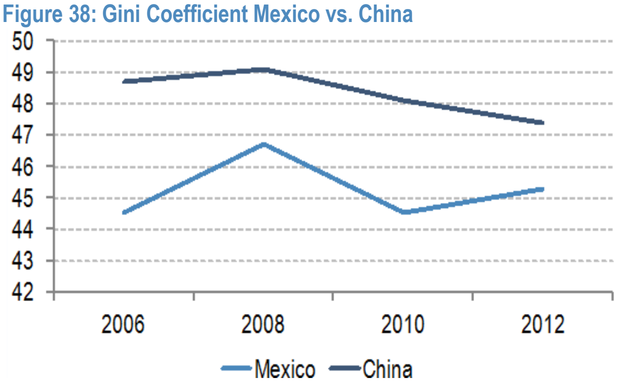
Figure 38: Gini Coefficient Mexico vs. China

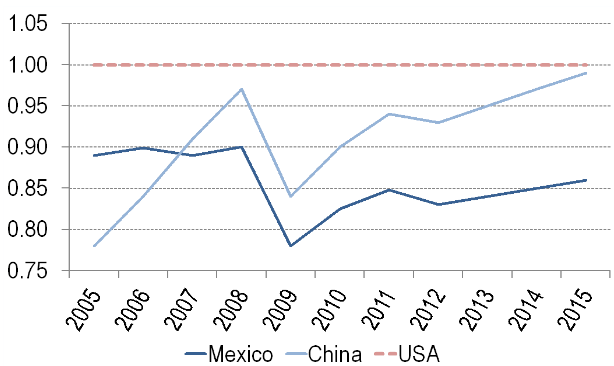


Source: INEGI, NBS.

According to Alix partners, **Mexico will continue to be a more attractive place for the US to outsource than China.** Manufacturing production costs in Mexico during 2013 represent c.84% of US costs, while China's were nearly at 95%.

Figure 39: Alix Partners Manufacturing-Sourcing Cost Index

% of US costs

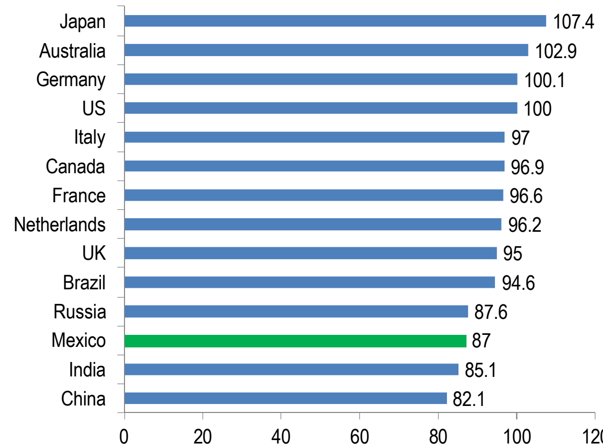


Source: Alix Partners.

Mexico is among the cheapest countries for car production globally. This has led Mexico to be the 8th largest car producer in the world. Considering that auto and auto parts represent Mexico's third-largest export (20% of total), competitiveness in the car industry is key for Mexico's economic development.

Figure 40: Auto Parts Manufacturing Cost Index

EUA = 100

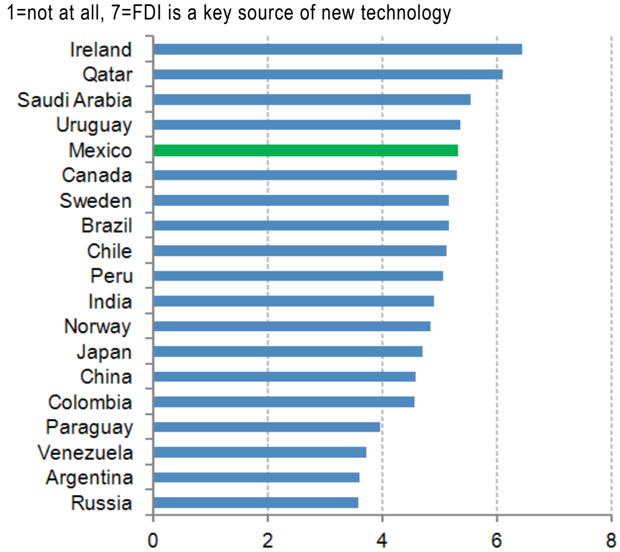


Source: Competitive Alternatives, KPMG's guide to international bussines locations, 2012 Edition, ProMexico.

Mexico's competitive advantages in the manufacturing industry have led to significant FDI for the sector. According to WEF the majority of foreign direct investment that Mexico receives goes to new technology. Mexico ranks better than its LatAm peers and countries like Sweden, China, India and the US.

Figure 41: FDI and Technology Transfer Index – To What Extent Does FDI Bring New Technology into Each Country?

1=not at all, 7=FDI is a key source of new technology



Source: OECD.

In WEF's Competitiveness Report for 2013-14, 20% of the answers on the most problematic factors for doing business in Mexico were related to crime, theft and corruption.

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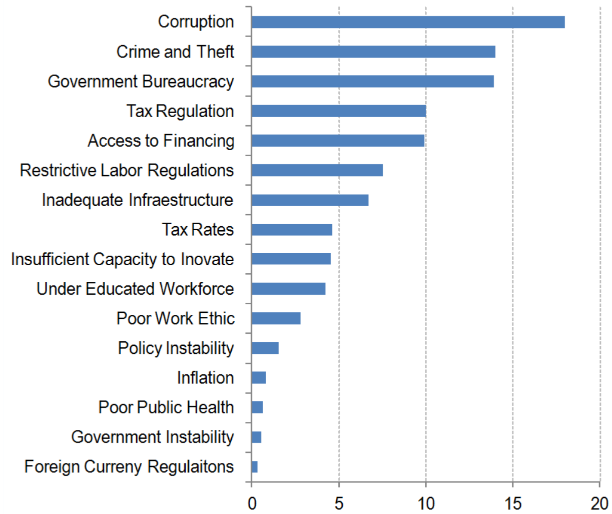
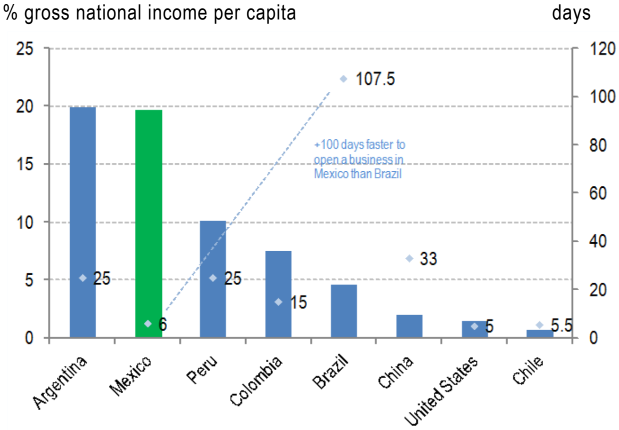
Figure 42: Most Problematic Factor for Doing Business in Mexico
% of responses



Source: WEF, Global Competitiveness Report 2013-2014.

In terms of days required to open a business, Mexico improved from 58 in 2003 to 6 in 2013. It is better ranked than Brazil (107 days) and the OECD's average (12days). Yet, **the cost to start a business in Mexico in 2013 was 19% of national per capita income.** In Brazil and Chile it costs ~4%, and in China ~2%.

Figure 43: Cost and Time to Open a New Business
% gross national income per capita days



Source: World Bank as of 2013.

Security

According to the Institute for Economics and Peace (IEP), **Mexico is the second least peaceful country in Latin America (only outranked by Colombia) as the economic impact of violence reached 27.7% of Mexico's GDP in 2012**. In worldwide terms, Mexico is ranked in 133rd place, out of 162, on the state of peace.

Guerrero, Morelos and Sinaloa stand as the states with the higher homicide rate.

Table 10: Mexico Peace Index 2013: Most and Least Peaceful States
5 - Worst grade

Most Peaceful States		
Rank	State	Score
1	Campeche	1.47
2	Querétaro	1.69
3	Hidalgo	1.87
4	Yucatán	1.87
5	Baja California Sur	2.12

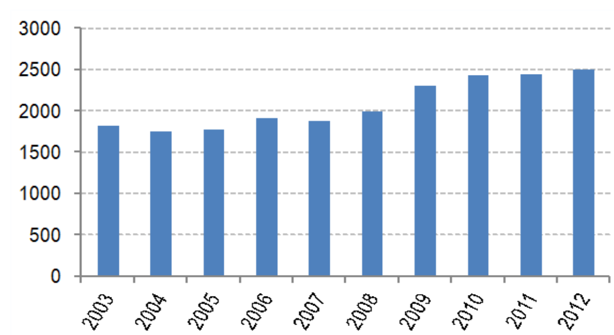
Least Peaceful States		
Rank	State	Score
28	Quintana Roo	3.44
29	Chihuahua	3.51
30	Sinaloa	3.7
31	Guerrero	3.82
32	Morelos	4.15

Source: IEP

Over the past years, the increase in violence in Mexico hasn't been a secret due to government efforts to stop organized crime, mainly in the northern states of the country.

Since 2003, the direct and indirect violence containment expenditures have increased by 73%, going from Mx$1,816 billion to Mx$2,499 billion in 2012. The increase in the cost of violence containment is tightly related to former President Calderón's policy of a declared war against drug lords and organized crime. For the same reason, Federal Police forces increased importantly, almost tripling in the first 5 years of the Calderón Administration. One of the biggest promises of Enrique Peña Nieto in his presidential campaign was to stop violence in the country and put an end to the war with the drug lords, focusing instead on education and providing social services to reconstruct the social fiber of the country.

Figure 44: Direct and Indirect Violence Containment Expenditures
Mx$ in billion



Source: IEP.

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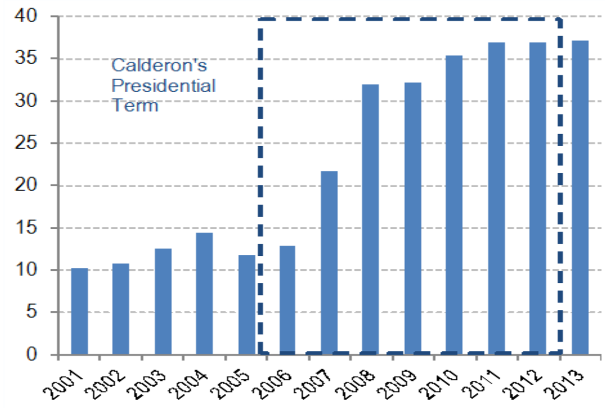
Figure 45: Evolution of Federal Police Force

thousand policemen

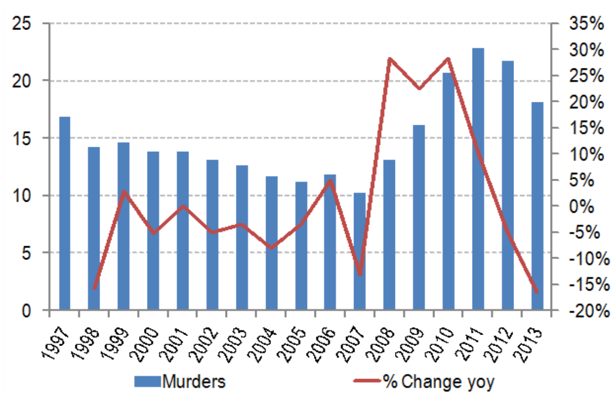


Source: INEGI.

In 2013, the number of murders fell for the second year in a row to 18,147 after a record high of 22,853 murders in 2011. 2007 was the year with lowest number of murders at 10,253.

Figure 46: Number of Murders per Year in Mexico

thousand murders

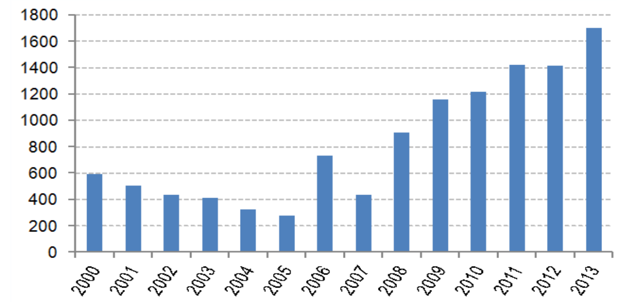


Source: INEGI.

Nevertheless, the number of kidnaps continues to grow in Mexico year over year. Kidnappings in Mexico have been growing at a 25% CAGR since 2007, reaching 1,702 reported kidnaps in 2013. It's estimated that this figure might be a lot higher as many of the crimes that are perpetrated in Mexico are not reported.

Figure 47: Increasing Number of Kidnaps in Mexico

number of kidnaps per year

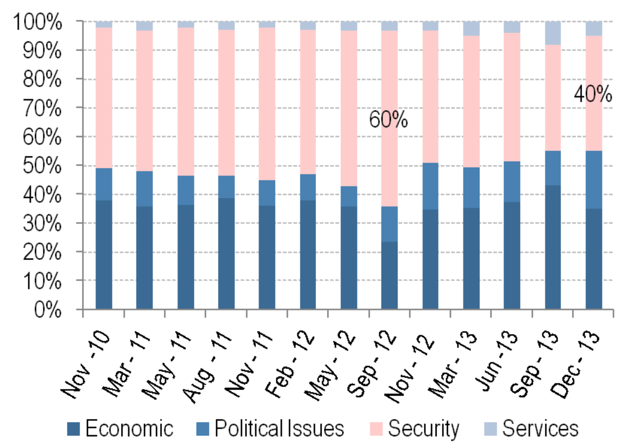


Source: INEGI.

According to a survey done by ISA, **concerns about security within Mexico decreased in 2013**, with only 40% of people interviewed considering insecurity as Mexico's greatest problem. In 2012, 45% of the people surveyed declared being directly affected by narcotics. In 2013 this proportion decreased to 20%. The economy, on the other hand, was more recurrently mentioned as one of the country's biggest problems, with responses increasing from 23% in 2012 to 35%. The amount of respondents claiming lack of adequate services as Mexico's biggest problem also increased slightly.

Figure 48: Mexico's Greatest Problem

% of surveyed people



Source: ISA-GEA.

The federal government hasn't stopped its efforts to stop organized crime. In February of 2014, Joaquin "El Chapo" Guzman, the world's most-wanted drug lord, was captured in Sinaloa, Mexico.

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Economy

Mexico is the second-largest economy in Latin America and the 14th in the world. It has been quite an open economy since 1996, when NAFTA – signed back in 1993 – really kicked in. This, combined with Mexico's strategic geographical location, has made the economy strongly dependent on US business cycles. In particular, manufacturing activity in Mexico is tightly linked to the US.

Table 11: Top 15 Countries in the World, Ranked by GDP

	Nominal GDP, US$ bn	Population mn	Nominal GDP per capita, $[1]
United States	16,724	317	52,839
China	8,939	1,361	9,828
Japan	5,007	127	37,135
Germany	3,593	82	39,468
France	2,739	64	35,680
United Kingdom	2,490	64	37,299
Brazil	2,190	200	12,118
Russia	2,118	141	18,083
Italy	2,068	61	29,598
Canada	1,825	35	43,146
India	1,758	1,243	3,991
Australia	1,488	23	43,042
Spain	1,356	46	30,128
Mexico	1,327	118	15,608
Korea	1,198	50	33,156

Source: IMF. Estimate values for 2013. 1. PPP-adjusted values.

The Mexican economy is focused on the services sector, which in 2013 made up 61% of GDP. The services sector employs 30.7 million people, accounting for 62.0% of the country's employed workforce.

In turn, the **industrial sector represents slightly less than 34% of Mexican GDP**. This proportion has been relatively stable since the 1980s. As of 2013, manufacturing is the most important industry in this sector, making up around 17% of total GDP, followed by construction (7.4%), mining (7.5%) and electricity, gas and water (2.2%). The industrial sector employs 11.8 million individuals, accounting for 23.8% of total employed individuals.

The **primary sector is a small part of the Mexican economy**, representing around 5% of GDP historically. It employs around 6.8 million people, 13.6% of the country's employed workforce.

Table 12: Supply-Side GDP Breakdown

	% Services	% GDP
Services	**- -**	**60.8**
Commerce/Trade	25.2	15.3
Real Estate	19.8	12.0
Transport, mail and storage	9.5	5.8
Financial Services and Insurance	7.2	4.4
Educational services	6.1	3.7
Government	6.1	3.7
Media	5.6	3.4
Managing & remediation of tailing	5.3	3.2
Professional, scientific & tech	3.5	2.1
Accommodation & food services	3.4	2.1
Other services ex government	3.4	2.0
Health & social services	3.3	2.0
Corporate services	0.9	0.6
Recreation & cultural services	0.7	0.4
IP	**- -**	**33.6**
Manufacturing	- -	16.6
Non-manufacturing	- -	17.1
Construction	- -	7.4
Mining	- -	7.5
Oil & gas	- -	6.1
Utilities	- -	2.2
Agriculture	**- -**	**3.0**

Source: INEGI. Data as of December 2013.

Mexico is a consumption-driven economy, with private and government consumption making up 79% of GDP – private 68% and government 11%. Gross fixed capital formation makes up 22% of GDP, and this share has been increasing since 1995, when it made up around 14%. The successful implementation of structural reforms should allow for an additional increase in investment's share of GDP.

Mexico's external sector is especially linked to the US economy, which accounts for almost 79% of Mexico's total exports. This share has declined from a peak of more than 90% in the late 1990s. Most exported items to the US are electric machinery and transport vehicles. Mexico is a country with one of the highest number of free trade agreements worldwide. The country also enjoys an enviable geographic position relative to the world's largest economy and relative to other trade-oriented economies.

Mexican imports are more diverse (on a geographical basis) than exports. US imports to Mexico make up around 49% of total imports, a share that has been decreasing from 75% back in year 2000. In contrast, imports from China have been gaining ground, going from less than 2% in 2000 to 16% nowadays. On a product basis, Mexican imports are focused on electrical and mechanical machinery mainly, which made up 38% of total imports last year. We note Mexican imports are highly concentrated in intermediate goods – mainly used in the manufacturing industry – which account for 75% of total imports.

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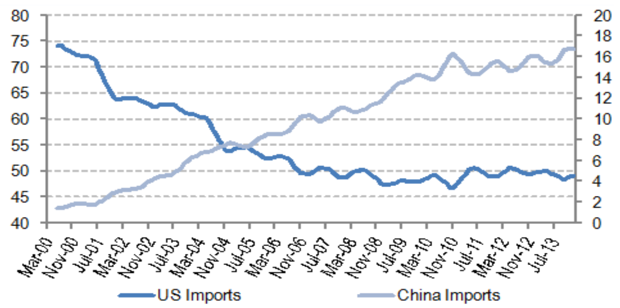
Figure 49: Imports form US & China
% of total imports, 6mma



Source: INEGI.

Table 13: Economic Summary

	Avg 07-11	2012	2013	2014F	2015F
Real GDP, Mx$ Bn	12,214	13,264	13,405	13,820	14,345
Nominal GDP, $ Bn	1,052	1,185	1,243	1,326	1,492
GDP per capita - $	9,385	10,213	10,592	11,193	12,464
Real GDP, % change	1.8	3.9	1.1	3.1	3.8
Contribution to GDP growth					
Consumption	1.3	3.5	1.8	2.0	2.6
Investment	0.4	0.3	-0.8	1.3	1.3
Net trade	-0.1	0.2	0.1	-0.1	-0.1
Consumer prices, %oya	4.5	4.1	3.8	4.1	3.0
% Dec/Dec	4.6	3.6	4.0	4.1	3.1
Producer prices, %oya	5.3	4.7	1.1	4.5	4.9
Gov balance, % of GDP	-1.5	-2.6	-2.3	-3.5	-3.0
Industrial prod., %oya	0.3	2.6	-0.7	2.7	3.4
Unemployment rate, %	4.8	5.0	4.9	4.6	4.2
Exchange rate, units/$, eop	12.78	12.85	13.04	12.80	12.10
Trade balance ($ bn)	-7.3	0.0	-1.0	-5.0	-7.7
Exports	288.2	370.7	380.2	405.7	448.8
Imports	295.5	370.8	381.2	410.7	456.6
Current account balance	-8.3	-5.6	-3.5	-6.3	-6.3
% of GDP	-0.8	-0.5	-1.8	-1.8	-1.7
Int. reserves, ($ bn)	102.1	162.6	176.6	186.6	194.1
Total ext debt, ($ bn)	194.6	191.3	221.0	230.9	237.8
Short term[1]	39.0	38.6	39.4	39.3	39.2
Total ext debt, % of GDP	18.3	16.1	16.6	17.0	15.7
Total ext debt, % of exp[2]	57.1	45.4	47.9	49.1	46.4
Interest payments, % exp	4.7	4.8	5.1	4.5	4.3

Source: J.P. Morgan. 1.Debt with original maturity of less than one year. 2. Exports of goods, services, and net transfers.

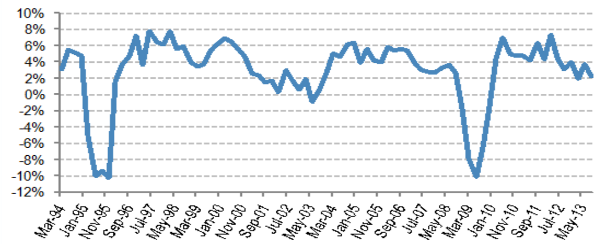
Domestic Demand

Consumption

The Mexican consumer was significantly affected by the global financial crisis of 2008/2009 as evidenced by the double-digit fall in real private consumption, a drop only comparable with the aftermath of the 1994-95 'tequila crisis.' Consumption has steadily recovered since then. However, weak growth momentum and employment moderation led to soft consumption dynamics last year. We expect employment growth in 2014 to provide a boost to private consumption.

Nevertheless, higher taxes and transitorily high inflation are likely to keep consumption from significantly expanding this year.

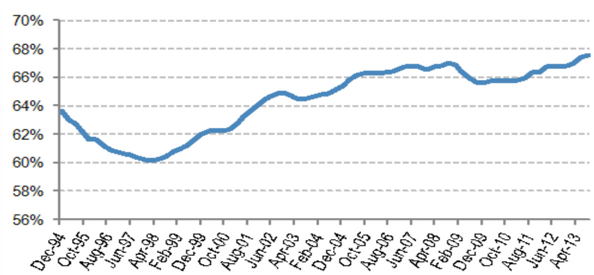
Figure 50: Real Private Consumption
%oya



Source: INEGI.

Private consumption accounted for 86% of total consumption in 2013, same as it did during 2012 and 2011. In terms of its share in GDP, private consumption has been flattening at around 68% in the past years, coming from lows of nearly 64% following the 1994-95 'tequila crisis.' Government consumption, on the other hand, accounts for around 11% of Mexican GDP, and its share has been virtually unchanged since the late 1990s.

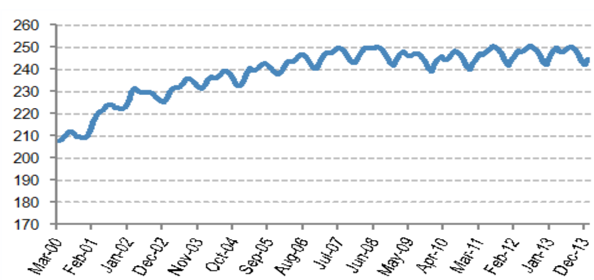
Figure 51: Private Consumption
as % of GDP, 4mma



Source: INEGI.

Average wage per employee has been fairly stable over the past decade, after recovering from the 'tequila crisis.'

Figure 52: Real Average Wage per Employee
MXN of 2010, 3mma



Source: INEGI.

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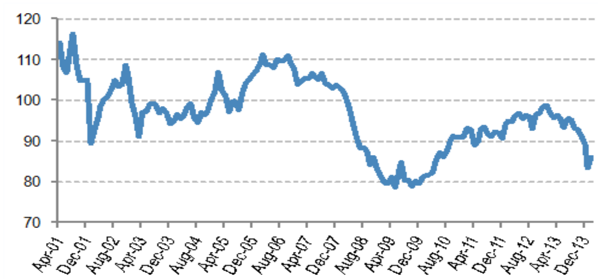
Consumer confidence is usually a reliable indicator of consumer spending in Mexico. Confidence had maintained an ascending trend in the years following 2009 as improving growth and employment conditions translated into an increase in disposable income. However, deceleration in growth in 2013, coupled with the imposition of higher taxes early this year, has significantly depressed consumer sentiment. We expect confidence to rebound later this year as tax effects fade and the economy gradually gathers strength.

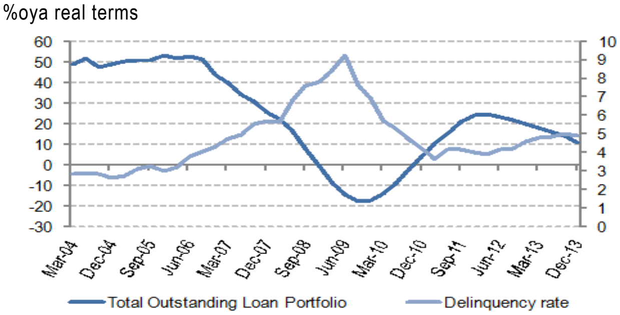
Figure 53: Consumer Confidence
index, sa



Source: INEGI.

Consumer credit growth is likely to stabilize at lower levels this year. Having steadily grown at a 15% annual pace in the three years through 2013, consumer credit has softened lately. Delinquency rates are moderate, while interest rates are running close to historical lows, two factors that should allow for a continued expansion in the sector. However, slack conditions in the labor market have led to a reduction in credit demand since the second half of 2013. On the other hand, credit expansion seems to be starting to stabilize at its natural growth rate after aggressively rebounding from the lows reached in 2008. The gradual recovery of the economy this year, coupled with the implementation of a financial reform aiming to boost credit will allow for higher credit growth rates. However, we do not see this taking place in the very short term.

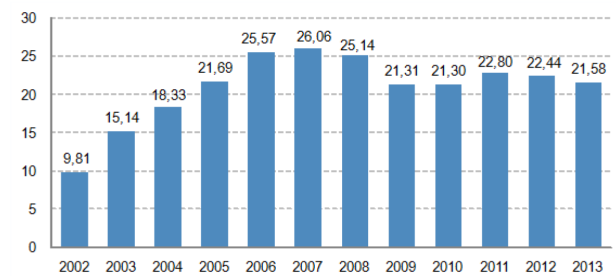
Figure 54: Credit Card Cycle
%oya real terms



Source: Banxico.

Even though family remittances represent slightly less than 2% of GDP, they are an important source of revenue for low-income families. Having persistently expanded in the years prior to the 2008 financial crisis, remittances have flattened around $22 billion over the past half decade. Such dynamics seem largely explained by the incipient recovery in the US economy, which has led to a partial reversion in migratory patterns, therefore limiting remittances growth. We would expect remittances to rise in coming years on the back of improving labor conditions in the US (see Remittances section above).

Figure 55: Yearly Remittances
US$bn



Source: Banxico.

Remittances are especially important for the poorest. According to Consulta Mitofsky, 51.2% of remittances go to basic needs such as food and rent, 10.9% to paying debts and 5.3% to other items related to consumption. Just 32.6% is allocated to investing, and from that, 20% to buying land or agricultural tools, 5.3% to buying houses, 4.6% to starting businesses and 2.7% to financing education.

Table 14: Consumer Spending Breakdown (% Total Consumption)

Items	%
Food, Beverages and Tobacco	25.99
Housing expenses, electricity and gas	20.40
Transportation expenses	19.04
Others	8.64
Education and entertainment	6.07
Cleaning products and furniture	5.34
Health care	4.05
Hotels and restauranys	4.03
Communication	3.45

Source: INEGI and J.P. Morgan estimates. Data as of 2010.

Consumption is highly concentrated. Spending allocation in Mexico among deciles shows that 30% of household total spending corresponds to the wealthiest 10% of households, while the wealthiest 30% accounts for nearly 60% of total spending. The bottom 20% accounts for less than 10% of total consumption.

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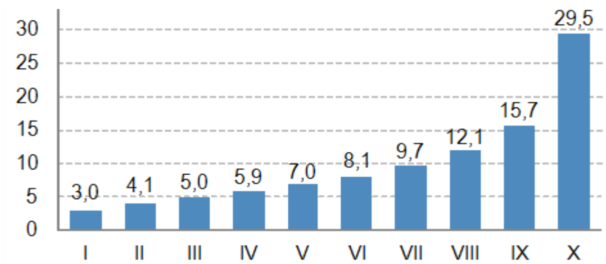
Figure 56: Total Spendig by Decile

% of total



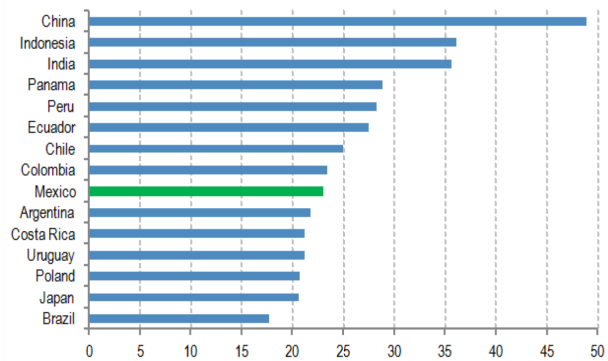
Source: INEGI.

Investment

Mexico's gross fixed investment/GDP is around 22%, slightly above both the world's average (19.2%) and developed markets such as the US (19.0%). However, it is only midtable amongst other major EM economies.

Figure 57: Comparative Investment Spending

GFI as % of GDP

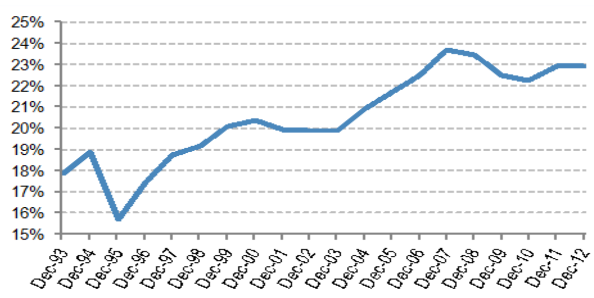


Source: World Bank. Data as of 2012.

Investment fell to a low of ~15%/GDP during the 'tequila crisis' but has steadily recovered since then to the current 22% levels, posting only a relatively minor fall at the beginning of last decade, as well as during the financial crisis of 2008-09.

Figure 58: Gross Fixed Investment

as % of GDP

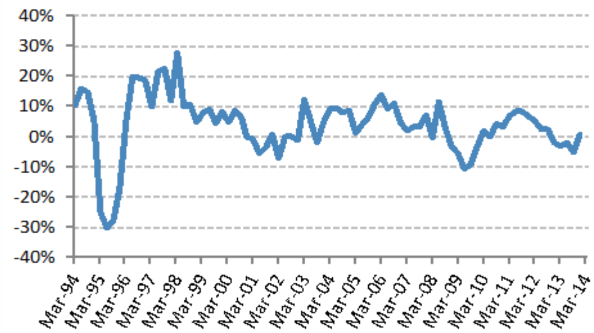


Source: INEGI.

While consumption held up moderately well last year (amid overall growth deceleration), investment posted its largest decline since 2009, falling around 2%oya. The drop was largely explained by a collapse in residential construction spending due to the near-bankruptcy of some of the main homebuilders in the country. This was further exacerbated by fiscal tightening, which led to a sizeable drop in public investment. The contraction in investment was accompanied by a sharp downshift in capacity utilization in the manufacturing sector.

Figure 59: Real Gross Fixed Investment

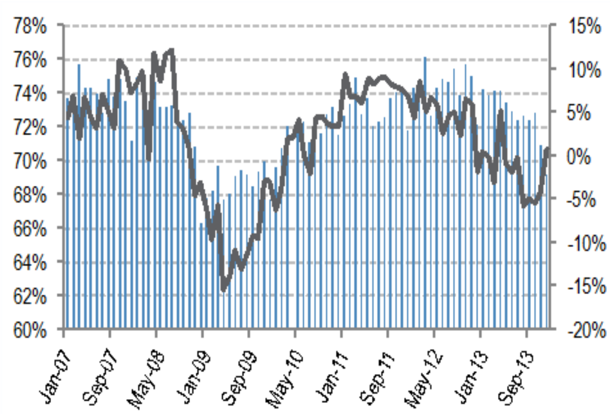
% oya



Source: INEGI.

Figure 60: Capacity Utilization in Manufacturing

% %oya



Source: Banxico, INEGI.

While we do not expect residential investment to recover soon, we do not expect it to deteriorate further. Meanwhile, **public spending should provide an important boost to public construction,** which we expect to grow at a two-digit pace this year. Altogether, this should help investment expand at a near-6% pace this year.

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In addition to larger construction spending, investment in the auto industry should remain supportive in 2014. As it has been the case in the last half decade, the automotive sector should continue to attract investment—foreign and national—as competitive gains bolster the share of the sector in the manufacturing industry. Large automakers have either announced the expansion of their production capacity in the next few years, or are already in the process of doing so.

Table 15: Automotive Companies' Announced Investments

	Announced date	US$, mn	State
Chrysler	1Q09	300	Coahuila
GM	3Q09	300	San Luis Potosi
Ford	4Q09	600	Chihuahua
Ford	4Q09	1,000	Cuatitlán
Chrysler	1Q10	550	Toluca
Volkswagen	1Q10	1,000	Puebla
Nissan	2Q10	600	Toluca
Mazda	4Q10	500	Guanajuato
Volkswagen	4Q10	550	Guanajuato
Toyota	4Q10	150	Coahuila
GM	1Q11	300	San Luis Potosí
Honda	2Q11	800	Guanajuato
Nissan	3Q11	330	Aguascalientes
Daimler & Chrysler	4Q11	1,000	- -
Audi	1Q12	2,000	Puebla
Nissan	1Q12	2,000	Aguascalientes
Hella	1Q12	100	Guanajuato
Magna International	1Q12	100	San Luis Potosí
Pirelli	2Q12	400	Guanajuato
Tachi-S	2Q12	32	Guanajuato
Nippon Steel	3Q12	39	Guanajuato
Hyundai	3Q12	131	Baja California
Hitachi Automotive Systems	4Q12	100	Querétaro
Mazda	1Q13	650	Guanajuato
BMW	1Q13	500	- -
Fiat	1Q13	1,000	Coahuila
Honda	2Q13	470	Guanajuato
Audi	2Q13	1,300	Puebla
GM	2Q13	691	Guanajuato
Chrysler	3Q13	160	Coahuila
Nissan	3Q13	57	Aguascalientes
Mazda	3Q13	120	Guanajuato
Chrysler	4Q13	1,249	Coahuila
Volkswagen	1Q14	700	Puebla

Source: J.P. Morgan, ProMexico.

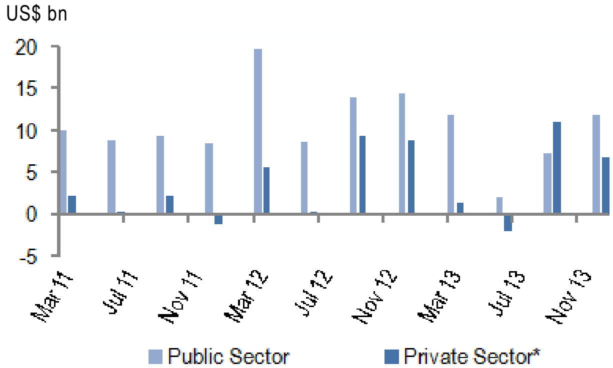
External Accounts

Mexico's current account deficit is expected to remain close to last year's levels. The deficit is expected to remain well financed by foreign direct investment and portfolio flows, but global jitters on the back of the start of the Fed's tapering are expected to create some uncertainty regarding the magnitude of portfolio inflows. While the current account deficit stood at $22 billion, the financial account posted a healthy surplus of $58.8 billion last year. Regarding FDI, this year we are expecting $25 billion of inflows, below last year's strong inflow of $37 billion which included $15 billion related to the Modelo acquisition by a Belgium brewery.

Even with the current account deficit expected to stay close to 2% of GDP, increasingly strong FDI flows should more than offset the persistently negative CA balance. Furthermore, capital flows should yield a net positive balance by the end of the year in spite of the diminished appetite for emerging market assets. The compelling story of economic reforms is expected to remain supportive of portfolio inflows in both equity and government debt markets.

Portfolio flows declined to $48.3 billion in 2013 from a historical high of $72.9 billion in the previous year on the back of monetary policy rotation in the U.S. towards less accommodation, which affected mainly stock market inflows. While private sector inflows to the stock market declined $942 mn after a solid inward flow of $10 bn in 2012, public sector flows reached $33.2 bn.

Figure 61: Portfolio Investment by Sector



Source: Banxico. *Includes investment in private equity and fixed income markets.

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Table 16: Balance of Payments and Components

$ in million

	2013	2012	2011	2010
Current account	-22,333	-14,767	-9,671	-1,949
Financial account	58,782	51,021	49,159	42,417
Direct Investment	25,221	-5,247	9,365	6,327
In Mexico (FDI)	35,188	17,224	21,504	21,372
From Mexican abroad	-9,968	-22,470	-12,139	-15,045
Portfolio investments	48,266	72,856	45,946	31,432
Liabilities	50,360	81,349	40,622	37,335
Public sector	33,156	56,869	36,975	28,096
Fixed-income market	21,973	46,643	31,650	23,126
Other	11,184	10,226	5,326	4,970
Private sector	17,204	24,480	3,647	9,239
Stock market	-942	10,035	-6,564	374
Other	18,146	14,446	10,211	8,865
Assets	-2,094	-8,494	5,324	-5,903
Other investments	-14,704	-16,588	-6,151	4,657
Liabilities	12,535	-10,314	-2,478	31,662
Public sector	-2,553	-1,432	302	5,478
Development banks	398	397	-283	648
Private sector	15,088	-8,882	-2,780	26,184
Assets	-27,239	-6,274	-3,674	-27,005
Errors and omissions	-18,661	-18,730	-11,308	-19,853
Change in reserves	13,150	17,841	28,621	20,695
Value adjustments	4,639	-317	-441	-79

Source: Banco de México.

Since the NAFTA was enacted back in 1994, Mexico has significantly expanded its free trade agreements with the rest of the world, including the EU in 2000 and Japan in 2005. The most recent free-trade agreement signed by the country was with Peru in April 2011.

Table 17: Mexico's Signed Free-Trade Agreements

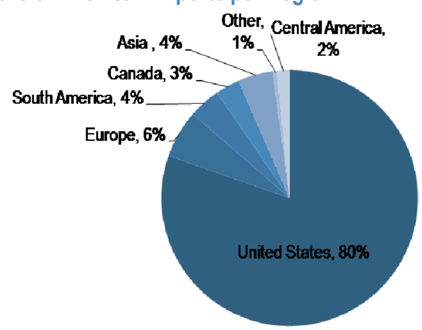
	Agreement	Partners:	Official Start Date:
1	NAFTA	US and Canada	1-Jan-94
2	TLC - G3	Colombia*	1-Jan-95
3	TLC - Mexico-Costa Rica	Costa Rica	1-Jan-95
4	TLC - Mexico-Bolivia	Bolivia	1-Jan-95
5	TLC - Mexico-Nicaragua	Nicaragua	1-Jul-98
6	TLC - Mexico-Chile	Chile	1-Aug-99
7	EUFTA	European Union	1-Jul-00
8	FTA - Mexico - Israel	Israel	1-Jul-00
9	TLC - Triángulo del Norte	El Salvador, Guatemala, Honduras**	15-Mar-01
10	FTA - European Free Trade Association	Iceland, Norway, Liechtenstein, and Switzerland	1-Jul-01
11	TLC - Mexico-Uruguay	Uruguay	15-Jul-04
12	FTA - Mexico-Japan	Japan	1-Apr-05
13	TLC - Mexico-Peru	Peru	30-Jan-12

Source: Ministry of Economics. *Venezuela was part of the agreement from January 2005 to November 2006. **Free trade agreement with Honduras started on June 1st, 2001.

Exports

As a percentage of GDP, exports have risen from 11% in 1993 just before the implementation of NAFTA, to an average of 30% of GDP in the past five years. In turn, manufactured goods' share in total exports has risen from an average of 37% of the total in the 1980s to over 80% in the past five years. It is worth noting that, despite Mexico's extensive network of free-trade agreements (FTAs cover 80% of the world economy) close to 80% of exports is shipped to the US. This percentage has gradually decreased over the past decade, as it went from nearly 89% in 2000 to 80% in January of 2014, as Mexico has diversified its export destinations – particularly to Europe and Latin America. The remaining 20% of Mexico's exports is well diversified among non-U.S. Americas (9.2%), Europe (6.0%) and Asia (4.4%). While the U.S. is the main export destination, Mexico is the third most important supplier of the U.S. after China (19.4%) and Canada (14.6%). Mexico supplies 12.4% of total U.S. imports.

Figure 62: Mexican Exports per Region



Source: Banxico. Data for 2013.

Mexico's exports-to-GDP ratio of nearly 33% is among the highest in Latin America, followed by Chile (32%) and well above the region's major economy, Brazil (10%).

Table 18: Exports Profile

% of total exports

	Total Exports (% GDP)	Commodity Exports	Exports to: US	EU	China
Argentina	18.6	76.0	5.0	17.0	7.7
Brazil	9.7	58.5	10.9	19.4	17.8
Chile	31.9	65.6	10.9	17.5	22.7
Colombia	13.8	85.8	36.2	14.9	5.5
Ecuador	13.8	86.0	45.2	14.6	1.7
Mexico	**33.0**	**18.6**	**77.6**	**5.9**	**1.6**
Peru	23.1	89.4	14.7	17.3	16.8
Uruguay	18.0	61.0	3.7	11.3	7.8
Venezuela	28.4	98.0	48.0	5.0	12.7
Latin America	**17.9**	**57.1**	**29.3**	**13.9**	**11.9**

Source: J.P. Morgan. Data as of 2012.

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Mexico's major exports are electrical goods (38%), cars/auto parts (17%) and oil (12%). Together they account for 67% of total exports.

Table 19: Mexican Exports Breakdown

Category	$ mn	% of Total
Electric machinery and other industries machinery	142,571	38%
Transport equipments, road vehicles	80,740	21%
Auto/Autoparts	76,038	20%
Mining	53,226	14%
Crude Oil	45,204	12%
Iron, steel and manufactures of those metals	17,185	5%
Medical machinery	13,193	3%
Pearls, precious and semiprecious stones	11,406	3%
Chemicals and related products	10,645	3%
Beverages, alcohol and tobacco	9,885	3%
Vegetables, fruits, cereals, coffee and others	9,505	3%
Miscellaneous manufactured articles	7,414	2%
Plastics	7,984	2%
Textiles, footwear, umbrellas and others	8,364	2%
Others	9,885	3%
Total exports	**380,189**	**100%**

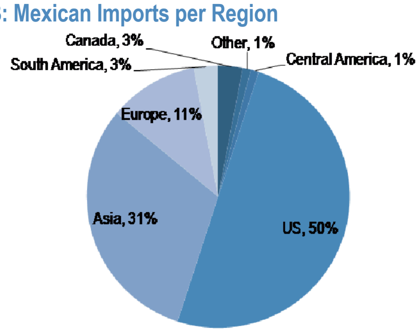
Source: Banxico, Data for 2013.

Imports

Just as exports, Mexican imports have risen significantly since 1994, when NAFTA was implemented. Since then, share of imports in GDP has gone from 14% to 32%**.** Although it is undeniable that commercial activity has been most active with the US than with any other country, the share of US imports of total imports (50%) is considerably lower than its share of total exports (80%).

Other relevant import partners are Asia, which accounts for 31% of total imports, and Europe, with an 11% share in total imports. Non-U.S. imports from the Americas account for 6.6% of total imports.

Figure 63: Mexican Imports per Region



Source: Banxico. 2013 average share.

Out of the 31% of Asian imports nearly half of it comes from China, a country that represents around 15% of Mexico's imports. China's share of total imports has not always been that important. In fact, back in 2000, when China was not yet in the WTO, imports coming from China accounted for less than 2% of the total. From a product perspective, last year Mexico imported mostly electrical machinery (39%) followed by transport equipment and road vehicles (9%) and mining (8%).

Table 20: Mexican Imports Breakdown

Category	US$ mn	% Total
Electric machinery and other industries machinery	148,672	39%
Chemicals and related products	29,734	8%
Transport equipments, road vehicles	34,881	9%
Iron, steel and manufactures of those metals	31,640	8%
Mining	32,022	8%
Fuels	30,497	8%
Plastics	27,447	7%
Medical machinery	13,342	4%
Vegetables, fruits, cereals, coffee and others	10,293	3%
Textiles, footwear, umbrellas and others	11,055	3%
Paper, paper pulp and others	8,387	2%
Beverages, alcohol and tobacco	7,243	2%
Miscellaneous manufactured articles	6,481	2%
Non-classified articles	7,243	2%
Others	13,250	3%
Total imports	**381,210**	**100%**

Source: INEGI and J.P. Morgan. Data for 2013.

The Central Bank

Mexico's Central Bank was founded in 1925. However, Banco de México did not become an independent institution until 1994. In sync with Banco de México's autonomy, the monetary authority adopted '*el corto'* (used to implement monetary policy through a signal based on monetary targeting to short or absorb liquidity in the interbank money market) as its monetary instrument.

Later on, in 2001, Banco de México officially implemented its inflation target level of 3%. Finally, in early 2005, Banco de México adopted the policy rate target (the O/N rate, or *tasa de fondeo*) as its main monetary policy instrument; *el corto* was officially discontinued on January 21, 2008.

The Central Bank's board is formed by its governor and four deputy-governors. The Central Bank governor is appointed for a six-year term by the president, and is subject to Senate approval. Deputy-governors are elected for eight-year periods. The current governor, **Dr. Agustín Carstens**, took office in January 2010, and was previously Mexico's Minister of Finance, Undersecretary of Finance, and Deputy Managing Director of the IMF. Mr. Carstens replaced two-term governor, Guillermo Ortiz.

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A renewed central bank. With Governor Dr. Agustín Carstens, the central bank has become more transparent and increased the channels of communication with market participants, particularly by releasing details of the discussions leading to the monetary policy decisions (i.e., Minutes). **Banxico cut the reference rate to a historical minimum of 3.5% in October 2013.** It implemented a 50-basis point cut in March, followed by two 25-bp reductions in the September and October meetings, respectively.

Table 21: Banco de México Summary

Objective	Price stability
Strategy	Inflation targeting
Policy instrument	Overnight interest rate
Ticker	MXONBR
Deciding board	Governor and four deputies
Meeting frequency	Two per quarter
Inflation target	3% (+/-1%)

Source: J.P. Morgan.

Table 22: Banco de México's Historical Highlights

Sep 1, 1925	Banco de México founded
Jun 22, 1992	The New Monetary Law (released on June 22, 1992) in which the government decided to "eliminate three zeroes from the peso", giving way to the creation of the 'New Peso' (1,000 Pesos = 1 'Nuevo' Peso)
Apr 1, 1994	Banco de México becomes an Independent Central Bank
Sep 13, 1995	Banco de México changed its policy instrument to a monetary target signal, also known as 'el *corto*,' in which commercial banks should hold a zero monthly cumulative balance with the Central Bank
1999	'Unofficial' adoption of an inflation target of 3%
2001	Official adoption of an inflation target regime
2002	Official adoption of a long-term inflation target of 3%
Jul 28, 2002	'Official' adoption of a long-term inflation target of 3% +/-1%
Jan 2003	The Central Bank's board started to meet on a biweekly basis to announce changes in monetary policy (before the board could make announcements every other day). It is worth noting that a statement was released only after the second meeting of the month
Apr 10, 2003	Banco de México modified its policy instrument 'el corto' to a daily balance, from a monthly cumulative balance
Aug 26, 2005	'Unofficial' adoption of the overnight rate as the monetary policy instrument of choice, instead of 'el corto'
Jan 2006	The Central Bank's board started to meet on a monthly basis to announce changes in monetary policy
2008	The number of policy meetings are reduced from 12 to 11
Jan 20, 2008	'Official' adoption of the overnight rate as the monetary policy instrument of choice.
2011	Banco de México reduces the number of monetary policy meetings per year from 11 to 8 (two per quarter).
Feb 4, 2011	The Central Bank published its first minutes intended to reflect the discussion leading to the monetary policy decision taken two weeks before.
March 8, 2013	Banxico takes its first public non-unanimous interest rate decision, which led to a 50bp cut in the Fondeo rate

Source: Banco de México.

Table 23: Heads of Banco de México[1]

Banxico''s Head	Period	UMS President
Alberto Mascareñas	Sep 1925 - May 1932	Plutarco Elias Calles Emilio Portes Gil Pascual Ortiz Rubio
Agustín Rodríguez	May 1932 - Apr 1935	Pascual Ortiz Rubio Abelardo L. Rodríguez Lázaro Cárdenas
Gonzalo Robles	Apr 1935 - Dec 1935	Lázaro Cárdenas
Luis Montes de Oca	Dec 1935 - Sep 1940	Lázaro Cárdenas
Eduardo Villaseñor	Sep 1940 - Dec 1946	Manuel Ávila Camacho
Carlos Novoa	Dec 1946 - Nov 1952	Miguel Alemán Valdés
Rodrigo Gómez	Dec 1952 - Aug 1970	Adolfo Ruiz Cortines Adolfo López Mateos
Ernesto Fernández Hurtado	Dec 1970 - Dec 1976	Gustavo Díaz Ordáz Luis Echeverría Álvarez
Gustavo Romero Kolbeck	Dec 1976 - Mar 1982	José López Portillo
Miguel Mancera Aguayo	Mar 1982 - Sep 1982	José López Portillo
Carlos Tello Macías	Sep 1982 - Dec1982	José López Portillo
Miguel Mancera Aguayo	Dec 1982 - Dec 1998	Miguel de la Madrid Hurtado Carlos Salinas de Gortari Ernesto Zedillo Ponce de León
Guillermo Ortiz Martinez	Jan 1998 - Dec 2009	Ernesto Zedillo Ponce de León Vicente Fox Quesada Felipe Calderón Hinojosa
Agustín Guillermo Carstens	Jan 2010 -	Felipe Calderón Hinojosa Enrique Peña Nieto

Source: Banco de México. 1. From 1925 to 1993 the head of Banco de México was named Director General. However, the Central Bank's head is "Governor "since 1994, when Banco de México achieved its autonomy

Early last year, President Peña Nieto appointed Mr. Javier Guzmán Calafell as deputy governor, replacing Dr. José J. Sidaoui, whose term ended on December 31, 2012.

Table 24: Banxico's Current Board Members

	At office since:	Current Period:	Possibility of Reappointment[1]
Agustin Carstens	2010	2010-2015	Yes
Roberto Del Cueto	2007	2007-2014	Yes
Manuel Sánchez-González	2009	2009-2016	No
Manuel Ramos-Francia	2011	2011-2018	Yes
Javier Guzmán Calafell	2013	2013-2020	No

Source: J.P. Morgan with data from Banco de México. 1. Possibility of reappointment in terms of requirements. The law establishes that the nominees must be less than 65 years old at the moment of appointment.

Prices & Wages

Inflation has been gradually converging to the Central Bank's 3% target over the past decade. Following long spells of two-digit inflation between the '70s and '90s, starting in 2000 inflation has begun to steadily converge to lower levels and has stabilized near the Central Bank's 3% target, even as it has failed to ever meet it.

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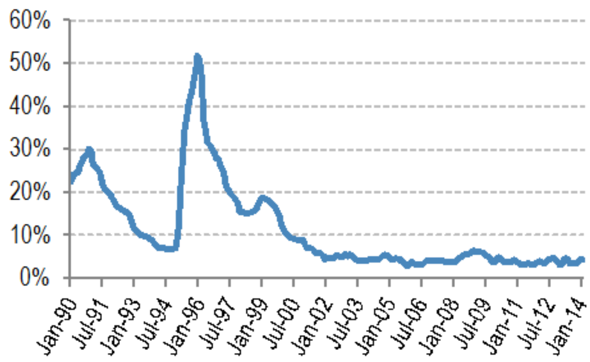
Figure 64: Inflation's Gradual Convergence

% oya

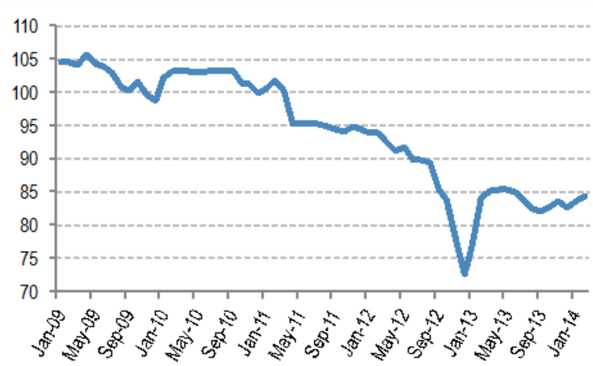


Source: INEGI.

Convergence has been fostered by a wide range of factors. Monetary and fiscal policy stability has played a key role (*see monetary policy and fiscal sections*), as it has allowed the country to develop strong macro fundamentals that help shield the economy in periods of international turmoil. On the other hand, though still in process, the market has become more competitive in key sectors such as retail, tourism services and, recently, in telecommunication services, a fact that has pushed down consumer prices. Reforms to further foster competition, particularly in the telecom sector, are expected to yield results over the next years. Furthermore, starting in 2015 fixed gasoline price increases are expected to fall to 3.5% per year down from their current 10% pace of adjustment.

Figure 65: Telephone Consumer Price Index

index, 2012=200



Source: INEGI.

CPI composition is increasingly dominated by services, to the detriment of both goods and volatile non-core products, such as raw food and energy. The weight of services in the consumers' average consumption basket increased significantly in the last decade, rising to 43% in 2013 from 38% back in 2002. A good part of the increase came on the back of a larger weight of telecom tariffs related to the higher proliferation of mobile phone and internet services. In contrast, the weight of goods declined 3%pts to 34.5% over the same period, while that of non-core components fell by 2%pts.

Table 25: Services Weight in CPI Has Been Increasing

%

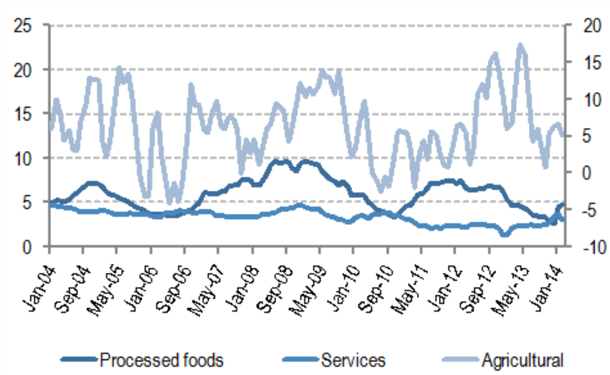
	2013	2002	Chg
Headline	**100**	**100**	**- -**
Core	77.4	**74.8**	**2.6**
Goods	34.4	37	-2.6
Processed foods	14.7	14.7	0.0
Other goods	19.7	22.4	-2.7
Services	43.1	32.5	10.6
Housing	19.5	17.9	1.6
Rent	14.1	12	2.1
Other housing services	5.3	5.9	-0.6
Other services	18.5	14.7	3.8
Education	5.1	5.2	-0.1
Non-core	22.6	**25.2**	-2.6
Agriculture	8.4	8.1	0.3
Fresh fruits and vegetables	3.6	3.3	0.3
Metal and egg	4.9	4.8	0.1
Energy and govt. regulated[1]	14.1	17.2	-3.1
Energy	8.8	7.8	1.0
Electricity	2.8	2.3	0.5
Gasoline[2]	4.2	3.7	0.5
Heating gas[3]	3.5	1.8	1.7
Govt. regulated	5.4	9.4	-4.0

Source: J.P. Morgan with data from Banco de México. 1. Previously known as administered and negotiated'. 2. Includes low and high-octane gasoline. 3. Includes natural and LP domestic heating gas.

It is worth noting that this shift in CPI weights tends to make inflation more stable, as prices in the services sector move more in line with the domestic demand cycle. At the opposite end, processed food, raw food and energy prices are subject to weather, as well as financial conditions, making them more volatile.

Figure 66: Inflation: Services, Agricultural and Processed Foods

% oya



Source: INEGI.

While inflation has structurally moved lower in the past decade, we expect prices to remain under

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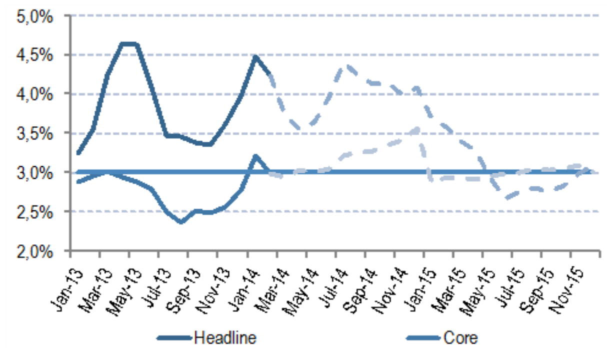
pressure in the short term. Tax hikes early this year are expected to shift up inflation by around 50bp in 2014, leaving it standing close to 4% throughout the year. It is important to note, however, that while headline inflation will trail above the central bank's target (3% ±1) during most of the year, once temporary effects from tax increases are removed, underlying inflation remains well behaved.

Figure 67: Inflation Projections

% oya

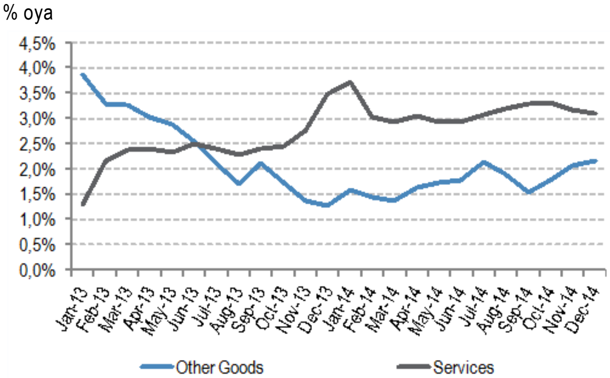


Source: INEGI, J.P. Morgan Estimates.

Services inflation – considered the best gauge of underlying inflation – will remain close to the bank's 3% target, pointing to absent demand-side inflation pressures. This is consistent with the fact that we forecast the output gap to remain negative at least through 1H15, limiting both wage and price increases. Furthermore, firms' weak pricing power coupled with soft import prices are also expected to keep non-food tradeable prices contained in the next couple of years. With underlying inflation pressures subdued, we look for inflation to converge back to 3% in 2015, as the effect of tax increases fades.

Figure 68: CPI: Services vs. Other Goods Inflation

% oya



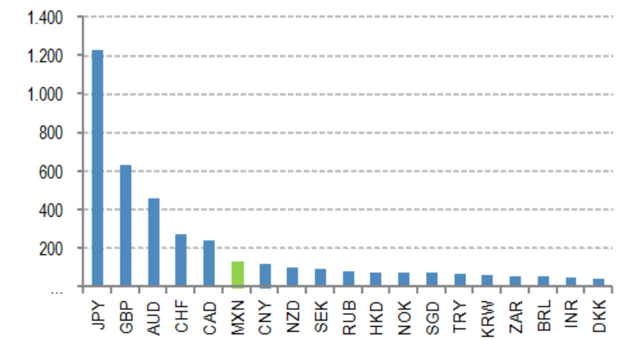
Source: INEGI.

Currency & Monetary Policy

With an estimated daily turnover of around $57 billion, the peso is the most liquid currency across emerging markets and the eighth most liquid globally, just below the Canadian dollar. Ample liquidity has led the peso to be one of the preferred hedging vehicles for EM assets. This usually leads the peso to come under pressure whenever volatility sets in across EM assets, and to trade more accordingly to its fundamentals in scenarios of absent volatility. According to J.P.Morgan Research (D. Pereira), the correlation between USDMXN and EM volatility has increased from close to 20% pre-financial crisis to close to 70% post-2008.

Figure 69: THE MXN Is Among the Most Liquid Currencies

$ in billion, daily turnover



Source: BIS.

Since the adoption of the free-floating exchange rate regime back in December 1994, there have been no restrictions on buying/selling the peso. Mexican authorities have characterized themselves for acting on 'rules rather than discretion' – meaning market intervention mechanisms are limited and pre-established. FX policy is in the hands of the Foreign Exchange Commission (FEC) –formed by members of the central bank and the MoF – which has opted to leave the Mexican peso to float freely, with interventions only in unique situations and preferably with rules-based mechanisms, such as the 2%-depreciation US dollar sales framework, or the US dollar put FX accumulation scheme used in previous years. This responds to the FEC's objective of having an FX market in which the price discovery process is efficient.

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Table 26: Mexico's Exchange Rate Regimes (1932-2011)

1932-1944	Free floating
1944-1948	Fixed exchange rate[1]
1948	Free floating
1949-1976	Fixed exchange rate
1976-1977	Free floating
1977-1982	Fixed exchange rate
1982-1991	'Dual' exchange rate
1991-1994	Crawling peg with the US dollar
1994-1998	Free floating with some FX interventions
1998-2008	Free floating
2008-2013	Free floating with some FX interventions[2]
April 2013	No mechanisms in place

Source: Banco de México, Ortiz, Guillermo, and Leopoldo Solís 'Estructura Financiera y Experiencia Cambiaria: México 1954-1977,' Documento de Investigación, 1978-01, Banco de México, 1978. 1. Mexico was part of the Bretton-Woods agreement. 2. The Foreign Exchange Commission (FEC) decided to intervene in the FX market to stabilize the exchange rate amidst the global financial crisis that started in the US subprime housing market.

USD put/MXN call options mechanism. In 2010 the MoF and Banco de México decided to implement an 'FX options' mechanism to accumulate foreign reserves. Since then, the central bank sold $600 million worth of USD put/MXN call options to local financial institutions every last business day of the month. For one month, options owners were able to exchange US dollars for pesos with Banco de México at the previous day's 'fixing rate' (i.e., the strike price) whenever they decided to exercise the options. The 'exercise window' of these options was 'open' if the reference rate (i.e., the previous day's 'fixing' rate) was below or at the 20-day moving average rate. This provided a structure that allowed the monetary authority to acquire US dollars from market participants whenever there was 'an excess supply' of dollars, minimizing the impact of the interventions. The FX options mechanism represented the second largest source of reserve accumulation in 2010-11. This mechanism was last used in October 2011.

Table 27: Banco de México's Foreign Reserves Accumulation

$ in billion

Year	Foreign Reserve Level	Chg	Breakdown			
			Pemex	Federal govt[1]	Market operations[2]	Other[3]
Dec-05	68,669					
Dec-06	67,680	-989	26,698	-23,401	-8,014	3,728
Dec-07	77,991	10,311	12,899	-4,218	-4,240	5,870
Dec-08	85,441	7,450	22,754	-5,413	-18,674	8,783
Dec-09	90,838	5,397	11,529	6,573	-16,246	3,541
Dec-10	113,597	22,759	16,037	2,338	4,466	-83
Dec-11	142,475	28,878	18,692	2,439	4,614	3,134
Dec-12	163,650	21,174	15,965	170	-646	1,274

Source: J.P. Morgan with data from Banco de México. 1. Includes government's short-term liabilities. 2. Includes Banco de México's US dollar sales to Mexican financial institutions as well as the Foreign Exchange Commission's USD Put/MXN Call options foreign reserve accumulation mechanism. 3. Includes the net return of the FX reserves' investments.

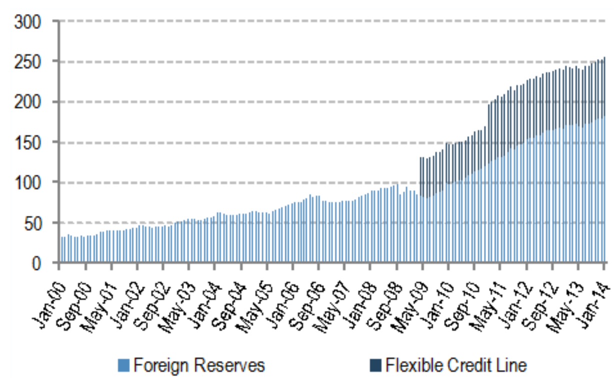
'Minimum price' daily US dollar auctions. Given the peso's rapid depreciation over the last months of 2011, in November 2011 the Ministry of Finance and Banco de

Mexico replaced the FX options mechanism with 'minimum price' daily US dollar auctions. Until April 2013, Banxico could sell up to $400 million if the peso depreciated 2% or more against the US dollar with respect to the previous working day's 'fixing' rate. This intervention was described as not targeting the USD/MXN level or trying to influence the exchange rate trend, but signaling that the FEC was concerned about disorderly behavior in the FX market, particularly in a context of slim liquidity. Note this is not the first time Banxico introduced this 'minimum price' auction mechanism. Following the financial crisis, Banxico used this mechanism between 2008 and 2010, selling around $8.4 billion to market participants and helping to dampen the negative effects that excessive FX volatility could have on the Mexican economy.

Despite the interruption of the reserve accumulation mechanism and the introduction of the above-mentioned 'minimum price' daily US dollar auctions through 2012, **Banxico has continued accumulating foreign reserves at a rapid pace over the past years**. Foreign reserves stood at a historical high of around $181 billion through the end of February 2014, $13 billion more compared with a year earlier.

Figure 70: Gross Foreign Reserves

$ in billion



Source: Banxico.

In addition to the central bank's strong reserves, **late last year the International Monetary Fund (IMF) renewed Mexico's Flexible Credit Line (FCL),** which was originally put in place in April 2009. The FCL – a credit line that allows countries with 'strong fundamentals' to increase FX reserves – was expanded to $73 billion from $48 billion. Although the government is unlikely to make use of the FCL in the short or medium term, it provides an important precautionary buffer. With these additional funds, Mexico's ratio of foreign-denominated resources to public external debt has improved to nearly 2.0 as of December 2013, from 1.5 in December 2010.

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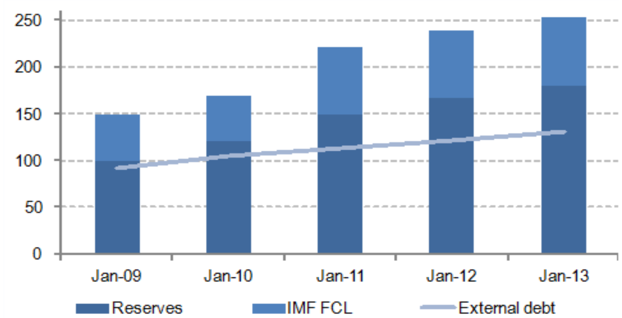
Figure 71: External Debt, IMF FCL & Gross Foreign Reserves
$ in billion



Source: Banxico and MoF.

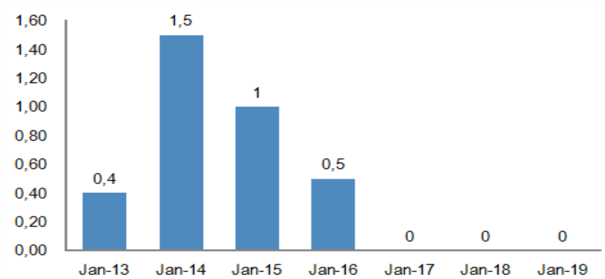
The 'fixing' rate. Banco de México provides a reference exchange rate level on a daily basis by conducting several intra-day surveys using electronic data of FX operations from the main FX brokerage firms. The fixing exchange rate serves as the official reference rate for US dollar-denominated contracts addressed in Mexico.

FX forward and futures market. In addition to the OTC market, the market for listed future peso contracts has continued to grow rapidly over the past few years through the Mexican Market of Derivatives (MexDer), as Siefores (*Sociedades de Inversion Especializadas en Fondos para el Retiro*, that is, pension funds) have turned more active.

Fiscal Policy

Mexico has kept a prudent fiscal stance over the last decades, running moderate fiscal deficits and holding a relatively low indebtedness level of around 39% of GDP. Without disregarding medium-term fiscal stability, the **government is expected to embark in countercyclical fiscal stimulus this year**, boosting its fiscal deficit to 1.5% of GDP (ex-Pemex investment of 2% of GDP) from 0.3% last year in an attempt to jump-start the economy after a disappointing growth performance in 2013.

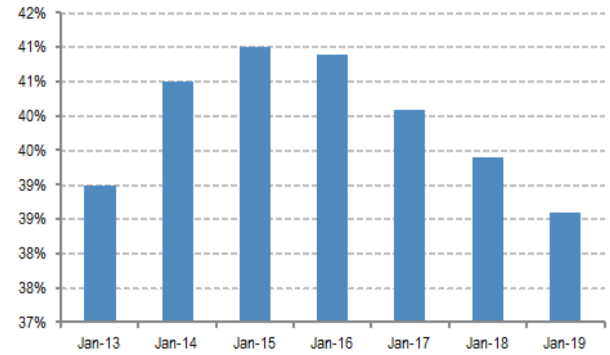
Figure 72: Projected Public Sector Deficit Ex. PEMEX Investment
% of GDP



Source: Ministry of Finance, J.P. Morgan Forecasts.

Larger deficits through 2015 should put debt metrics in an ascending trend in the next couple of years to then come back to current levels by 2018. We expect debt-to-GDP to peak at 41% by 2016 and trend back to 38% by 2018.

Figure 73: Projected Public Sector to GDP
as % of GDP



Source: Ministry of Finance.

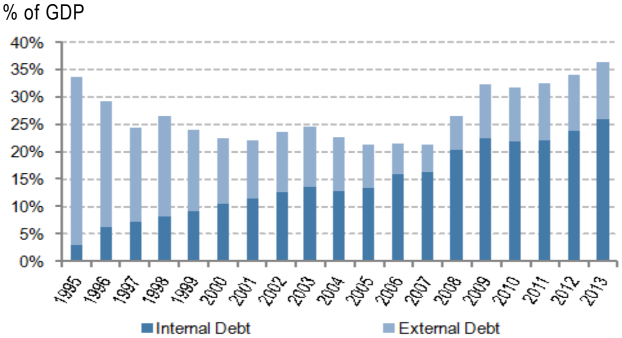
Table 28: LatAm Fiscal Deficits
budget balances (% of GDP)

	2012	2013	2014F
Latin America	**-2.4**	**-2.7**	**-3.2**
Argentina	-2.5	-2.5	-2
Brazil	-2.5	-3.4	-4.1
Chile	-0.2	-0.7	-1.5
Colombia	0.3	-1.2	-1.2
Ecuador	-2.4	-3	-2.5
Mexico	-2.6	-2.4	-3.2
Peru	2.2	0.1	-0.2
Venezuela	-8	-6	-4

Source: J.P. Morgan.

Besides maintaining a low debt-to-GDP ratio, the Mexican government has been able to persistently shift the composition of its sovereign debt from a **strong dependence on external liabilities to an internally biased debt composition** and is likely to continue to do so ahead.

Figure 74: Composition of Mexico's Sovereign Gross Debt
% of GDP



Source: Ministry of Finance.

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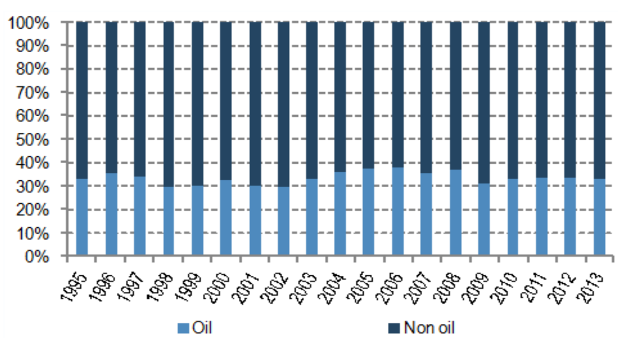
Breakdown of Mexico's fiscal income and expenditures. Despite maintaining a prudent fiscal stance and a low debt-to-GDP ratio, government revenues continue to be strongly dependent on oil. **Oil-related revenues account for 1/3 of total revenues.** The recently approved fiscal reform had been expected to address this issue. While it did so, it made little progress in altering the composition of oil and non-oil fiscal revenues (see fiscal reform section).

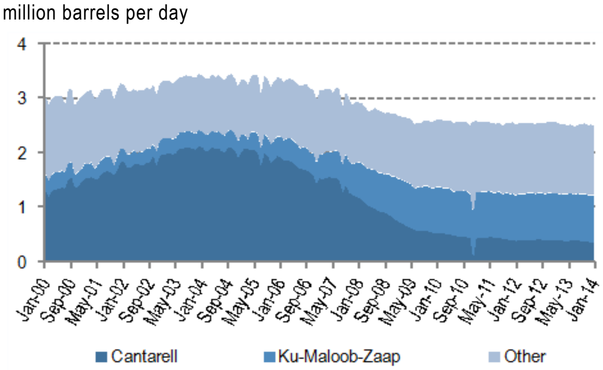
Figure 75: Share of Oil and Non-Oil in Fiscal Revenues
%



Source: Ministry of Finance.

In this context, it is worth noting that after consistently falling in the four years through 2010, **oil production stabilized in the past few years**. While production in previously oil-abundant fields as Cantarell has been decreasing, it has started to be more than offset by rising production in other fields, such as Ku-Maloob-Zaap. According to government estimates, approved constitutional amendments to the country's oil regime will boost oil production by 0.5mbpd to 3.0mbpd by 2018 (see energy reform section).

Figure 76: Crude Oil Production
million barrels per day



Source: PEMEX.

Mexico's strong dependency on oil revenue is reflected in its relatively weak tax collection. Despite imposing high direct and indirect tax rates, collection remains low, accounting for only 41% of total income and 10.2% of GDP. Low tax collection is a result of both a large informal sector (2/3 of the labor market) and a fiscal regime with ample loopholes, issues that the fiscal reform should partly revert in coming years.

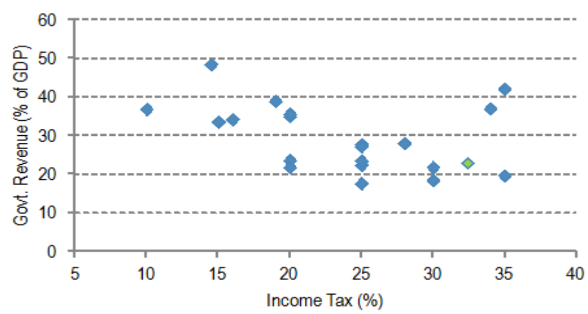
Table 29: Budgetary Revenues Excluding Fiscal Deficit
Mx$ in billion, unless otherwise stated

	2013	2012	% of total[1]
Total	3,804	3,515	- -
Oil revenues	**1,261**	**1,184**	**0.33**
Non-oil revenues	**2,543**	**2,331**	**0.67**
Tax	1,644	1,517	0.43
Non-tax	280	215	0.07
Entities under government control	618	597	0.16

Source: Ministry of Finance. 1. Percentage of 2013 forecasted total revenues.

Income tax (ISR and IETU) and cash deposit taxes brought in 61% of the total tax revenues in 2013, while value-added tax brought in around 36%. Import taxes and other tariffs accounted for the remaining 2%.

Figure 77: EM Comparative Income Tax and Government Revenue



Source: J.P. Morgan.

In terms of gross domestic production, **total fiscal revenues accounted for 23.6% of GDP last year.** This year, the share is expected to stand at 21.7%, low in comparative terms.

On the expenditure side, non-discretionary (programmable) spending represents around 80% of total public expenditure. Within programmable expenditure, administrative branches (Ministries and Commissions) account for 52% of spending, while entities under state control (oil and electricity companies, as well as social security entities) stand for 35%. Out of the remaining 13% around half is devoted to social security contributions, with the other half transferred to states. That states receive large contributions from the federal government is explained by the fact that most taxes are collected federally in Mexico; states collect little in taxes on their own.

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Table 30: Total Public Expenditure

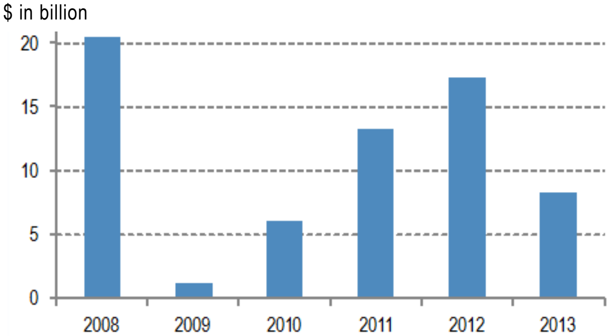
	Mx$ bn	% of total
Total fiscal expenses	4,182	- -
Non discretionary	**3,321**	**79.4**
Federal Government	2,279	54.5
Administrative branches	1,081	25.8
Non-administrative	1,122	26.8
Social security	438	10.5
Transfers to states	527	12.6
Other	157	3.8
State-controlled entities	1,438	34.4
Pemex	487	11.6
Other	951	22.7
Other	-396	-9.5
Discretionary	**861**	**20.6**
Financial costs	314	7.5
Other	547	13.1

Source: Ministry of Finance.

Within non-programmable expenditure – which accounts for 20% of total spending – financial costs usually explain around 1/3. Among other expenditures, the subsidy to gasoline prices has become a significant drag on fiscal accounts, representing around 0.7% of GDP last year. Changes in the fiscal and energy regimes introduced by their respective reforms should lead to a gradual elimination of this subsidy.

Figure 78: Fiscal Burden of Gasoline Price Subsidies

$ in billion



Source: Ministry of Finance, J.P. Morgan.

Borrowing requirements and financial strategy in 2014. This year's public sector borrowing requirements stand at Mx$1,627 billion, or 9.2% of GDP, up from 8.3% in 2013. Amortization needs account for the largest share, representing 5.9% of GDP, while the remaining 3.4% of GDP corresponds to net indebtedness. According to the Ministry of Finance, both net financing needs and amortizations are expected to drop over the subsequent years, reaching their low by 2018.

Table 31: Public Sector Borrowing Requirements

	% of GDP	
	2013	2014F
Total (A+B)	**8.3**	**9.2**
A. Net debt	**2.8**	**3.4**
B. Amortizations	**5.5**	**5.9**
External debt	**0.5**	**0.3**
Bonds	0.4	0.2
IFI's	0.1	0.1
Domestic debt	**5.0**	**5.6**
Securities	5.1	5.6
Cetes (zero-coupon)	3.3	3.5
Bondes D (floating-rate)	0.2	0.3
Mbonos (fixed-rate)	1.3	1.1
Udibonos (real-rate)	0.4	0.7

Source: Ministry of Finance. Note: There might be differences in additions due to the number of decimals shown in the table.

In order for the government to meet its financial obligations, Congress approved a net debt ceiling of Mx$594 billion for this year, of which only 22% can be issued in foreign-denominated currency.

Table 32: Net Indebtedness Ceiling

billion, currency

	Maximum limit		
	Mx$	$	% of total net debt
Total net indebtedness	416	32.2	100%
Domestic indebtedness	416	32.2	100%
External indebtedness	90	7	22%

Source: Ministry of Finance.

As has been the case over the past years, the government's financial strategy looks to **fund the government's spending needs mostly through the issuance of internal debt**, trying to mainly do so through the issuance of long-term fixed-rate securities. One of the main goals of the last administrations has been to gradually increase the average maturity of its outstanding debt. In fact, domestic debt's average maturity has increased from 1.5 years in 2000 to around 8 years currently. However, given the government's expected larger financial needs in the next couple of years plus with rising global interest rates, average maturity is not likely to further increase in coming years, but rather remain flat or even decline at the margin.

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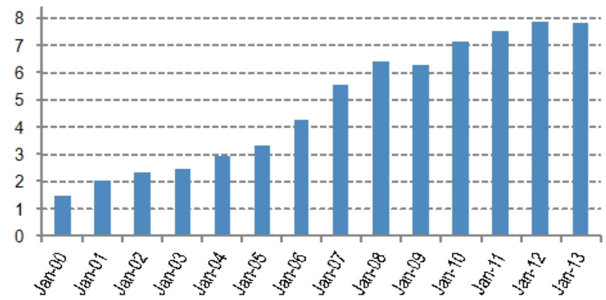
Figure 79: WAM of Government Domestic Debt

WAM in years



Source: Banxico.

Government debt issuance is conducted through weekly auctions, in which zero-coupon bills, fixed-rate and inflation-linked bonds with maturities ranging between three and thirty years are periodically offered. In addition, to provide further liquidity across the whole yield-curve, the government issues zero-coupon Cetes, whose maturity ranges between one month and one year.

Table 33: Long-Term Domestic Debt Placements 2013

	Maturity	Auction periodicity	Amount auctioned, mn[1]
Fixed-rate Mbonos			
3y	Dec-17	4 weeks	11,000
5y	Jun-18	4 weeks	10,500
10y	Dec-24	6 weeks	8,500
20y	May-31	6 weeks	4,000
30y	Nov-42	6 weeks	3,500
Udibonos[2]			
3y	Jun-16	4 weeks	950
10y	Jun-22	4 weeks	800
30y	Nov-40	4 weeks	600

Source: Ministry of Finance. 1. The amount auctioned can vary slightly from quarter to quarter. 2. Auctioned amount expressed in million UDIs (Inflation-linked investment units). Data according to the MoF 1Q14 auction program.

In order to complement domestic debt issuance, while diversifying its creditor base and solidifying the country's access to international capital markets, the government looks to maintain a relatively minor but sufficiently liquid external debt share in its portfolio. **Most external debt is issued in the international capital markets (67%), and is denominated not only in dollars but also in Euros, Japanese yens and Pound sterling**; however, the government also relies on credits with IFOs (30%), as such credits constitute a stable and countercyclical source of funding. As with domestic debt, external debt is mainly issued through long-term instruments; external debt's weighted average maturity currently stands at 16.4 years, with duration of 7.9 years.

Sovereign Credit Ratings

Mexico is rated investment grade. Back in late 2009, Standard and Poor's and Fitch Ratings downgraded Mexico's sovereign debt rating by one notch to BBB, from BBB+. Such grade is in line with that of other emerging economies as Brazil, Russia or Peru, and marginally below that of countries such as Poland or Chile. One of the main weaknesses stressed by the rating agencies is its high dependence on oil revenues, which reach 1/3 of total revenues; similarly, tax collection is not perceived as strong as a higher rating would warrant.

Table 34: Mexico's Historical Long-Term Sovereign Debt Credit Ratings[1]

S&P	Chg. Date	Moody's	Chg. Date	Fitch	Chg. Date
		A3 (S)	**Feb-14**		
BBB+ (S)	**Dec-13**			**BBB+ (S)**	**May-13**
BBB	Dec-09			BBB	Nov-09
BBB+	Oct-07	Baa1	Jan-05	BBB+	Sep-07
BBB	Jan-05	Baa2	Feb-02	BBB	Dec-05
BBB-	Feb-02	Baa3	Mar-00	BBB-	Jan-02
BB+	Mar-00	Ba1	Aug-99	BB+	May-00
BB	Feb-95	Ba2	Feb-91	BB	Aug-95
BB+	Jul-92				

Source: S&P, Moody's and Fitch Ratings. 1. Outlook between parentheses. 2. Moody's Investors Service ratified Mexico's sovereign rating at Baa1 on August 5, 2009.

However, all major credit rating agencies upgraded Mexico in the months following the approval of major reforms. First, Fitch caught up with Moody's and upgraded Mexico to BBB+ in May of 2013, followed by Standard & Poor's in late December, right after the enactment of the energy bill. Finally, in early February of this year, Moody's upgraded Mexico to the single-A category for the first time ever (and the first Moody's upgrade since 2005).

Mexico's credit rating could improve further in the near future, subject to the correct implementation of the structural reforms. Given the recent upgrade by Moody's, we would not expect an additional upgrade by this firm in the short term. Hence, Fitch and Standard & Poor's are next in line among the major agencies. We expect a change in outlook from at least one agency this year, followed by an outright upgrade provided secondary laws are discussed swiftly this year.

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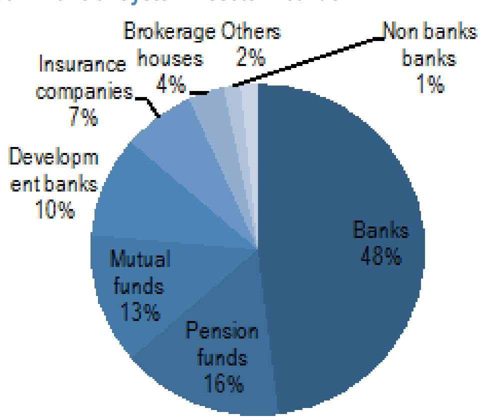
Financial System

Mexico's financial system is made up of banks, credit organizations, insurance companies, brokerage firms, pension fund and mutual fund managers, as well as regulatory and supervisory institutions: SHCP (Ministry of Finance) – the highest authority in the financial system – Banco de México (the central bank), CNBV (National Banking and Securities Commission), CNSF (National Commission of Insurance Companies), CONSAR (Pension Funds Regulator), CONDUSEF (Consumer Credit Protection Agency) and IPAB (Savings Protection Institute).

The CNBV regulates credit institutions, auxiliary credit organizations and securities organizations; CNSF regulates insurance companies; and CONSAR regulates the Mexican pension funds (Afores and Siefores). *Afores* are the pension fund administrators and *Siefores* are the pension fund portfolios.

Figure 80: Financial System Assets Breakdown

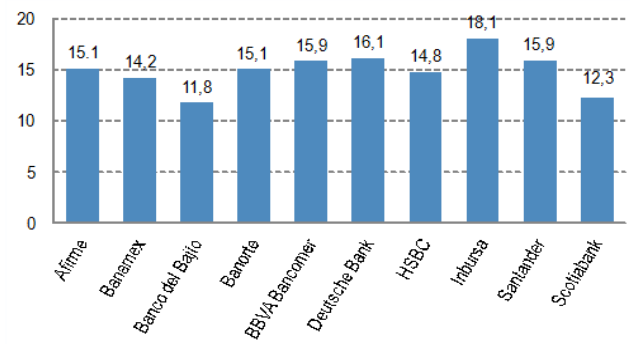


Source: Banxico. Data as of September 2013.

The Mexican banking system is well capitalized (capital/risk-weighted assets ratio of 16%), with nonperforming loans at a moderate 3.3% of total (Dec13), and a minimum capitalization rate of 10%.

Figure 81: Major Banks' Capitalization Rate

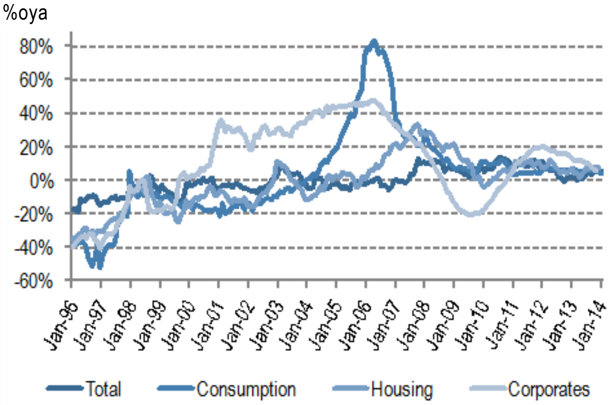
%



Source: CNBV.

Figure 82: Nominal Loans Yearly Growth Rate by Type

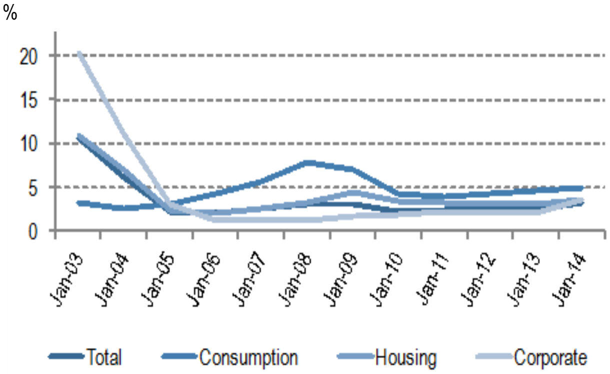
%oya



Source: Banxico.

Figure 83: Delinquency Rates by Sector

%



Source: Banxico.

With $513 billion in assets, the Mexican banking system is dominated by foreign-controlled banks, which make up over 70% of system assets. BBVA-Bancomer (22.8%) and Citibank-Banamex (16.2%) are the two largest banks in the country.

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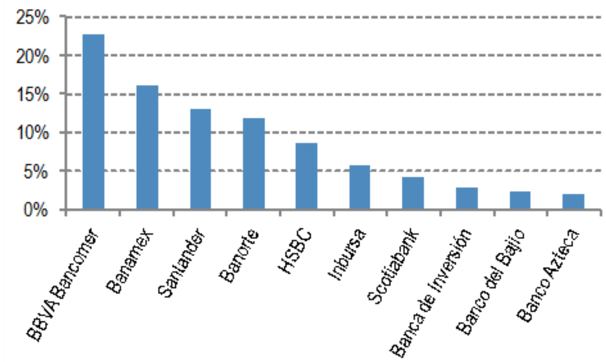
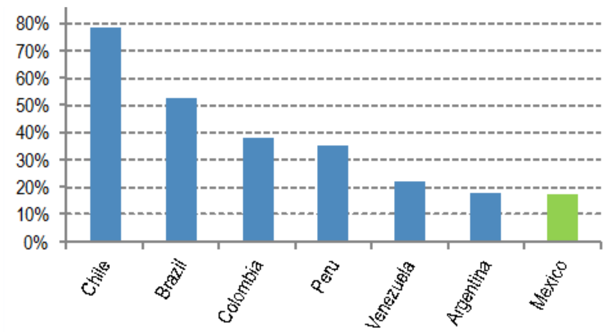
Figure 84: Top 10 Banks in Mexico
% of assets



Source: CNBV. Data as of January 2014.

Banking credit penetration in Mexico is low by both global and regional standards at around 18% of GDP versus over 57% in Brazil, and over 79% in Chile. This low penetration level is partly explained by the Mexican devaluation and subsequent banking crisis of 1995. However, as the crisis is left behind and the system regains its strength, credit penetration should start broadening again. A financial reform looking to slash costs of financing and foster competition in the banking sector should allow for a significant pickup in credit penetration (see financial reform section).

Figure 85: Bank Credit to Private Sector
as % of GDP



Source: J.P. Morgan.

Financial Stability Council

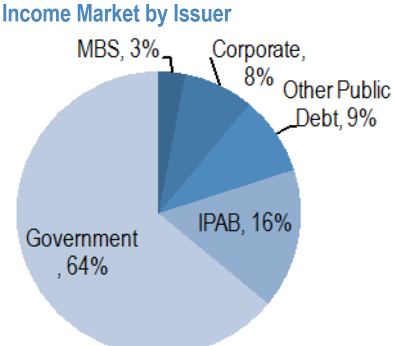
In May 2010, Central Bank Governor Agustín Carstens urged the government to form a committee constituted by various government entities **to identify and analyze significant risks that could cause disruptions in the financial system and could eventually pose major risks to the economy** as a whole. On July 29, 2010, President Calderón announced the creation of the Financial Stability Council (FSC), with former Minister of Finance Ernesto Cordero as head of the council. Nowadays, Luis Videgaray Caso, current Minister of Finance, occupies the chair.

In March of last year the Council delivered its annual report on the financial system. The report highlighted that one of the main risks to the stability of the financial system in the near future has to do with the normalization of monetary policy in the US, which could eventually lead to a reversal in capital inflows to emerging market economies. On the local front, risk of over-indebtedness due to the increase in "easy-to-collect" personal credits (payroll credit) was mentioned as one of the key risks to monitor ahead. Overall the Council concluded that the financial system must continue to enhance the system's stability through the diversification of credit institutions' portfolios.

Fixed Income Market

Federal Government Securities (FGS). Federal government securities make up about 67% of Mexico's local fixed income market, followed by IPAB, the Savings Protection Institute (13%), other public debt (10%), corporate debt (7%) and mortgage-backed securities (3%).

Figure 86: Fixed Income Market by Issuer



Source: Banxico. Data as of January 2014.

Government debt is highly concentrated in fixed-rate Mbonos, which account for 50% of total outstanding debt. The remaining 50% is distributed across inflation-linked Udibonos (22%), zero-coupon Cetes (16%) and floating-rate Bondes D (5%) and other debt (8%).

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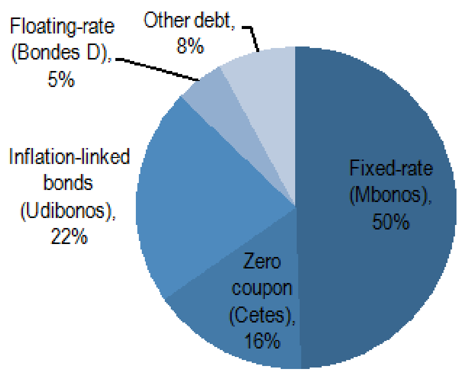
Figure 87: Government Debt Composition



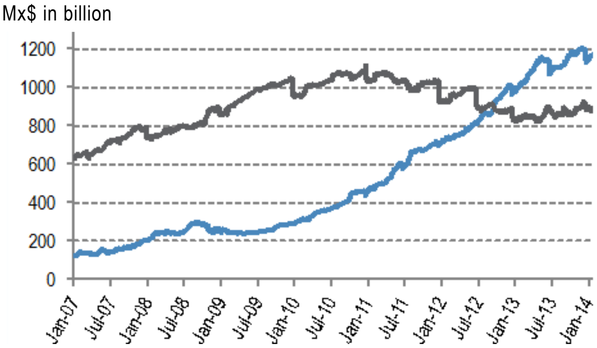
Source: Banxico.

Cetes: Short-term (up to 1 year) zero-coupon bonds auctioned every week (except for the 1-year bond, which is auctioned every four). These bonds are Euro-clearable, and most foreigners are exempted from withholding taxes.

Mbonos: Medium- and long-term fixed-rate Mbonos that are also Euro-clearable; most foreigners are exempt from withholding taxes. Average daily turnover reaches over $1.2 billion. We highlight that in October 2010 Mbonos were included in Citigroup's World Government Bond Index (WGBI). Mexico was the first Latin American country to be included in the WGBI. This, in addition to ample liquidity conditions, a global search-for-yield and Mexico's strong fundamentals, has triggered large foreign inflows into the Mbono market. Foreigners currently hold around 56% of outstanding Mbonos, up from 25% in 2010.

Figure 88: MBonos Holdings by Type of Investor

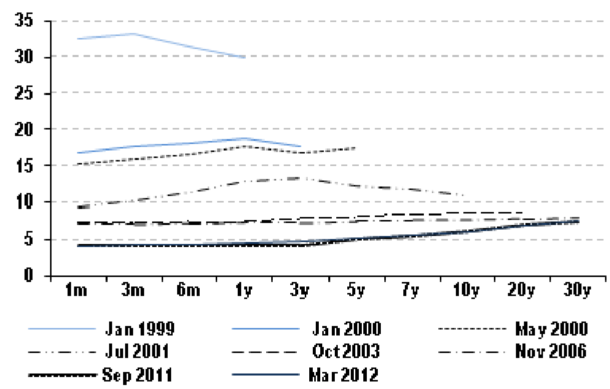
Mx$ in billion



Source: Banxico.

Despite being relatively large and liquid, the local market is also young. The local debt yield curve has expanded from 1-year maturity in 1995 to a 30-year tenor in March 2006.

Figure 89: Extension of the Yield Curve



Source: Banco de México.

Bondes D: These floating-rate bonds were issued in August 2006 to cancel out the Central Bank's BREMS and acquire USD used to prepay external debt. There is practically no secondary market for these bonds.

Udibonos: These are linkers denominated in inflation-indexed units called UDIs but paid in MXN. The UDI (inflation-linked investment unit) is a non-traded monetary unit used to translate the price, interest payment, and principal of UDI-denominated securities (or swaps) into pesos. The value of an UDI is a function of the biweekly CPI. Despite liquidity in Udibonos increasing over the past years, the Udibonos are still much less liquid compared with Mbonos. Nevertheless, they are the real-rate benchmarks for corporate issuance. The UDI is published on Banco de México's website (www.banxico.org.mx) with the release of biweekly inflation (usually the 10th and 25th days of each month).

The formula to calculate the value of the UDI is:

*UDIt = UDIt-1 *[(1+p) 1/n]*

where:

p = latest biweekly inflation rate at time t. Inflation for the second half of each month (days 16 to 30 or 31) is published the tenth day of the following month; inflation for the first half of each month (days 1 to 15) is published the 25th day of that month.

n = number of days between the release of biweekly inflation data (from days 11 to 25 by day 10 of each month, and from day 26 to 10 of the following month by day 25 of each month).

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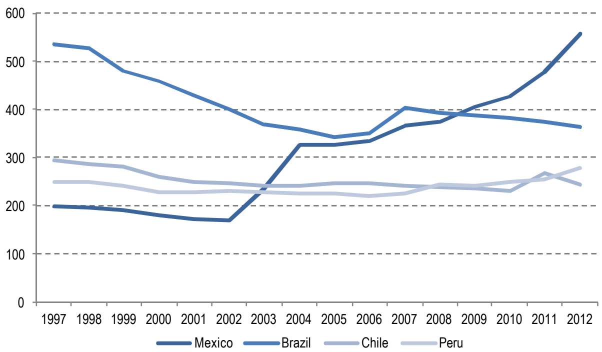
Capital Markets

The Mexican Stock Exchange hosts 1,054 listed equities. Out of these**,** 206 are issued by or represent a basket of Mexican companies. The rest are GDRs and ETFs/ETCs with international focus. There are 133 Mexican companies represented among these 206 stocks, while 19 of them are Mexican ETFs. This compares with 406 Brazilian companies in the Bovespa and 229 Chilean stocks in the IPSA. In 1997 the number of single stocks listed in Mexico was 198 vs. 536 in Brazil. Latest data show that there are now 588 listings in Mexico and 410 in Brazil.

Figure 90: Number of Listed Entities

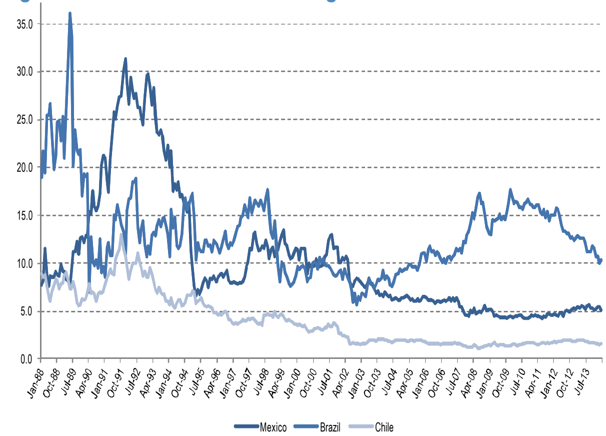


Source: World Federation of Exchanges, MSE, Bloomberg.

The total market cap of all the listed Mexican companies in the Mexican Stock Exchange is c. $535bn, or 42% of the country's 2013 nominal GDP. The *Indice de Precios y Cotizaciones* (*IPC*), the benchmark index of the Mexbol, is composed of 35 stocks weighted by free-float-adjusted market cap. Rebalances are quarterly, and the sample is taken yearly (unless there are specific corporate events such as delistings; then the IPC is resampled on a discretionary basis). The MSCI Mexico Index is also widely used, mostly by international investors. It includes 29 companies, and weights are also calculated using free-float-adjusted market cap.

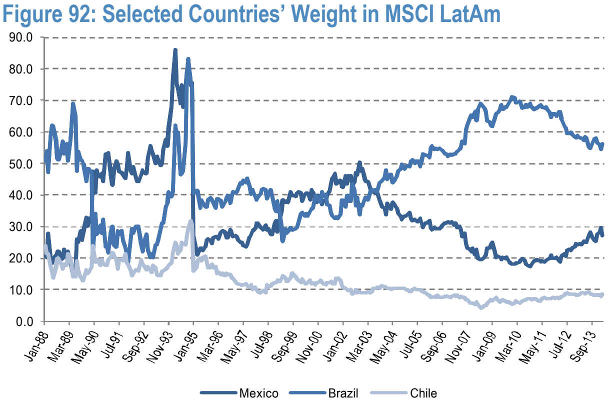
Mexico's weight in the MSCI EM index, now at 5%, is less than half the level of 10 years ago. Mexico's weight in the index has come down from last year's 5.5% on the back of the market's underperformance but is up from its lows of October 2010**.** In a LatAm context, Mexico's weight in the MSCI is also lower than its peak attained in February 1994, but has picked up from last year's 24% weight. Latest weight in the index is 27.4%, but we attribute this increase to relative allocation shifts as Brazil's weight in the index has come down to 56.4% from last year's 58%; its weight has dropped from a peak of 51% to below 25%.

Figure 91: Selected Countries' Weight in MSCI EM



Source: MSCI, J.P. Morgan.

Figure 92: Selected Countries' Weight in MSCI LatAm



Source: MSCI, J.P. Morgan.

New issuance reached a record high in 2012, being over 10x larger than that in 2011. 2013 was an even better year. Total equity issuance, including REITs and securitized financing (capital development certificates or CKDs) was over $12.1bn, more than 12x 2012's equity issuance. Though IPO activity was more muted than in 2012 ($5.1bn vs. $6.8bn), amounts issued in follow-ons was more than twofold that of 2012. Structured finance issuance (CKDs) was also lower in 2013, attributable to lower infrastructure activity stemming from stalled government spending. In the pipeline for 2014 there are – officially – already 2 REITs (same that delayed issuance in late 2013), Office Depot Mexico IPO (delayed issuance from January 2014), a follow-on offering from Alsea, IPO of low-cost airline Viva Aerobus and one CKD issuance. Some other companies have expressed interest to tap equity markets in 2014. Though high valuations and benign market conditions propelled a bout of equity issuances since 2012, historically Mexican

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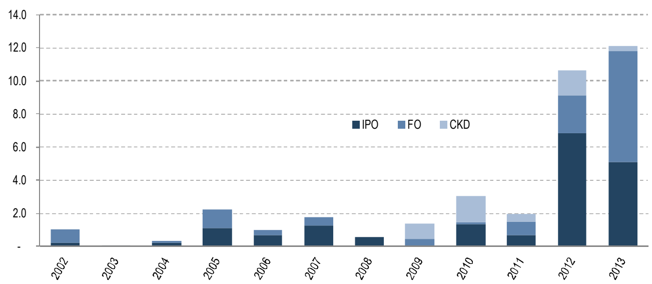
companies are reluctant to go public due mostly to (1) cheap funding and easy access to debt markets and bank lending, (2) disclosure requirements, and (3) insecurity perceptions.

Figure 93: Equity Issuance in Mexico
$ in million



Source: Mexican Stock Exchange.

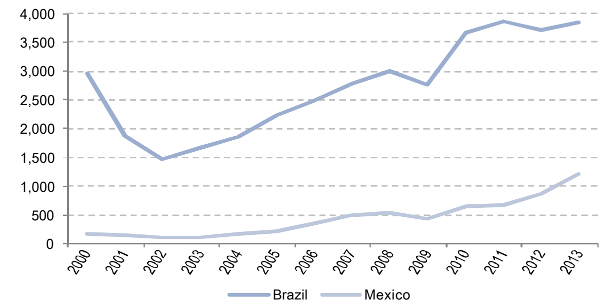
Table 35: Mexico Equity Issuance in 2013

Issuer Company	Type	$in million
Cultiba	IPO	271.13
Sanborn's	IPO	829.98
Fibra Inn	IPO	292.55
Terrafina	IPO	770.00
Hoteles City Express	IPO	203.17
Fibra Shop	IPO	369.50
Volaris	IPO	420.72
Danhos	IPO	410.63
Lala	IPO	956.05
IEnova	IPO	583.19
Fibra Uno	FO	1,741.04
Fibra Hotel	FO	395.11
OHLMEX	FO	549.43
Inbursa	FO	1,002.41
Oma	FO	74.65
Vesta	FO	228.94
Oma	FO	186.07
Banorte	FO	2,166.90
Grupo Financiero Interacciones	FO	329.32
Corporacion Actinver	FO	53.49
TOTAL		**12,118.24**

Source: Mexican Stock Exchange.

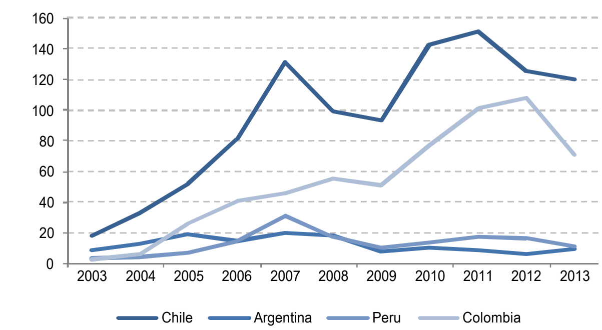
The Mexbol is the 2nd-most liquid exchange in Latin America, with an average daily traded volume (ADTV) in 2013 of more than $1.2bn, below Brazil's ADTV of c.$3.9bn. In April 2004 the Mexican pension funds were allowed to trade in local equities through the use of ETFs, and ADTV spiked 67.5%. After stalling in 2012, daily traded volume in 2012 and 2013 increased significantly as a result of improved investor sentiment coupled with record-high equity issuance. The pace of acceleration was significantly above that of Brazil, likely due to the same factors. In 2012 average traded volume increased by 30% in Mexico while falling 4% in Brazil. In 2013 volume was up by c.43% while in Brazil it was up by 4%.

Figure 94: Average Daily Traded Volume in Mexico and Brazil
$ in million



Source: MSE, Bovespa.

Figure 95: Average Daily Traded Volume in Peru, Chile and Colombia
$ in million



Source: MSE, Bovespa.

Table 36: IPC & MSCI Top 10 Constituents

Company	Weight in MSCI	Weight in IPC	3m ADTV
América Móvil	19.6	16.5	112.3*
Femsa	9.1	10.2	26.8
Banorte	8.3	8.8	45.1
Televisa	7.7	8.6	72.1*
Cemex	7.6	7.9	43.4
Walmex	6.7	6.6	53.8
Grupo Mexico	6.5	6.3	31.9
Alfa	4.1	5.1	20.1
Coca Cola Femsa	2.3	2.7	7.7
Santander Mexico	2.0	2.2	11.6
TOTAL	**74.0**	**75.0**	**424.8**

Source: MSCI, Mexican Stock Exchange.*3m ADTV of the ADR.

Within the equity market, new vehicles have gained importance in recent years: ETFs and REITs.

ETFs in Mexico have grown as many investors prefer to invest in broader instruments rather than stock pick. This is particularly true for Afores, which before Feb 2010 could not trade single stocks. The two most important ETFs tracking Mexico indices are the NAFTRAC (locally traded, 3mADTV = $174 million) and the EWW

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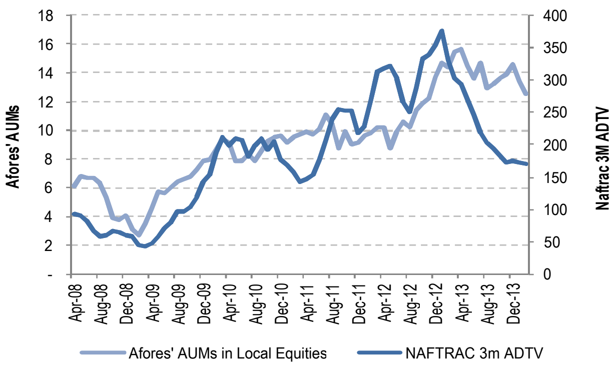
(3mADTV = $203 million). The EWW is the oldest ETF and is composed of 45 securities, while the NAFTRAC holds only 35 but is the most traded by local investors. There are another four ETFs that seek to replicate a Mexican Index: ILCTRAC (Large Cap), IMCTRAC (Mid Cap), IHBTRAC (Homebuilders), and ICMTRAC (broader, total return index). None of them is very liquid.

Figure 96: Afores' AUMs in Local Equities vs NAFTRAC's 3m ADTV

$ in million



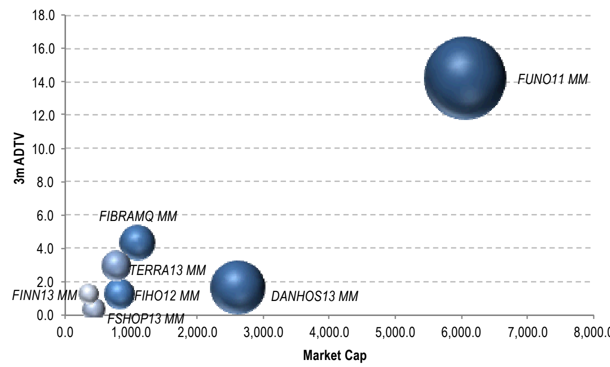
Source: CONSAR, Mexican Stock Exchange.

The drop in Naftrac's 3m ADTV in 2013 partly reflects more Afores focusing on single-stock investments rather than on the broad market while they increased diversification internationally (see Pension Fund section).

The REIT market in Mexico has grown significantly after Fibra Uno's IPO in 2011. There are currently 7 FIBRAs (Mexican REITs) actively trading in the Mexican market. In 2012 Fibra Hotel and Fibra Macquarie launched issuing $319mn and c.$1.2bn each. These were followed by Fibra Inn, Terrafina, Fibra Shop and Danhos in 2013. Mexican REITs are obliged to invest at least 70% of their assets in real estate and pay out at least 95% of non-taxable earnings as dividends or capital reimbursements. The sector has become an attractive yield opportunity particularly for local pension funds that are more income-oriented. Mutual funds were not able to invest in FIBRAs until recently due to tax issues. New FIBRA-focused mutual funds will refer to the Mexican Stock Exchange's new Fibra Index launched in September 2013.

Figure 97: The Mexican REIT Market: Market Cap and Average Daily Traded Volume

$ in million

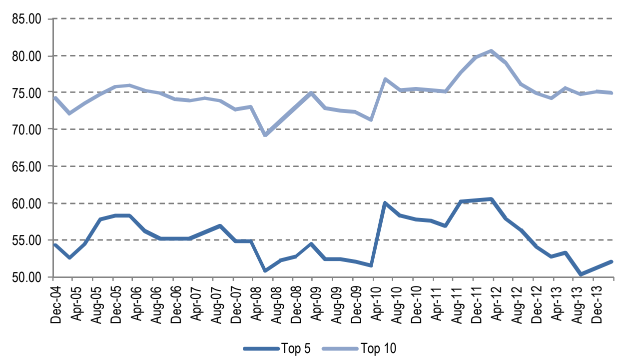


Source: J.P. Morgan, Bloomberg.

The Mexican equity market is highly concentrated. The first 5 companies of the Mexbol make up c.52% of the index. In 2012 concentration came down from its historical highs, when the top 5 companies represented over 60% of the Mexbol.

Figure 98: Total Weight in IPC from Top 10 and Top 5 companies

%



Source: Bloomberg, MSE.

One other important characteristic of the Mexican equity market is its monopolistic nature. The top 10 companies in Mexico have an average 50% market share in their respective sectors. Other companies that are not part of the top 10 are also dominant, like Kimberly on personal care items (~50% market share), Bimbo (~80% on bread distribution) and Gruma (~70% of corn flour production). The government has actively introduced laws to tackle monopolies as well as strengthening the regulatory powers of the CFCE (*Comisión Federal de Competencia Económica,* Mexico's Anti-trust Agency) for enforcing tougher sanctions and fees for monopolistic practices.

Table 37: Market Share in Relevant Sector for Top 10 Companies in Mexbol & MSCI

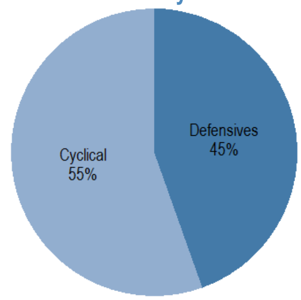
Company	Core Product/Business	Market Share	Mexbol %	MSCI%
América Móvil	Fixed & Mobile Communications	73%	19.60	15.87
Femsa	Oxxo convenience stores	79%	9.13	10.51
Banorte	Financial services - Total Loans	14%	8.30	8.56
Televisa	Broadcasting / Advertising	70%	7.74	8.43
Cemex	Cement	45%	7.57	8.02
Walmex	Formal Retail	42%	6.66	6.70
Grupo Mexico (3)	Mining / Railroads	71%/+50%	6.53	6.27
Alfa(1)	Food / Petrochemicals / Autoparts	37% / 37% / 75-80%	4.12	5.35
Coca Cola Femsa	Bottling(2)	37%	2.29	2.74
Santander Mexico	Financial services - Total Loans	13%	2.03	2.29

Source: J.P. Morgan, MSCI, Bloomberg. (1) Sigma's market share (43% Processed Meat, 27% Cheese, 19% Yogurt & Other) weighted by 2013's revenue breakdown; Alpek's market share = ~40% PTA/PET (NAFTA) + 33% Polypropylene; Nemak's market share in aluminum blocks and engine heads = ~75-80% (NAFTA, outsourced production). (2) Market share across all the soft drink sector in Mexico (incl. Coke and Pepsi bottlers). (3) Though GMexico has over 70% share in Mexico's copper production, given that this is a commodity the company has no pricing power.

Sector-wise, Mexico is rightly perceived to be a defensive market. The MSCI Mexico's return beta to EM is 0.9, the second largest after Brazil's 1.1. However, measuring Mexbol's returns beta to MSCI EM (i.e., excluding currency effect), the beta is much lower at 0.44. This is due to the currency's liquidity and continuous use as a hedge for other EM positions (for more information please refer to the section on Currency & Monetary Policy).

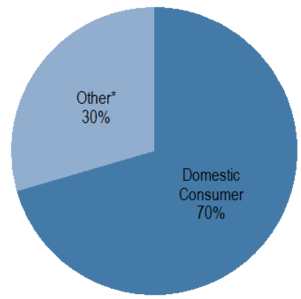
In terms of the **market's composition**, 47% is defensive stocks (including Consumer Staples and Telecom only). Domestic stocks exposed to the local consumer represent 70% of the Mexbol, including in this classification Telecom & Media, Consumer Staples, Consumer Discretionary and Financials. 57% of the companies in the index are exporters (services & manufacturing); however, over 65% of the index's revenue is generated locally, making it much more exposed to domestic consumer than to external cyclicality. The most important sectors are Consumer Staples, Materials and Telecom.

Figure 99: Mexbol: Defensives vs. Cyclical Allocation



Source: Mexican Stock Exchange.

Figure 100: Mexbol: Exposure to the Domestic Consumer



Source: Mexican Stock Exchange. Other* includes industrial, materials and utilities sectors.

The index is a close representation of the economy with the largest weights being Services and Manufacturing goods.

Table 38: GDP vs. IPC Breakdown

	GDP Breakdown	Representation in IPC
Services	62%	53%
Manufacturing	17%	36%
Mining	7%	8%
Construction	8%	3%
Agriculture	4%	0%
Utilities	2%	1%

Source: INEGI, Mexican Stock Exchange.

While total exports represent c.31% of Mexico's 2012 GDP, **exporting companies make up over 57% of the index.** Distribution among exporting sectors is very different from that of the economy. The main difference is much lower exposure to manufacturing export companies and oil-related exports.

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Table 39: Export Profile and Representation in IPC

	% of Exports in 2013	% of Total Exporting Companies in IPC
Manufacturing	79%	36%
Petroleum	12%	0%
Services	5%	13%
Agriculture	3%	0%
Mining	1%	8%

Source: Banxico, INEGI, Mexican Stock Exchange.

Pension Funds

Mexico has a fully funded compulsory contribution private pension fund system with individual accounts. It was introduced back in 1997, to replace the previous 'pay-as-you-go' system, and is based on the Chilean model introduced back in 1980, widely adopted across the region. Employers contribute with 5.15% of their employees' base salaries while employees complement these savings with 1.125% of their base salaries. The rest comes from the government, which contributes with 0.225% of the workers' base salaries. Contributions are limited to 25x the current general minimum wage. Contributions are divided between funds available for retirement and funds available for old age unemployment benefits. Additionally to this, the employer is responsible for contributing with 5% of the workers' base salaries for housing. Afores are responsible only for booking these resources. The funds are managed by the housing institutes of Infonavit or Fovissste.

Mexico's pension fund system has one of the lowest contribution rates in LatAm among countries with defined contribution plans. Most of the burden rests with the employer/government whilst the employee is responsible only for a 1.1% contribution. Retirement age and vesting period in Mexico are above the LatAm average, but coverage is significantly below, considering Mexico's low number of active contributors. In terms of pension spending, however, Mexico's demographic bonus kicks in as, considering the relatively young age of the Mexican population, total spending in pension benefits represents only 2.4% of GDP vs. an average 4.5% in LatAm.

Table 101: Contributions to Defined-Contribution Plans in LatAm

Country	Employee	Employer	Total
Uruguay*	17.8		17.8
Colombia*	4.0	12.0	16.0
El Salvador*	6.3	6.8	13.0
Peru*	11.9		11.9
Chile	10.0	1.0	11.0
Panama*	7.5	3.5	11.0
Dominican Republic	2.9	7.1	10.0
Mexico*	1.1	5.2	6.3
Costa Rica*	1.2	3.3	4.4

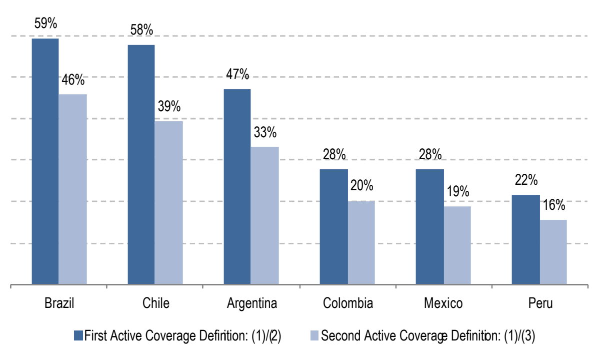
Source: J.P. Morgan, World Bank HDNSP Pensions Database, CONSAR. *These countries have both defined contribution and defined benefit pension plans.

Table 102: Selected LatAm Countries: Retirement Ages and Vesting Periods

	Retirement Age		Minimum Vesting Period	
	Women	*Men*	*Women*	*Men*
Argentina	60	65	30	30
Brazil	60	65	30	35
Chile	60	65		
Colombia*	57	62	26	26
Mexico	65	65	25	25
Peru	60	60	20	20
AVERAGE	60.3	63.7	26.2	27.2

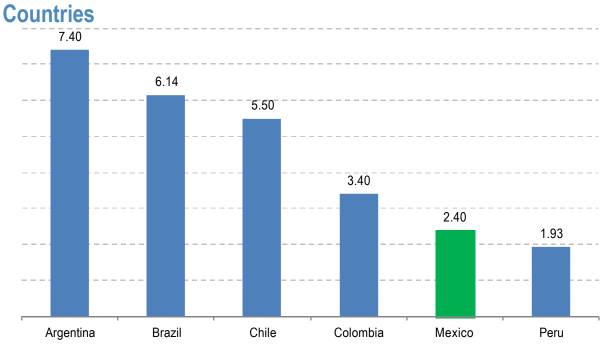
Source: J.P. Morgan, World Bank HDNSP Pensions Database, CONSAR. *Colombia's retirement age was recently legislated and will become effective 2014; 26-yr vesting period will become effective 2015.

Figure 103: Pension Fund Coverage in Selected LatAm Countries



Source: J.P. Morgan, World Bank HDNSP Pensions Database, CONSAR. (1)/(2) = Total Number of Active Contributors / Labor Force. (1)/(3) = Total Number of Active Contributors / Working Age Population.

Figure 104: Pension Spending as % of GDP in Selected LatAm Countries



Source: J.P. Morgan, World Bank HDNSP Pensions Database, CONSAR.

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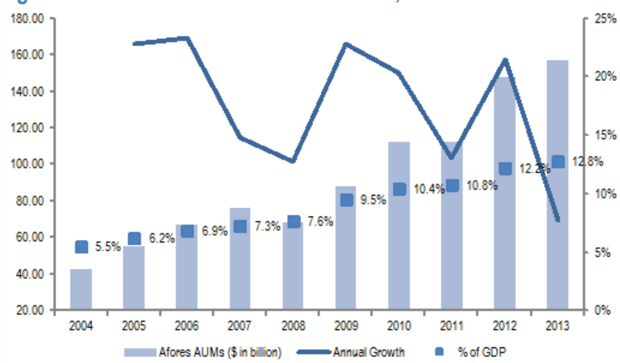
Mexican pension funds' assets under management have increased by 37% on average during the past 9 years (2004-13 CAGR). They have gone from representing 5% of Mexico's nominal GDP to 12.8% in 2013. However, 2013 was the worst year on record (since 2004) in terms of AUM growth, with an increase of barely 8% vs. 2012's 12% year-over-year growth in assets. Lower growth was mostly attributable to market losses as net flows in 2013 were positive by $7.8bn.

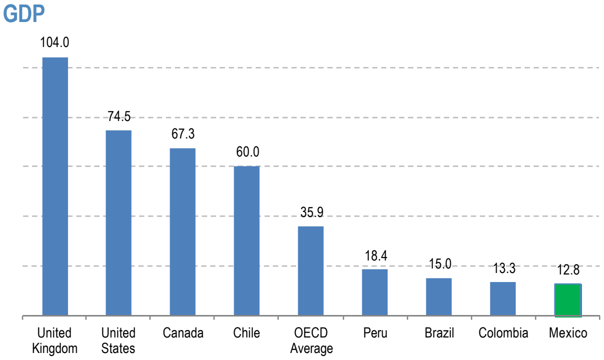
Figure 105: Mexican Pension Funds AUMs, Growth and % of GDP



Source: J.P. Morgan, CONSAR, Bloomberg.

Still, there is significant room to grow. Mexico's pension system is number 15 among OECD countries based on total pension fund assets as % of GDP. Mexico ranks significantly below the US or Chile but above countries like Spain, Germany, Turkey, France and Greece.

Figure 106: Selected Countries' Pension Fund Assets as % of GDP



Source: J.P. Morgan, OECD, CONSAR. Data as of 2012 for all but Mexico. Data for Mexico as of Dec.2013. Includes selected non-OECD countries Brazil, Peru, and Colombia.

The system was reformed in March 2008, from a two-fund asset allocation model to one offering five funds ('multifunds') with distinct risk/return asset allocations. The number of funds was then reduced to four in October of 2012, as the two funds with highest risk/return profiles were merged. Fund 1 is the most conservative – with equity exposure limited to 5% of AUM – and it covers contributors aged 60 and over. By contrast, Fund 4 is the most aggressive, with an equity limit of 40%, and it covers those aged less than 36 years old.

Table 40: Afores' Investment Regime

	SIEFORE	1	2	3	4
	Age	*>=60*	*[46,59]*	*[37,45]*	*<=36*
Concentration and Diversification (Maximum exposure unless stated otherwise)	A	51%	0%	0%	0%
	B	100%	100%	100%	100%
	C	100%	100%	100%	100%
	D	20%	20%	20%	20%
	E	5%	25%	30%	40%
	F	0.20%	1.00%	1.20%	1.60%
	G	5% (Only FIBRAs)	15% (10% in FIBRAs or CKDs + 5% other)	20% (13% in FIBRAs or CKDs + 7% other)	20% (13% in FIBRAs or CKDs + 7% other)
	H	0%	5%	10%	10%
	I	10%	15%	20%	30%
Risk	J	0.30%	0.45%	0.70%	1%

Source: J.P. Morgan, CONSAR. Key: A = Minimum Fixed Income (incl. Derivatives), B = Federal Government Debt, C = Foreign Fixed Income (Investment Grade), D = Foreign Investments, E = Equity (incl. Derivatives, ETFs, Mutual Funds & Mandates), F = Stock Picking (only for stocks listed in MSE), G = Structured Products, H = Commodities (incl. Derivatives, ETFs, Mutual Funds & Mandates), I = Securitizations, J = Differential of Conditional VaR.

Table 41: Afores VaR Breakdown and Limit Consumption

	VaR	Limit	Consumption
Portfolio 1	0.59	0.70	84%
Portfolio 2	0.78	1.10	71%
Portfolio 3	0.93	1.40	66%
Portfolio 4	1.04	2.10	49%
System	0.87	1.46	60%

Source: CONSAR.

Table 42: Afores' Investment Breakdown by Fund

	1	2	3	4
Total investment	100	100	100	100
Government Securities	66.7	55.1	50.2	45.4
Cetes (zero-coupon bonds)	4.4	9.8	8.4	6.7
Mbonos (fixed-rate bonds)	11.7	18.1	18.7	17.2
Bondes (floating-rate bonds)	6.9	1.2	0.9	0.7
Udibonos (inflation-linked)	40.6	22.7	19.0	17.3
Repo operations	1.4	2.0	1.4	1.5
UMS global bonds	1.7	1.4	1.7	2.0
Non-government securities	29.2	20.7	20.1	18.0
Equities	4	19.1	22.9	29.8
Local	1.3	6.4	8.0	11.2
Foreign	2.8	14.2	16.7	20.8
Structured Products	0.0	3.6	5.0	4.6

Source: CONSAR.

Afores have played a major role in the development of local markets over the past 10 years, particularly for

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the bond market. They are the largest domestic holder of MBonos owning ~16% of total par amount outstanding. They are the main price setters for long-dated bonds as they currently hold 48% of long-term bonds (maturity of 2029 and beyond). Weighted average maturity as of February 2014 was 11.8 years.

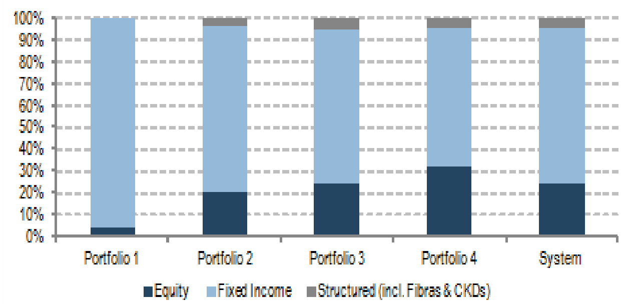
Table 43: Pension Fund Holdings

$ in billion

	$	% Exposure[1]
Total investment	157.5	100.0
Fixed-income	112.9	71.6
Government Securities	81.2	51.5
Cetes (zero-coupon bonds)	12.9	8.2
Mbonos (fixed-rate bonds)	27.8	17.7
Bondes (floating-rate bonds)	2.6	1.6
Udibonos (inflation-linked)	32.8	20.8
Repo operations	2.5	1.6
UMS global bonds	2.6	1.7
Non-government securities	31.7	20.1
Equities	38.2	24.2
Local	12.6	8.0
Foreign	25.6	16.2
Structured Products	6.4	4.1

Source: CONSAR (Pension Funds regulatory commission). 1. Percentage of total net assets under management plus accountable commissions; used to set the investment regime limits. Data as of February 2014.

Figure 107: Afores' Investment Breakdown by Fund



Source: CONSAR.

Despite having increased significantly over the past years, equity allocations are low by regional and global standards. As a result CONSAR (pension funds' regulator) has been gradually liberalizing the system to encourage greater equity allocations. Before, pension funds were allowed to own only certain equity ETFs or trackers. However, reforms introduced since 2010 have been gradually allowing pension funds to purchase individual stocks within authorized indices. In 2012, CONSAR approved the use of mandates to "outsource" management of alternative assets or equity markets ex. Mexico.

Table 44: Selected LatAm Countries Pension Fund System – Equity Exposure vs. Maximum Limits

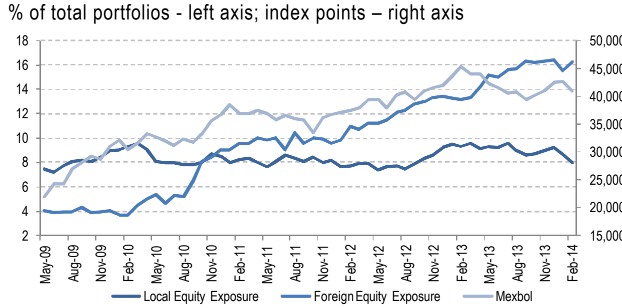
	% of total portfolios	Maximum Limit	Limit Consumption	Cushion
Brazil	29%	70%	41%	41%
Chile*	41%	42%	98%	0.8%
Colombia*	39%	42%	94%	2.4%
Mexico*	24%	30%	82%	6%

Source: J.P. Morgan, CONSAR.* Weighted by AUMs.

The majority of Afores' equity exposure is invested in foreign assets. Mid-2013 CONSAR ceased to report foreign equity breakdown allocation per region; however, considering last data available and empiric evidence, it is fair to assume that pension funds' greatest foreign exposure is to the US and Asia. Locally, equity exposure hovered between 8% and 9% in 2013. Though portfolio managers are allowed to do stock picking in Mexico, it is only but a few Afores that do this. The majority still invests through the Naftrac (for more details please see Capital Markets section).

Figure 108: Afores – Local vs. Foreign Equity Exposure

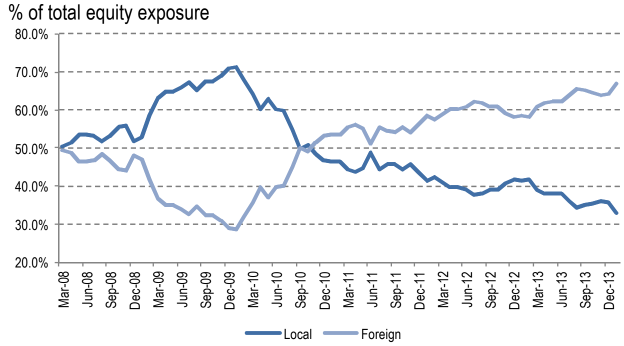
% of total portfolios - left axis; index points – right axis



Source: J.P. Morgan, CONSAR, Bloomberg.

Figure 109: Local vs. Foreign Equity Allocation

% of total equity exposure



Source: CONSAR.

There are currently 12 *Afores* in Mexico, with the top 5 being XXI-Banorte (resulting from the merger of Banorte and XXI, and their acquisition of Bancomer), Banamex, SURA (previously ING), Profuturo GNP and PensionISSSTE. There has been significant consolidation

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in the industry, as well as a clear effort from CONSAR to lower management fees. At the time of writing, Congress is discussing a new Pension Fund Law mandating a significant cut to pension funds' management fees.

Table 45: Breakdown of the Mexican Pension Fund System by Manager

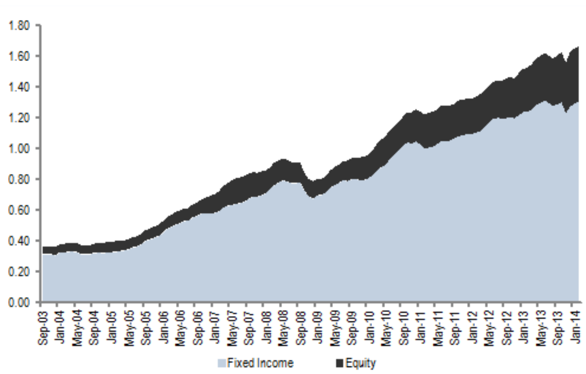
	AUMs (% of Total)	Accounts Managed (% of total)	Management Fee (on net AUMs)
XXI Banorte	25.2	35.1	1.3
Banamex	16.0	15.1	1.3
SURA	13.2	11.9	1.1
Profuturo GNP	10.8	6.0	1.3
Pensionissste	10.2	2.2	1.1
Principal	6.4	7.5	1.3
Invercap	5.6	6.1	1.3
Inbursa	4.5	2.2	1.0
Coppel	4.0	10.3	1.2
Metlife	2.9	2.0	1.2
Azteca	1.0	1.6	1.2
Afirme Bajío	0.2	0.1	1.1

Source: CONSAR.

Mutual Funds

The mutual fund industry has over US$ 125 billion of AUM as of February 2014, making it not dissimilar in size to the better-known *Afores* pension funds system. As of 2013 the mutual fund industry represented 9.8% of GDP.

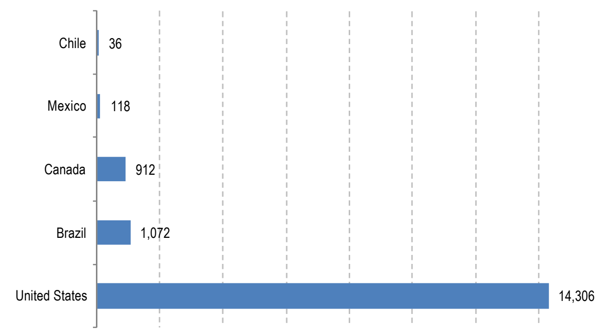
Figure 110: Mutual Funds AUM Historical Evolution
Mx$ in trillion



Source: J.P. Morgan, CNBV, AMIB.

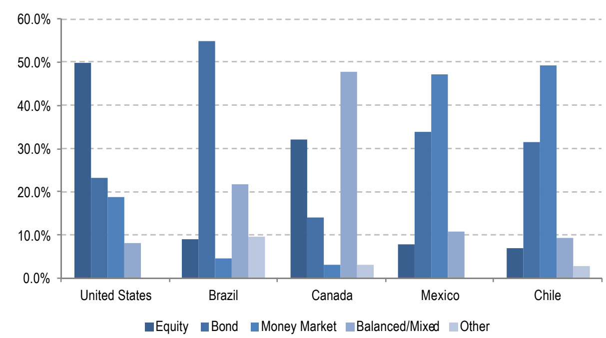
The Mexican mutual fund industry is the 4th largest in America, according to the latest data available on the Investment Company Institute website (www.ici.org). The US represents 87% of the total, followed by Brazil with 7%, Canada with 6% and Mexico at 0.7%. Chile comes last at 0.2% of total Americas' mutual fund AUMs. The breakdown between equity vs. fixed income or balanced funds is very different across the sample. The US mutual fund industry is evidently biased towards equity mutual funds, while Brazil is concentrated in fixed income mutual funds. Mexico and Chile are at a younger stage with the majority of the assets invested in money market funds.

Figure 111: Total Net Assets
$ in billion



Source: Investment Company Institute, ICI.

Figure 112: Mutual Fund Investment Breakdown
% of total mutual funds



Source: ICI.

Having moderated sharply through 2008-09, mutual funds' AUMs have expanded at a strong average pace of 15.5%oya since then. Absent episodes of marked financial volatility, it is likely assets will continue to expand at a healthy pace over the next years. Equity-focused mutual funds have experienced the greatest growth since the crisis (27% oya average growth rate since 2010 and up to February 2014), while Fixed Income focused mutual funds have grown 13.5% oya in average during the same period. This has led to a significant increase in allocation to equity mutual funds vs. fixed income funds in the total system. Nonetheless, as happens with the rest of the Mexican market, 78% of the system's resources are invested in fixed income funds while only 22% are invested in equity funds.

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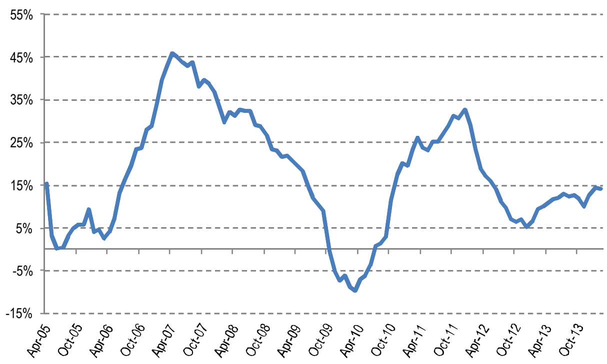
Figure 113: Mutual Funds' AUMs Growth Rate

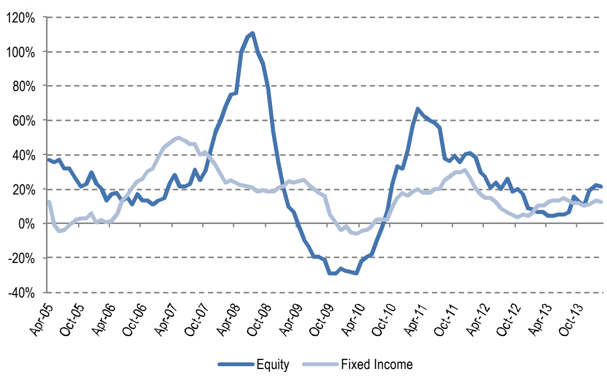
%oya



Source: CNBV.

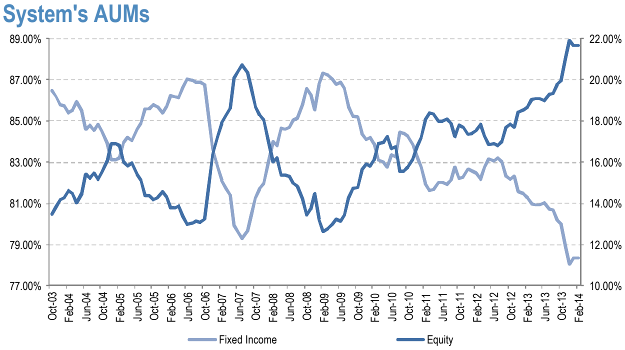
Figure 114: Equity and Fixed Income Mutual Funds' AUM Growth Rate

%oya



Source: CNBV.

Figure 115: Equity vs. Fixed Income Funds as % of Total System's AUMs

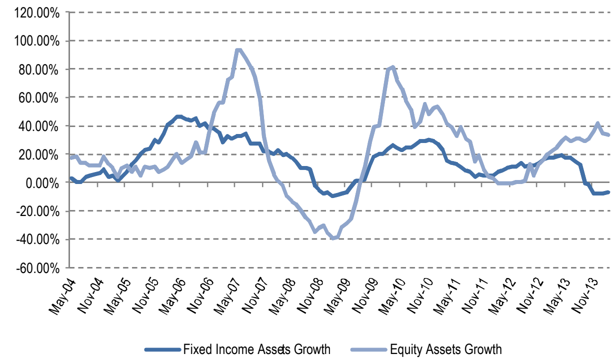


Source: J.P. Morgan, CNBV, AMIB.

Equity/Fixed Income mutual funds are classified by the focus of investments. However, that doesn't preclude them from taking small positions in a non-core asset class if the expected return justifies it. Thus, **assets invested in equities/fixed income instruments differ from the industry mutual fund breakdown.** Since mid-2012, mutual funds started to become more aggressive on equity. Equity investments grew by 22% oya since they reached a bottom in May 2012. Fixed income investments, on the other hand, grew 9.3% oya in average during the same period.

Figure 116: Mutual Fund Equity vs. Fixed Income Investments

% oya growth

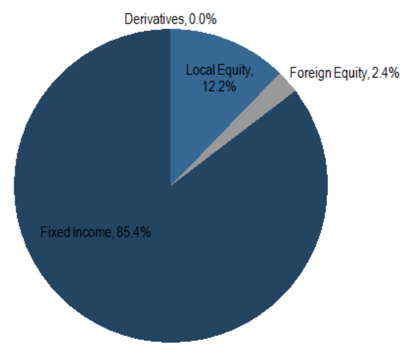


Source: J.P. Morgan, CNBV, AMIB.

Despite a faster increase in the rate of growth for equity investments, **fixed income still dominates the system's portfolio.** Mutual funds are the 2nd largest local holder of government debt, owning c.12% of total par amount outstanding.

Figure 117: Mutual Fund System: Investment Breakdown

% of total system's investments



Source: J.P. Morgan, CNBV, AMIB.

One of the most evident differentiators between mutual funds in Mexico and pension funds is their equity allocation. Mutual funds have a lower total equity exposure than Afores (15% as of February 2014 vs. Afores' 24%). This represents $18.4bn vs. Afores' $38bn, according to the latest data available. However, the breakdown between local and foreign exposure makes mutual funds a much more relevant player in the local space than pension funds. Mutual funds have 12% of their portfolios invested in local equities, whilst Afores

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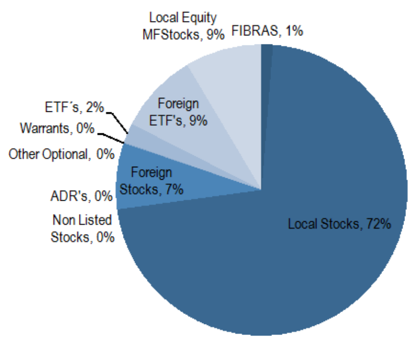
have only 8%. Considering assets under management for each, total mutual fund investments in the local equity space amount to $15.4bn while pension funds' are only $12.6bn.

Figure 118: Mutual Fund Equity Investment Breakdown

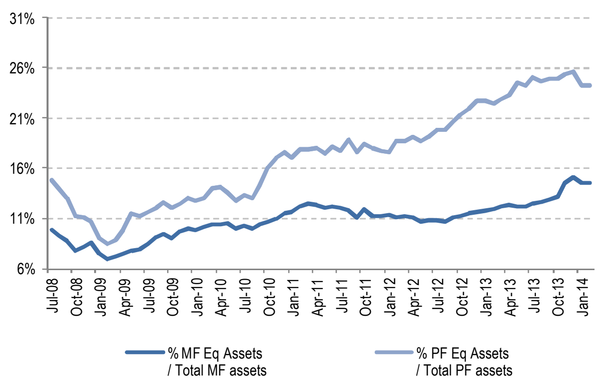
% of total equity exposure



Source: J.P. Morgan, CNBV, AMIB.

Figure 119: Pension vs. Mutual Fund Total Equity Exposure

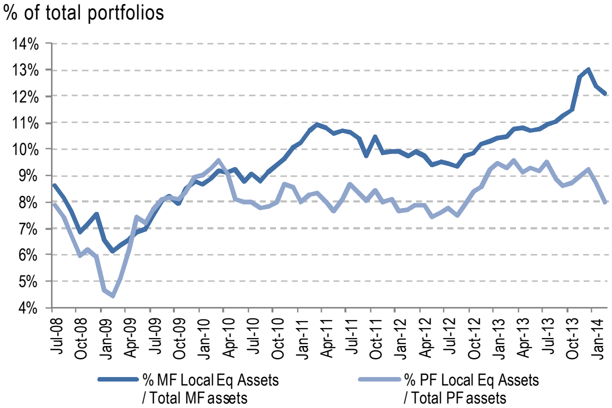
% of total portfolios



Source: J.P. Morgan, CONSAR, CNBV, AMIB.

Figure 120: Pension vs. Mutual Fund Local Equity Exposure

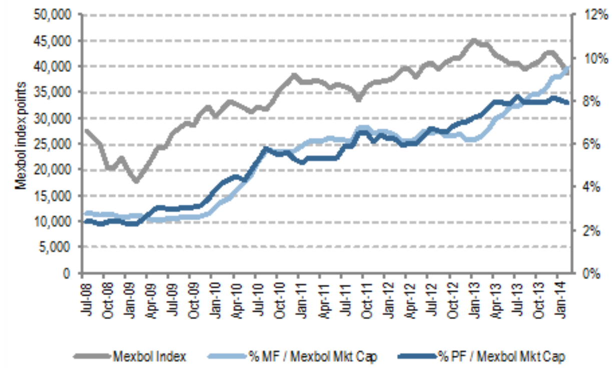
% of total portfolios



Source: J.P. Morgan, CONSAR, CNBV, AMIB.

Figure 121: Pension & Mutual Fund Local Equity Investments as % of Mexbol's Market Cap

% of Mexbol's market cap



Source: J.P. Morgan, CONSAR, CNBV, AMIB, Bloomberg.

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The Reforms in Mexico

Reforms at a Glance

Table 46: Description and Potential Long-Term Impact of Key Structural Reforms on Potential GDP

Bill	Main goals	Impact on GDP	Sectors Impacted
Labor reform	• Increase labor market flexibility by trimming hiring and firing costs. • Introduce temporary contracts and outsourcing as legal figures. • Create specialized labor courts to bring down litigation costs. • Include productivity as a driver for job promotions and remuneration.	0.1% - 0.3%	• Retailers & Mining: Simpler hiring and firing terms benefit labor-intensive companies. • Financials: Shift from informal workers to the formal economy over different contract schemes. • Consumer Discretionary: Credit growth over more formal employment driving domestic consumption.
Telecom reform	• Allow foreign investment up to 100% in the telecom and satellite communication sectors. • Enhance antitrust bodies. • Introduce measures to curb monopolistic behavior (ex. asymmetric connectivity tariffs and must offer / must carry). • Auction 2 new open TV networks to increase competition in the sector.	0.1% - 0.3%	• TMT: Increasing competition via FDI and reducing mayor players' market share will favor small players in the industry.
Financial reform	Boost commercial and development banks' lending to the private sector, with special focus on SMEs, through: • Lowering financial costs and boosting competition within the banking sector. • Strengthening the legal framework through specialized courts to facilitate banks' claims on collateral. • Increased transparency through the creation of a National Credit Bureau.	0.2% - 0.4%	• Industrials & Infrastructure: Development banks boosting lending to SMEs and infra projects. • Financials: Credit growth on improved legal certainty and transparency. • Discretionary consumption: lower rates from higher competition and credit availability.
Energy reform	• Increase energy output and efficiency through greater private participation. • Foster private participation through several forms of contracting, including profit and production sharing agreements, licenses and service contracts. • Lower energy prices on greater availability of cheaper fuels (gas) and cheaper electricity from increased competition in electricity generation. • Increase Pemex's investment flexibility through enhancements to its labor and fiscal regimes and corporate governance. • Create a National Oil Fund to manage oil-related revenues and foster internal savings for the government, strengthening public finances.	0.6% - 0.8%	• Manufacturing & Transportation Industries: Savings on electricity costs & input prices + greater competition foster greater merchandise & product traffic. Business traffic should increase benefitting airports. • Industrials & Materials: New investments and business opportunities due to the opening of the sector + cheaper energy lowers input costs. • Financials should boost lending to SMEs seeking to exploit business opportunities in the energy sector.
Total impact of Main Structural Reforms on Potential GDP Growth		1% - 1.8%	
Current Estimated Annual Potential Output		3.30%	
Estimated Annual Potential Output with Reforms		**4.3% - 5.1%**	

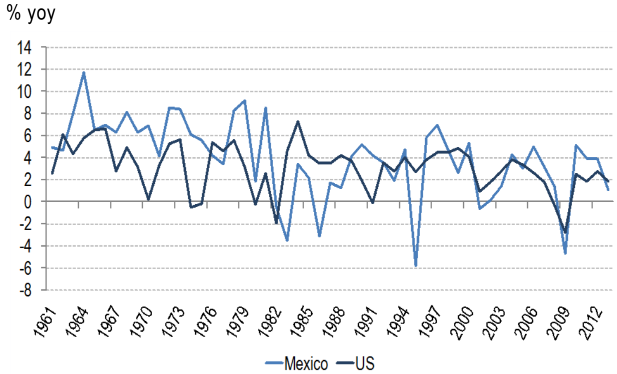
Source: J.P. Morgan.

After a history of economic crises and government finance blowouts, **Mexico has been able to sustain a healthy +3% average growth rate for the past 16 years, after the Tequila Crisis in 1994-95**. The country was even able to recover from the 2008-09 global economic crisis faster and to a greater degree than the recovery in the US despite the unprecedented monetary easing and public policy to stimulate the US economy.

Though growth has been healthy, the most remarkable feature of the Mexican economy in the years since the Tequila Crisis has been stability and strengthening of public finances. Reserves are at their historical maximum levels, even excluding the IMF credit line. Inflation is currently well within Banxico's target range, and government finances are much more solid than other EM countries.

Figure 122: US vs. Mexico GDP Growth

% yoy



Source: INEGI, BEA.

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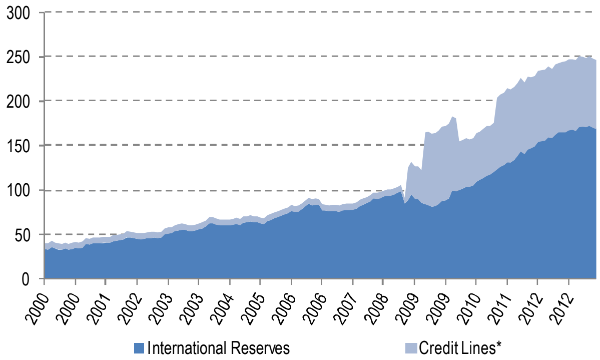
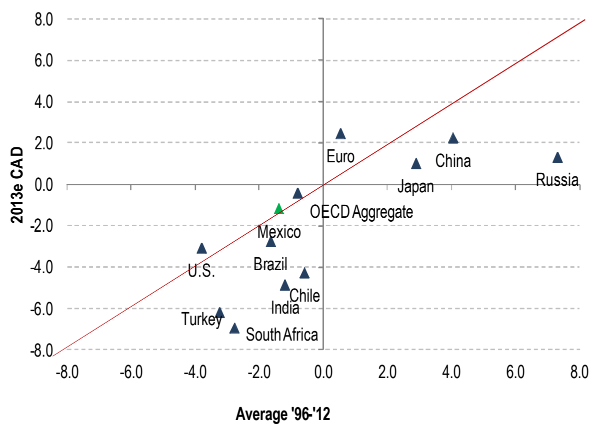
Figure 123: Mexico's International Reserves
$ in billion



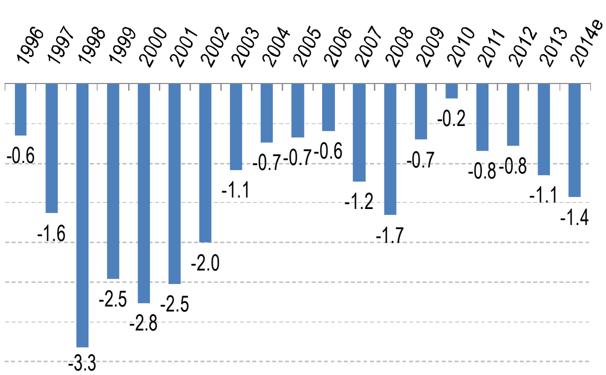
Source: Banxico.

Figure 124: 2013e Current Account Balances vs. 1996-2012
% of GDP



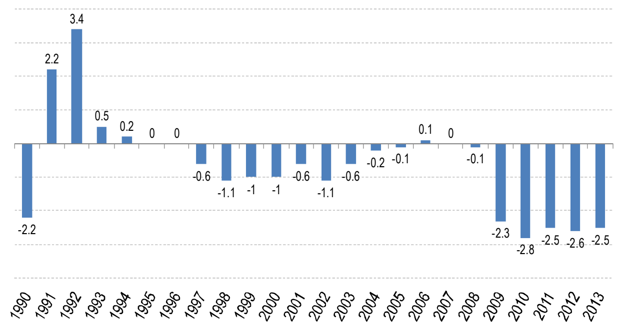
Source: J.P. Morgan. OECD.

Figure 125: Current Account Deficit in Mexico
% of GDP



Source: J.P. Morgan, OECD.

Figure 126: Budget Deficit in Mexico
% of GDP



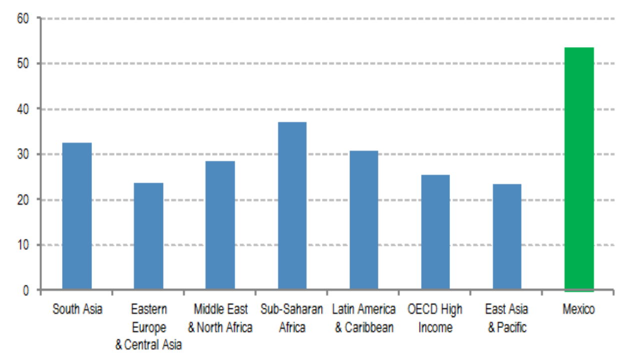
Source: SHCP.

Labor Reform

Shortly after the elections, outgoing President Calderón sent to Congress the proposal for a full-fledged **Labor Reform.** The proposal was submitted to be voted in a "fast-track" mode, which only allowed 30 days for parliamentary review. It was finally **approved by Congress in November 2012** and published in the Official Gazette in November 2012.

Mexico's previous Federal Labor Law dated back to the 1930s. In fact, the Mexican labor system was classified by the World Bank among the 20 most rigid countries in the world, mainly because of the high costs and difficulty of firing. Furthermore, labor rigidity and lack of productivity have been some of the most important factors keeping Mexico from realizing greater levels of economic growth.

Figure 127: Employment Rigidity Index – Per Region



Source: World Bank's Doing Business 2012-2013. *Higher score means more rigid labor conditions.

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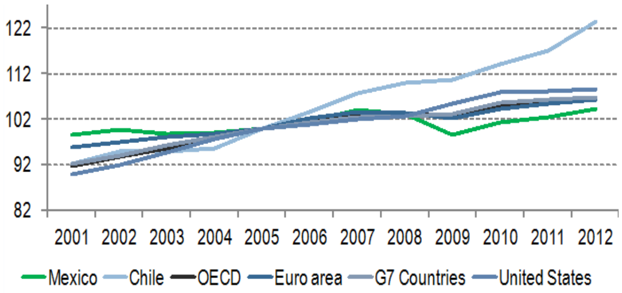
Figure 128: Labor Productivity Index

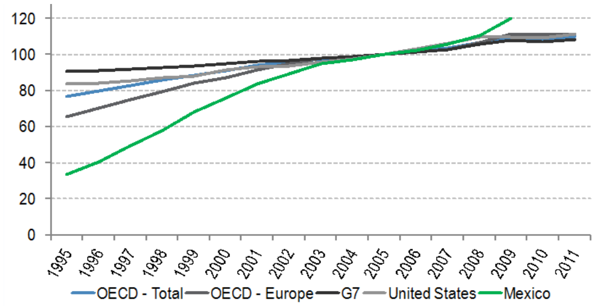
2005 = 100



Source: OECD.

Figure 129: Unit Labor Costs Index

2005 = 100



Source: OECD. Mexico data as of 2009, the rest up to 2011.

The main issues included in the reform are:

Increase flexibility of hiring and firing terms

Hiring

- New types of temporary contracts, such as per hour, trial, and training periods. These contracts' deadlines would not be extended any further than the initial period, and the same company would not be able to offer to the same person more than once, even if it is for a different positions. Pay and benefits would be as per law according to time worked.
- Home office as a valid form of employment, thus meriting all rightful benefits (including social security).
- Oversight and regulation on outsourcing, to avoid usual malpractices related to social security, work safety, and fiscal transparency.

The main beneficiaries of new hiring practices and contract types are young people first entering the workforce and women, who tend to forgo their jobs to focus on their families. Together they represent 53% of the economically active population.

Firing

- Use of certified mail is allowed as an official form of notice of dismissal, as well as parallel notice to the Conciliation & Arbitration Board over employment contract termination notice.
- In the event of a labor trial on unjustified dismissal, the employer is responsible for covering due wages to the employee for up to six months, after which only 2% annual interest will be borne on the accumulated balance.
- If unjustified dismissal is determined in a trial and if the employee worked at the company for less than three years, the employer has the obligation to provide severance payment but is not obliged to reinstate him/her as it used to be.

Increase productivity of existing workforce

- Elimination of restrictive job descriptions to promote "multi-skilled" workers.
- Increase training offers provided to the employee by the company.
- Link wages and total compensation to employee qualifications, acquired capabilities, and productivity.
- Filling of vacant positions should be done according to (1) productivity, (2) qualifications, (3) punctuality, and (4) seniority.

The following table summarizes the changes described above.

Table 47: Labor Reform Summary – Key Changes & Effects

Key Change	Before	Now	Effect
Contracting	Fixed & Indefinite	Fixed, Indefinite, per hour, seasonal workers, for trial, training	Fosters hiring of young and inexperienced workers and employers are able to hire people specifically for jobs required.
Dismissals	Employee had to be notified personally, otherwise dismissal was not valid.	Employee can be notified by mail	Lower the # of labor litigations, which usually end up being very burdensome for companies, especially SMEs.
Back-Pay Salaries	In the event of labor trials, the employer has to accumulate back-pay for the worker involved for as long as the trial goes on	Back-pay is limited to 1yr in the event of labor lawsuits	Indefinite labor trials bankrupted many SMEs; now litigations can be budgeted by companies
Productivity links	Job promotion and salaries are legally linked to seniority	Will now be linked to productivity	Employer is required to provide training for the employee as well as promoting his/her capabilities and reinforcing his/her strengths.

Source: J.P. Morgan, Cámara de Diputados.

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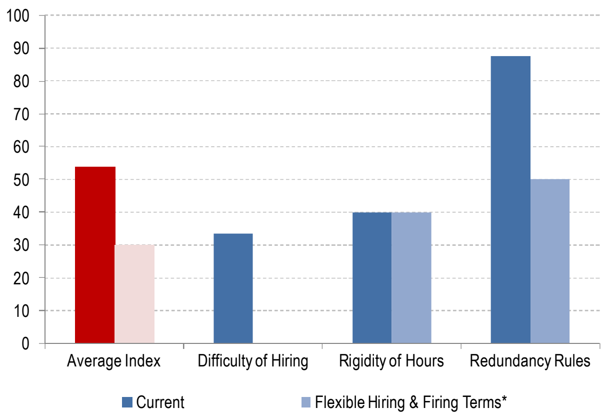
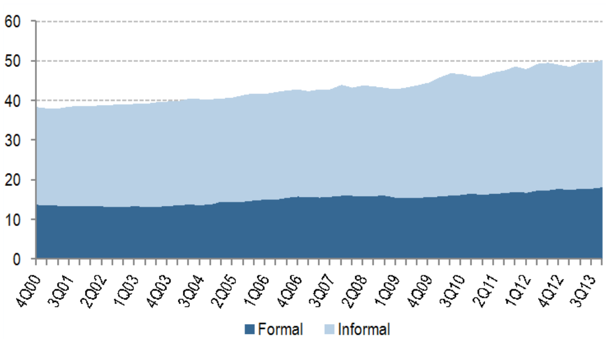
Only accounting for changes in the regulations for hiring and firing terms, **Mexico's ranking in terms of Employment Rigidity, according to World Bank's Doing Business, would improve by 68 places** (from being the 17th most rigid economy, globally, it would go to the 85th spot). Mexico would be slightly ahead of even Chile, which ranks in the 81st position.

Figure 130: Employment Rigidity Index: Current vs. Mild Labor Reform



Source: J.P. Morgan, World Bank's Doing Business. *Allowing for different contract modalities and flexible firing terms.

Figure 131: Employment in Mexico
million people



Source: INEGI.

Nonetheless, **formalization of the economy will be a long-term process**, especially while private companies adjust to new regulations and the right incentives are put in place for people to become formal employees. Some of these incentives include access to social security and unemployment benefits. The Social Security Reform was approved late 2013 alongside 2014's budget and included the creation of a universal social security system and unemployment benefits for formal workers. Other incentives for formalization include access to formal lending. Currently, credit penetration in Mexico is the lowest in LatAm, and Mexican families are financing more through informal channels than through the formal banking system. Lower debt service incentivizes consumption and provides support to the domestic economy.

While the most important macroeconomic impact from the reform has to do with long-term gains in productivity and competitiveness, in the short to medium term we should expect a mild spillover derived from increased flexibility in the market and the expectation of lower costs for employers. Formal sector hiring should improve gradually, boosting credit and private consumption while at the same time broadening the base of tax collection. **We expect the labor reform to contribute in a five-year period with 0.1-0.3%pct to potential annual GDP growth.**

Short-term savings from such a labor reform (considering only simpler hiring and firing terms) would be meager for companies overall as most of the impact would come with new jobs created, and that would depend on each company's growth plans and how labor intensive each company is (manufacturing companies would likely be the main beneficiaries). Most of the impact would be felt in the long term as (1) new employees are added to the company's workforce under the new contract forms, and (2) employment growth stimulates spending and thus strengthens the economy.

The reform should entail a shift from informal workers to the formal economy. This makes such employees now able to receive credit from banks. Growth in employment would thus translate into higher growth in loan book portfolios for financial institutions. Furthermore, room for expansion is ample in light of the low penetration of credit in Mexico vs. the rest of the region (less than 20% of GDP vs. LatAm average of 37%).

Telecommunication Reform

In March 2013, President Enrique Peña Nieto proposed changes to the Constitution to modify regulations for communications and media sectors. The main issues addressed were to (1) increase competition in these markets by eliminating monopolies and lowering barriers to entry for new participants, (2) strengthen regulatory bodies, and (3) revise limits to FDI in the sector.

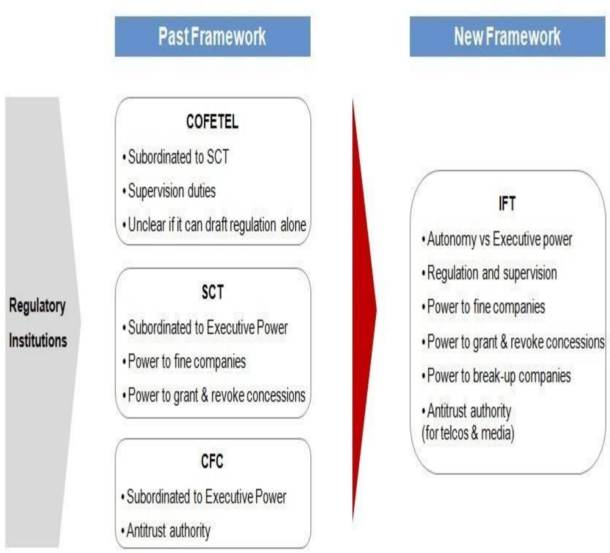
The OECD estimates the lack of competitive environment in the telecom sector has cost the Mexican economy about USD 25 billion, which represents ~2% of the country's GDP. America Móvil currently has 68% market share in mobile services in Mexico as well as 75% and 63% share in fixed line and broadband, respectively.

Key changes approved by the reform are:

- Strengthen the regulatory bodies in Mexico though the Federal Institute of Communications (IFT) with the elimination of Cofetel.
- Allow FDI for Media (49%) and Telecom (100%).
- Ensure broadcast TV to all Mexicans and better prices in telecom services.
- The creation of specialized courts in the areas of telecom and antitrust.
- Higher competition with market share limit.
- Asymmetric regulation to foster competition. This includes forced sharing of infrastructure and asymmetric interconnection rates.
- Introduction of "dominant player" definition, which says that no company can have more than 50% market share.

Former regulators (Cofetel and CFC) were the base for creating the new regulatory body (IFT). The previous framework divided the activities in three different entities, while with the new structure of the IFT has total autonomy from the executive power and the ability to impose more aggressive sanctions.

Figure 132: Creation of Stronger Regulation



Source: Mexican Congress and J.P. Morgan.

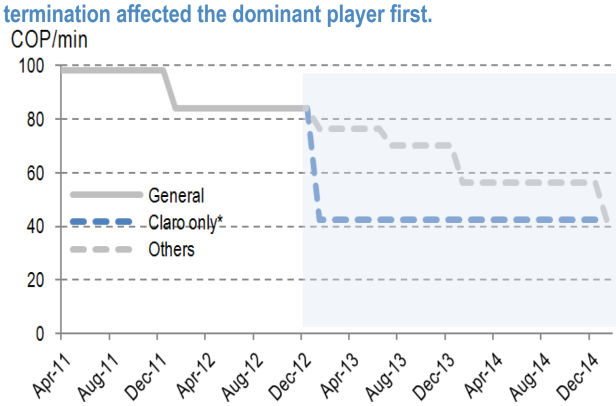
Consolidation of the three institutes into a single entity should lead to synergies and less inefficiencies in regulating the sector. Furthermore, the creation of specialized courts in TMT affairs eliminates non-homogeneous rulings from ordinary courts, thus streamlining and increasing fairness in legal processes.

In the media sector, the government is pushing to increase competition in the TMT industry by auctioning two new digital TV channels to compete with Televisa and TV Azteca in broadcasting. Also, the government plans to reduce barriers to entry by allowing small and mid caps to increase their capex though FDI.

Prior to the reform the media sector had limited access to FDI. However, new changes now permit FDI in broadcasting up to 49% (prev. 0%). In mobile, the FDI limit was raised from 49% to 100%.

Asymmetric interconnection rates between the companies will also lead to a more competitive environment. IFT will be in control of setting prices, thus precluding companies from giving preferential tariffs to their own subsidiaries (e.g., Telmex and Telcel, both subsidiaries of AMX). This will benefit smaller players in the industry.

Figure 133: The Colombian Example: Asymmetric mobile termination affected the dominant player first.



Source: Mintic and J.P. Morgan Estimates. *Claro is the Colombian subsidiary of AMX. Highlighted area: Projections as of Dec 2012.

After the creation of the IFT, the regulator had 180 days to rule on preponderance in the telecom and broadcasting sector. As expected, America Movil in telecom, and Televisa in broadcasting were declared by the IFT as preponderant. Implications of the ruling where different for each company:

- America Movil: AMX will need to allow competitors to use their passive infrastructure and its mobile network for Mobile Virtual

Network Operators (MVNOs). It will be subject to asymmetric interconnection rates, price controls, and will be restricted on the purchase of relevant exclusive content (Olympics, World Cup, Mexican soccer play-offs, and all content declared relevant by the IFT before March 30th).

- Televisa: TV shall share its broadcasting infrastructure with broadcasters with less than 12MHz and make public contracts of its broadcast advertising services (fees and specifications). Televisa is restricted to purchasing relevant exclusive content and to bid for the two new over-the-air channels.

On March 24, 2014, the federal government delivered to the Upper Chamber in Congress the draft of the new Telecom & Broadcasting Federal Law. The base case scenario is for the Congress to approve it before 2014's first period of ordinary sessions ends on April 30th.

Table 48: Telecom & Broadcasting Federal Law Main Points

Main Change	Implications
IFT Attributions	(1) Impose national and regional limits for concentration, (2) Ruling on asset divestiture from preponderant players, (3) Settle disagreements between concessionaires, (4) Request concessionaires for their shareholder structure before April 30th of each year.
Concession Revoking	There will be 20 reasons for concession revoking including denying interconnection or taking economical advantage of the must-offer scheme while being a preponderant player. Concessions will be revoked for a 5 year period.
Fines	Up to 5% of revenues & 82 million minimum wages (c. Ps. $5.5bn) or double if recidivism.
Unique Concession	20 years concessions that allows for all telecommunication services to be offered by the same concessionaire.

Source: J.P. Morgan, Cámara de Diputados.

We expect the telecom reform to add around 0.2%pct to potential GDP on the back of a gradual increase in foreign investor involvement and a reduction in interconnectivity tariffs. Barriers to entry in the sector will limit the short-term gains, but the lower tariffs have already benefited consumers, and this should continue to be the case as competition increases and antitrust bodies gain strength.

Education Reform

The education reform was the first tangible achievement of the Pact for Mexico. The reform was enacted on February 25 by President Peña Nieto. The initiative addresses commitments made in the Pact for Mexico regarding Social Development, and it includes changes to Constitutional Articles 3 and 73, and deals with three main topics:

Professional Teaching Services

Access, permanence, and promotion in the Education System
(Art. 3 of the Constitution)

- Individual performance criteria for access, promotion, and permanence for all participants of the Education System. This includes teachers and any supervisory position from elementary to high school.
- In the event of more than one applicant for the same position, candidates will be evaluated and selected under applicable regulation.

These changes prevent any access or promotion to the educational system made by any means different from those established in the regulatory law, weakening the strong influence of the Teachers' Union in the selection process.

General Evaluation Systems

Creation of the National Education Evaluation Institute
(Art. 3 of the Constitution)

The institute will:

- Establish the guidelines for the evaluation of the Educational System in order to guarantee quality in the education services.
- Design and perform measurements regarding components, processes, and results in the Educational System.
- Provide federal and local education authorities with guidelines for evaluating processes and educational services in their respective jurisdictions.
- Evaluate teachers as part of the National Educational System and at the same time provide training materials.
- Generate and disseminate information on quality of education using INEGI to perform census in the sector (schools, teachers, and students) in order to consolidate one data platform on Educational Services.

This last point has been one of the most controversial due to objections from the Teachers' Union to have teachers evaluated.

Inclusion, autonomy & full-time schools

(Art. 73 of the Constitution & other transitory constitutional articles)

- "Inclusion" and "diversity" are to be included as goals of the educational system.

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The reform aims to strengthen the legal framework to allow schools to make autonomous decisions in terms of their own infrastructure improvement and supplies. It also establishes the gradual implementation of full-time schools and the prohibition in schools of any food that does not promote the health of the students.

On August 14, 2013, President Peña Nieto sent to Congress **three secondary laws for the implementation of changes to constitutional articles** 3 and 73 called for by the Education Reform.

Professional Teaching Services

Administrative personnel designations and pay.

- *Previous.* Administrative personnel in the union would be paid as teachers by the Ministry of Education. Positions were negotiated under unclear criteria.
- *Current.* Union administrative personnel receive salaries from their union.

Treatment of absences

- *Previous.* Sanctions for teachers missing classes were treated on a case by case basis.
- *Current.* Teachers who miss classes more than 3 days in a row (without viable justification) will be discharged.

On granting teaching tenures

- *Previous.* Evaluations are voluntary and did not impact granting a teaching position.
- *Current.* Teaching posts are dependent on approving a mandatory evaluation (3x limit exam fails).

General Education Law

- *Previous*. Schools charged "voluntary" fees from the students (it promoted corruption and service conditioning).
- *Current*. Introduces regulation and transparency in fees. Avoid any fee that conditions schools' services.

National Education Evaluation Institute

- *Previous.* Didn't exist.
- *Current.* The institute would be in charge of establishing the general framework for teachers' evaluation. Evaluations will consider demographic and social environment in each region to assess quality of education providers. It will be in charge of creating an Education Information System to keep better track of information inside schools.

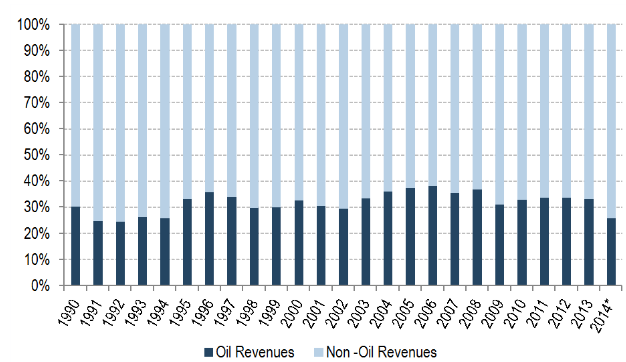
Protests by an arm of the Teachers' Union, the Teachers' National Coordination Group (CNTE by initials in Spanish), took over Mexico City's streets in a series of demonstrations **calling for the revoking of the Education Reform and especially against the approval of the Professional Teaching Services Secondary Law.** Teachers deemed illegal the proposal of implementing a national evaluation mechanism for access to teaching positions as it jeopardized their tenure. After more than one month of continuous demonstrations across Mexico City, the Lower Chamber in Congress approved the Secondary Laws pertaining to the Education Reform, shortly after the inauguration of the 2013's 2nd Ordinary Session in Congress. The bill was then turned to the Senate for its final approval and signing. President Peña Nieto signed the secondary laws on September 10th. National Education Evaluation Institute, General Education Law, and Professional Teaching Services Laws were published in the Official Gazette on September 11th.

Mexico has the largest teachers' union in LatAm, the SNTE (*Sindicato Nacional de Trabajadores de la Educación*) **with c.1.5mn unionized teachers.** The SNTE receives around $127 million every year. In 2013, the long-standing president of the Union, Elba Esther Gordillo, was arrested for fund embezzlement.

Fiscal Reform

Non-oil tax collection in Mexico is among the lowest in LatAm, according to the OECD. Over 30% of the federal government's revenues come from oil-related sources. This poses a significant risk for the government's finances as oil production in the country declines. The fiscal reform and the energy reform were thus complementary to each other as an increase in non-oil–related revenues was expected to increase Pemex's flexibility for investments under the new regime, allowed by changes enforced by the Energy Reform.

Figure 134: Historic Public Sector Oil Revenue Dependency
% of total revenue



Source: SHCP. *As of January 2014.

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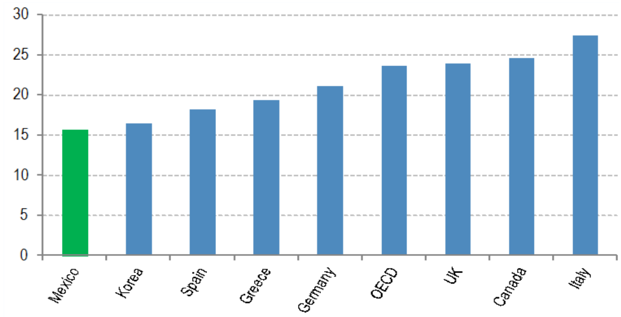
Table 49: Tax Collection in LatAm

	Income Tax (A)		VAT (B)		Total (A+B)
	Tax Rate	*% GDP*	*Tax Rate*	*% GDP*	*% GDP*
Average	4-34%	5.80%	16.70%	6.70%	12.50%
Brazil	0-35%	6%	0-60%	7.40%	13.40%
Chile	0-40%	7.70%	19%	8.10%	15.80%
Argentina	9-35%	5%	21%	7.10%	12.10%
Peru	15-30%	6.90%	18%	8.30%	15.20%
Mexico	0-30%	5.30%	16%	3.70%	9.00%
Colombia	0-33%	5.80%	16%	6.30%	12.10%
Venezuela	6-34%	3.90%	12%	6.20%	10.10%

Source: J.P. Morgan. Excludes oil fiscal revenue.

Figure 135: Tax Revenues in OECD Selected Countries

% of GDP



Source: OECD.

One of the most important changes expected to take place with the Fiscal Reform was the generalization of VAT across the economy, as currently in Mexico there is no VAT on food and medicine. The changes to the tax regime approved late October 2013 fell short of such expectations as it fails to significantly increase the taxing base while doing little to fight informality, another important source of the shortfall to the government's non-oil revenues. Lawmakers approved an 8% excise tax on high-caloric content food and Mx$1 per liter on sugary drinks, as well as generalization of VAT across the country (formerly, border states paid only 11% VAT) and introduced 16% VAT on intermediate imports for non-exporters and regional public transport. Other changes included adding 3 new income tax brackets with higher income tax rates to increase taxation on the richest 1% of the population. For companies, one of the most important changes was the elimination of the fiscal consolidation scheme, which allowed companies to defer taxes for up to 5 years and offset earnings with losses from other subsidiaries.

Table 50: Selected Items from the Fiscal Reform: Impact on Individuals

Theme	Main Changes
VAT on Transportation	Elimination of VAT exemptions for public transport excluding for urban areas services
VAT for Pets	Elimination of 0% VAT rate for the acquisition of pets and pet food
VAT for chewing gum	Elimination of 0% VAT rate for chewing gum
Capital Gains Tax	10% tax on capital gains on stock holdings
Inc. Tax on home sales	Tax exemption limit for home sales of Ps.$3.5mn
Personal Income Tax	32% (+ Ps.$750k annually) 34% (+ Ps. $1mn annually) 35% (+ Ps. $3mn annually)
Deductions	Limits annual deductions to the minimum between 10% of annual income and 4 annual minimum wages.

Source: Minister of Finance, Official Gazette of the Lower House, Official Gazette of the Senate.

Table 51: Selected Items from the Fiscal Reform: Impact on Individuals & Corporates

Theme	Main Changes
Equal VAT	Generalization to 16% across the country
Dividend Tax	10% tax on dividend payments paid at a corporate level
Excise tax on sweetened beverages	Ps. $1 per liter for sweetened beverages Excluding: Flavored milk flavors, medicines with sweeteners.
Excise tax on high caloric food	8% tax for: Snacks, confectionery, chocolate, caramel, peanut and hazelnut butter, ice cream.
Excise Tax for alcoholic beverages and beer	Keep it unchanged rate for 2014 at 26.5% for beverages with alcohol content <14°D.L. and 53% for beverages with alcoholic content >20°D.L. (Initially a reduction in 2014 had been proposed in this year's budget)
Social Benefits Deductions	Companies will be able to deduct only 50% of exempt benefits. IMSS fees will not be deductible
Employment Subsidy	For people earning up to 2 minimum wages, the Federal Government will provide the total social security quota.

Source: Minister of Finance, Official Gazette of the Lower House. Official Gazette of the Senate.

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Table 52: Selected Items from the Fiscal Reform: Impact on Corporates

Theme	Main Changes
VAT for Temporary Imports	Eliminate VAT exemptions on temporary manufacturing imports*.
Green Tax	Changes to highly pollutive energetic and pesticides. (Click here to see details on this)
Excise Tax to Pesticides	6-8% Excise tax on pesticide depending on toxicity levels with 2 stage implementation (50% in 2014 + 50% in 2015).
Fiscal Consolidation	Elimination of the fiscal consolidation. Introduction of the Optional Fiscal Regime for Societary Groups.
Mining Royalties	7.5% royalty + 0.5% on precious metals, on EBITDA
Mixed-rent FIBRAs	Trusts will remain exempt as long as at least 95% of its income comes directly from rents (not services provided).
Tax deduction for investments mining companies	Deducibility is limited to 10% of investments
Tax regime for telecom spectrum	Approved with royalty payment reduction for spectrum use to 0.055dlls/MHz per habitant. For the 698MHz-806MHz networks, payment will be 0.023dlls/MHz per habitant.
Immediate deduction of new investments in fixed assets	Elimination of deduction of 100% in one fiscal exercise. Deduction should be according to straight line depreciation.
Tax deduction of 12.5% on business meals in restaurants	Companies will only be able to deduct 8.5% of restaurant bills for business meals.
Tax deduction of 12.5% on business meals in restaurants	Companies will only be able to deduct 8.5% of restaurant bills for business meals.
Deductions on purchases of company cars	New deductible amount limit = Ps.130,000 per unit
Tax deduction for homebuilders and real estate companies	Elimination of deduction of a 100% of land acquisition costs. The acquired land needs to be destined for housing developments and that at least 85% of the company's revenue comes from home sales.
IETU and IDE	Eliminate to simplify corporate tax regime

Source: IMMEX* standards compliers can have a100% fiscal credit. Note: The IMMEX Program allows industrial temporary importations to be exempted of general import tax, value added tax and, where appropriate, countervailing duties.

Table 53: Official Expectations for Mid-Term Tax Collection Effects from New Fiscal Regime (2014-2019)

% of GDP

	2014	2015	2016	2017	2018	Total
Total collection	1.4	0.6	0.3	0.3	0.3	2.9

Source: Ministry of Finance, CGPE 2013.

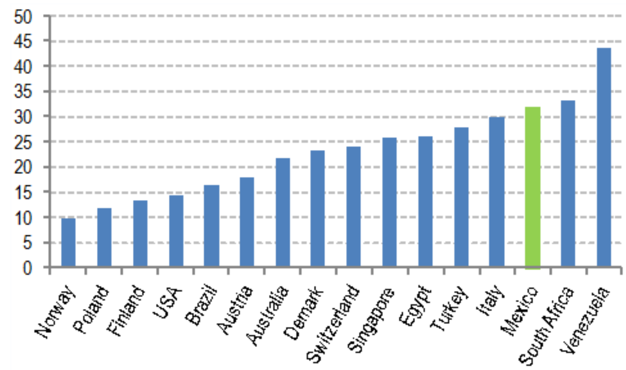
As a response to the private sector's numerous complaints about the new scheme, **Pres. Peña Nieto's administration signed a "fiscal amnesty" pact, in which the government promised not to make any more changes to the tax regime until the end of this presidential term.**

Financial Reform

Although Mexico's financial system is rather healthy, with strong capitalization levels and low non-performing loan ratios, at less than 20% of GDP credit penetration in Mexico remains significantly low by international standards. Low credit penetration has been the result of several inefficiencies in Mexico's financial system, ranging from a weak legal framework to the lack of competition. According to the WEF the cost of enforcing contracts in Mexico stands amongst the highest in the world, accounting, on average, for around 35% of the value of a legal claim.

Figure 136: Cost of Enforcing Contracts

as % of legal claim, average

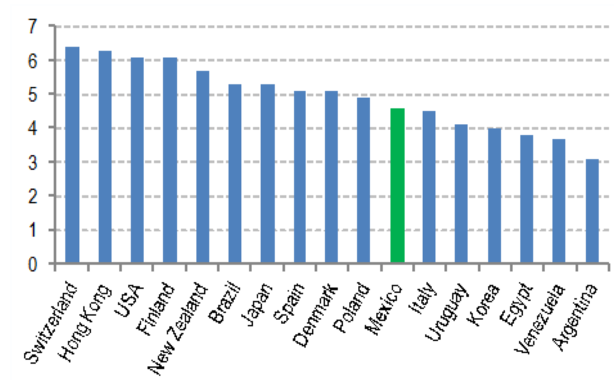


Source: WEF. Data as of 2011.

Meanwhile, **competition in the financial system is limited,** with 5 major banks accounting for nearly 75% of credit issuance. This has resulted in relatively elevated financing costs and limited availability of financial services.

Figure 137: Availability of Financial Services

index, scale from 1 to 7



Source: WEF. Data as of 2013.

SMEs have been most affected by the reduced credit supply. According to the Ministry of Finance, while

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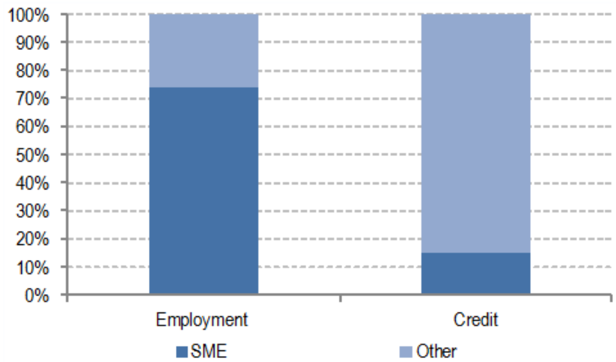
SMEs generate around 75% of jobs in the country, only 15% of total financing is allocated to such firms.

Figure 138: SMEs Employment and Credit

% of total



Source: CNBV, INEGI & Ministry of Economy. Data as of 2012.

In 2013 the Congress approved a broad-based reform of Mexico's financial system. The reform aims to boost financial services penetration in the country by fostering competition in the financial system, enhancing the country's legal financial framework and boosting the role of development banks.

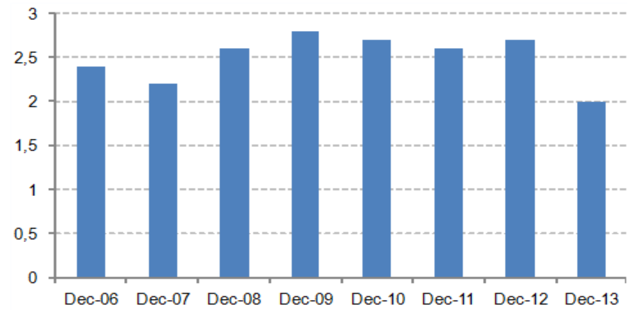
Measures to boost competition include strengthening regulatory bodies; facilitating mobility across financial institutions by allowing portability of claims across institutions and prohibiting product bundling and other monopolistic practices.

To diminish transaction costs and lower interest rates, the government proposed several measures to enhance the financial system's legal framework. Some of the most relevant are reducing information costs by creating a unified credit bureau, simplifying the allocation and execution of credit guarantees, and modifying the country's bankruptcy law to slash legal costs associated with bankruptcy processes.

Lastly, in order to **boost development bank credit,** the government proposed to modify development banks' legal mandate while providing them with more flexibility to allocate credit.

Figure 139: Development Bank Credit to Private Sector

as % of GDP



Source: Ministry of Finance.

In our view, the **correct implementation of the financial reform should allow banking credit penetration to nearly double in the next five years**, reaching 40% of GDP by the end of the current administration (2018). We estimate that broader financial deepening will help shift potential growth by around 0.2%-pts to 0.3%-pts over the next five years.

Electoral & Political Reform

The main goals of this reform are twofold, looking to guarantee a fair electoral ground in the future and reorganize the political picture in a way in which the potential fruits of the economic reforms are distributed in a more even way across parties. The political reform retakes some of the issues called for by Calderón in 2009 while adding a few others.

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Figure 140: Political bill presented by former President Calderón back in 2009 *

Amendment/addition	Approved (2012)	Secondary laws **
Reelection for legislators and local government officials (not governors)		
Reduce the number of senators by 32 to 96 and the number of representatives by 100 to 400		
Increase the minimum share of national votes for a party to obtain its registration to 4% from 2%		
Allow citizens to introduce bill initiatives ("citizen initiatives'")	x	
Allow individuals that are not affiliated with a particular party to run for all public offices	x	
Introduce a two-round voting system for the presidential election		
Create a preferential initiative that forces Congress to vote a bill presented by the President (if not voted the bill is approved)	x	x
Allow the President to make observations on the fiscal budget approved by Congress		
Recognize the Supreme Court's faculty to present bill initiatives of issues within its competence		
Introduce national referendums that can be summoned by the president, 1/3 of any of the chambers or 2% of the electoral register ***	x	

Source: Mexico's Official Gazette (*Diario Oficial de la Federación*).. * Though first presented in 2009, the reform was not approved until 2012. ** Secondary laws allowing the implementation of the bill have already been approved. *** Results will be binding when 40% or more of the electorate participates in the referendum.

The main points of the political reform approved are:

- **Reelection of legislators and non-governor local officials.**
- Define and allow for "**Citizen Initiatives**" and "**Citizen Candidacies**" as well as National Referendums.
- **Autonomy to the National Council for the Evaluation of Social Development Politcs** (CONEVAL).
- Creation of a **General Attorney's Office** replacing the General Prosecutor's Office of the Republic (PGR).

Regarding the electoral reform, the bill focuses on mechanisms to guarantee more transparency and fairness in electoral processes. The reform calls for:

- **Stricter spending limits** for political campaigns and government publicity (less than 0.5% of the federal government's budget as opposition is looking to tackle government spending and propaganda).
- Tougher **sanctions for breaching spending limits**, including fines and nullification of electoral results.
- Creation of a **National Electoral Institute**, to replace Local Electoral Institutes and preclude state governors from taking a preponderant role in state elections. (This is particularly important considering that the PRI governs 21 of the 31 states in the country.)
- **Votes needed for Political Party registration increases from 2% to 3%.**
- **Gender equality in Congress nominations.**

Energy Reform

Before 1938, the oil sector in Mexico was completely open to foreign and private investments. After 1938, Pres. Lázaro Cárdenas expropriated oil companies, making it the nation's own, after which oil became a national symbol and private participation in the industry was practically wiped out. However, oil production started to decrease in 2004 while reserve depletion was evident. In 2008, Pres. Felipe Calderón undertook an energy reform, in which the figure of "integrated contracts" was introduced. This modality allowed for private participation in the upstream segment and rewarded companies depending on the number of barrels produced. This led to a short-term stabilization in production levels.

Nonetheless, **Pemex's inability to increase production and refining capacity is evident,** especially in light of a more demanding local consumer who is facing energy shortages and high costs due to lack of natural gas supply and import prices vs. gas prices in the US. The company's inefficiency is largely explained by the financial burden imposed by the federal government in terms of taxes and royalties charged to Pemex. On average, the company has been paying 50-60% of its revenues in royalties or duties. Pemex royalties and taxes to the Mexican government represent close to 33% of total government revenue. This has forced the company to resort to leverage, further pressuring free cash flow generation. Moreover, exports have declined, and in the long term Mexico's main energy trading partner, the US, is expected to become self-sufficient. That is why a thorough Energy Reform in Mexico was critical.

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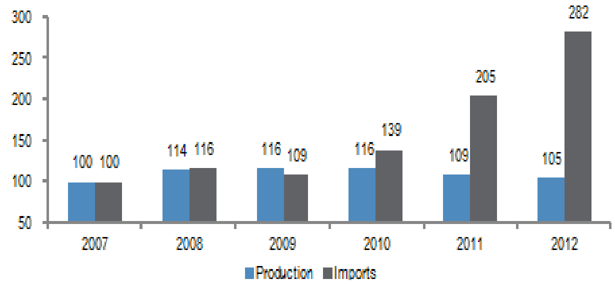
Figure 141: PEMEX Natural Gas Production vs. Imports

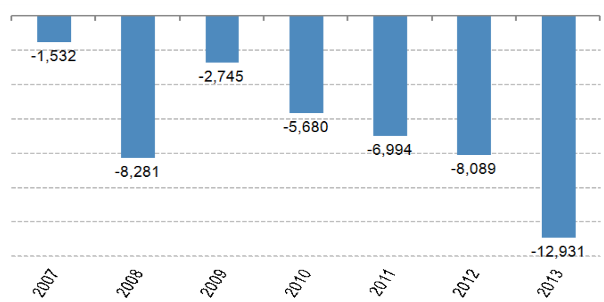
million cubic feet per day



Source: Company reports and J.P. Morgan estimates.

Figure 142: PEMEX's Net Income

$ in million



Source: Company reports and J.P. Morgan estimates.

PEMEX is the main subject in the reform. The company is currently a decentralized entity of the government that has the right to exploit hydrocarbon reserves in the country; its budget has to be incorporated into the national budget and has to be approved by Congress.

An inflection point in Mexico's history, the Energy Reform was approved mid-December 2013. Approved changes surpassed expectations on the openness and access granted to private investors in the Mexican Energy Sector. New forms of contracting include profit-sharing agreements, production sharing agreements and licenses, a huge step forward vs. the previous scheme of only allowing service contracts. It also grants more independence to Pemex and CFE in terms of strategic investments and CAPEX plans, while creating a National Oil Fund and excluding Pemex's Union from the company's board.

Table 54: Energy Reform Main Points

Table	Main Change
Constitutional Amendments	Art. 25: State Productive Companies Art. 27: Contract Regime Art. 28: National Oil Fund & Electricity Generation
Contracting Schemes	Concessions remain prohibited while different contracts schemes are permitted: (1) Profit-Sharing, (2) Production-Sharing, and (3) Licensing
Booking of Reserves	Companies with exploration & exploitation contracts will be able to report the expected benefits of the contract, the contract itself or the oil reserves regarding the project in their balance sheets.
Electricity	Elimination of the State exclusivity of electricity generation. The State will be the one fully responsible of transmission and distribution of electricity while having the possibility to outsource to private contracts this activities compliance to corresponding laws..
Round Zero for Pemex	Pemex will have priority vs. other private participation in the bidding rounds for new potential oil fields, as long as the company proves its technical capabilities and expertise. Pemex will have the possibility to continue working up to 5 years in areas where it has made commercial discoveries or exploration investments based on established plans. If these activities comply with the exploration plan it could continue with the extraction activities otherwise the area must be reverted to the State.
National Oil Fund	Created as a public trust to receive and distribute oil revenue to the different funds as mandated by the law. These funds include: The Mexican Oil Fund, Oil Income Stabilization fund, Federal Entities Stabilization fund, and the Hydrocarbon Extraction fund. The trust will be guarded by Banxico. Resources from the fund destined to the Federal Budget will be limited to 0.7% of the GDP.
State Productive Companies	Pemex and CFE will become state productive companies, subject to external auditing procedures. Transition towards this new scheme will be less than 2 years.
Board Composition	Hydrocarbon State Productive Companies will have to comply with international corporate governance best practices. In the case of Pemex tenure of members of the board of directors will be limited to 10 members which include 5 representative of the Federal Government (including the Minister of Energy which will preside the board and will have a casting vote) and 5 independent advisors. Pemex members of the workers' Union will not participate in the board anymore.
Strengthening Regulation and Oversight	National Hydrocarbon Commission to be the autonomous entity in charge of regulating the contract awarding, exploration and extraction regulation. Energy Regulatory Commission to be the autonomous entity in charge of the operation of the National Electric System. Create National Natural Gas Control Center to be in charge of operating the national oil & gas pipeline system. Create National Energy Control Center to be in charge of the operation of the National Electric System Create Hydrocarbon Information National Center to be in charge of gathering seismic and soil information.
Transparency	The State will be responsible for making publicly available all information pertaining to payment considerations from the contracts celebrated with private companies on hydrocarbon related projects.
Sustainability	National Industrial Security and Environmental Protection Agency in charge of operational security and environmental protection. Includes waste disposal. Sustainability criteria in natural resource exploitation.

Source: Cámara de Senadores.

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Table 55: Potential Impact of Energy Reform on Key Macro Variables

%oya, unless noted

	Pre-reform	Post-reform
GDP potential annual growth	3.3%	3.7%-3.9%
Foreign-direct investment	US$15-20 billion	US$28-32 billion
Formal employment growth	2.5%	2.9%

Source: J.P. Morgan.

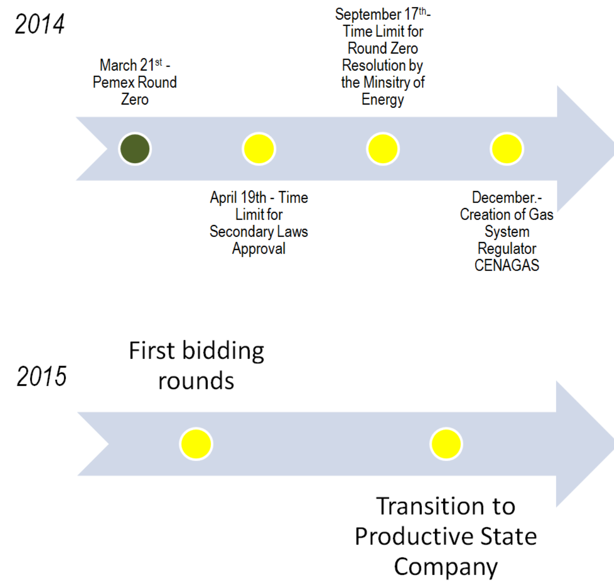
Though the changes approved by the constitutional reform are important, details of such regulation and implementation still pose some risks. As per the constitutional transitory articles, the Energy Reform's secondary laws will have to be approved 120 days after the final approval of the main bill.

Table 56: Key Things to Watch For in the Secondary Laws

Oil Sector	
National Content	Possible Scenarios: Pemex participation in certain % of the projects, mandatory CapEx in national suppliers, minimum national employees.
PEMEX as market participant	Conditions to avoid too much advantageous conditions for Pemex that precludes private participation. Transmission of all the seismic and oil information from Pemex to the CNH.
First round of biddings	Restrictions in some areas or field types. Fields offered in packages or areas.
Contract Scheme	Fiscal regime per contract or per reserve type or region.
Electric sector	
CFE as market participant	Conditions for CFE participation in competitive market. Conditions for private sector participation in expansion and maintenance of electric infrastructure.
Regulators	Legal attributions from the new independent regulatory body CENACE to avoid unequal treatment among some private players and free access to the CFE's distribution line network. Legal attributions of the new independent regulatory body CENAGAS to effectively enable gas pipeline development to foster gas availability for electric generation
Tariffs	Electric energy commercialization tariffs. Price for the use of distribution lines.

Source: J.P. Morgan.

Figure 143: Key Dates for the Energy Reform



Source: J.P. Morgan.

Pemex Round Zero

On March 21, 2013, Pemex submitted the list of oilfields it wants to keep for its own exploitation and development. Details of the requested list were not disclosed as the company argued this would be against its strategic plans and would only benefit its competition.

Pemex asked for 100% of 1P reserves (probability of extraction = 90%), 83% of 2P (50% probability), and 71% of 3P (10%). Fields are both in shallow waters and deep waters where the company already has some investments.

Pemex left most of the shale gas reserves out of its wish list, as well as other non-conventional fields.

69% of prospective resources (estimated only) were left for private investments. Prospective resources come from fields that have not been perforated or explored but whose existence is assumed through evaluation of indirect evidence.

The Ministry of Energy has until September 17 to present a resolution to Pemex's request.

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Sectors

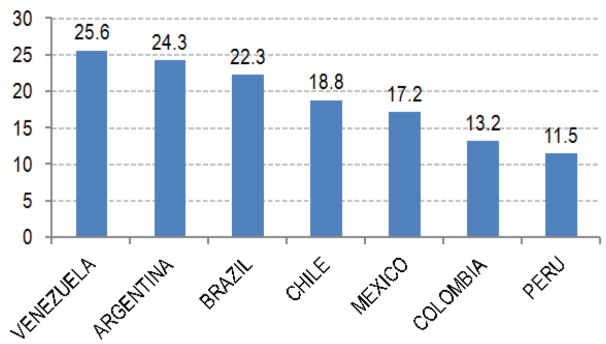
Telecom & Media

Telecom

For a long time, state-owned company *Teléfonos de México* (Telmex) was the only provider of fixed-line telephony in Mexico. During the presidency of Carlos Salinas (1988-1994), Communications reform was enacted, resulting in **the privatization of Telmex and the creation of the mobile telephony market**.

Among LatAm countries, Mexico is below average in fixed line penetration. According to the IFT, in 2012 Mexico had 17.2 fixed lines per 100 habitants, while countries like Venezuela, Argentina and Brazil had 25.6, 24.3 and 22.3 fixed lines per 100 habitants, respectively.

Figure 144: Fixed Line Penetration, Fixed Lines per 100 Habitants

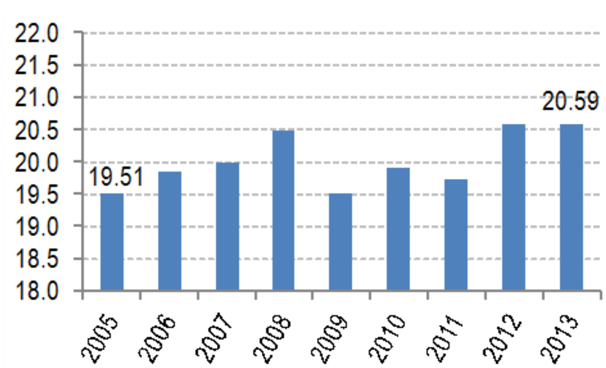


Source: IFT.

Despite the low penetration compared with other LatAm countries, the **number of fixed line subscriptions in the country reached its highest number in 2013** with 20.6 million subs, growing from 19.5 million in 2005 at a 0.67% 8yr-CAGR.

Figure 145: Fixed-Line Subscriptions, 2005-2013

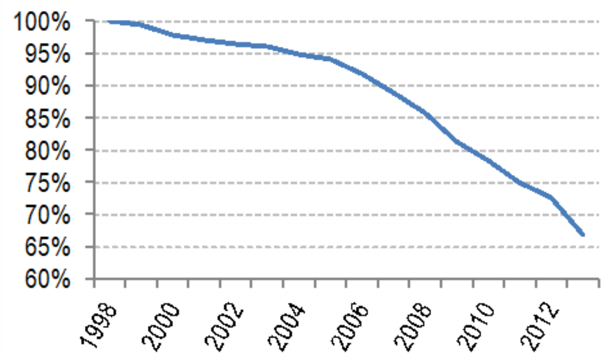
Million subs



Source: IFT.

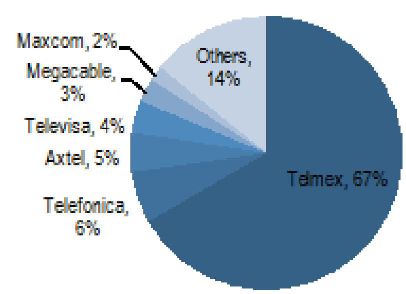
In the late 1990s, Telmex controlled the fixed-line market, with 100% of market share. Over the years, the entrance of new competitors, such as Telefonica, Axtel, and Televisa, has led Telmex's market share to shrink to 67% as of 1Q13. Nonetheless, it still is the dominant player in the sector.

Figure 146: Evolution of Telmex's Market Share in Fixed-Line Telephony, 1998-2013



Source: IFT, Company Data.

Figure 147: Fixed-Line Market by Company



Source: IFT. J.P. Morgan Estimates. Data as of March 2013.

América Móvil (ticker: AMX), Mexico's biggest telecom player, was created in September 2000 as the result of a spin-off from Telmex. In 2011, AMX concluded its tender offer for Telmex's outstanding shares, thus delisting TMX from the US and Mexican exchanges while creating the leading telecom company in the region.

As of 2Q12, Mexico's mobile market represented the second largest in LatAm, with 18% of total mobile subscriptions, only surpassed by Brazil (48% of mobile subscriptions in LatAm). Argentina and Colombia are ranked as 3rd and 4th with 47.2 million and 28.1 million subscriptions, representing 11% and 9% of LatAm's mobile market, respectively.

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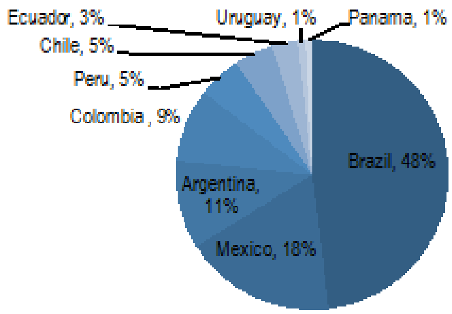
Figure 148: LatAm Total Mobile Subscriptions by Country

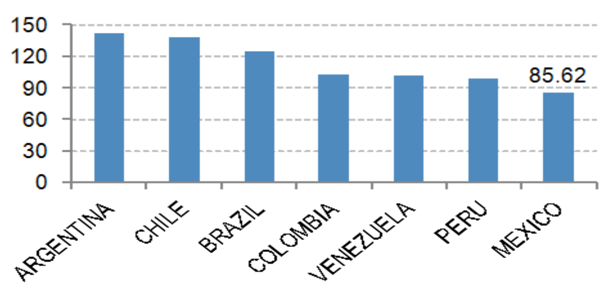


Source: Wireless Intelligence. Data as of 2Q 2012.

The Mexican mobile market has potential upside in the coming years, in our view, as it has one of the lowest penetration rates compared to international peers. Within LatAm, Mexico has one of the lowest penetration rates with 85.62 mobile subscriptions per 100 habitants, compared to 142.51 in Argentina and 124.19 in Brazil.

Figure 149: Mobile Penetration in LatAm

subs per 100 habitants

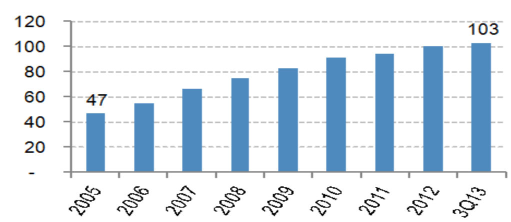


Source: IFT. Data as of 2012.

Mexico had 103.2 million mobile subscriptions as of September 2013, growing 4.3% yoy. Sixteen percent of total mobile subscriptions in Mexico (~16.2 million subs) are post-paid plans, the rest, 84%, are subscriptions in pre-paid plans. Trunking in Mexico is a post-paid only service. It accounts for ~18% of subscriptions, which decreased by 27.4% yoy in 2012-2013.

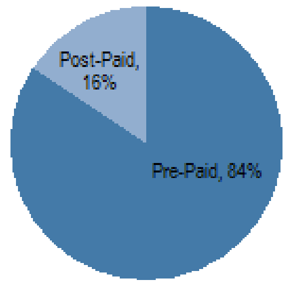
Figure 150: Mobile Subscriptions in Mexico

million subs



Source: IFT.

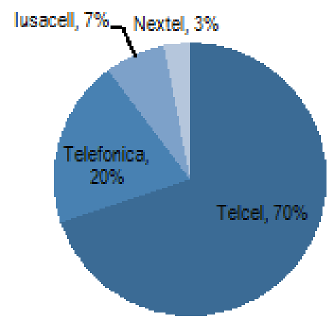
Figure 151: Mexico's Mobile Market by Subscription Type



Source: IFT. J.P. Morgan Estimates.

Telcel, a subsidiary of America Movil, is the largest player in Mexico's mobile maket, with 70% share. The second largest player is Telefonica Movistar, with 20% market share and the third is Iusacell, a joint venture between TV Azteca and Televisa, with 7%.

Figure 152: Mexico's Mobile Market by Company



Source: IFT. Company Data. J.P. Morgan Estimates.

Mexico is experiencing a growing trend towards mobile data. Instant messaging apps are replacing common texts, thus increasing the use of mobile data. In 2012, Mexico had the second lowest 2G penetration in LatAm (62%), yet in 3G penetration Mexico tops LatAm's average of 22%.

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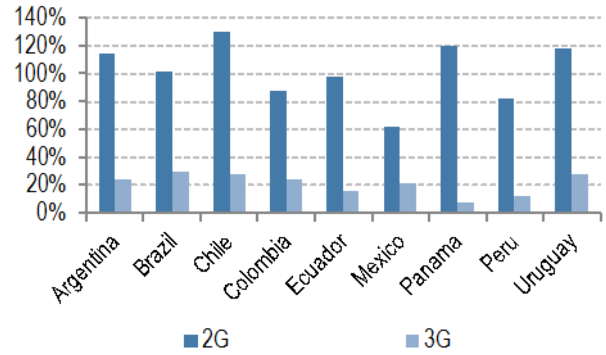
Figure 153: Data Penetration in LatAm, 2G & 3G

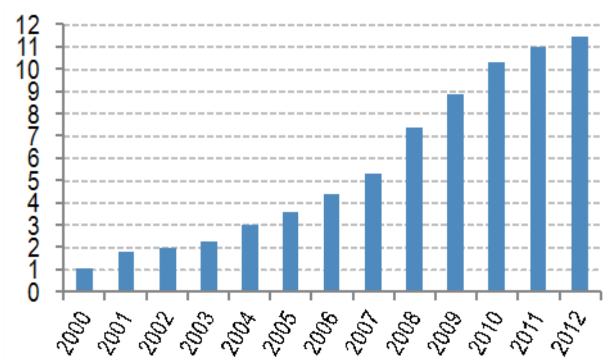


Source: Wireless Intelligence. Data as of 2012.

According to Cisco, Mexico's mobile traffic in 2013 was 116x the volume of mobile traffic in 2008. Cisco expects mobile data traffic in Mexico to grow at a 73% CAGR in 2013-2018.

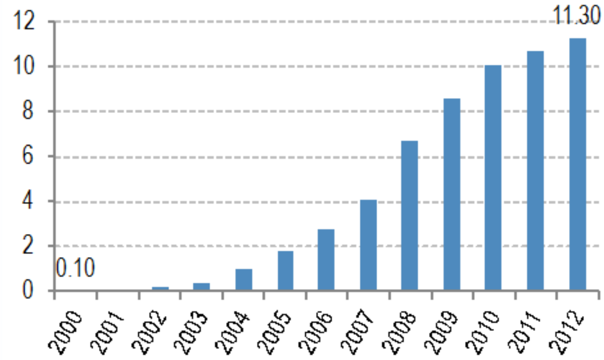
Mexico is above the LatAm average in internet and broadband penetration. In 2012, there were 11.5 internet subscriptions per 100 habitants in Mexico, growing at an 18% CAGR since 2005 (3.6 subs per 100 habitants). Broadband penetration had higher growth in the same period, growing at a 30% CAGR, from 1.8 subscriptions per 100 users in 2005 to 11.3 in 2012.

Figure 154: Internet Subscriptions per 100 Habitants in Mexico



Source: IFT.

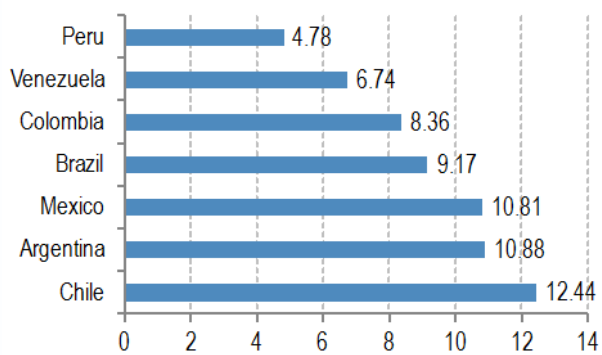
Figure 155: Broadband Penetration in Mexico, Number of Subscriptions per 100 Habitants



Source: IFT.

If we compare broadband penetration with other countries in LatAm, Mexico has the third highest number of subscriptions per 100 users, below Chile (12.44) and Brazil (10.88). Peru has the lowest penetration, with just 4.78 subs per 100 habitants. Compared to developed economies, Mexico's penetration rate is below that of South Korea and Germany, which have 37.56 and 34.04 subs, respectively.

Figure 156: Broadband Subscriptions in LatAm



Source: IFT.

Media

Television is considered the most popular means of communication in the world. According to INEGI, 98% of the homes in Mexico have at least one TV, either analog or digital. The two main players in free-to-air television are Televisa (~70% of market share) and TV Azteca (~30% market share).

According to LAMAC (Latin American Multichannel Advertising Council), pay-TV penetration in Mexico is just below 45%, the lowest in LatAm. Argentina and Chile have the highest Pay-TV penetration, with 87% and 85%, respectively.

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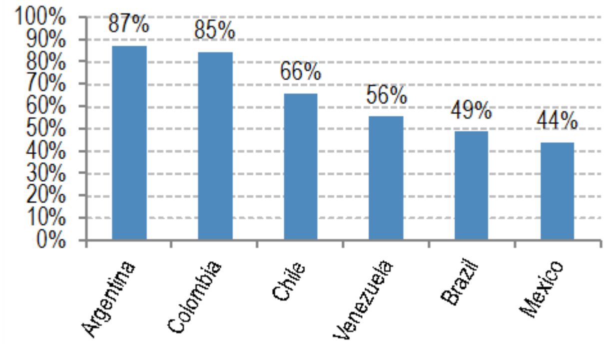
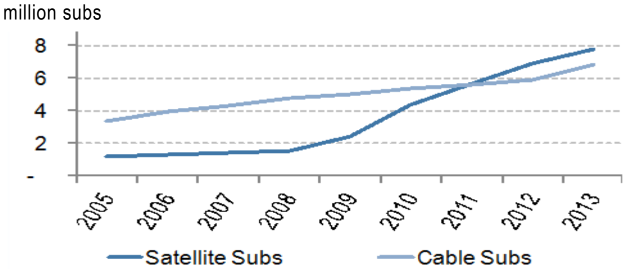
Figure 157: LatAm Pay-Tv Penetration



Source: LAMAC.

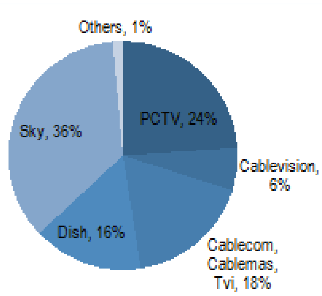
Subscriptions to satellite TV have had the largest growth since 2005, growing at a 26.6% 8yr-CAGR while cable penetration grew at a 9% CAGR in the same period. In 2013, satellite TV subscriptions totaled 7.8 million, with 6 million coming from Sky (Televisa is owner of 58% of Sky, while the other 42% is the property of DirecTV). Televisa participates in cable TV through three subsidiaries: Cablevision, Cablemas, and TVI. Televisa reported 2.49 million cable users by the end of 2013. In August 2013, Televisa acquired Cablecom, a Pay-TV service provider, for US$745mn.

Figure 158: Satellite and Cable Tv Subscriptions, 2005-2013



Source: IFT.

Figure 159: Pay-Tv Market Share

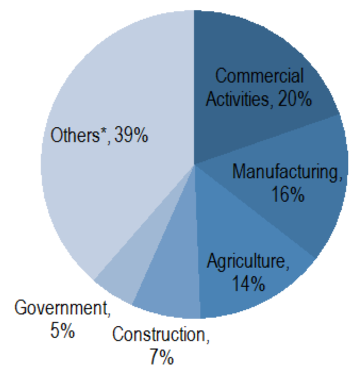


Source: LAMAC. Data as of December 2013.

Construction

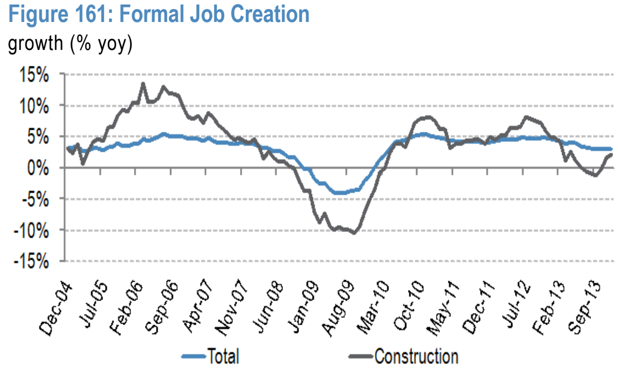
The construction sector employs c. 7% of the Mexican total economically active population. In September 2013, job creation in the construction sector reached its lowest level since Jan-2010, after falling 1.2% yoy. December 2013 numbers suggest an improving trend, as the amount of jobs created in the sector increased 2% yoy.

Figure 160: Employment Breakdown by Sector



Source: As of 4Q13. Source: INEGI. *Others include: Mining, Utilities distribution, Media, Financial Services, Real Estate Services, Technical and Professional Services, Education Services, Health Services, Lodging and Feeding, and Non Government Activities.

Figure 161: Formal Job Creation



Source: INEGI.

Construction weights c.8% of nominal GDP. Activity in the sector is cyclical and aligned partly to government transition, as the incumbent party tends to frontload expenditures in the first months of the year before elections (presidential elections in Mexico are in July). This makes for a tougher comparison base for incoming administrations. Coupled with this, the learning curve for the new government could hinder lending and public spending.

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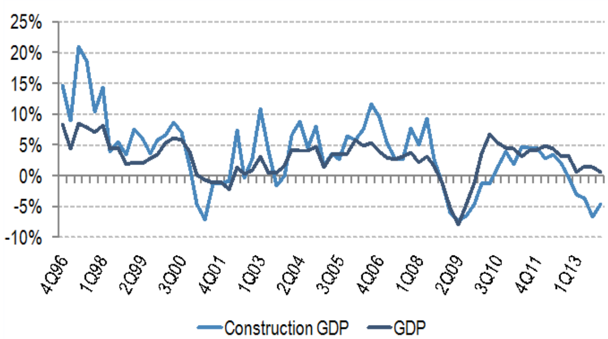
Figure 162: Construction GDP vs. GDP Growth

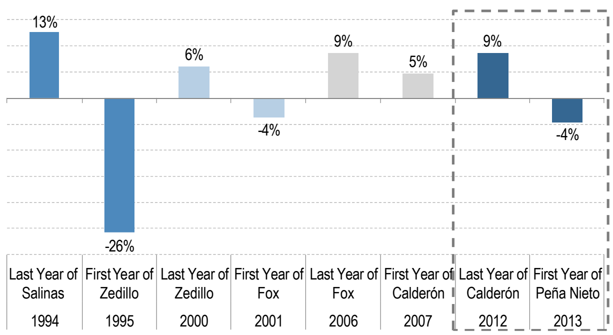
% yoy



Source: INEGI.

Figure 163: Construction is Sensitive to Government Transitions

%CAGR—Construction GDP



Source: J.P. Morgan, INEGI.

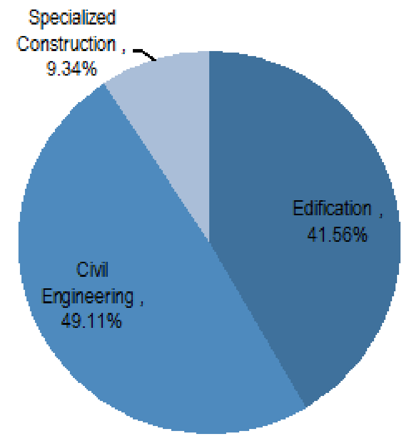
INEGI classifies construction production in three subsectors, using as a base the sector in which the company engages in the activity:

1. **Edification** refers to the product of companies focused on the construction of **multi-family housing, non-residential construction, and supervision of construction of buildings**.

2. **Civil Engineering** refers to the product of companies whose work is related to the **supply of water, oil, gas, and electricity,** as well as work related to **communications,** including the division of land and **urbanization,** the construction **of roads**, and the supervision of construction of civil engineering works.

3. **Specialized Construction** refers to the product of companies focused on supplying inputs to edification and civil engineering companies, including **foundations, prefabricated structures, and masonry.**

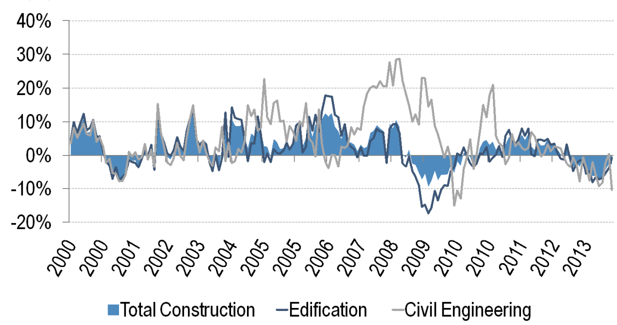
Figure 164: Construction Production by Subsector



Source: INEGI.

Figure 165: Construction Production Growth

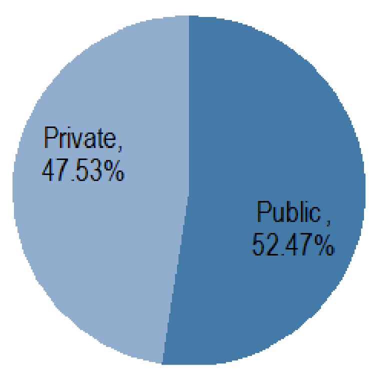
% yoy



Source: INEGI.

Private sector's participation, including concessions awarded to private companies, represents c.48% of total construction. The rest is constituted by government entities' work, including PEMEX and CFE. Most public participation is concentrated in civil engineering work, while 76% of edification work is conducted by private companies.

Figure 166: Private vs. Public Participation in Total Construction Production



Source: INEGI.

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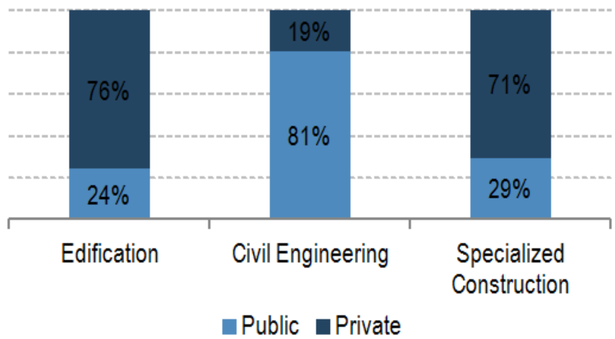
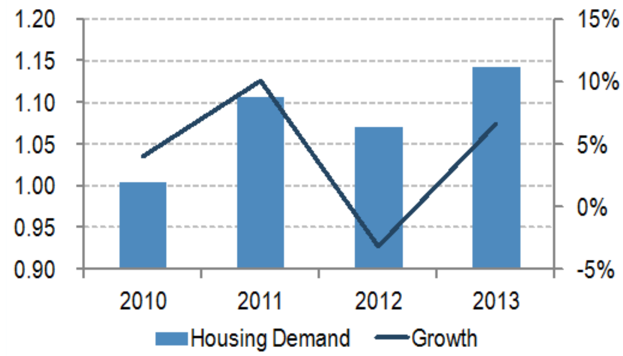
Figure 167: Private vs. Public Participation by Construction Subsector
% of total production



Source: INEGI.

Figure 168: Housing Demand
million units



Source: SHF.

Housing

The latest census (2010) estimated 28.6 million houses in Mexico with 3.9 occupants per household, down from five in 1990. CONAPO estimates the population will grow to 38.1mn in 2030 with an average occupancy ratio of three occupants per household.

Housing demand in Mexico is driven mostly by the existing housing deficit, followed by household formation and by housing mobility. Housing demand in 2014 was estimated at 1.1mn houses, growing 7% from 2012.

Table 57: Population & Household Outlook
millions

	2015	2020	2025	2030	2035	2040
No. Homes	30.2	33.1	35.7	38.1	40.1	41.7
No. of Households	31.1	34.1	36.8	39.2	41.3	43.0
Avg. Occupants per Household	3.6	3.4	3.2	3.1	3.0	2.8

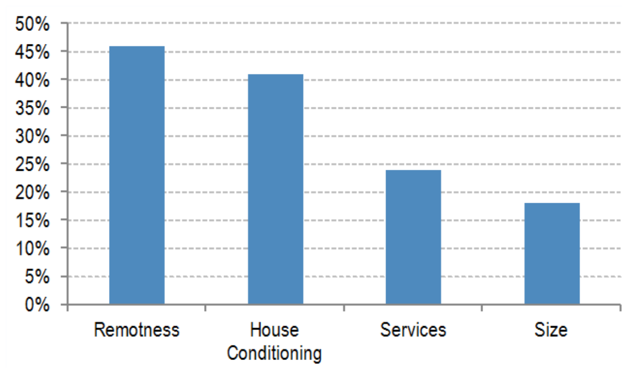
Source: CONAPO.

The average age of the houses in Mexico is estimated at 20.4 years with 10% of them less than 10 years. SHF (*Sociedad Hipotecaria Federal*) estimates c.9mn houses under deficit conditions. To determine housing deficit, CONAVI (Comisión Nacional de Vivienda) evaluates the following criteria: more than one family living in the same house, waste materials as part of the house's infrastructure, tin plate roofs and wooden walls, among others.

According to the latest census data, 75% of the homes in Mexico are estimated to have between 1 and 2 bedrooms, 23.4% have 3-4 and only 1.2% has four or more. Six percent of the houses reported to have "dirt" floors. Ninety-seven percent of the houses count with electric services, 88% has water pipe systems installed, and 70% have direct connection to the sewage system.

According to the 2010 population census, **uninhabited houses were 14% of the total.** Current estimates range from 0.7 to 1 million homes. This can be explained by the population's tendency to migrate to urban centers and little to no access to public services and infrastructure in some of the new, far away developments. In rural zones with less than 15,000 inhabitants, abandoned houses account for 20% of the total. House abandonment is an important source of concern both for the government and for home developers, as people who abandon their houses also typically default on the loans taken to purchase those properties.

Figure 169: Reasons for Abandonment
% of responses



Source: Infonavit Housing Survey.

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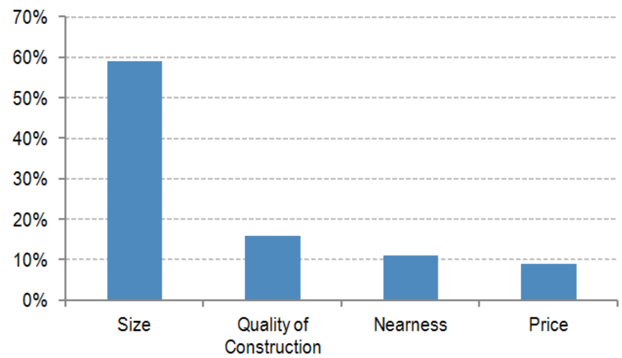
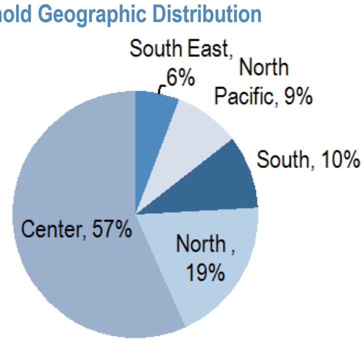
Figure 170: Priorities for Housing Consumers
% of responses



Source: Infonavit Housing Survey.

Housing demand is concentrated in only seven (out of 32) states in the country, accounting for 45.6% of total housing demand. States with the largest housing demand in the country are Veracruz (9.5% of the total) and Mexico State, with an 8.5% share of total housing demand.

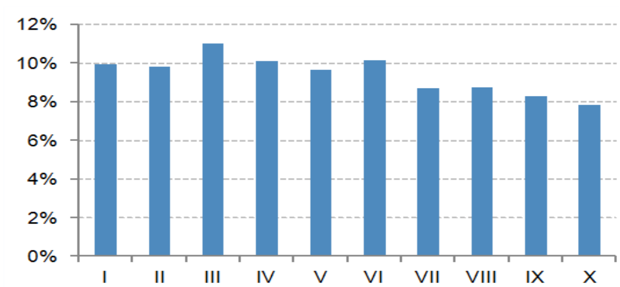
Figure 171: Household Geographic Distribution



Source: CONAPO and J.P. Morgan. Data as of 2010 census.

Housing fixed expenses, including utilities services, rent, and property taxes, represent 10% of the lowest income deciles, while for the richest deciles this represents c.8% of their total expenses.

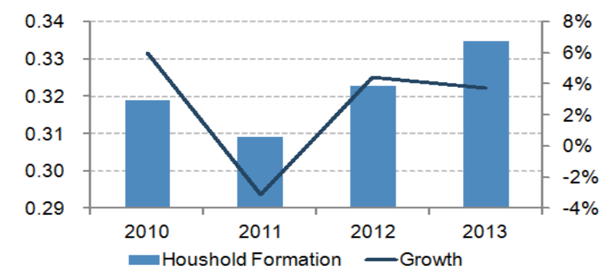
Figure 172: Household Expenditure in Housing
% of total household income



Source: ENIGH.

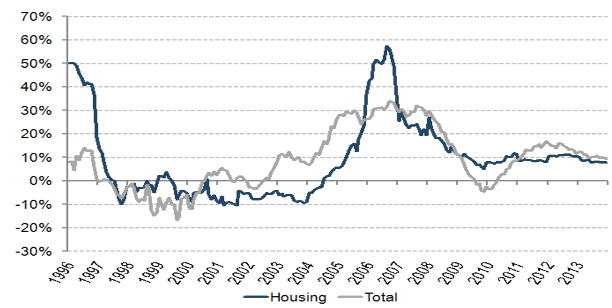
Bank credit to the housing sector more than tripled from 2006 to 2013, according to Banxico. Mexico's commercial housing credit's 7yr CAGR is 18%, mostly driven by a boom during 2004-07. Sixty percent of total housing demand in 2013 came from of households that met the criteria described earlier for determining housing deficit. These families were able to purchase new homes through mortgage loans.

Figure 173: Estimated New Households Requiring Mortgages
million units



Source: SHF.

Figure 174: Bank's Outstanding Credit Portfolio Growth
% yoy



Source: Banxico.

By the end of 2013 mortgages represented c.19% of banks' total outstanding loan portfolio. Housing NPLs were 3.71%, 64bps below the NPL rate for the total loan portfolio.

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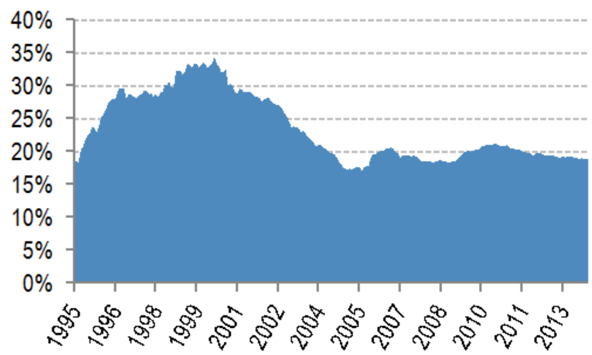
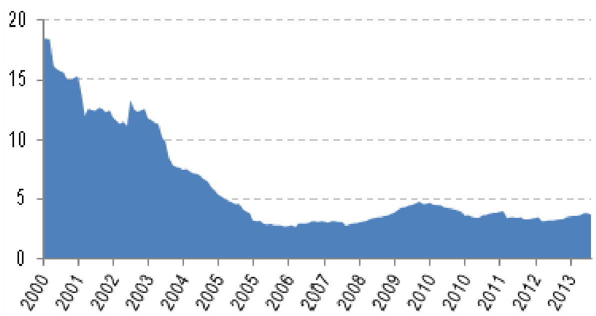
Figure 175: Mortgages as % of Banks' Total Outstanding Loans



Source: Banxico.

Figure 176: Banks' Housing Portfolio NPLs

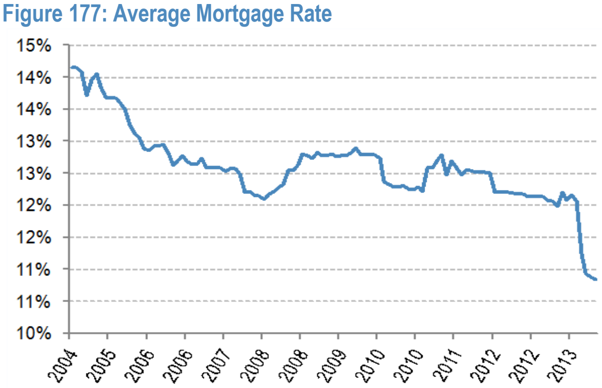
%



Source: CNBV.

At c.11%, average mortgage rates are at historical lows. Current rates are 3ppt lower than in 2004. The highest mortgage rate as of January 2014 was at 17% while the lowest was at 10.15%. Total mortgage cost during the same period came in at an avg. of 13.45%.

Figure 177: Average Mortgage Rate



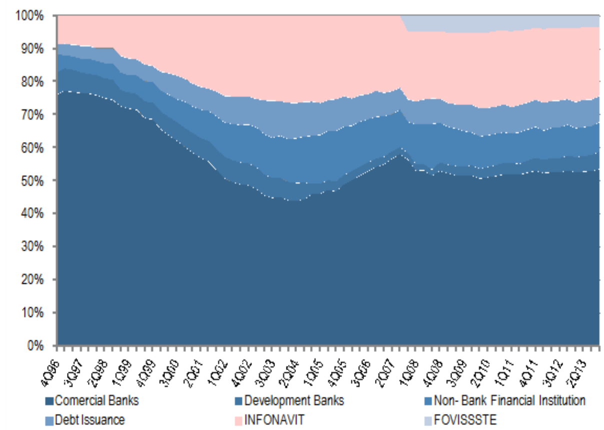
Source: Banxico.

In the past years, many changes were made to develop financing channels for the housing sector. Government participation via institutions, such as FOVISSSTE, Infonavit or SHF, played a key role in developing this market.

Infonavit is an autonomous institution that provides entry-level mortgages to lower-income families. It serves private-sector workers and is looking to expand loan offerings to the non-affiliated population. Public sector workers are served by FOVISSSTE. As of 4Q13, Infonavit accounted for c. 21% of total private financing. In terms of mortgage generation, Infonavit represents c.36% of the housing credit market, measured by size of loans.

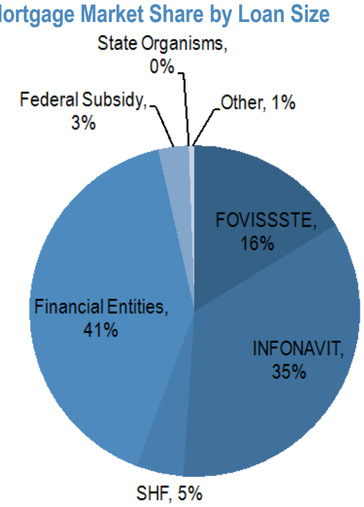
Figure 178: Domestic Private Financing by Institution

% of total



Source: Banxico.

Figure 179: Mortgage Market Share by Loan Size



Source: CONAVI.

Debt collections and mandatory contributions represent the largest cash inflows for Infonavit (59% and 37% of total, respectively). The employer is required

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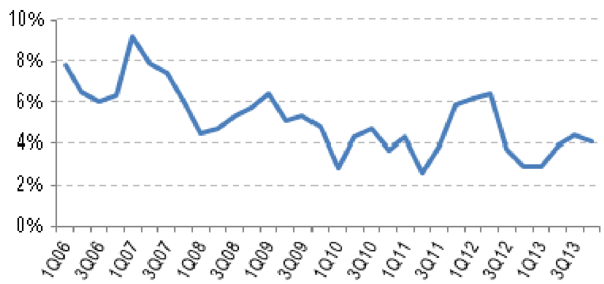
to contribute 5% of the employee's salary to the worker's Infonavit account. These funds are deposited together with the employer's contributions to the employee's pension fund (Afore - for more details please see Pension Funds), but are managed by Infonavit directly. Part of these resources were typically intended to fund the purchase of a house for the worker, yet with the changes in the Retirement Fund Law approved March 2014, 2% out of the 5% contribution will continue to go to the housing fund and the remaining 3% will go to fund the recently introduced unemployment insurance.

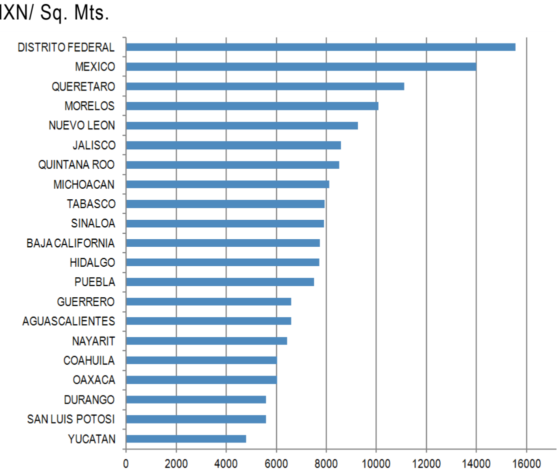
The growth rate of the average housing price from 2006 to 2013 has been fairly stable at c.5% and was led mostly by major cities. Mexico City averaged the largest price increase at 6.52% CAGR during 2013 while Nayarit had the lowest increase at 2.32%.

Figure 180: Housing Price Index Growth
% yoy



Source: SHF.

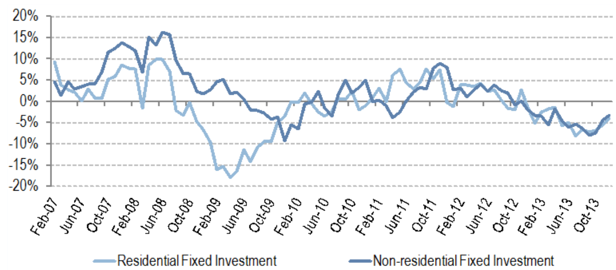
Figure 181: Price per Sq. Mts. in Selected States
MXN/ Sq. Mts.



Source: SHF. As of 2013.

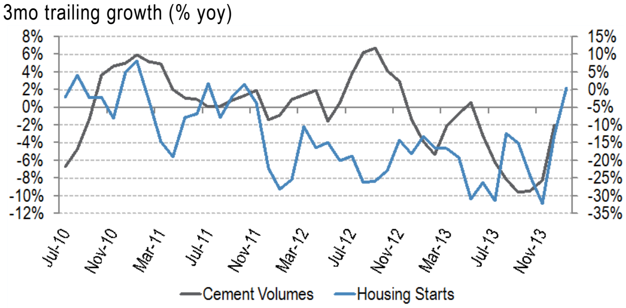
Residential fixed investment accounts for c.45% of total construction fixed investment. The sector struggled in late 2012 and all of 2013 on the back of government changes (leading to lagging government spending) and the difficult financial situation of major players (Geo, Homex, and Urbi). In early 2014, however, indications have emerged pointing to an improvement for the sector, as housing starts grew 57% yoy during December 2013 while cement demand grew 5% yoy.

Figure 182: Fixed Investment in Construction
index growth (% yoy)



Source: INEGI.

Figure 183: Housing Starts vs. Cement Volumes
3mo trailing growth (% yoy)



Source: RUV, INEGI.

After the 2009 financial crisis, public homebuilders started focusing on low income (social interest) housing developments, which are subject to government subsidies, arguing for more stable incomes. According to CIDOC, during 2012 80% of public homebuilders' production was focused on these kinds of developments.

During February 2013, the new government presented a new National Housing Policy that aimed to adjust urban growth and housing quality in terms of public services and proximity to urban areas. Upon this new set of rules, government loans and subsidies would be focused on developing vertical housing projects that foster orderly urban growth. Infonavit's financing plans were aligned to the urban development plan from the government.

With the new regulation, major public homebuilders faced a very difficult financial situation. High leverage impeded them to be flexible enough to adapt to the new

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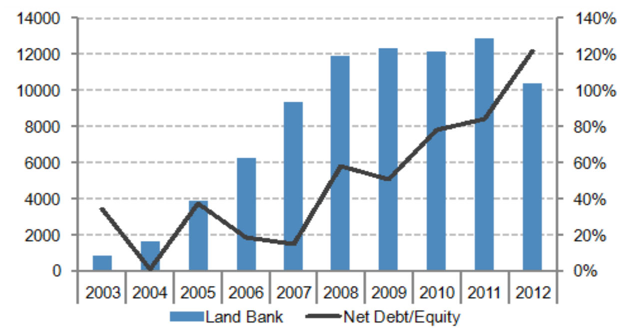
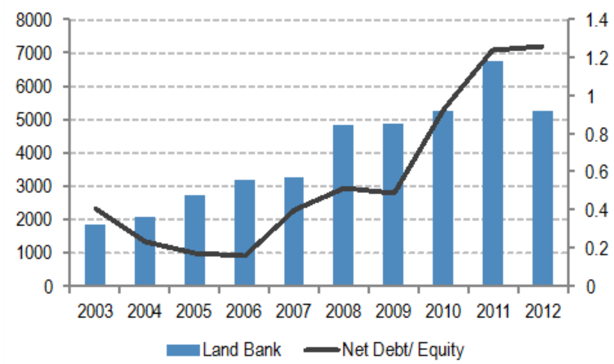
regulation, considering the larger working capital needs for urban vertical projects. Most of this leverage was taken to acquire a significant amount of land for future developments. However, with the 2013 regulation focused on fostering development of urban centers, most of the land bank owned by these companies was rendered worthless.

Figure 184: HOMEX: Land Bank vs. Leverage
Mx$ in billion



Source: Company Reports, J.P Morgan Estimates.

Figure 185: GEO: Land Bank vs. Leverage
Mx$ in billion

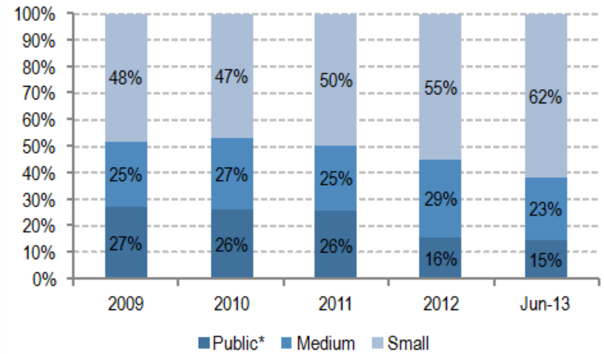


Source: Company Reports, J.P Morgan Estimates.

In March 2014, GEO filed for bankruptcy. The company reached an agreement with a group of debt holders representing 50% of its consolidated debt. Once the restructuring takes place, equity dilution would leave creditors with 88% ownership of the company, while management and current shareholders would keep 4% and 8%, respectively. Banamex, Banorte, Santander, Inbursa, and BBVA Bancomer are among the company's mayor debt holders.

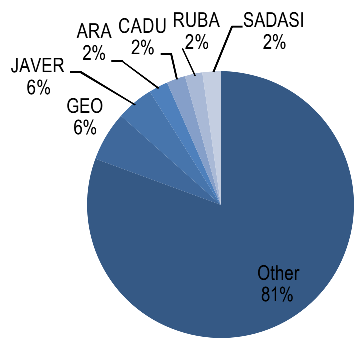
Room left by the financial distress on the three largest homebuilders opened a window of opportunity for increased business by smaller players. Small construction companies have gained market share, going from 48% in 2009 to 62% in June 2013.

Figure 186: Housing Starts Market Share



Source: CIDOC, RUV. *Public Includes: HOMEX, GEO, URBI, ARA and SARE.

Figure 187: Housing Sector Market Share by Company



Source: Company Reports. As of October 2013.

FIBRAS

(For more details please refer to JPM LatAm Cement & Construction analyst Adrian Huerta and team's initiation on the Mexican FIBRAs).

The Mexican REIT market was born in 2011 with Fibra Uno's IPO. Mexican REITs are locally known as FIBRAs (*Fideicomiso de Inversión en Bienes Raíces*). As of today, there are seven such vehicles, with a combined market cap of $13bn and trading $30mn daily. Upon the introduction of these investment trusts, the Mexican government established income tax exemptions for the party selling an asset to the FIBRA. These tax incentives allow Fibras' bids for a given asset to be more competitive than those of other players in the real estate market.

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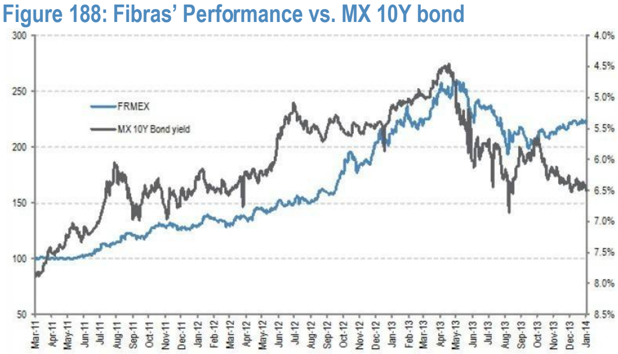
Table 58: List of Recent IPOs

FIBRA	Year	Proceeds (US mn)
FUNO IPO	2011	300
FUNO follow-on	2012	710
FIHO IPO	2012	331
FIBRAMQ IPO	2012	1,000
FUNO follow-on	2013	1,307
TERRA13 IPO	2013	665
FINN IPO	2013	317
FIHO follow-on	2013	390
HCITY IPO	2013	203
FSHOP IPO	2013	380
Danhos IPO	2013	416

Source: J.P.Morgan, Bloomberg. Vesta, a real estate company, launched its IPO in 2012. However, it is not included in the table as it was issued as equity, not under the FIBRA regime.

FIBRAs are required to invest at least 70% of their assets in real estate and to pay out 95% of earnings that are not taxable at the corporate level. The sector has become an attractive yield opportunity, particularly for local pension funds, which are more income oriented. Mutual funds were not able to invest in FIBRAs until recently due to tax issues.

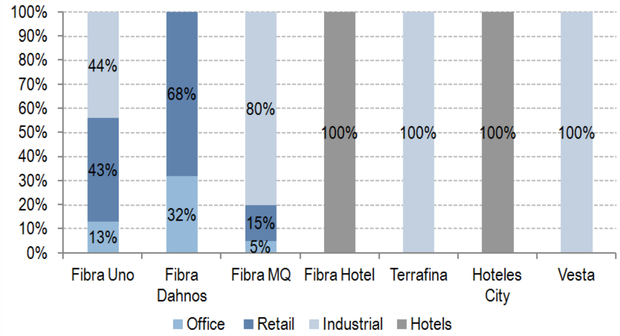
Figure 188: Fibras' Performance vs. MX 10Y bond



Source: Bloomberg.

FIBRAs own ~15% of the Mexican commercial real estate vs. ~30% in the US. The asset class is highly correlated to Mexico's main industrial activity: manufacturing. Our sector analysts estimate total value of industrial assets at $20bn, of which publicly traded companies own c.35%.

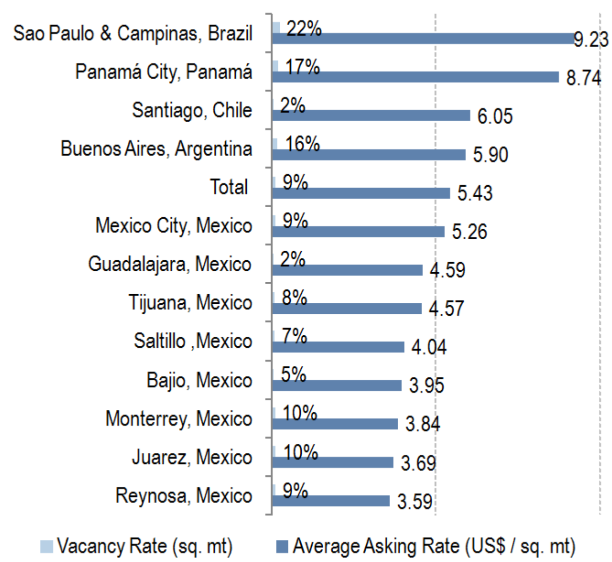
Figure 189: Exposure by Asset Class (3Q13)



Source: Company reports and J.P. Morgan estimates.

Market consultants (CBRE and Colliers) expect the Bajio region's industrial properties to grow at annual rates of ~7%. Monterrey is the largest market in terms of industrial assets, with a little less than 6.5 mn m2 of space. It has doubled in the past ten years, growing at an annual rate of 9-14% until 2008 and since then at a rate of 4%, according to CBRE.

Figure 190: Industrial Real Estate Market in LatAm



Source: CBRE Research, 4Q13-

Energy

The energy sector is key for Mexico. Pemex, the state owned monopoly in the sector, is the ninth-largest crude oil producer company in the world and is considered the 11th-largest integrated company. It was founded in 1938 after President Lázaro Cardenas nationalized the sector.

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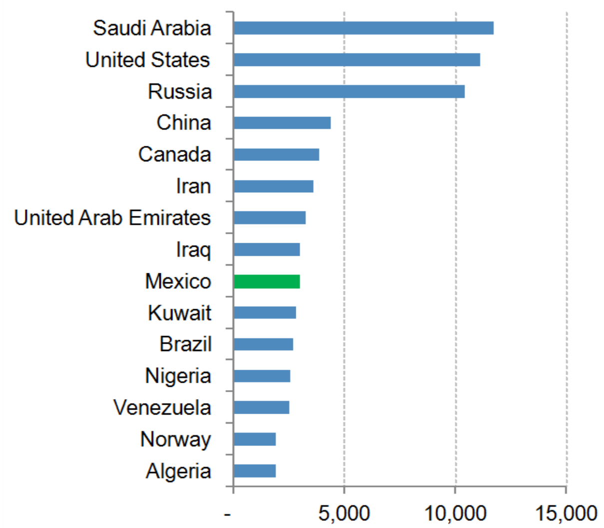
Figure 191: Top World Oil Producers
million barrels per day

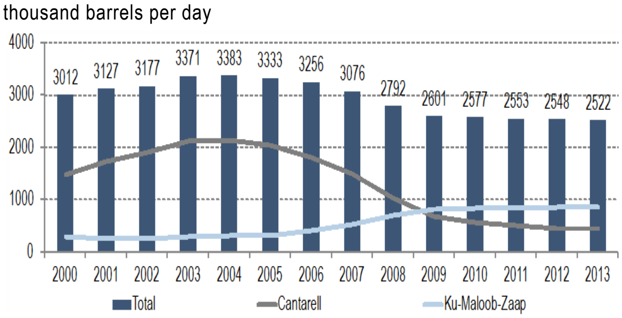


Source: EIA. Data as of 2012.

Oil & Gas

Pemex's production has been dropping mostly due to a decline in Cantarell field's production. Cantarell was considered one of the most important oil complexes in the world and by far the largest in Mexico. Cantarell's share in total crude production has gone from 80% in 2003 to 17% in 2013, leading Ku-Maloob-Zaap to become the most productive oilfield in Mexico. In 2013, total crude oil production, was 2.5mn daily barrels.

Figure 192: Crude Oil Production
thousand barrels per day



Source: Ministry of Energy

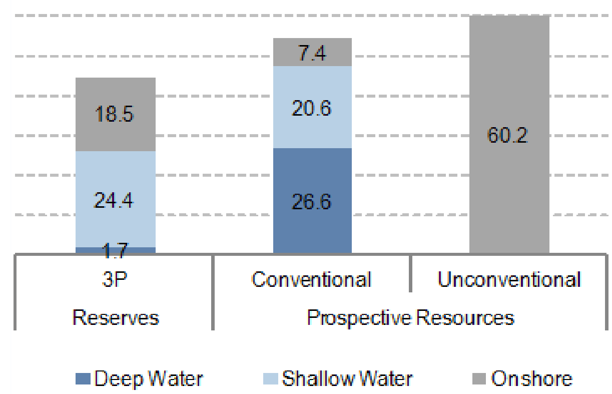
Table 59: Pemex Production Highlights

Commodity	2010	2011	2012	2013	2014*	CAGR
Crude Oil (Mbd)	2,577	2,553	2548	2,522	2,506	-2.3%
Nat.Gas (MMcfd)	7,020	6,594	6385	6,370	6,460	-8.9%

Source: Pemex. *As of January 2014.

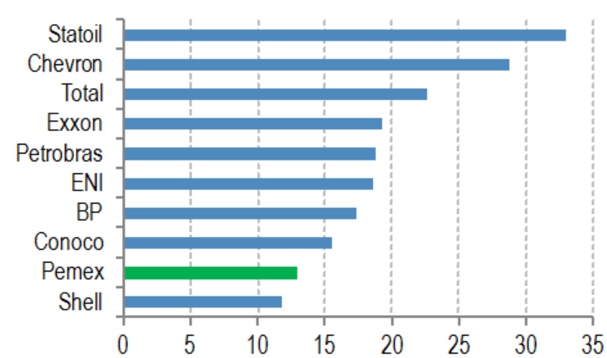
Given the profile of existing oilfields in Mexico, production costs are the lowest among peers. Currently, most of the fields exploited by Pemex are shallow water or onshore fields. However, the greatest potential lays in deep water exploration. So far, only four fields have been developed in deep water in the Gulf of Mexico: Kunah, Trion, Supremus, and Exploratus. As deep water becomes a more relevant part of Pemex's production as well as unconventional resource exploitation (shale oil & gas), exploration and development costs are expected to increase.

Figure 193: Reserves & Prospective Resources
billion barrels



Source: PEMEX, J.P. Morgan.

Figure 194: Exploration and Development Costs per Barrel of Oil Equivalent
USD



Source: PEMEX. As of 2012.

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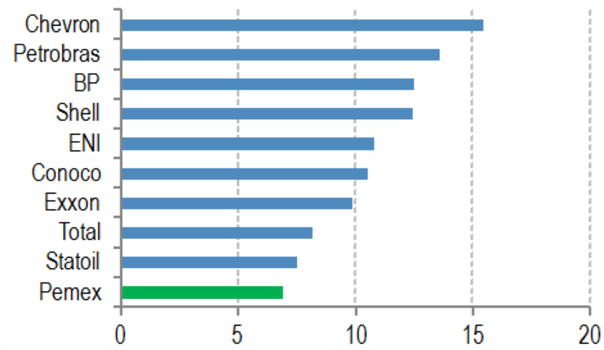
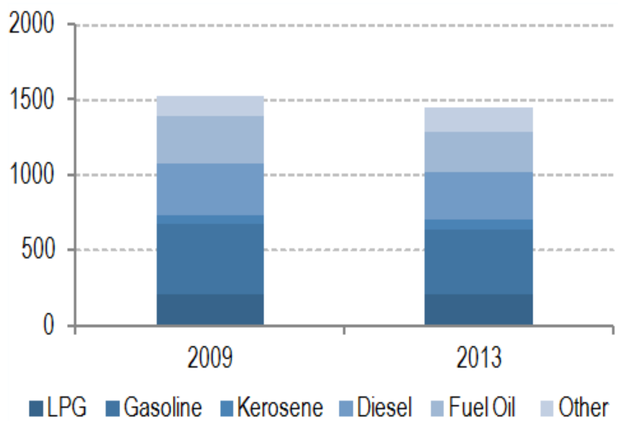
Figure 195: Production Costs per Barrel of Oil Equivalent
USD



Source: PEMEX. As of 2012.

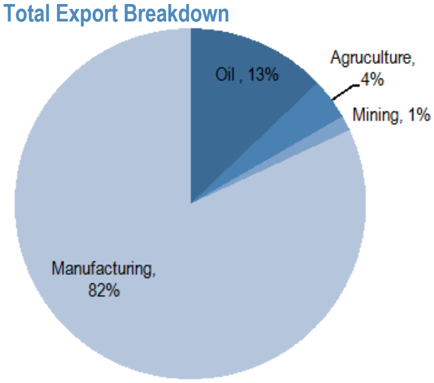
Figure 196: Oil & Derivatives Production Breakdown
thousand barrels per day



Source: PEMEX.

Oil and derivatives represent 13% of Mexican exports. Mexico is the 7th most important exporter of oil.

Figure 197: Total Export Breakdown



Source: INEGI.

Table 60: Oil Exports by Country & Region
thousand barrels daily

Country	Crude Exports
Middle East	17,646
Former Soviet Union	6,049
West Africa	4,328
S. & Cent. America	3,143
Canada	2,437
North Africa	2,139
Mexico	1,290
Other Asia Pacific	767
Europe	383
Australasia	272
East & Southern Africa	86
China	26
US	23

Source: BP Statistical Review of World Energy.

Pemex exports over 50% of its production. Only 48% remains in the country to satisfy domestic demand. Despite being one of the largest oil exporters in the world, Mexican oil exports have been below the historical average since March 2010. As of January 2014, oil exports were c.1.3mn barrels a day, 16% below the historical average of 1.5mn barrels a day.

Figure 198: Energy Balance: Crude Oil
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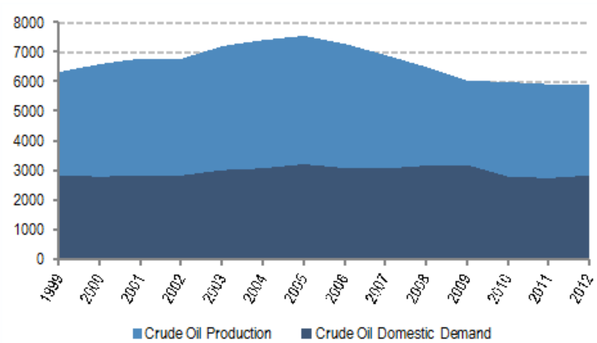
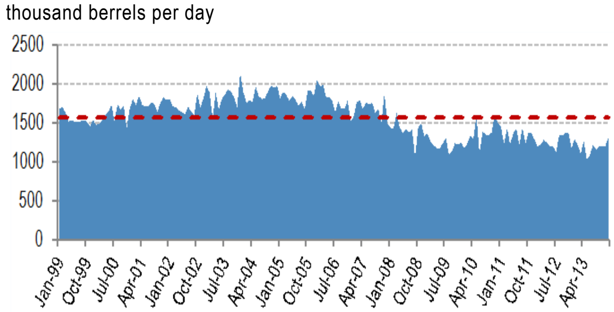


Source: SIE, Ministry of Energy.

Figure 199: Mexico Oil Exports
thousand berrels per day



Source: SIE, Mnistry of Energy. As of Dec 2013.

The US is Mexico's main oil export destination. Exports to the country have decreased significantly from their peak in 2006-2007 given a continued decline in

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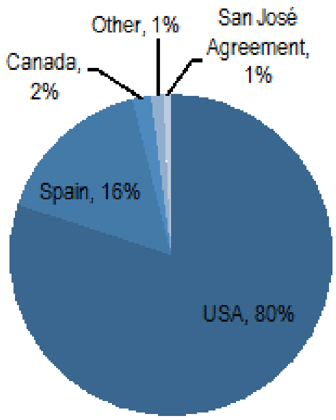
Mexico's production together with increasing self sufficiency in the US. The US net oil import gap (% difference between supply and demand) is estimated to close in the coming years from 40% in 2012 to 32% in 2038.

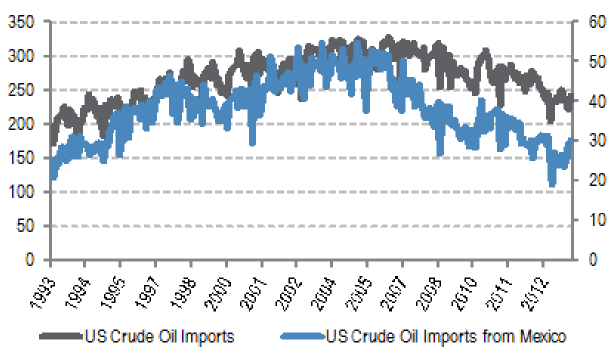
Figure 200: Oil Exports Breakdown per Country



Source: SIE, Ministry of Energy.

Figure 201: US Crude Oil Imports from Mexico vs. Total

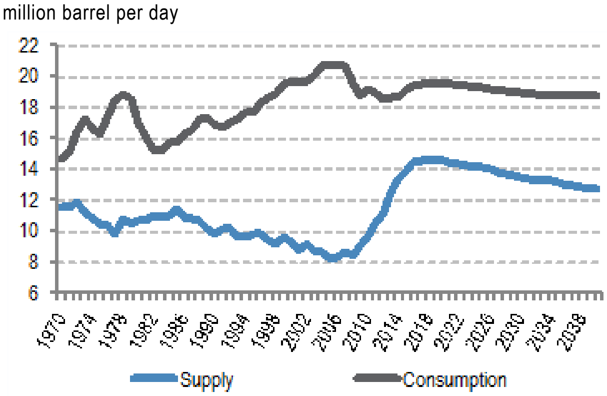
million barrels



Source: EIA.

Figure 202: US Oil Supply

million barrel per day

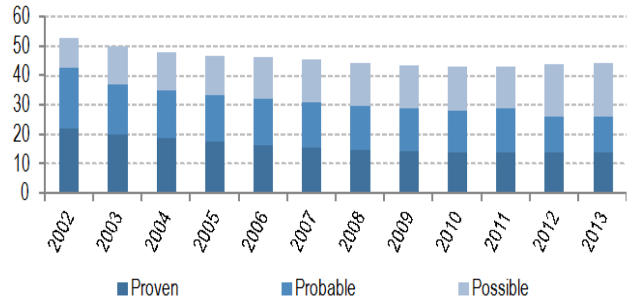


Source: EIA. Includes oil and other liquid fuel supply.

In 2013, Mexico's total reserves (proven + probable + possible) summed 44.5 mn barrels. Mexico has 11.4 billion barrels of proven oil reserves, accounting for less than 1% of global share. Mexico ranks lower than Brazil, with over 15bn boe of proven reserves. Venezuela and Saudi Arabia, together, have over 500bn boe of proven reserves, accounting for 33% of the world's total proven reserves.

Figure 203: Mexico Oil Reserves

billion barrels



Source: PEMEX.

Table 61: Oil Proved Reserves 2012

billionbarrels

Country	Proven Reserves	(R/P) Ratio*
Venezuela	297.6	-
Saudi Arabia	265.9	63
Canada	173.9	-
Iran	157.0	-
Iraq	150.0	-
Kuwait	101.5	89
United Arab Emirates	97.8	79
Russian Federation	87.2	22
Libya	48.0	87
Nigeria	37.2	42
US	35.0	11
Kazakhstan	30.0	47
China	17.3	11
Brazil	15.3	19
Mexico	11.4	11
Ecuador	8.2	45
India	5.7	17

Source: Statistical Review of World Energy 2013. *Reserves-to-production ratio - If the reserves remaining at the end of any year are divided by the production in that year, the result is the length of time that those remaining reserves would last if production were to continue at that rate.

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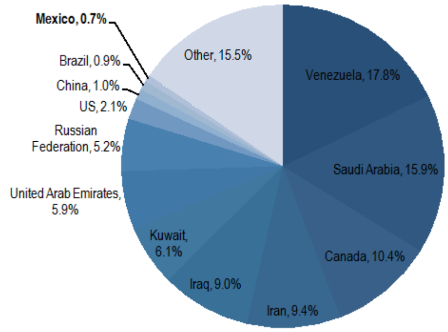
Figure 204: Global Reserves Market Share

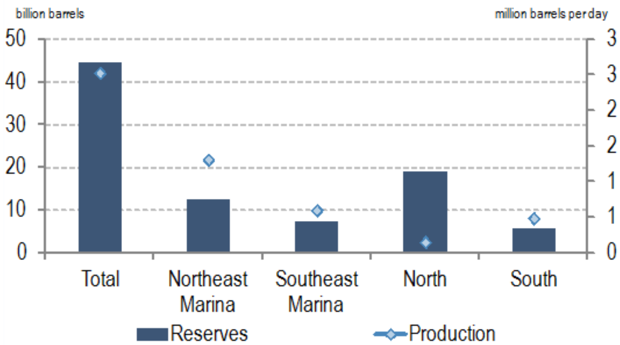
% of total reserves



Source: Statistical Review of World Energy 2013.

Reserves in Mexico are distributed into four major areas: Northeast Marina, (which includes Canatarell and Ku- Maloob Zaap), Southeast Marina, North, and South.

Figure 205: Oil Reserves vs. Production: Regional Breakdown



Source: PEMEX, Ministry of Energy.

Apart from the conventional reserves, Mexico ranks highly in unconventional oil and gas resources (shale oil & gas). Mexico has 13bn boe of technically recoverable shale oil resources and ~550tn cubic feet of shale gas resources.

Table 62: Technically Recoverable Shale Oil Resources

billion barrels

	Country	Shale Oil Resources
1	Russia	75
2	US	58
3	China	32
4	Argentina	27
5	Libya	26
6	Australia	18
7	Venezuela	13
8	Mexico	13
9	Pakistan	9
10	Canada	29

Source: US Energy Information Administration – An Assessment of 137 Shale Formations in 41 Countries Outside the United States. June 2013.

Table 63: Technically Recoverable Shale Gas Resources

trillion cubic feet

	Country	Shale Gas Resources
1	China	1,115
2	Argentina	802
3	Algeria	707
4	U.S.	665
5	Canada	573
6	Mexico	545
7	Australia	437
8	South Africa	390
9	Russia	285
10	Brazil	245

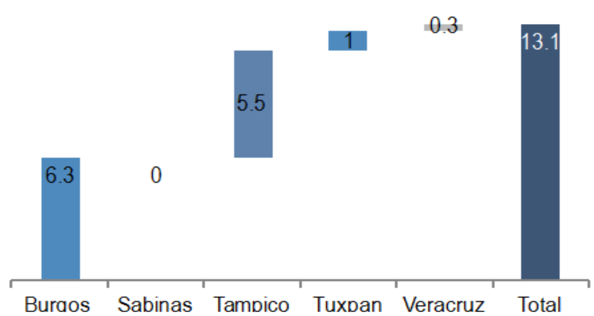
Source: US Energy Information Administration – An Assessment of 137 Shale Formations in 41 Countries Outside the United States. June 2013.

Figure 206: Shale Oil & Gas Main Basins

Source: EIA, PWC.

Figure 207: Shale Oil Reserves per Basin

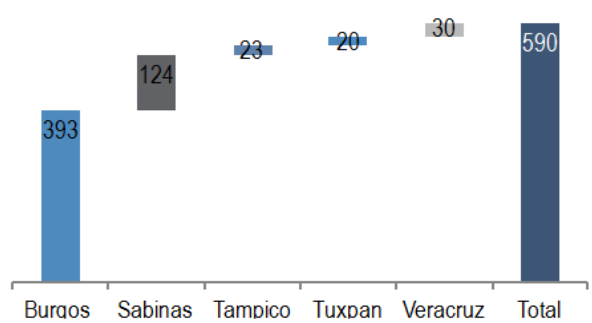
billion barrels



Source: EIA, PWC.

Figure 208: Shale Gas Reserves per Basin

trillion cubic feet



Source: EIA, PWC.

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Mexico ranks 35th in proved natural gas reserves. Natural gas reserves in Mexico are about 12.7trillion cubic feet. Natural gas production in Mexico increased by 61% since 2000 up to 2013. However, annual growth rates decelerated significantly after the 2008 crisis due to the general slowdown in economic growth and lower gas prices. Production in 2013 was 6.4bn cubic feet per day, down from its peak of 7 in 2009.

Table 64: Proved Natural Gas Reserves

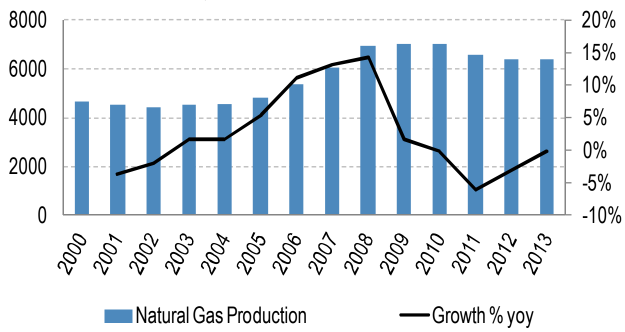
trillion cubic feet

Country	Reserves	World Participation
Iran	1,187.30	18.00%
Russia	1,162.50	17.60%
Qatar	885.1	13.40%
Turkmenistan	618.1	9.30%
United States	300	4.50%
Saudi Arabia	290.8	4.40%
Arab Emirates	215.1	3.30%
Venezuela	196.4	3.00%
Nigeria	182	2.80%
Algeria	159.1	2.40%
Australia	132.8	2.00%
Irak	126.7	1.90%
China	109.3	1.70%
Indonesia	103.3	1.60%
Norway	73.8	1.10%
Mexico	12.7	0.20%

Source: BP Statistical Review of World Energy 2013.

Figure 209: Natural Gas Production

million cubic feet per day



Source: Ministry of Energy.

Mexico is a natural gas net importer, as local production is not enough to satisfy domestic demand. The majority of the country's imports come from the US. With the drop in gas prices vs. oil prices, Mexican industrial companies have shifted from the use of regular petrochemicals for energy generation to natural gas. Natural gas is expected to go from 64.8% to 74% share in industrials' energy matrix by 2027.

Figure 210: Natural Gas Balance

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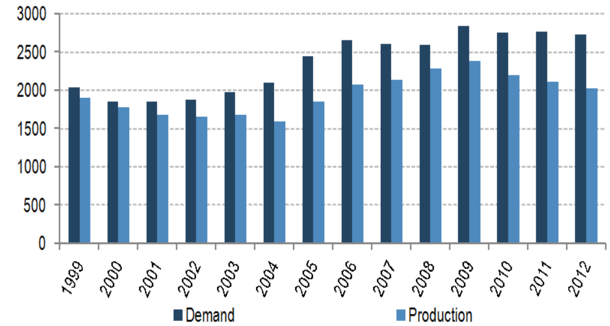
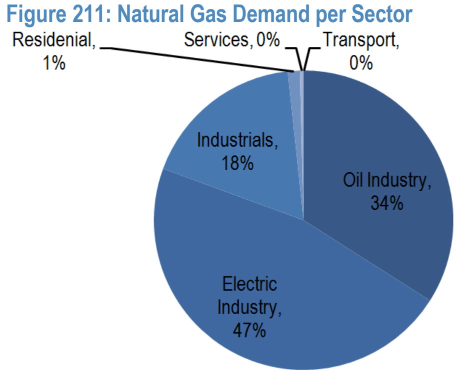


Source: SIE, Ministry of Finance.

Figure 211: Natural Gas Demand per Sector

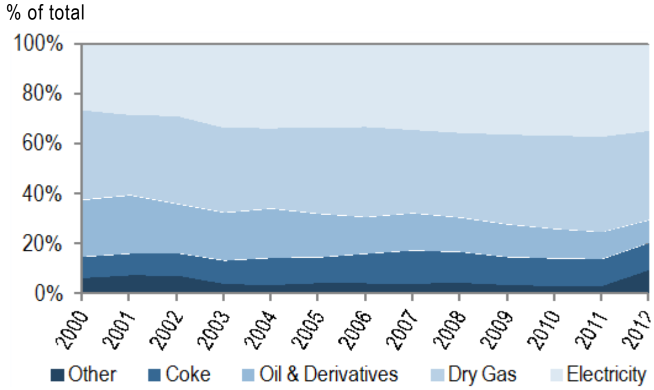


Source: SIE, Ministry of Energy.

When demand surpasses natural gas supply, Pemex issues a "Critical Alert" in order for industrials to limit consumption. According to Competition Institute, these alerts have registered a 125% increase from 2010 to 2013 causing losses of c.$1.5bn in the industrial sector in the country. Regardless of low gas prices in the US, the increase is explained in its majority by a shortfall in pipeline infrastructure in Mexico, which limits importing capabilities for the sector.

Figure 212: Energy Consumption in the Mexican Industrial Sector

% of total



Source: SIE, Ministry of Energy.

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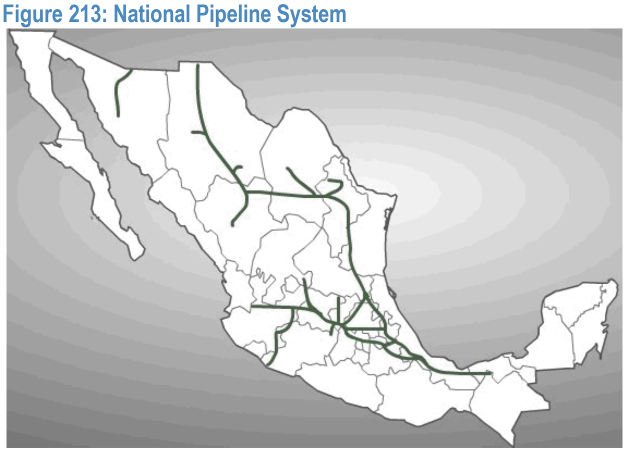
The current pipeline system was created to supply demand to the electric sector's combined cycle generation plants. The existing gas pipeline system is 7,656km long. Import pipelines located in Chihuahua and Tamaulipas states have an installed capacity of 1,356 million sq. feet daily. Increasing industrial gas requirements have caused system saturation in some regions.

Figure 213: National Pipeline System

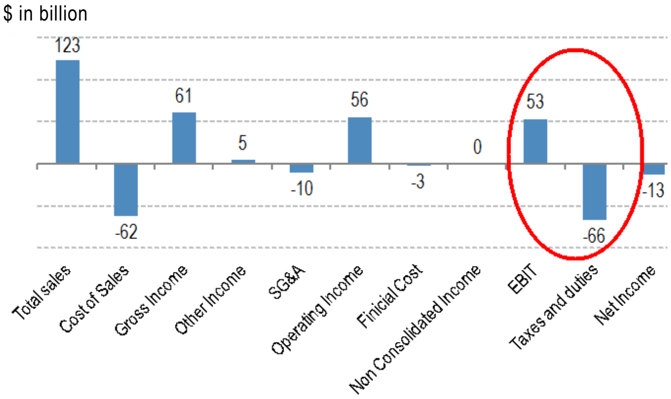


Source: PEMEX.

Pemex's Financial Situation and Government Finances

Pemex's financial situation is critical. It generates positive income before taxes, but as it cannot deduct all its costs, it has to become indebted to pay taxes. In 2013, taxes accounted for $66.4bn while income before taxes was $53bn. The 2005 new fiscal regime helped Pemex to have more available resources, which reduced its leverage; but with the 2008-09 economic crises, Pemex had to increase its debt to pay for taxes due to a fall in oil federal revenue. As of December 31, Pemex had total consolidated debt of c.$58 billion.

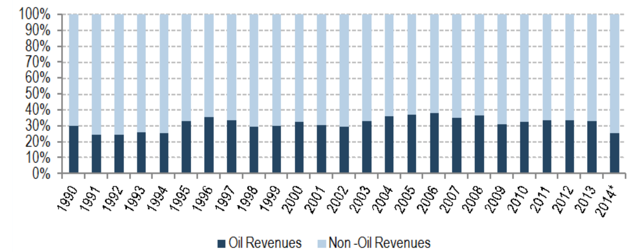
Figure 214: Pemex YE13 Earnings
$ in billion



Source: PEMEX.

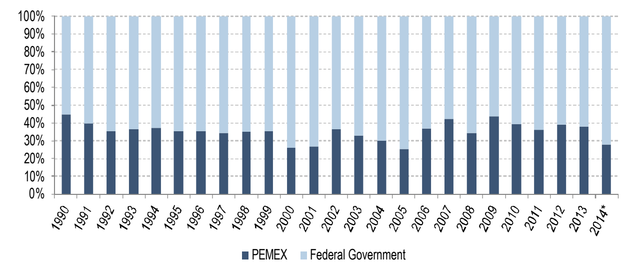
Total oil income accounts for 33% of total federal revenues. As per the Federal Income Law, rights and royalties from oil extraction and exports do not account as fiscal revenue for federal total income. Thus, total oil non-fiscal revenues (net of gasoline subsidy and including royalties and rights paid by Pemex) represent 54% of non-fiscal federal revenues. However, out of total oil-related revenues federal government rakes in over 60%, leaving only 40% to Pemex's own operational expenses.

Figure 215: Mexico's Total Income: Oil vs. Non-Oil Revenues
% of total income



Source: SHCP.*As of January 2014.

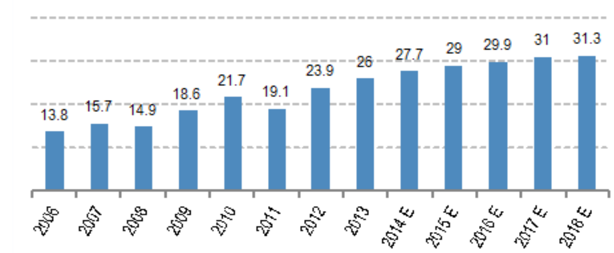
Figure 216: Who Keeps Mexico's Oil Revenue?
% of total



Source: SHCP. As of January 2014.

Pemex's CapEx is expected to be around $27.7bn in 2014, up from $26.bn in 2013. Eighty-five percent of the investments will be destined for exploration and production while 15% will be used for industrial processes.

Figure 217: Pemex's Historical and Expected CAPEX
$ in billion



Source: PEMEX.

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In Mexico, the oil price is fixed throughout the year, and it is set each year-end in the next year's budget for the federal government. If market oil prices are above this fixed price, the "excess" is allocated in three stabilization funds: for the federal government, for Pemex, and for the states. Forty percent of "excess revenues" are allocated to the federal fund and 30% each to the Pemex and state funds. Regarding Pemex's fund, there is a target level of savings (relatively low at around 1.2% of GDP) and the rest is allocated to investment (75%) and pension fund restructuring (25%).

Since the expropriation of the oil industry in 1938 by President Lázaro Cardenas, there have been two major reforms (in 2008 and in 2013 *click here to see details of 2013 Energy Reform*) aimed at maximizing oil revenues by allowing various forms of private participation in the industry.

Table 65: Main Pemex's JVs with Private Sector

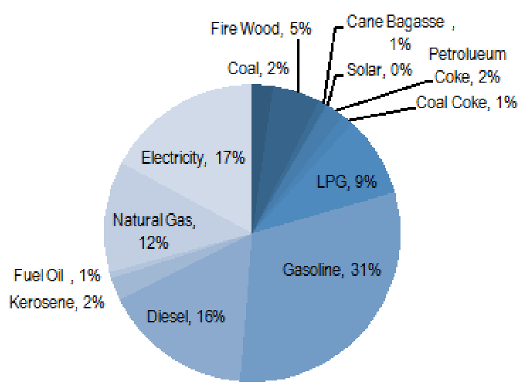
Participants	Investment (USD million)
Braskem - Pemex	3500
Alfa – Pemex	300
Agrogen - Pemex	200
Unigel - Peñoles - Pemex	150
Mexichem - Pemex	15
Unigel- Pemex	90
Diabaz - Pemex	40

Source: IMCO.

Fuels

Oil derivatives are still predominant in Mexico's energy matrix. However, Pemex's gasoline production (438k boe daily) doesn´t cover domestic consumption and thus, despite being an important oil-producer, Mexico is a net importer of gasoline. Gasoline imports account for 40% of total oil imports.

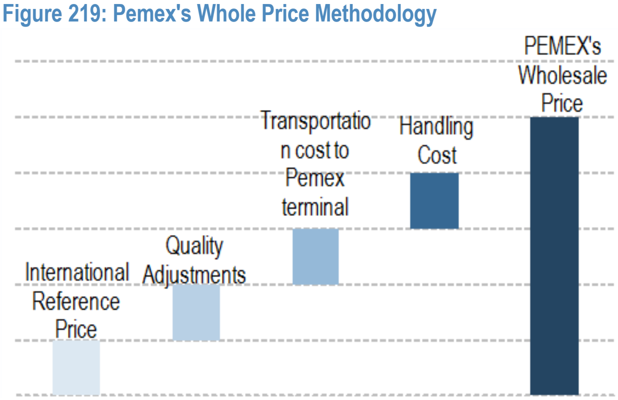
Figure 218: Energy Consumption by Energetic
petajoule



Source: SIE, Ministry of Energy.

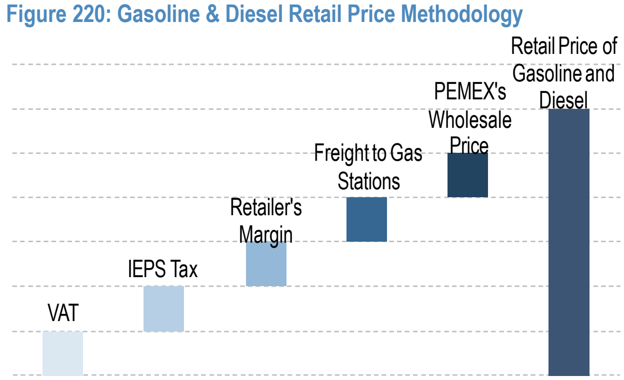
Gasoline prices in Mexico are set by the government through energy subsidies and a mechanism to smooth price volatility. The burden of such subsidies is assumed by the federal government, not by Pemex. Gasoline prices are calculated by Pemex and the Ministry of Finance. The final retail gasoline price takes into account Pemex's wholesale price adding taxes and retailers' margin.

Figure 219: Pemex's Whole Price Methodology



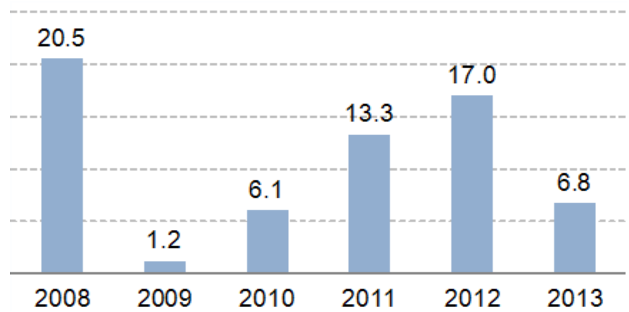
Source: PEMEX.

Figure 220: Gasoline & Diesel Retail Price Methodology



Source: PEMEX.

Figure 221: Gasoline Price Subsidy
US billion



Source: SHCP.

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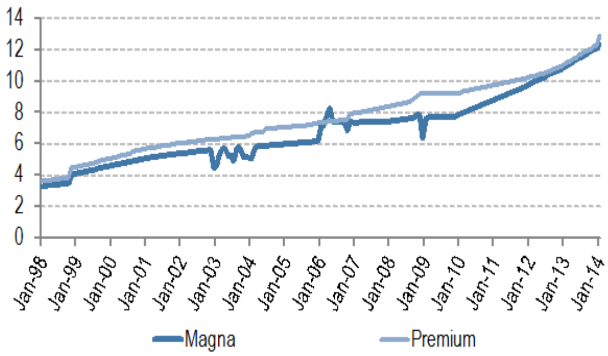
To reduce the impact of the subsidy for gasoline prices on the government's finances, a crawling increase was established in 2009. Since then, Magna gasoline's price has been increasing by 8 cents per liter every month, upping the increase to 9cts in 2012 and to 11 in 2013. Premium gasoline increased 11 cents per liter during 2013. Due to these monthly adjustments, average gasoline prices in Mexico surpassed US prices in October 2013.

Figure 222: Gasoline Prices

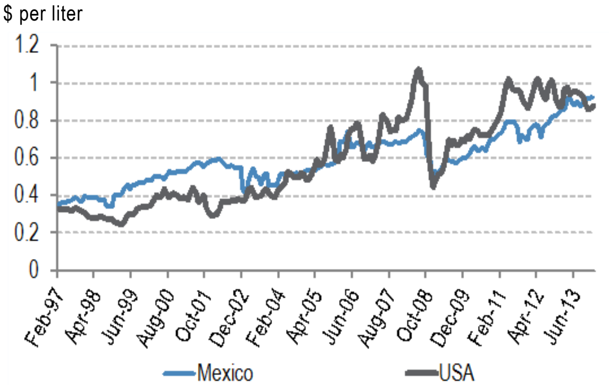
Mx$ per liter



Source: INEGI. As of January 2014.

Figure 223: Gasoline Prices in Mexico vs. USA

$ per liter



Source: INEGI, EIA, J.P. Morgan.

Though gasoline prices in Mexico are among the lowest in the world, the burden to the consumer is relevant. The average consumer in Mexico spends c.11.38% of his/her daily wages to buy a single gallon of gasoline vs. 2.6% in the US.

Table 66: Gasoline Prices in the World

USD per gallon

	Gas Price	Affordability	Income Spent
Norway	10.08	3.49%	0.84%
Turkey	9.55	31.02%	0.86%
France	8.13	6.90%	0.83%
Hong Kong	8.11	7.63%	0.40%
Germany	8.01	6.64%	1.57%
United Kingdom	7.75	7.44%	1.77%
Switzerland	7.25	3.29%	1.30%
Chile	6.22	13.95%	2%
Japan	5.9	5.32%	1.76%
Brazil	5.58	16.57%	1.40%
China	4.67	25.71%	1.30%
Colombia	4.52	20.03%	1.14%
United States	3.66	2.60%	3.18%
Mexico	3.43	11.38%	3.18%
Arab Emirates	1.77	1%	0.46%
Venezuela	0.04	0.13%	0.05%

Source: Bloomberg, INEGI, and EIA. Data as of 3Q13. Affordability refers to the portion of a day's wage needed to buy a gallon of gasoline.

Electricity Generation

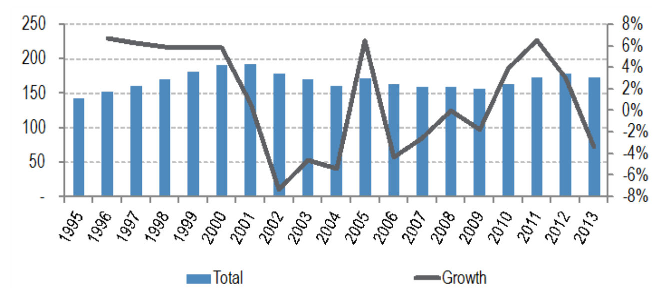
Electric energy transmission and distribution is state controlled through the *Comisión Federal de Electricidad* (*CFE*), which serves 97.6% of the population with a total installed capacity of 51,921 MW as of January 2014 (including independent producers' installed capacity).

On October 11, 2009, the Mexican government closed state-owned electricity provider *Luz y Fuerza del Centro* (LyFC). The company had been operating at a chronic loss for years. The operations were absorbed into the CFE. The company employed nearly 40,000 workers, who were in charge of providing electricity to 20 million people, 19% of the total population, across five states (Distrito Federal, State of Mexico, Morelos, Hidalgo, and Puebla).

The Ministry of Energy in Mexico estimates that demand for electricity will increase by 3.6% annually on average for the next 15 years, while petrochemical demand for energy will grow by only 2.6% annually during the same period.

Figure 224: Historical CFE's Electricity Generation

TW/hour



Source: INEGI.

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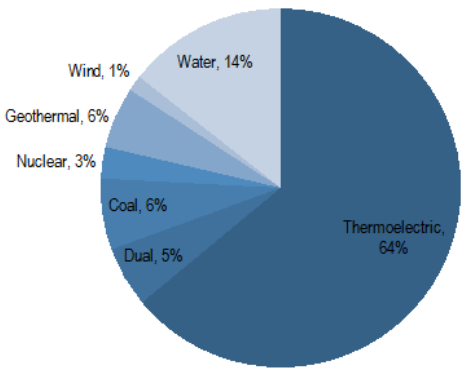
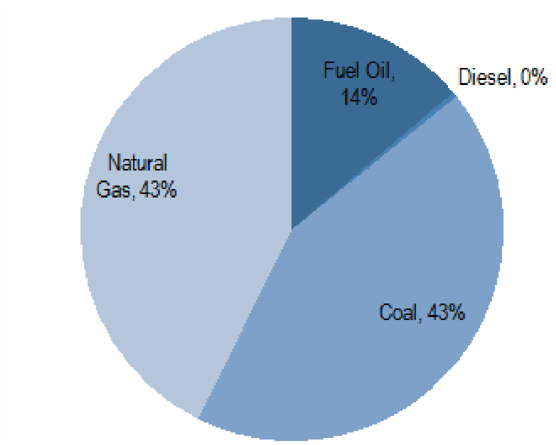
In line with installed capacity, **most of the electricity that is produced in Mexico comes from hydrocarbon sources** and is generated through combined-cycle processes. However, within hydrocarbons, natural gas is becoming more relevant vs. fuel oil generation due to consistently low gas prices.

Figure 225: Electricity Generation by Source



Source: CFE.

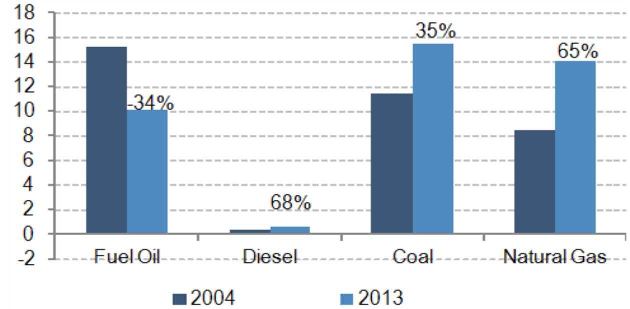
Figure 226: Materials Used for Electric Generation
as % of total



Source: SIE, Ministry of Energy.

The use of natural gas as a source for electricity generation has increased significantly in the past ten years. Natural gas participation in electricity generation has gone from 17% in 2000 to 50% in 2011 while oil derivatives have dropped from 48% in 2000 to 16% in 2011. In 2013, natural gas sourced 43% of total electricity generation due to the shortages experienced in the country.

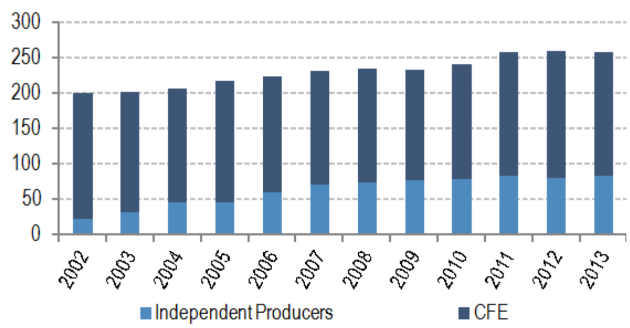
Figure 227: Materials Used for Electricity Generation
liters for fuel oil & diesel; kg for coal; m3 for natural gas.



Source: SIE, Ministry of Energy.

Power generation has seen private-sector involvement under the modality of independent power producers. Independent producers' (IP) installed capacity was over 24% of total effective installed capacity in the country. Foreign companies such as AES, Union Fenosa, Gas Natural, InterGen, Mistubishi, EDF International, Iberdrola, TransAlta, and Mitsui operate in Mexico under the private-public partnership modality.

Figure 228: Electricity Generation by Producer
TW/hour



Source: CFE.

After 2013's Energy Reform, CFE will be transformed into a State Productive Company. Though transmission and distribution will remain in the hands of the company, the new set of rules in the sector aim to create a spot market for electricity where privates can participate under competitive conditions and increase their share from the current 32% of total production.

There are 224 electric-generation facilities in Mexico, including 27 independent power producer plants (22 combined cycle and 5 wind-power generation). Mexico's total electricity production in 2013 was 172.7 TW/hour, including both CFE and independent producers. Most of the electricity produced in Mexico is through combined-cycle processes. CFE estimates an important increase for combined cycle electric

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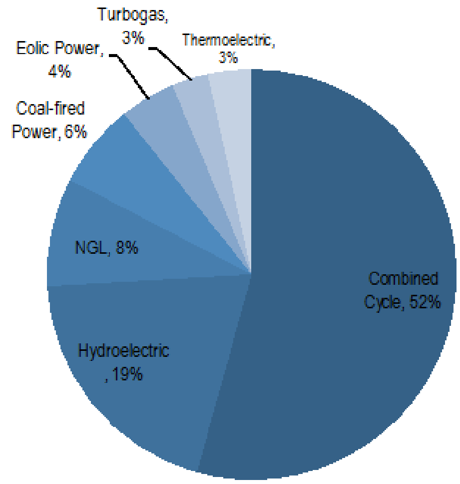
production (to 52% in 2026 from 34% in 2012), thus natural gas relevance in the electric industry should increase.

Figure 229: Estimated Generation Capacity by Process in 2026

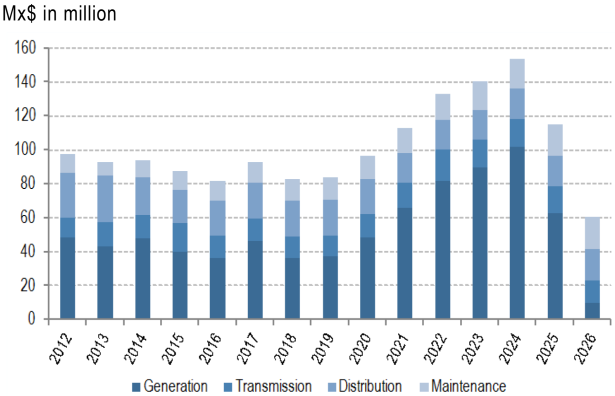


Source: CFE.

50% of the required investment for 2014 is in electric generation. This includes infrastructure investments to migrate electic generation to natural gas. As part of a vertical integration to become an energy company, CFE will enter into the natural gas distribution business.

Figure 230: CFE's Future Investment Requirements

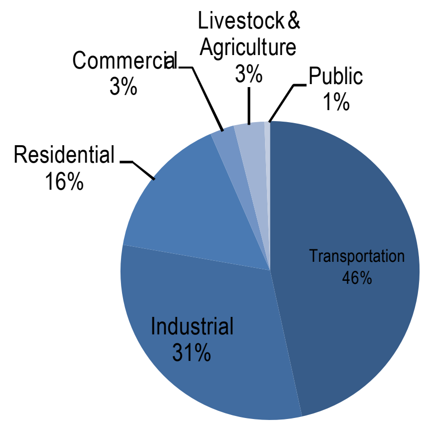
Mx$ in million



Source: CFE.

Transport sector and Industrials are the main users of energy, followed by residential consumption. Oil derivatives and electricity are the main energetic resources used by the industrial sector.

Figure 231: Final Energy Consumption per Sector

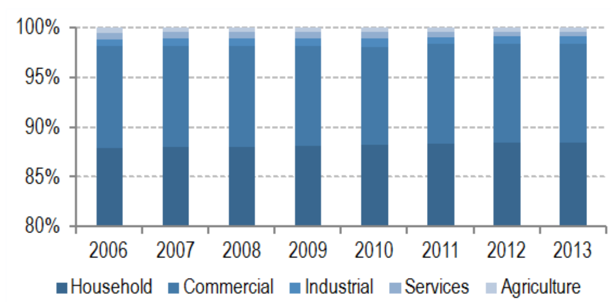


Source: SIE, Ministry of Energy. As of 2012.

Residential customers make up 88.5% of total clients; commercial businesses are 10% of clients and ~1.5% include service providers, agriculture and other industries. However, by revenue, industrials are the most important customers, representing c.60% of CFE's revenues. Households represent only 24%, while commercial clients are 7%.

Figure 232: CFE's Total Client Base Breakdown

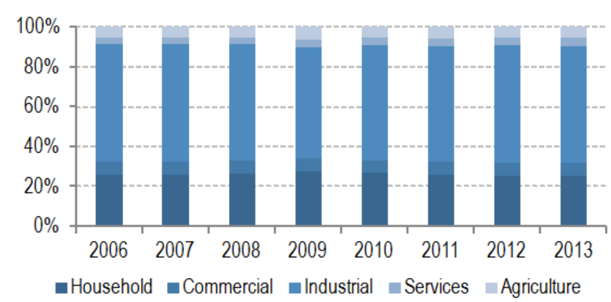
% of Total Clients



Source: CFE.

Figure 233: CFE's Revenues by Client

% of Total Revenues



Source: CFE.

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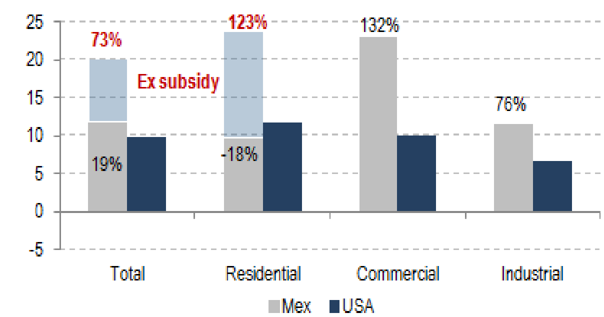
According to the World Economic Forum, Mexico ranks at 81 (out of 142 countries) on quality of electricity supply. This number is two spots down from last year's ranking at 79. Households lacking electric infrastructure are estimated at 1.77% of total households, or 1.8mn people.

Compared with the US, electric tariffs in Mexico are less competitive, mostly due to natural gas prices and distribution efficiency. Residential tariffs are subsidized in Mexico, leading Mexican households to have lower tariffs than in the US, yet taking away the subsidy, the residential tariff in Mexico would have been 123% larger than in the US in 3Q13.

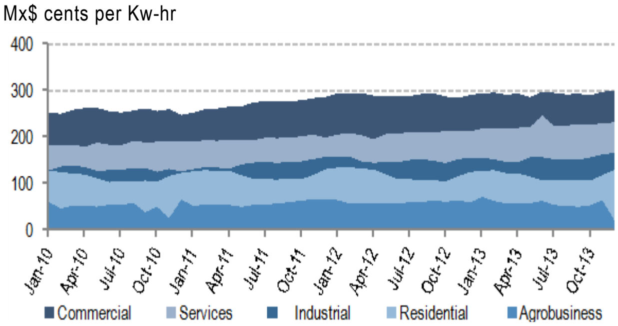
Figure 234: Electric Tariffs in Mexico vs. USA
$ cents per Kw-hr



Source: EIA, Ministry of Energy. As of 3Q13.

Electric tariffs are established by the Minister of Finance based on the production costs of CFE. The commercial tariff (highest of all) was Mx$3 per Kw/hr. at the end of 2013, increasing 3% yoy. Household expenditure for electricity for the poorest decile represents 5% of the total expenditure while for the richest decile, it represents 3%.

Figure 235: Electric Tariff per User
Mx$ cents per Kw-hr

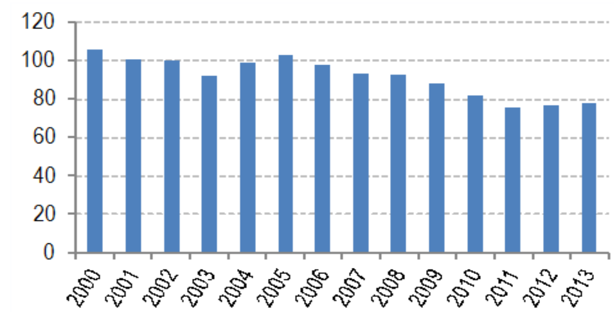


Source: CFE. As of December 2013.

Tourism

Tourism is a key industry for Mexico. It is one of the most important sources of foreign exchange, generating $13.8bn of inflows in 2013, up 8% from 2012. Since 2000, when the number of international travelers entering Mexico reached its maximum, the number of travelers has been decreasing 2% on average annually, reaching 778 million travelers.

Figure 236: Number of International Travelers entering Mexico
million people



Source: Banco de México.

In 2011, Mexico was the tenth most popular destination by number of arrivals, according to the World Tourism Organization. Within the Americas, Mexico is the second most popular destination after the United States, which has c.40mn more visits per year.

Table 67: International Tourist Destinations within the Americas

Country	Million Tourists		
	2010	*2011*	*2012**
United States	59,796	62,711	66,969
Mexico	23,290	23,403	23,403
Brazil	5,161	5,433	5,677
Argentina	5,325	5,705	5,599
Dominican Republic	4,125	4,306	4,563

Source: UNWTO. *Preliminar Figures.

According to UNWTO, the Americas have a 16% share of worldwide arrivals. North America accounts for ~2/3 of all arrivals, which increased 4% yoy in 2012. This growth came solely from tourism to the US and Canada, as international flow to Mexico was flat vs. 2011. Central America had the highest increase (+8%), led by Nicaragua and Belize, both growing at 11%.

UNWTO expects that worldwide international arrivals will expand by an average of 3.3% yoy from 2012 to 2030. Given this projection, the number of international arrivals to Mexico should be 44.5 million in 2030.

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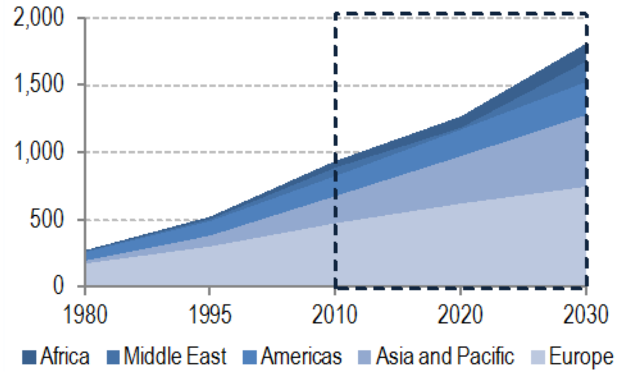
Figure 237: International Tourist Arrivals by Region, 1980-2030

million arrivals



Source: UNWTO.

In terms of total receipts, Mexico was considerably below the average of the top ten countries with the highest income from international tourism. Mexico accounts for 6% of total international tourism receipts in the Americas, while the United States' share is at 59.4%.

Table 68: International Tourist Receipts

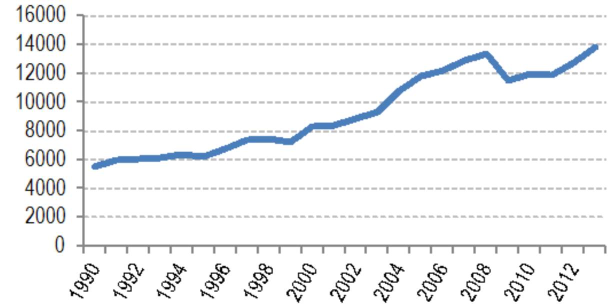
Country	Billion US$ 2011	Billion US$ 2012*
United States	115.6	126.2
Spain	59.9	55.9
France	54.5	53.7
China	48.5	50.0
Macao (China)	38.5	43.7
Italy	43.0	41.2
Germany	38.9	38.1
United Kingdom	35.1	36.4
Hong Kong (China)	27.7	32.1
Australia	31.5	31.5
Average of Top 10	49.3	50.9
Mexico	11.9	12.7

Source: UNWTO. *Provisional Figures.

According to Banxico, Mexico received $13.8 billion in 2013 from international, up 8% yoy. Even when the number of passengers has been dropping since 2000 until 2013 at a -2% CAGR, inflows have been increasing at a 4% CAGR for the same period, meaning larger average expenditure per visitant.

Figure 238: Inflows from International Travel to Mexico

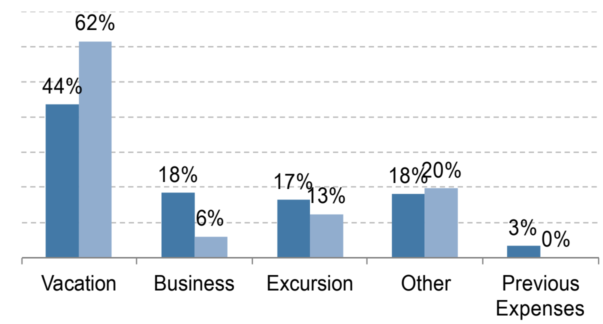
$ in millions



Source: Banco de México.

National tourism accounts for roughly 80% of total tourism in Mexico. The number one reason for traveling to Mexico is vacation while business traveling is the second most popular.

Figure 239: Reasons for Traveling to Mexico

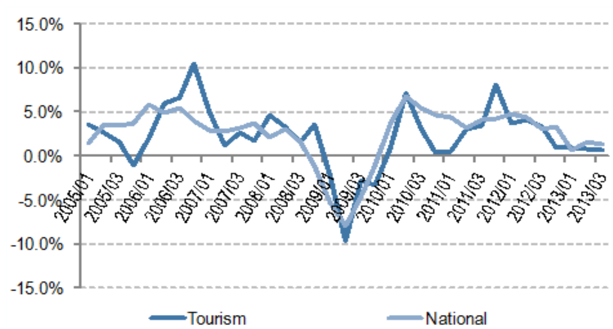


Source: Sectur. Data as of 2011.

As of 4Q13, the tourism sector employed 3.4 million people, a 4.5% increase from 2012. Tourism as percentage of the annual GDP has been declining since 2003, when touristic activities accounted for 8.8%. This is explained by the 2008 crisis, the influenza epidemic, and insecurity.

Figure 240: GDP Quarterly Growth Rates

% yoy



Source: INEGI.

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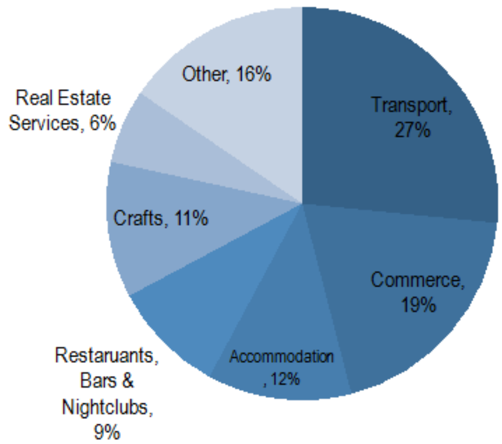
Transportation is the main revenue source for tourism-related activities. In 2011, transportation had a 27% participation in the Tourism GDP that was calculated by the INEGI.

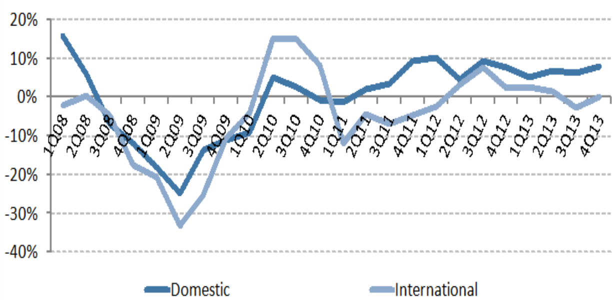
Figure 241: Source of Tourism Revenues



Source: INEGI. Data as of 2011.

Arrivals by air account for more than 80% of total entries to the country. Nonetheless, ground transportation is the main way for national passenger movement within the country.

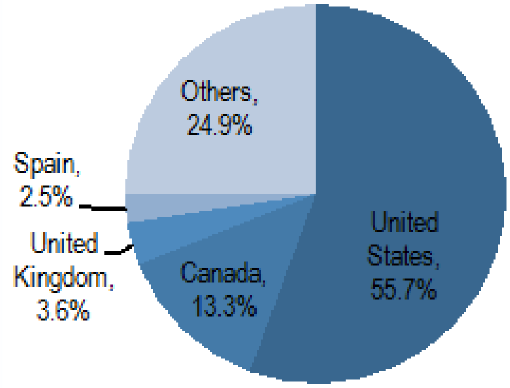
Figure 242: Domestic vs International Passenger Traffic Growth Rates



Source: Company Reports. Note: Consolidated numbers for the 3 public listed airports in Mexico.

As of September 2013, 69% of the tourists that entered Mexico by air came from North America, being that the United States is the country where more people came from (55.7% of total entries). Travelers from the United Kingdom represented 3.6% of total tourists (+20bp since last year). Japan + China accounted for less than 2% of tourists entering by air.

Figure 243: Origin of International Tourists entering Mexico by Air

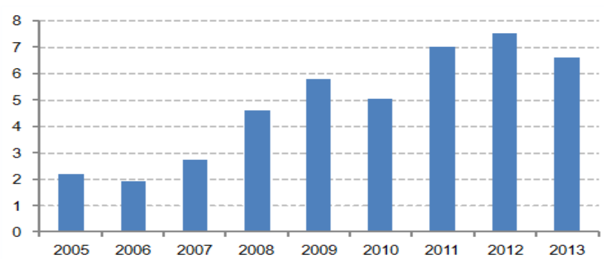


Source: Secretaría de Turismo.

Efforts to promote tourism are focused on Cancún and the Riviera Maya, followed by Los Cabos and by Loreto in the northwest. That said, Caribbean beaches are by far the most popular, as they have the added benefit of being close to the Mayan heartland and popular archaeological attractions Tulum and Chichen-Itzá. Even with all the promotion focused on the southeast region, the number of passengers that arrive to the country on a cruise has decreased since 2007, when it reached almost seven million people.

For 2014, the government budgeted Mx$6 billion for tourism, which represents 0.14% of the federal budget for the year. Last year's budget was 16.2% lower, but the actual expenditure was Mx$6.6 billion, topping this year's budget. In Calderon's administration, expenditure for tourism had a boost, growing from Mx$1.9 billion in 2006 to Mx$7.5 billion in 2012.

Figure 244: Government Expenditures for Tourism
Mx$ in billion



Source: SHCP.

Beverages

Mexico's biggest beverage market is the soft drink market. The second biggest market is the alcoholic market, due to the great consumption of beer in the country. Nevertheless, taking away beer, the alcoholic

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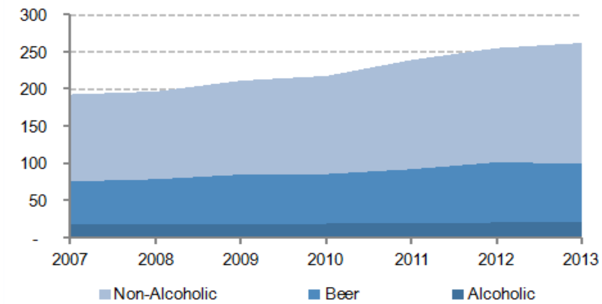
market is highly corrupted, as it is estimated that ~45% of the market is illegal.

Figure 245: Total Revenue for the Mexican Beverage Industry
Mx$ in billion



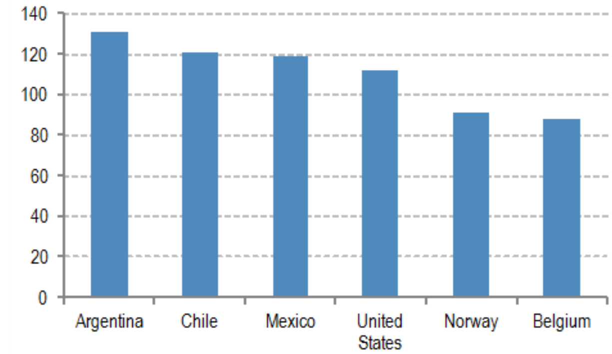
Source: INEGI.

According to the Mexican Association of Soft Drink Producers (*Asociación Nacional de Productores de Refrescos y Aguas Carbonatadas,, ANPRAC*), **the industry is comprised of 122 bottling plants, 415 distribution centers, and +35,000 formal distribution vehicles**. Over the past years, the soft drink industry has been investing at an average pace of $600 million annually. In Mexico, there are more than 1.3 million points of sale that sell soft drinks in Mexico, of which over one million are "mom & pop" stores.

According to a study carried out by the consultant Kantar Worldpanel, Mexicans spend on average Mx$4,590 for beverages per year, out of which Mx$2,216 are for carbonated soft drinks. This implies Mexican households purchase, on average, 310 liters of carbonated soft drinks per year, representing 11% of their expenditures in mass consumption products. The study details that carbonated soft drink penetration is close to 100%, as all homes buy at least one beverage per year.

Mexicans drink on average 119 liters of soft drinks, according to data released by Euromonitor in 2012. Mexico was outranked by Argentina and Chile as the nations with the largest consumption of soft drinks, with 131 and 121 liters, respectively. In 2011, the same study ranked Mexico as the number one consumer; nonetheless, the number came down to 119 in 2011 as health and image awareness became more relevant on consumption patterns.

Figure 246: Countries with Largest Carbonated Soft Drink Consumption per Capita

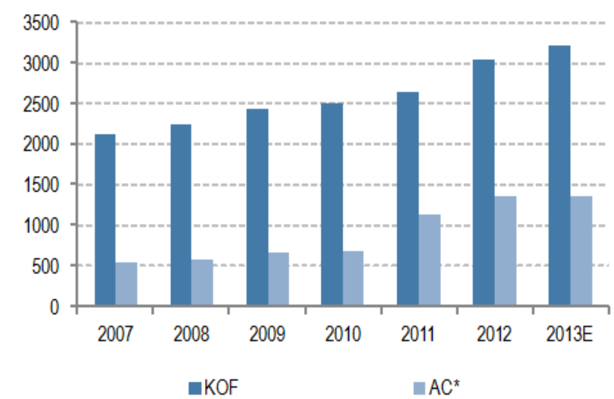


Source: Euromonitor.

Multinational players like Coca-Cola, PepsiCo and Cadbury Schweppes account for around 90% of industry revenues, mostly for soft drink sales. Regardless of the new excise tax (click here to see details on excise tax implemented), Coca-Cola announced no changes to its capex plan for 2014, planning to spend $1bn, in line with the past nine years' expenditures. PepsiCo announced $5bn in capex for the next five years.

The world's second largest Coca-Cola bottler is Coca-Cola FEMSA (Ticker: KOF), which controls 50% of Coca-Cola's volumes in Mexico. The other key Coca-Cola bottler in Mexico is Arca Continental (Ticker: AC*), a product of the merger of three local bottlers: Proyección Corporativa, Empresas El Carmen, and Embotelladoras Argos, finalizing the merger with Grupo Continental. Arca Continental's volumes are half of FEMSA's (25%) and it covers the northern part of Mexico.

Figure 247: Sale Volumes of Top Bottlers in Mexico
million unit cases



Source: Company Data, J.P. Morgan Estimates.

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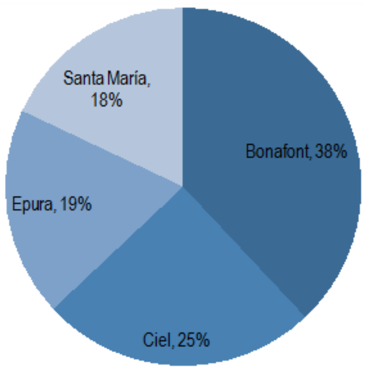
In Mexico, 73% of households consume bottled water. In 2013, Mexico was the largest water consumption country, beating China and the United States, previously ranked No. 1 and 2, respectively. Nonetheless, bottled water accounts for only 5% of non-alcoholic beverages revenues. Only four players dominate the bottled water business in Mexico.

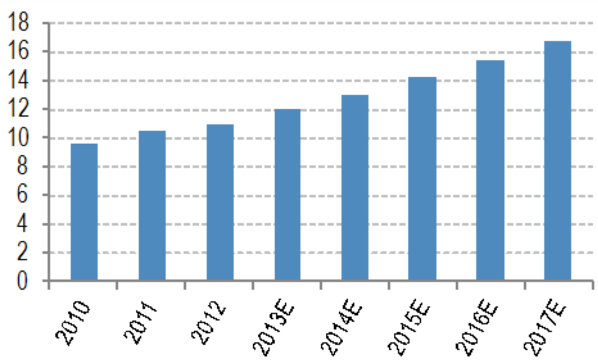
Figure 248: Bottled Water Market



Source: Euromonitor.

Mexico's alcoholic drink market is dominated by beer, where Heineken (formerly Femsa Cerveza) and AB InBev (formerly Grupo Modelo) have the largest market share. According to Business Monitor, beer sales will increase by 40.5% from 2012 to 2017 at $16.8 billion, representing a CAGR of 7.4%. Sales should be driven by population growth and marketing efforts from manufacturers.

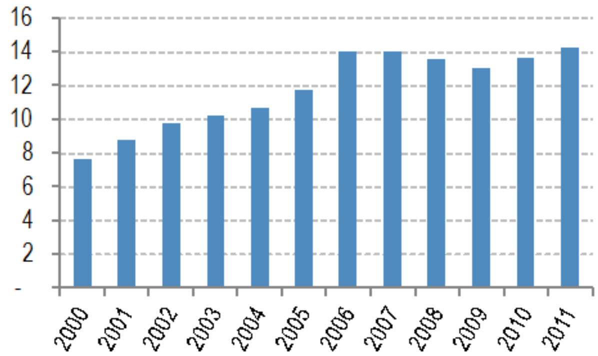
Figure 249: Beer will Boost Total Alcoholic Drinks Sales
$ in billion



Source: Business Monitor International.

Mexico is the US's top beer supplier, with 52% of the country's beer imports coming from Mexico. According to The Beer Institute, the USA imported 14.3 million barrels (31 gal. per barrel) in 2011, up 87% from 2000. The US's second largest beer supplier is the Netherlands, with ~5mn barrels per year.

Figure 250: US Beer Imports Coming from Mexico
million 31-gallon barrels



Source: The Beer Institute.

Since 2007, Mexico's beer production has been c.8 bn liters per year. After a small decrease in 2010, production has recovered to its pre-crisis levels, growing at a 0.8% CAGR. Last year, 8.5 billion liters were produced in Mexico.

Mexico's beer consumption is greater than wine. However, countries with large beer consumption like Germany or Netherlands have experienced a slow shift towards wine consumption because of its health benefits.

Spirits and wine sales represent around 14.5% of total alcoholic drink sales (~$1.85 billion in 2012). The leading players in the spirit sector are Bacardi (rum), Cuervo (mainly tequila), and Domecq. Tequila production, Mexico's flagship alcoholic beverages, could decline in the following years as farmers prefer to grow other products with higher margins than blue agave, necessary for Tequila production. The wine market continues to be small and underdeveloped in the country, with only a few producers and limited demand.

The beverage sector in Mexico has been active in M&A through the years. The second largest M&A transaction in Mexico was concluded in April 2013, when Anheuser-Busch InBev was cleared by the US Department of Justice to acquire the remaining 50% of Grupo Modelo for $20.1 billion.

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Table 69: M&A Transactions in the Mexican Bottling Universe, 2010-2013

Deal	Date	Target	Acquirer	Seller	$ (US mill.)
DIV	12/11	Bottling Operations	KOFL	G.Fomento Queretano	479.9
ACQ	9/11	Corp de Los Angeles	KOFL		841.2
JV	7/11	Empresas Polar SA	GEUPECB		N/A
DIV	6/11	Bev. Bottling division	KOFL	G. Tampico	785.4
ACQ	2/11	G. Azucarero Mexico	GEUPECB		35.4
ACQ	1/11	G. Continental	AC*		2200.2
ACQ	10/10	G. Industrias Lacteas	KOFL		N/A
ACQ	9/10	Arca Ecuador	AC*		345
DIV	1/10	FEMSA Beer Operations	Multiple acquirers	FEMSA	7439.1
ACQ	6/12	G.Modelo	ABI Inbev		17231.3
ACQ	1/13	G.Yoli	KOFL		726.6
ACQ	7/13	Companhia Fluminense	KOFL		448
ACQ	10/13	SPAIPA	KOFL		1,860

Source: Bloomberg, company reports, J.P. Morgan. *DIV = Divestiture, ACQ= Acquisition, JV= Joint venture. GEUPECB = Grupo Embotelladoras Unidas, SAB. Data as of March 2014.

Table 70: Biggest Beer Brewing Companies in the World

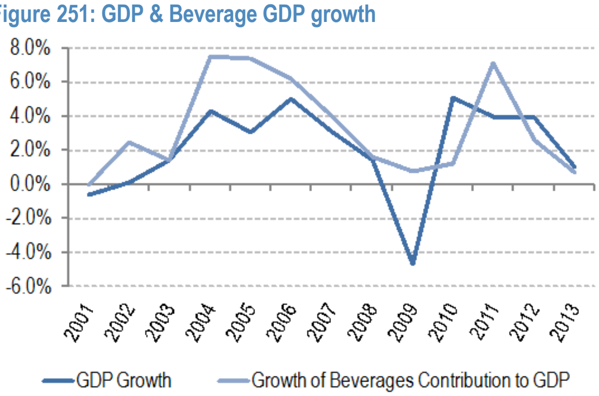
million hectoliters

Company	Country of Origin	Production Volume
Anheuser-Busch InBev	Belgium	352.9
SABMiller	UK	190
Heineken	Netherlands	171.7
Carlsberg	Denmark	120.4
China Resource Brewery Ltd.	China	106.2

Source: Company Data.

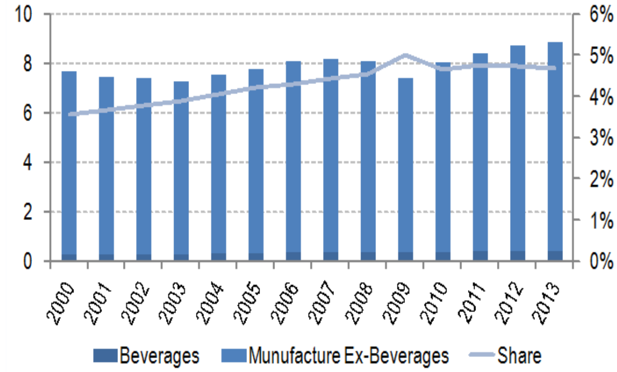
Beverage GDP has been growing at a 3.3% CAGR since 2000, 120bp above total GDP. Beverage GDP growth has been decelerating after experiencing an important rebound in 2010, growing at a 0.7% y/y rate in 2013. Even with the deceleration, beverages increased their share within the manufacturing industry, from 3.6% in 2000 to 4.7% share in 2013.

Figure 251: GDP & Beverage GDP growth



Source: INEGI.

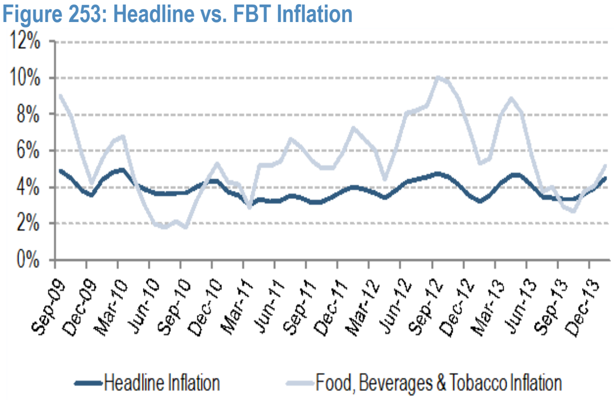
Figure 252: Beverage Participation in the Manufacturing Industry



Source: INEGI.

Beverages (soft, alcoholic and nonalcoholic) account for 5.1% of the consumer price index (CPI) and 21.9% of the food, beverage and tobacco (FBT) sub-index. FBT makes up 23.14% of the total price basket. Given the industry concentration, Mexican bottlers have high pricing power and are able to pass on price increases to the consumer.

Figure 253: Headline vs. FBT Inflation



Source: INEGI. Data as of Jan 14.

Retail

Commerce and trade is the largest subsector of the services industry in Mexico, accounting for 15% of GDP as of Q413 and 25% of the total services sector. Wholesale commerce employs c.2.33% of the economically active population, while retail share is at 17.34% (8.7mn people).

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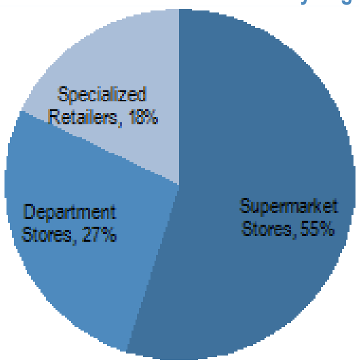
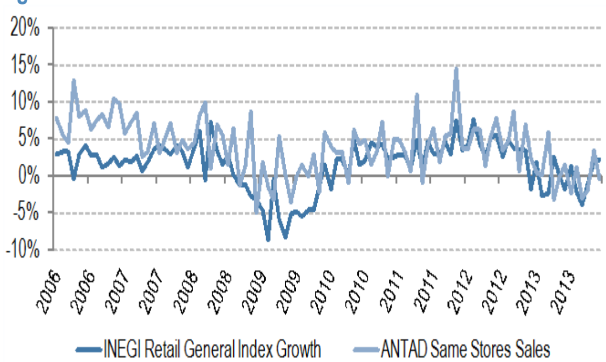
Figure 254: ANTAD Distribution of Workers by Segment



Source: ANTAD.

The National Retailers Association (*Asociación Nacional de Tiendas de Autoservicio y Departamentales, ANTAD*) gathers information from Mexico's largest formal retailers and department stores. ANTAD statistical output serves as proxy indicators to assess the formal retail dynamics in the Mexican economy.

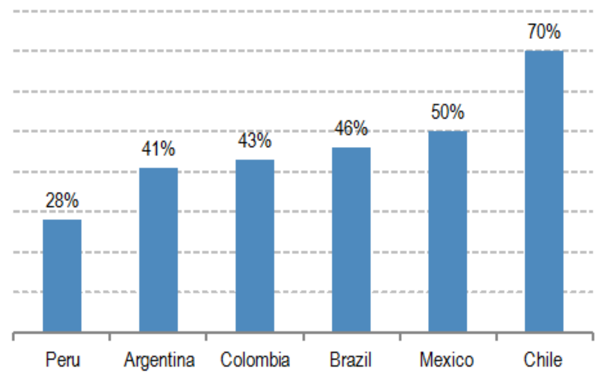
Figure 255: INEGI Retail Sales General Index vs. ANTAD SSS



Source: INEGI, ANTAD.

Retailers in the informal economy are the biggest competitors for companies in the industry. According to INEGI, c.64% of the total economically active population operates in the informal sector, while ANTAD estimates the informal economy to represent c.12% of Mexico's GDP.

Figure 256: Formal Retail Penetration in LatAm



Source: Company Reports, J.P. Morgan.

A significant portion of the informal retail establishments in Mexico are *Tianguis*. These are open-air markets or bazaars established along the sidewalks of many cities' main streets or in large warehouses. These are made up of various independent sales points controlled by different owners called *puestos*. The average number of *puestos* per *Tianguis* is at 200. ANTAD estimates 5,575 *Tianguis* in the country generating average daily revenues of Mx$300k each.

Table 71: Tianguis vs. ANTAD

	Tianguis	ANTAD
Av. Sales Floor (sq. mts)	6.9mn	23.6mn
Stores/Puestos	1.15mn	32,121
Total Sales	Mx$538bn	Mx$1.1tn

Source: ANTAD 2013.

The formal retail sector in Mexico has gone through an important consolidation process, leading to 5 players in the industry – a concentration of 95% of the formal market.

Table 72: Retail Industry in LatAm

Country	Market Size $bn	CAGR '09-13	Share of Formal Market	Share of Top 5	Top Players
Brazil	125	10.7%	42%	52%	CBD, Carrefour, Wal-Mart
Mexico	53	9.1%	50%	95%	Walmex, Comerci, Soriana
Colombia	14	7.0%	48%	75%	Exito, Carrefour, Olimpica
Chile	16	9.6%	63%	100%	Wal-Mart Chile, Cencosud, SMU, Falabella (Tottus)
Average	**52**	**9.1%**	**51.3%**	**80.6%**	

Source: J.P. Morgan, Company Reports.

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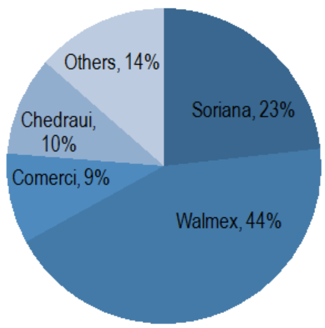
Walmex is the Mexican-listed subsidiary of Walmart USA, with a free float of 31%. The company is the **leading retailer in Mexico,** with a market share of 44% of ANTAD's total sales floor.

Figure 257: Supermarket Sales Area Market Share

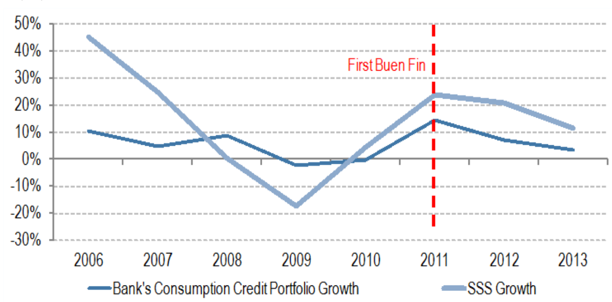


Source: ANTAD, Company Reports.

In November 2011 the "Buen Fin" promotional effort (similar to "Black Friday" in the US) **was put in place to stimulate retail sales across segments, especially durable goods sales.** During the same period, banks increased their credit offers and promotions to attract customers. One of the clearest effects of the "Buen Fin" is a shift in seasonality, as November now becomes the strongest time of the year for retailers, while previously it was December.

Figure 258: November's "Buen Fin" Consumer & Credit Dynamics

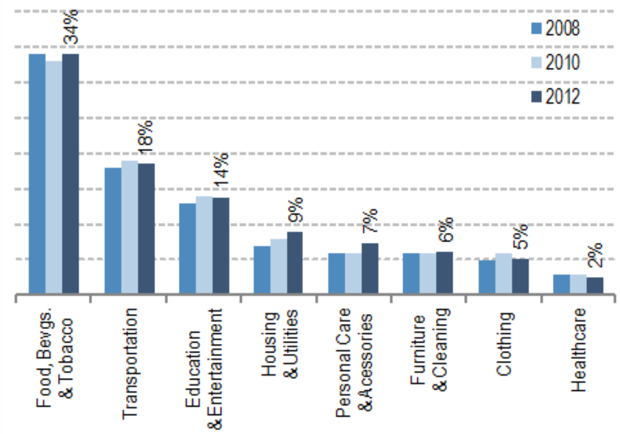
% yoy



Source: Banxico, ANTAD.

Higher consumer confidence since the 2009 crisis has led to several changes in consumer dynamics, among them, higher consumption of durable goods (due to expanding credit) as well as a shift towards convenience or mom & pop stores vs. full-format supermarkets. However, on the latter shift, consumers are not willing to sacrifice low prices yet, so we see convenience stores targeting not only fulfilling their clients' immediate needs, but also offering competitive pricing. Nielsen estimates **500,000 mom & pop stores** exist, representing **40-50% of fast-moving consumer goods sales.**

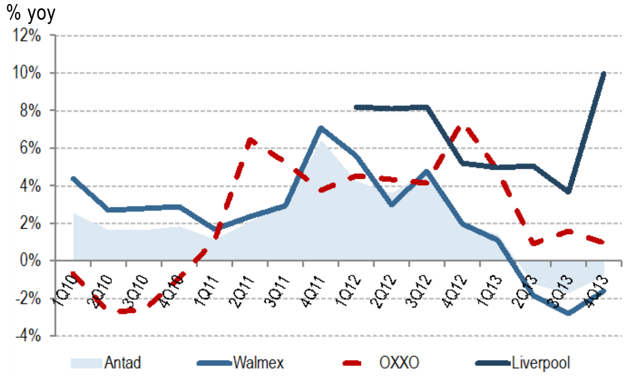
Figure 259: Household Expenditure Profile



Source: INEGI, ENIGH.

Figure 260: SSS for Mexico Retail Formats

% yoy

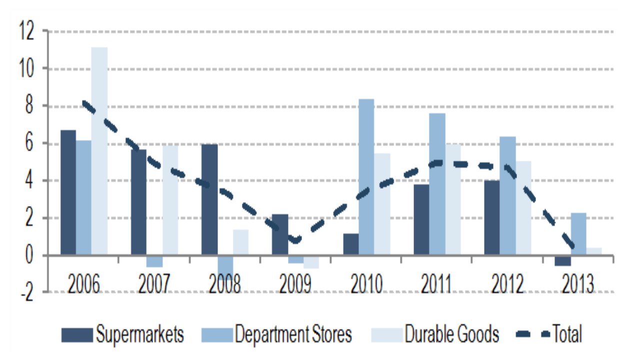


Source: Company Reports, ANTAD.

Average ANTAD SSS growth from 2006 to 2013 has been at 4%. Sluggish performance of the sector during 2013 at 0.01% is attributed to delays in budget spending, weather disasters, and the slowdown in US industrial production early in the year, which partly led to a reduction to the pace of remittances to Mexico.

Figure 261: Historical Same-Store Sales by Retailer Type

%



Source: ANTAD.

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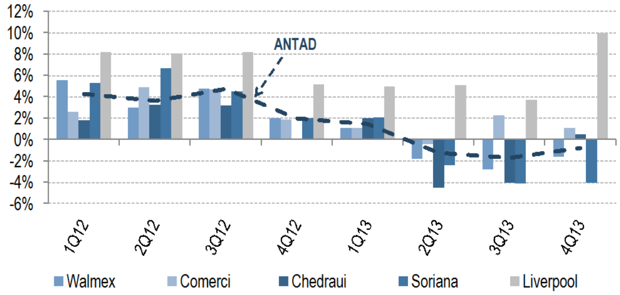
Figure 262: Public Retailers SSS vs. ANTAD

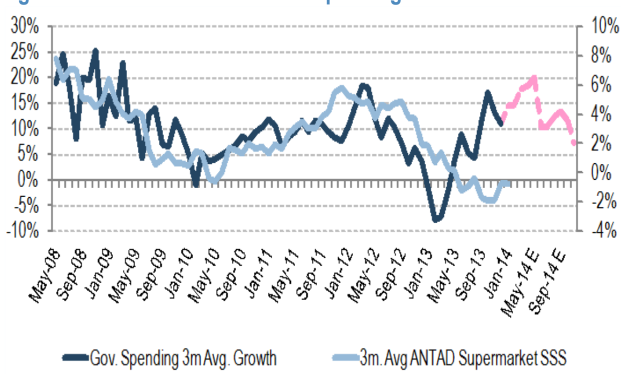
% yoy



Source: ANTAD, Company Reports.

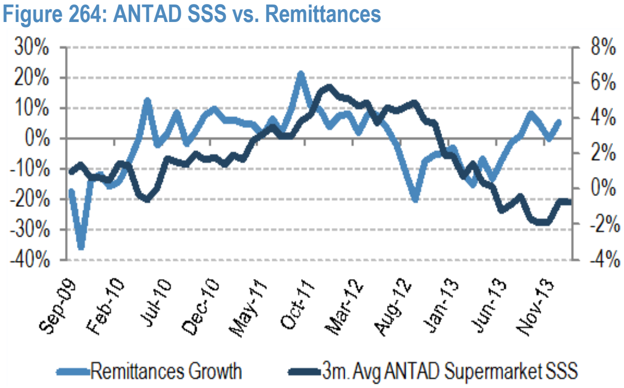
Government spending and remittances are two of the most important drivers for consumer dynamics in Mexico. Historical statistical analysis shows that public spending has a three-month lag to permeate into the real economy through retail sales. Remittances historically drive supermarket sales as the low-income population receiving them spends a large part of their income in food & beverages.

Figure 263: ANTAD SSS vs. Gov. Spending



Source: ANTAD, SHCP. 2014 expenditure forecasted on based on the annual approved budget and 2012 monthly avg. expenditure pace.

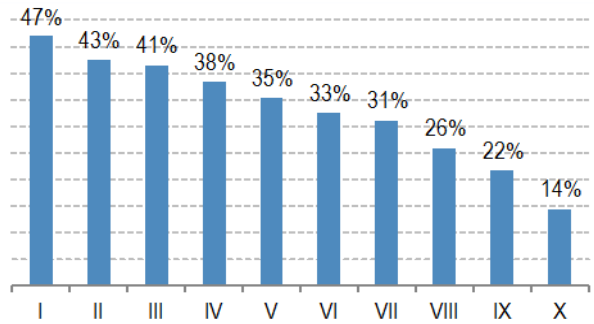
Figure 264: ANTAD SSS vs. Remittances



Source: ANTAD, Banxico.

Figure 265: Food & Beverages Expenditure per Income Deciles

% of total income

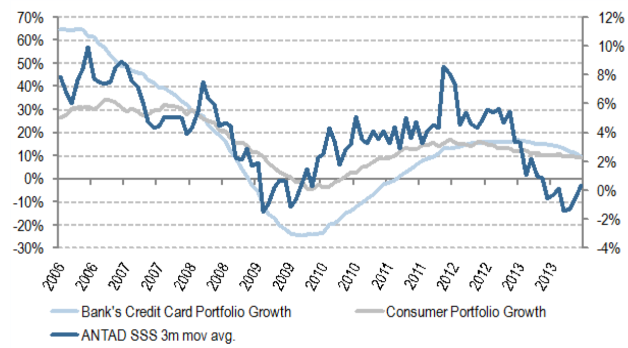


Source: INEGI, ENIGH.

Credit has also been an important driver for retail especially for department stores. **Credit for consumer has been growing at an 8% 5yr CAGR since 2009**. Credit card portfolio represents 45% of total consumer credit portfolio.

Figure 266: Consumer Credit Dynamics vs. ANTAD SSS

% yoy



Source: Banxico, ANTAD.

Going forward credit should remain as one of the main drivers for overall consumption (especially for department stores/discretionary consumption), as Mexico's credit card penetration is low at 13%. This should come not only by the traditional bank credit card but also from the stores giving their own credit lines. As of 2013 Liverpool was the 3rd largest credit card issuer in the country and 1st within non-banks.

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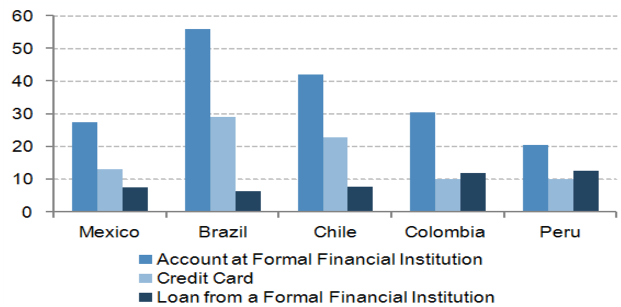
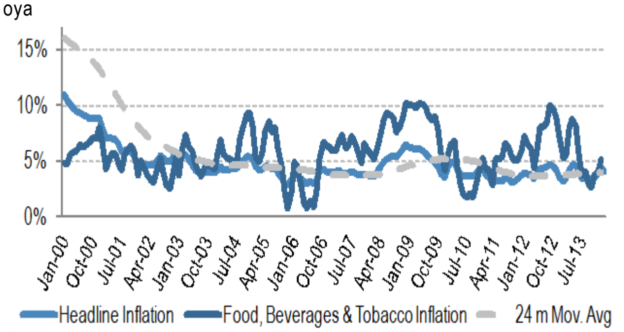
Figure 267: Financial Inclusion in Selected LatAm Countries
% of total population



Source: World Bank.

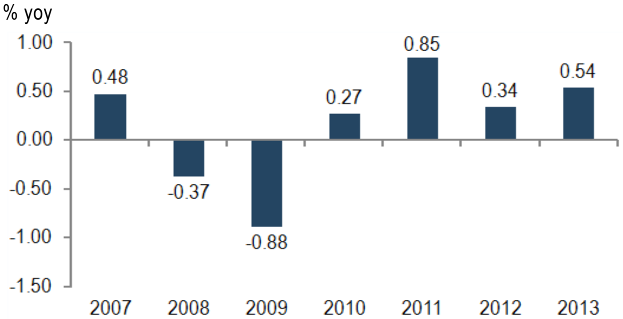
Headline and FBT Inflation has remained stable for the last 14 years on the back of an active Central Bank and no demand-side pressures from the labor market. The Central Bank's sole mandate in Mexico is to control inflation. Banxico has established a 3% inflation target with +/- 1ppt as lower and upper bounds. Subdued wage revisions give further support to inflation stability.

Figure 268: Inflation Remains Stable
oya



Source: INEGI.

Figure 269: Real Wage Revisions
% yoy



Source: Ministry of Labor.

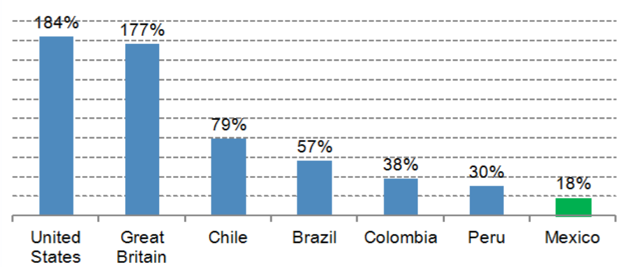
Mexico remains an attractive destination for retailers due to a growing middle-income segment, healthy macroeconomic data and credit expansion.

Financials

(For more details on Mexico's and other LatAm countries' banking systems, please refer to JPM LatAm Financials analyst SaulMartinez & team's Credit Bible).

Mexico has one of the lowest credit penetrations among LatAm countries at 18.2% of GDP. Though penetration has increased from 2005's 12% of GDP, it is still substantially below pre-Tequila crisis levels in 1994, when credit penetration was at 38%.

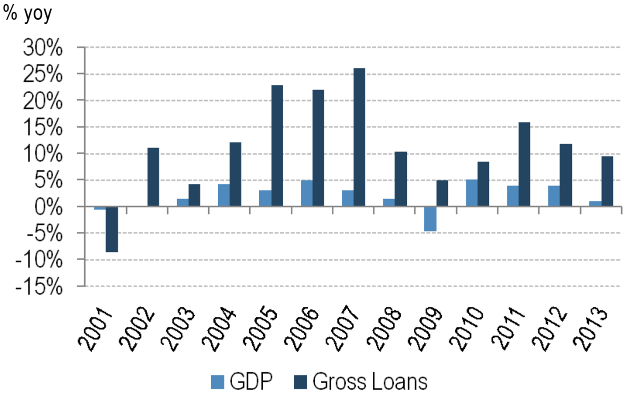
Figure 270: Credit Penetration in Selected Countries
loans as % of GDP



Source: Source: J.P. Morgan, Central Bank of Brasil, Superintendencia de Bancos e Instituciones Financieras (Chile),Superintendencia Financiera de Colombia, Comisión Nacional Bancaria y de Valores (Mexico), Superintendencia de Banca, Seguros, Y AFP (Perú), and Bloomberg. Data for United States and Great Britain are as of 2012.the rest are as of 2013.

Credit growth in Mexico has averaged a +10pp premium over real GDP growth. At the end of 2013 banking system gross loans posted a 9% increase relative to the 1.1% growth in Mexican economy.

Figure 271: GDP vs. Credit Growth
% yoy



Source: INEGI, Banxico.

The two most important factors that have constrained credit growth in Mexico is high informal labor rates and the high cost of enforcing contracts. Informality in Mexico represents c.64% of the economically active

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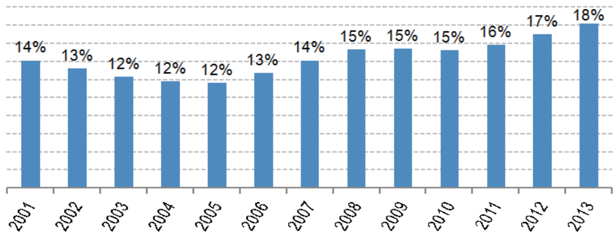
population. According to the World Bank, Mexico's cost of enforcing contracts is amongst the highest in the world accounting, on average, for around 35% of the value of a legal claim.

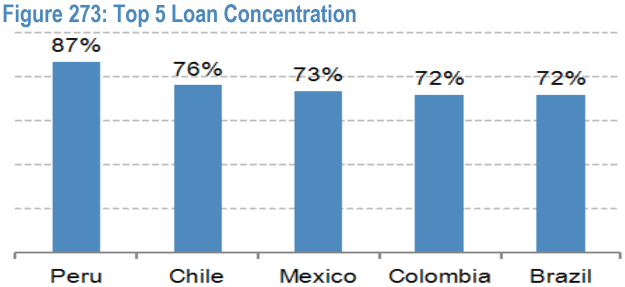
Figure 272: Evolution of Credit Penetration in Mexico
loans as % of GDP



Source: J.P. Morgan, INEGI, and Comisión Nacional Bancaria y de Valores. Note: Includes SOFOMES owned by banks.

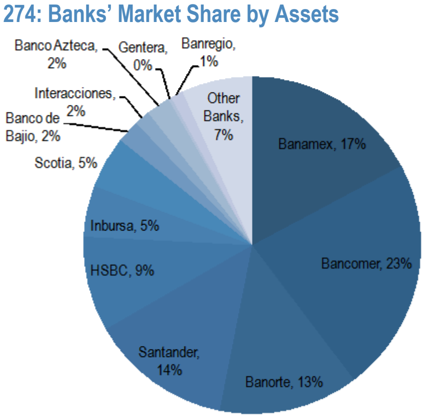
As of 2013 credit offer in Mexico was dominated by the top 5 banks in the country accounting for 75% of total loans in the system. In terms of assets major market participants are subsidiaries of foreign banks; BBVA Bancomer is the largest bank with a 23% market share as of February 2014, followed by Banamex (Citi's subsidiary) with 17%.

Figure 273: Top 5 Loan Concentration



Source: J.P. Morgan, Central Bank of Brasil, Superintendencia de Bancos e Instituciones Financieras (Chile),Superintendencia Financiera de Colombia, Comisión Nacional Bancaria y de Valores (Mexico), Superintendencia de Banca, Seguros, Y AFP (Perú), and Bloomberg. Data as of 2013.

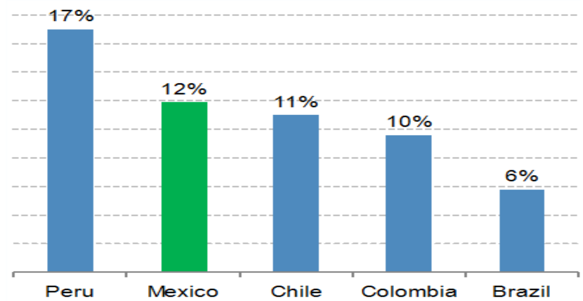
Figure 274: Banks' Market Share by Assets



Source: CNBV.

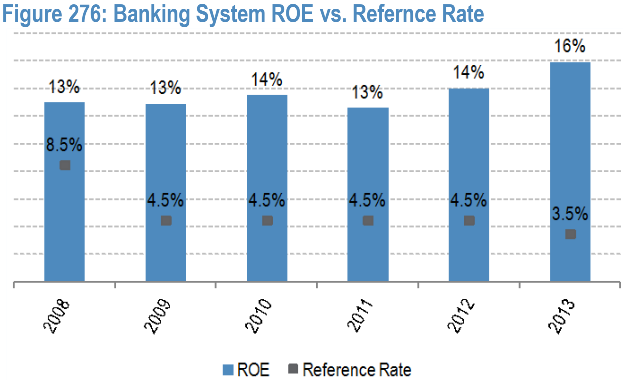
At 15.9% Mexico has the third largest ROE among LatAm countries in 2013, topped only by Peru (21.1%) and Chile (16%). Relative to the cost of borrowing, the outlook for the banking system in Mexico seems more positive in the LatAm context as ROE less average Mexico's reference rate was 12% in 2013.

Figure 275: ROE less Average Reference Rate



Source: J.P. Morgan, Central Bank of Brasil, Superintendencia de Bancos e Instituciones Financieras (Chile),Superintendencia Financiera de Colombia, Comisión Nacional Bancaria y de Valores (Mexico), and Superintendencia de Banca, Seguros, Y AFP (Perú). Note: Reference rate data as of March 27, 2014. For Brazil, ROE figure represents the nine months annualized through September 2013.

Figure 276: Banking System ROE vs. Refernce Rate



Source: Banxico.

Consumer credit is the second largest part of the banking system's loan portfolio. Before the 2007-10 crisis, consumer credit was growing at an average 43% yoy rate with NPLs at 4%. During the crisis, average NPLs increased to 7% and loan growth decelerated to -19% on average. By the end of 2013 average NPLs were at 5%, 1pp above the 2012 level on the back of lagging economic performance.

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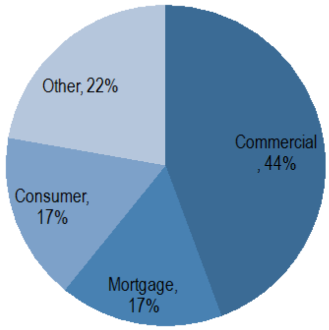
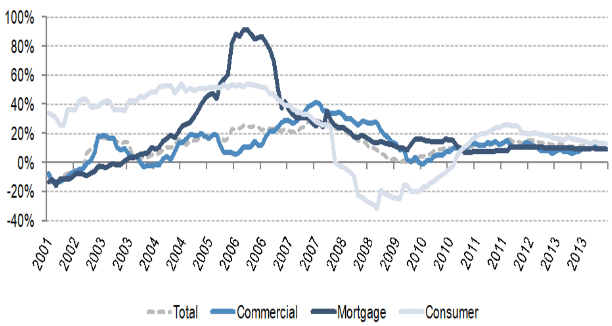
Figure 277: Gross Loans Break Down



Source: Banxico. As of Feb 2014.

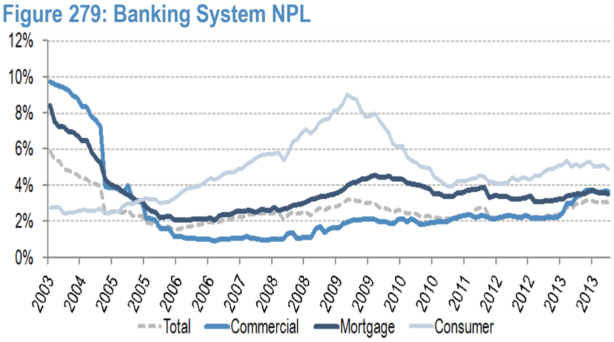
Figure 278: Banking System Gross Loan Growth

% yoy



Source: Banxico.

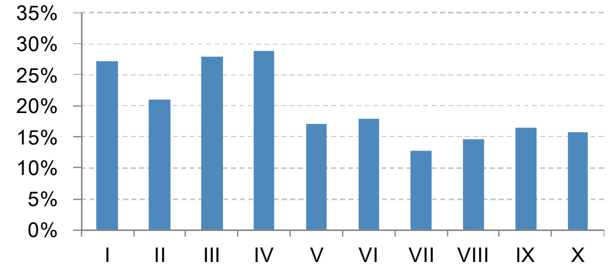
Figure 279: Banking System NPL



Source: Banxico.

Despite the low credit penetration in Mexico, **debt service represents c. 27.2% of Mexican household disposable income**. According to a survey conducted by our J.P. Morgan LatAm Financials Team (click here to see full report on Consumer Debt Survey), only 38% of the Mexican survey respondents owe money to a bank while the rest owe money to different parties including retailers and independent lenders.

Figure 280: Debt Service as % of Disposable Income per Income Decile

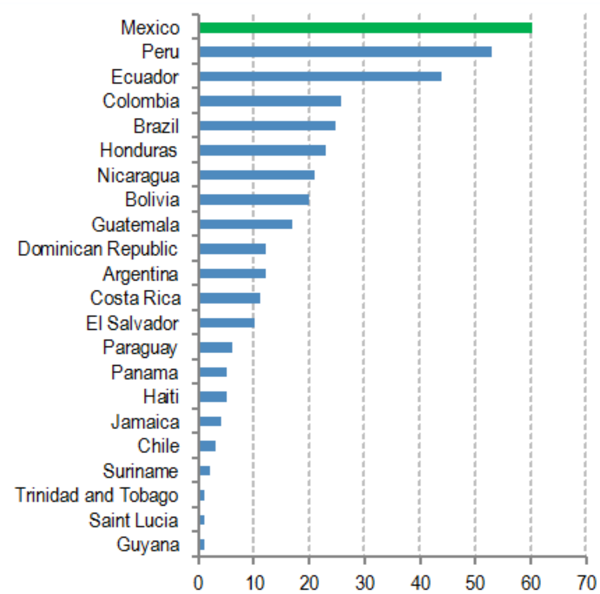


Source: INEGI, ENIGH. Data as of 2012.

Low credit penetration and high informality levels in the economy have driven the development of the microcredit industry in the country. Many of today's microfinance institutions started as nonprofit organizations looking for improvement in the country's financial inclusion. Mexico has the largest amount of microfinance institutions among LatAm countries with 60 different institutions. Microfinance institutions include: regulated financial institutions, nonregulated financial institutions and corporations.

Figure 281: Microfinance Institutions in LatAm

No. of Institutions



Source: Mix Market. Latest available data.

The *Sociedades Financieras Populares* (SOFIPOS, for-profit financial partnerships) are the main regulated vehicles for microfinance, along with *Sociedades Cooperativas de Ahorro y Crédito* (SOCAPS, non-profit savings and loan cooperatives). Nevertheless, the main figure adopted for these

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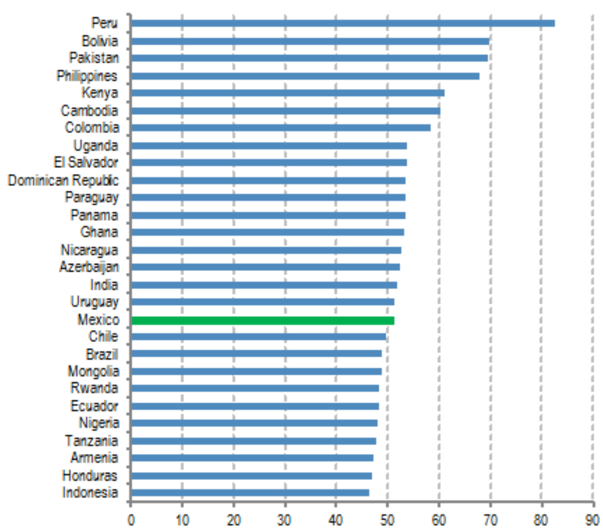
institutions is SOFOMES (*Sociedad Financiera de Objeto Multiple*). These kinds of entities are enabled to lend money to third parties but are restricted to receive deposits from the general public, thus their funding depends mostly on equity and debt issuance. SOFOMES are regulated if they have a direct link to regulated financial institutions such as banks. As of 2Q13 13% of the affiliates in the National Program for Financing of SMEs (*Programa Nacional de Financiamiento al Microempresario,* PRONAFIM) were regulated entities. These represent 77% of total assets.

Mexico ranks 18th in the overall microfinance business environment ranking published by The Economist magazine. Regulatory framework, transparency, client protection, and political stability are among the criteria used to rank the microfinance environment.

Figure 282: Overall Microfinance Business Environment Rankings

(1-100 where 100 is most favorable)

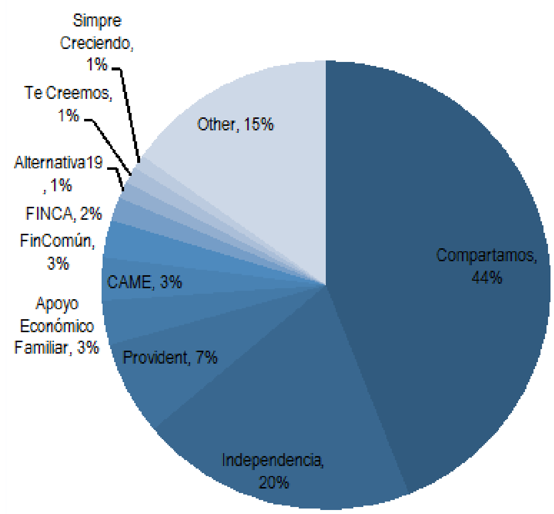


Source: The Economist: Intelligence Unit.

Banco Compartamos is the largest participant in the microfinance sector in Mexico, with c.2.5mn clients and a Total Portfolio of Mx.$20.7bn as of 4Q13. It is controlled by Gentera, which is a publicly traded company listed on the Mexican Stock Exchange.

Figure 283: Mexico's Microfinance Institutions Market Share

% of total gross loans



Source: Pronafim, Pro Desarrollo.

Table 73: Microfinance Institutions Balance Sheet Highlights

Mx$ in million

	2010	2011	2012	2013e*
Total Assets	31,184.74	37,795.47	43,522.21	48,358.14
Gross Loan Portfolio	24,543.80	28,902.96	34,036.62	37,746.36
Total Lialbilities	19,468.89	24,529.28	28,352.55	29,721.50
Equity	11,715.85	13,266.19	15,169.65	15,847.63
Net Income	2,017.44	1,713.55	2,405.93	2,678.10

Source: Pronafim, Pro Desarrollo. *Estimates from source based on a liner extrapolation.

Adding to the credit offer, **pawn shops in Mexico have traditionally served the lowest income levels.** The first pawn shop in Mexico was established in 1775, Nacional Monte de Piedad, as a nonprofit social institution. Since then the pawn shop market has grown to an estimated **6,200 shops in 2010**. The traditional pawn loan in Mexico was backed by precious metal jewelry; yet, with the expansion of the market and the entry of foreign companies, coupled with the lower gold prices, the market has turned to general merchandise backed loans.

Manufacturing

The Mexican manufacturing sector has gone through a significant transformation since the Mexican government initiated the Border Industrialization Program in 1965, as a response to the demise of the US government's 'Bracero Program' in 1964. Since then, the free-trade agreements implemented in the 1980s and 1990s have been the cornerstone of Mexico's manufacturing-sector boom. As of 4Q13, the sector employed around 7.8 million people or 16% of the total

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economically active population and represented 16% of Mexico's GDP.

The industrial sector in Mexico has hovered around 29-33% of GDP since the 1980s and represented 33% as of 4Q13. Industrial production is divided into four sub-sectors – manufacturing, construction, mining and utilities production – with manufacturing being by far the largest of the four.

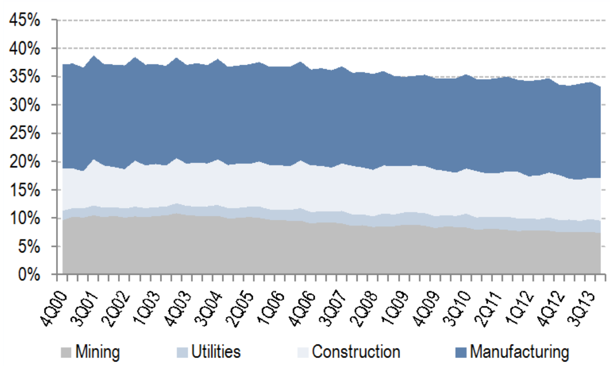
Table 74: Industrial Production Weight & Growth

4Q13	% of GDP	Growth (% yoy)
Manufacturing	16%	2%
Construction	8%	-5%
Mining	7%	-1%
Utilities	2%	1%

Source: INEGI.

Figure 284: Industrial Production Components

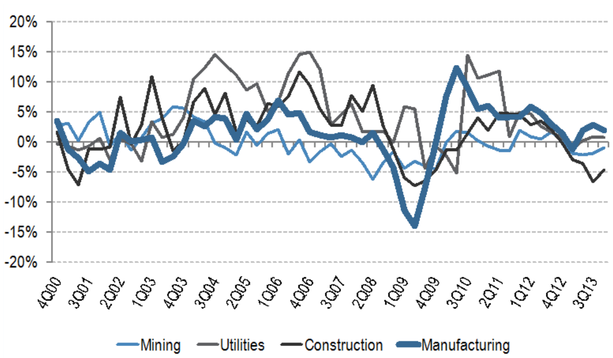
% of GDP



Source: INEGI.

Figure 285: Industrial Production Components Growth

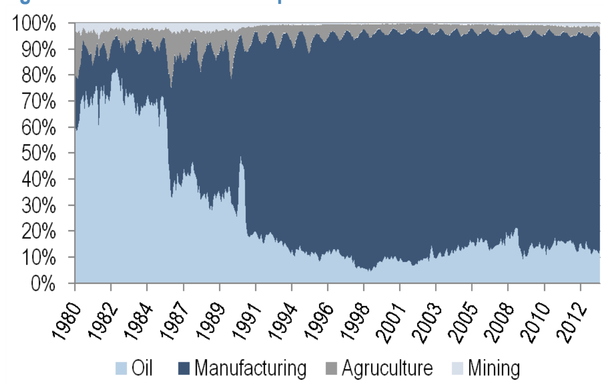
% yoy



Source: INEGI.

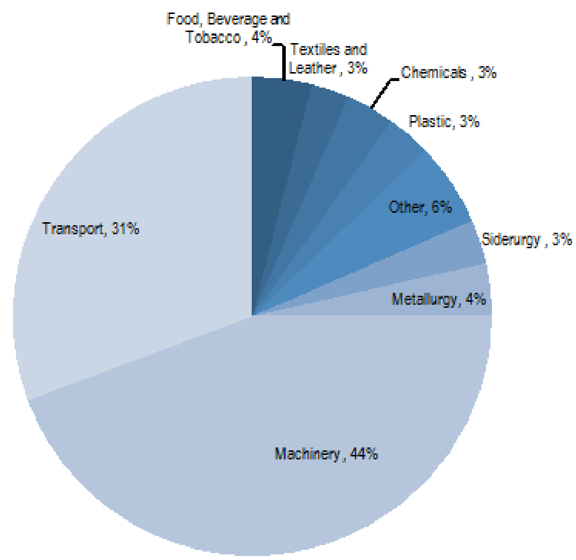
Manufacturing exports have increased their share in total exports from 20% in 1980 to 83% in 2013. Electric machinery and auto/auto parts manufactures are the two most important manufacturing exports, with revenues of $234bn in 2013.

Figure 286: Mexico's Total Export Breakdown



Source: INEGI.

Figure 287: Manufacturing Exports Breakdown



Source: INEGI.

The USA is Mexico's largest trade partner, accounting for 83% of total exports in 2013 and 80% of total non-oil exports. Non-oil exports to the USA closed 2013 at $18.5bn. The relationship was further enhanced after the NAFTA agreement was signed. Since then manufacturing exports from Mexico to the US increased by 533% from 1994 to 2013. Indeed, Mexico's manufacturing production is heavily linked to US industrial production with a 97% correlation from 2000 to 2012.

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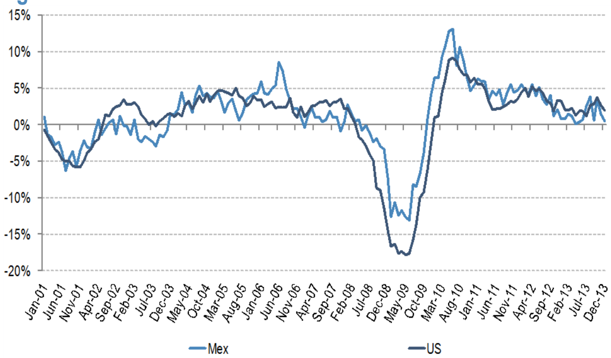
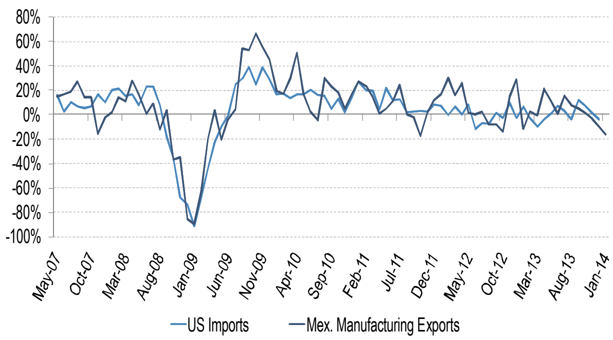
Figure 288: US & Mexico Industrial Production



Source: INEGI, FRB.

Figure 289: Manufacturing Exports vs. US imports from Mexico

%3m/3m saar

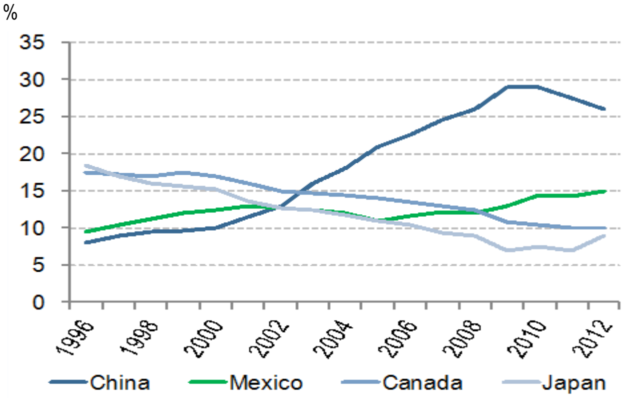


Source: INEGI, Census.

China's entry into the world trade organization in 2010 caused Mexico's market share in USA's manufacturing imports to fall. However, the trend has reversed gradually as manufacturing costs in China increased while Mexico's remain stable.

Figure 290: Share of US Manufacturing Imports by Origin

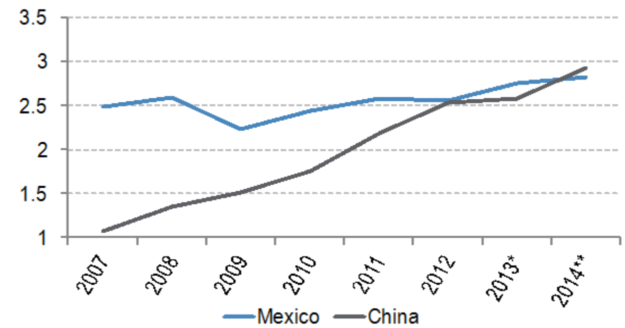
%



Source: IMF.

Figure 291: Wages in the Manufacturing Sector

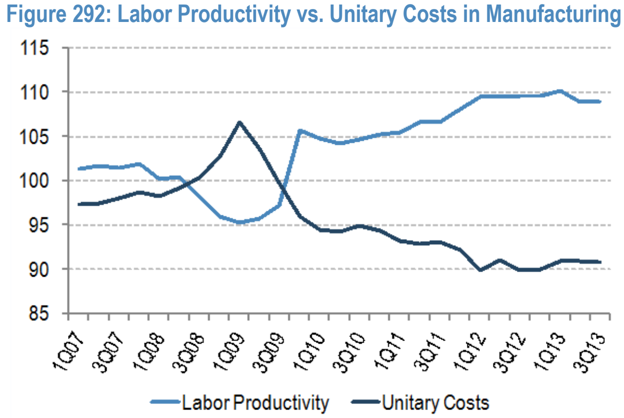
$ per hour



Source: INEGI, J.P.Morgan. Data for China is adjusted to 50 work hours per week. *2013 data for China is preliminary, based on the 3Q13 annualized data. **J.P.Morgan estimates based on average wage annualized growth rates.

However, Mexican manufacturing is not only about low-cost labor and a depreciated currency. Factors like geographical location, lower logistics costs, cluster creation, government support and a highly skilled labor force are factors that have positioned Mexico as a leading manufacturing country. Mexico's long list of free trade agreements is another competitive advantage for industries' capital allocation decision.

Figure 292: Labor Productivity vs. Unitary Costs in Manufacturing



Source: INEGI.

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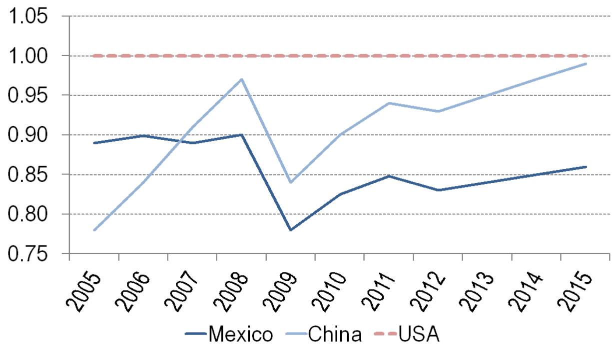
Figure 293: Alix Partners Manufacturing-Sourcing Cost Index

% of US costs



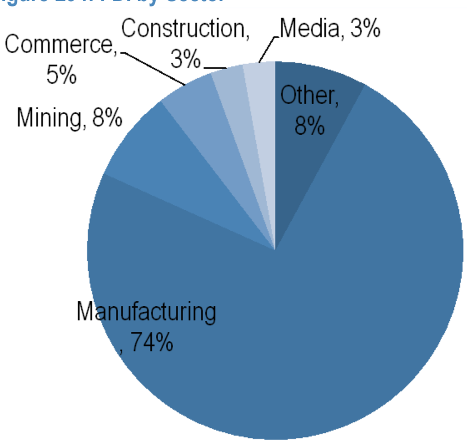
Source: Alix Partners.

Table 75: Mexico's Signed Free-Trade Agreements

	Agreement	Partners:	Official Start Date:
1	NAFTA	US and Canada	1-Jan-94
2	TLC - G3	Colombia*	1-Jan-95
3	TLC - Mexico-Costa Rica	Costa Rica	1-Jan-95
4	TLC - Mexico-Bolivia	Bolivia	1-Jan-95
5	TLC - Mexico-Nicaragua	Nicaragua	1-Jul-98
6	TLC - Mexico-Chile	Chile	1-Aug-99
7	EUFTA	European Union	1-Jul-00
8	FTA - Mexico - Israel	Israel	1-Jul-00
9	TLC - Triángulo del Norte	El Salvador, Guatemala, Honduras**	15-Mar-01
10	FTA - European Free Trade Association	Iceland, Norway, Liechtenstein, and Switzerland	1-Jul-01
11	TLC - Mexico-Uruguay	Uruguay	15-Jul-04
12	FTA - Mexico-Japan	Japan	1-Apr-05
13	TLC - Mexico-Peru	Peru	30-Jan-12

Source: Ministry of Economics. *Venezuela was part of the agreement from January 2005 to November 2006. **Free trade agreement with Honduras started on June 1st, 2001.

Figure 294: FDI by Sector

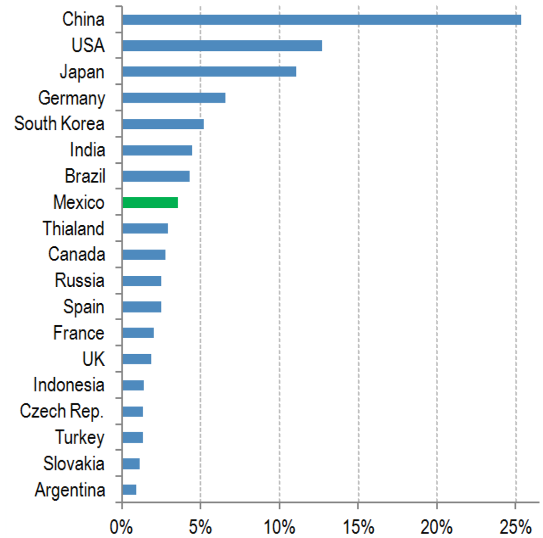


Source: Ministry of Economy.

Auto and Auto Parts

Autos and auto parts represent Mexico's **third-largest export (20% of total), contributing to 17% of industrial GDP and 3% of total GDP.** The sector employs more than 560,000 people. Mexico is the world's 8th-largest car producer, with over 82% of its production being exported.

Figure 295: Motor Vehicle Production Share by Country

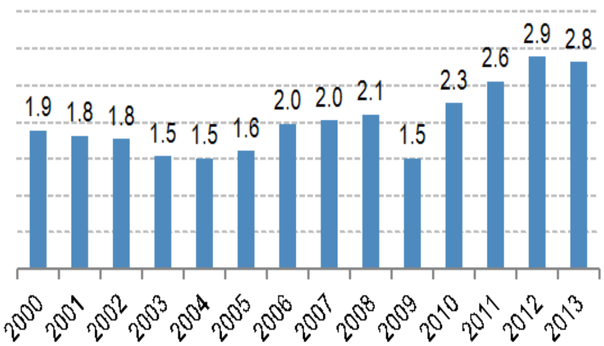


Source: OICA.

Auto production has grown ~17% yoy in average for the past 4 years. However, 2013 was weak (production fell 3% yoy) due to struggling local and external demand and overall economic deceleration in the country leading to an increase in demand for imported, cheaper used cars (used car imports grew 41% during 2013).

Figure 296: Auto Production in Mexico

units in million



Source: AMIA.

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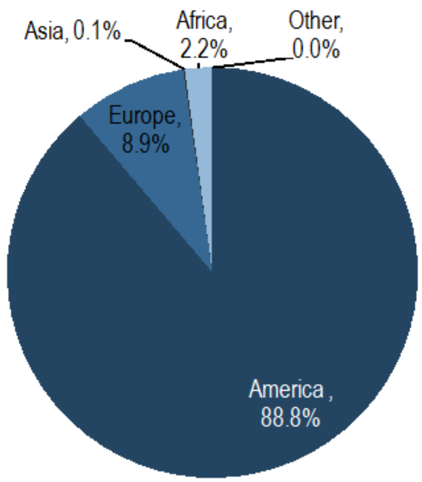
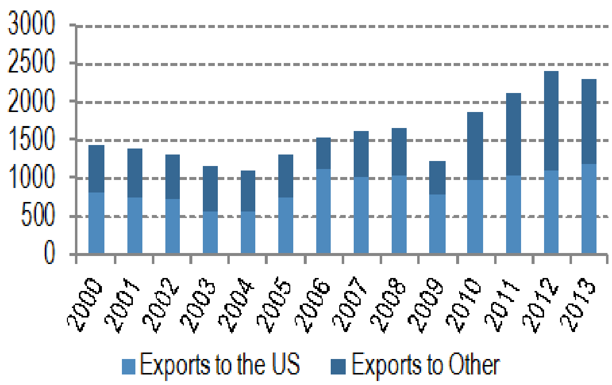
The majority of Mexican exports is bound for North America at c.90% of total auto exports. Mexico auto exports to the US at 1.2mn units grew 7.8% yoy in 2013.

Figure 297: Mexico Auto Exports by Region



Source: AMIA.

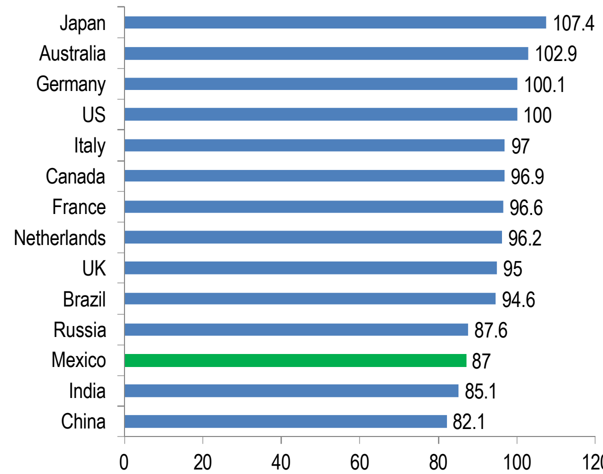
Figure 298: Auto Exports to the US
thousand units



Source: BEA, AMIA.

One of the main strengths of the automotive sector in Mexico is its competitive costs. According to KPMG, Mexico ranks 3rd in a list of auto parts manufacturing countries from lowest to highest production costs, and the 1st in Latin America.

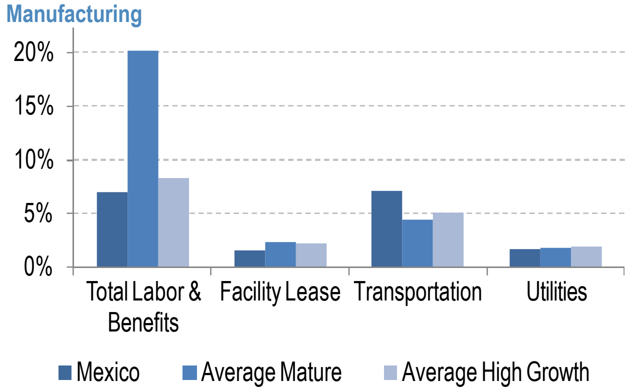
Figure 299: Auto Parts Manufacturing Cost Index
US = 100



Source: Competitive Alternatives, KPMG's guide to international business locations, 2012 Edition, ProMexico.

Mexico's competitive position is based on low labor, land lease and utilities costs. Though in most areas Mexico has higher costs than China or India (except utilities, for which Mexico has the lowest expenses), total costs are still half those in Brazil.

Figure 300: Costs as Percentage of Total Cost in Auto Parts Manufacturing



Source: Competitive Alternatives, KPMG's guide to international business locations, 2012 Edition, Promexico. *Mature countries: Canada, US, France, Germany, Italy, Netherlands, UK, Australia, and Japan. High-growth countries: Brazil, Mexico, Russia, China, and India.

Mexico's competitive advantages have led to a bout of FDI in recent years. Honda and Mazda recently inaugurated facilities in Guanajuato. In recent news, BMW is analyzing the possibility of opening a new facility in the country. Volkswagen's facility in Puebla is the largest car assembly plant in North America.

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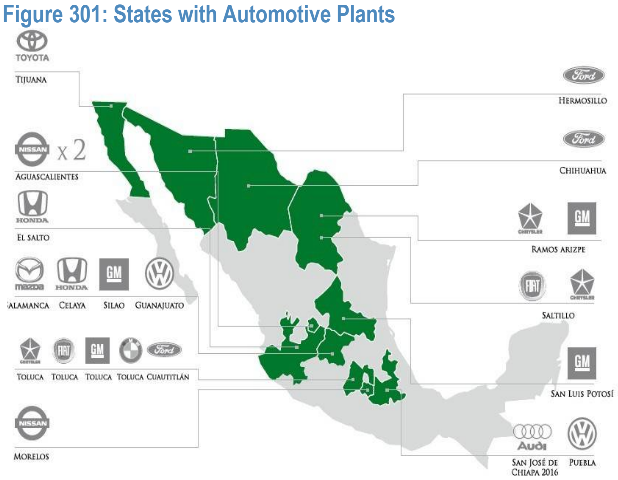
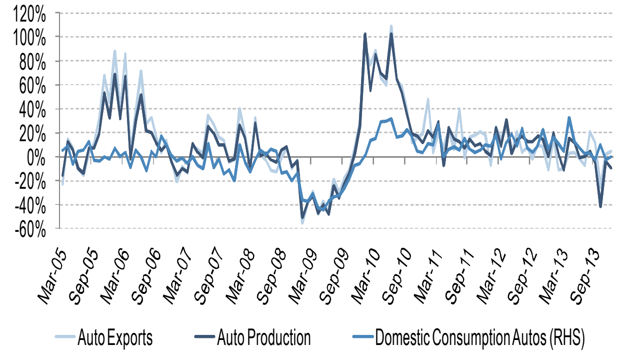
Figure 301: States with Automotive Plants



Source: ProMexico.

Figure 302: Auto Production, Sales & Exports

% growth yoy



Source: AMIA.

Table 76: FDI in Automotive Sector

	Announced Date	US$, mn	State
Nissan	1Q12	1,900	Aguascalientes
Mercedes Benz	1Q12	10	Nuevo León
Ford	2Q12	1,300	Sonora
Audi	2Q12	2,000	Puebla
Hyundai	2Q12	130	Baja California
General Motors	3Q12	420	S.L. Potosi & Gto.
Nissan	3Q12	650	Morelos & Aguascalientes
Nissan	4Q12	90	S. L. Potosi
Ford	4Q12	59	Chihuahua
Mazda	1Q13	650	Guanajuato
Nissan	1Q13	220	Aguascalientes
Mercedes Benz	1Q13	15	Nuevo León
Daimler	1Q13	20	Nuevo León
Honda	2Q13	470	Guanajuato
Audi	2Q13	1,300	Puebla
General Motors	2Q13	691	Gto., S.L Potosí & Edo.de México
Chrysler	3Q13	160	Coahuila
Nissan	3Q13	57	Aguascalientes
Mazda	3Q13	120	Guanajuato
Total	--	**10,262**	--

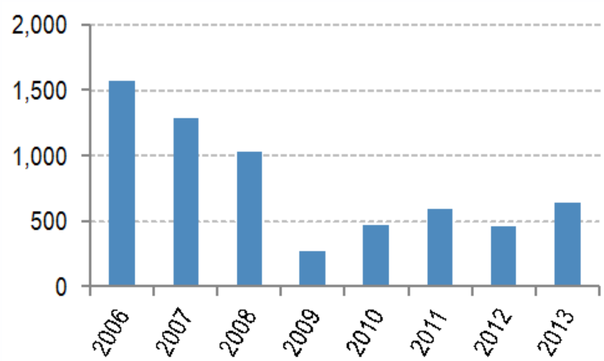
Source: ProMexico.

Domestic sales have been gradually increasing but still remain below other countries' penetration rates. In 2013 domestic car purchases were 1.07mn units, up 7% yoy. However, numbers are still low compared with 2006's 1.14 million units. Mexico's numbers are also low in an international context. Average domestic sales are 6 per 1,000 inhabitants vs. 14 in Brazil or 4-50 in developed markets. If per capita sales were similar to Brazil's, the Mexican market would more than double its current size.

The sector is constrained by cyclical and structural issues, namely a big used car market – having been flooded last decade by US used car imports (now reduced), high taxes of 16% VAT + 4% new vehicle tax, and low credit penetration (banking credit/GDP < 20%). As consumer confidence recovers, this number should improve.

Figure 303: Used Car Imports

thousand units



Source: AMIA.

Infrastructure

According to the World Economic Forum, Mexico is ranked 66th globally on the overall quality of its infrastructure (out of 142 countries), down 1 spot from last year's ranking. Mexico is better ranked for roads and railroads, whilst ports and airports are the worst ranked. However, quality of port infrastructure had the largest ranking improvement, moving up 2 spots. Mobile phone penetration also improved sharply, adding 4.4 subscriptions per 100 habitants.

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Table 77: Overall Mexico Infrastructure Ranking, Out of 142

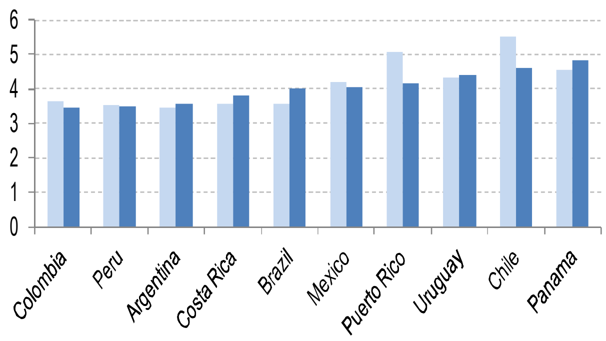
Category	Rank 2012-2013	Rank 2013-2014
Quality of Overall infrastructure	65	66
Quality of Roads	50	51
Quality of railroad infrastructure	60	60
Quality of port infrastructure	64	62
Quality of air transport infrastructure	64	64
Available airline seat kilometers	21	21
Quality of electricity supply	79	81
Fixed telephone lines/100 pop	73	71
Mobile telephone substrciptors/100 pop	107	112

Source: WEF Competitiveness Report 2013-2014.

Mexico ranks at number 5 in terms of its quality of infrastructure vs. other LatAm countries. Panama has the best ranking (30th place out of 143) while Colombia ranks last in the region (117th place).

Figure 304: Quality of Overall Infrastructure in LatAm

1 = extremely undeveloped; 7 = extensive & efficient

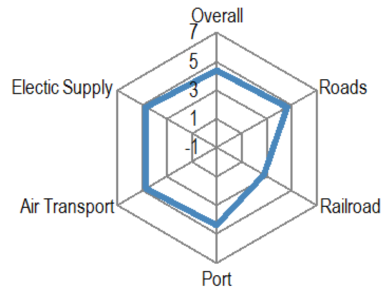


Source: WEF Competitiveness Report 2013-2014.

Mexico's infrastructure development is more evident in roads and railroads, while it is electric supply infrastructure that remains underdeveloped vs. other LatAm peers. Mexico's score has improved vs. 2012-13's rankings in roads and ports, while its score is lower for air transportation infrastructure.

Figure 305: Quality of Infrastructure in Mexico

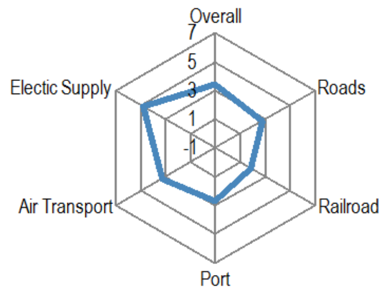
1 = extremely undeveloped; 7 = extensive & efficient



Source: WEF Competitiveness Report 2013-2014.

Figure 306: Quality of Infrastructure in Brazil

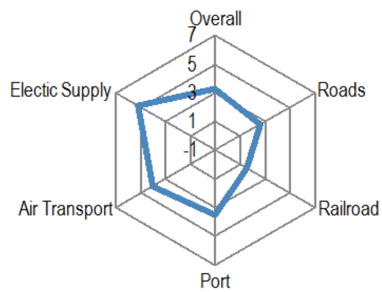
1 = extremely undeveloped; 7 = extensive & efficient



Source: WEF Competitiveness Report 2013-2014.

Figure 307: Quality of Infrastructure in Colombia

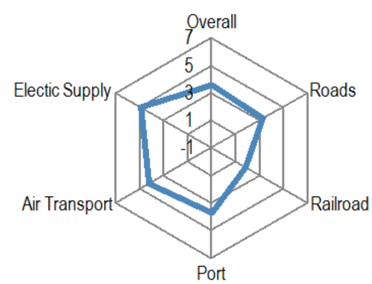
1 = extremely undeveloped; 7 = extensive & efficient



Source: WEF Competitiveness Report 2013-2014.

Figure 308: Quality of Infrastructure in Peru

1 = extremely undeveloped; 7 = extensive & efficient



Source: WEF Competitiveness Report 2013-2014.

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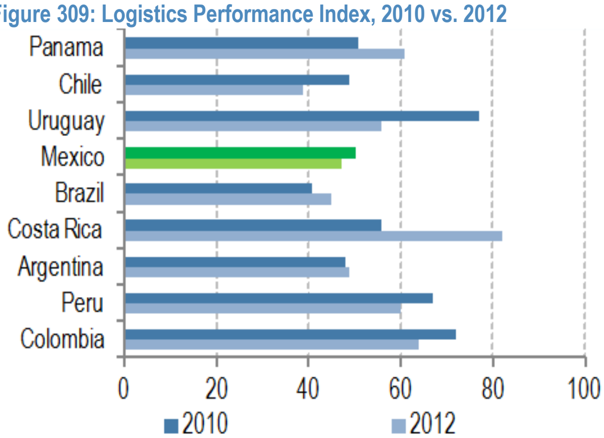
One of the country's main competitive advantages is its geographical location and its frontier with the US. Every two years, the World Bank carries out a worldwide survey of freight operators that provide feedback about the friendliness of each country's logistics. In 2012, the Logistics Performance Index ranked Mexico in 47th place, with 3.06 points out of 5, moving up three spots from the 2010 survey.

Figure 309: Logistics Performance Index, 2010 vs. 2012



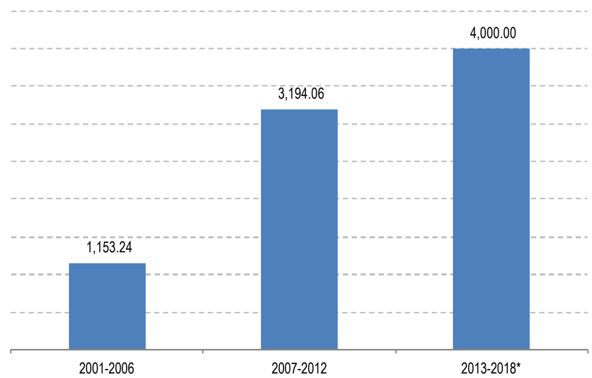
Source: World Bank.

Even with this improvement, Mexico has a long way to go to fully exploit its geographical position.

Last year, the Communication and Transportation Ministry released the "Investment Program in Transport and Communication Infrastructure" for 2013-18. The program highlights the importance of infrastructure to foster Mexico's development as a logistics and manufacturing platform for nationwide distribution (with the lowest cost), promoting productivity, competitiveness, economic development, and job generation. The government has planned for Mx$4 trillion (~$315 billion) in investments for the period 2013-18, to be financed through public and private partnerships. This amount includes investments in Pemex, CFE, Water Commission, Transportation, Communications and Infrastructure. It implies a 25% increase vs. the last administration's 5-year budget.

Figure 310: Six-year Capital Investments by the Public Sector

Mx$ in trillion

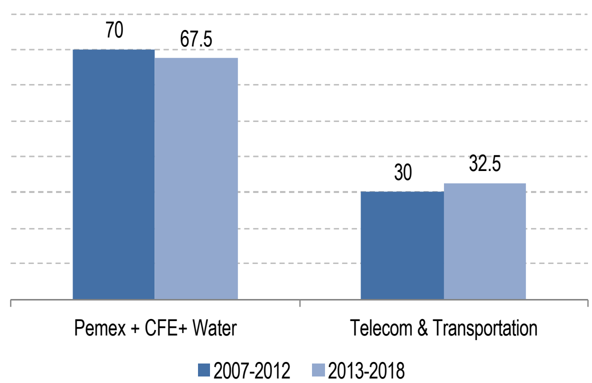


Source: INEGI, SHCP. *Expected, from National Infrastructure Program, and to be financed through both public and private partnerships.

Out of the Mx$4 trillion budget, the government has planned for Mx$1.28 trillion in investments for transport and communication infrastructure. This implies 32.5% of the total budget, which is higher than the last administration's allocation to these sectors (30%).

Figure 311: Infrastructure Expenditure Breakdown

% of 6-year total



Source: J.P. Morgan, Plan Nacional de Infraestructura 2007-2012, Speech of Gerardo Ruiz Esparza, Minister of Communications and Transportation.

The largest portion of this budget will go to investments in telecom. This will be destined to develop the state's fiber optic network to foster universal internet access among other developments. The budget allocated to telecom is Mx$700 billion. The rest (Mx$582 billion) is intended for non-telecom infrastructure, including ports, roads, airports, trains, etc.

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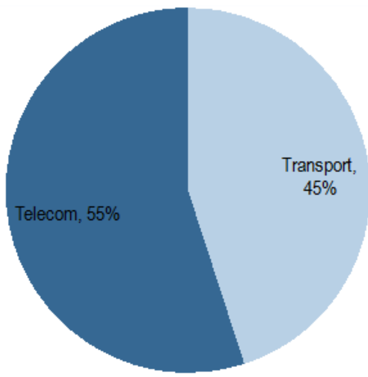
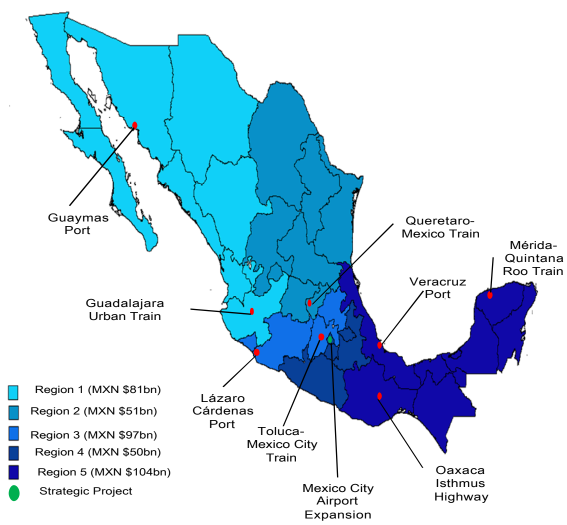
Figure 312: Federal Government's* Planned Investments in Infrastructure Breakdown
% of total



SSource: J.P. Morgan, Plan Nacional de Infraestructura 2013-2018. Federal Government excludes investments in Pemex, CFE and Water Commission.

Figure 313: Investments in Transport Infrastructure by Region, Including Key Projects
2013-2018



Source: SCT.

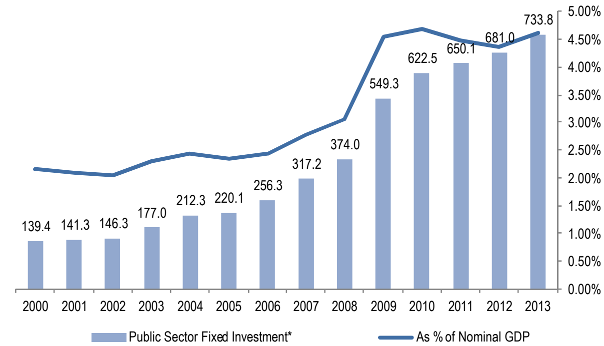
Figure 314: Ministry of Communications and Transportations' Plan for Investments ex. Telecom

Category	# of Projects	KM	Investments (Mx$ in million)
Highway Infrastructure	149	5,410	386,255
Railroads and Mass Transportation	19	956	98,098*
Ports	21	N/A	62,381
Airports	21	N/A	35,036*
TOTAL	*201*		*581,770*

Source: J.P. Morgan, SHCP, SCT. *Includes investments by existing concessionaires.

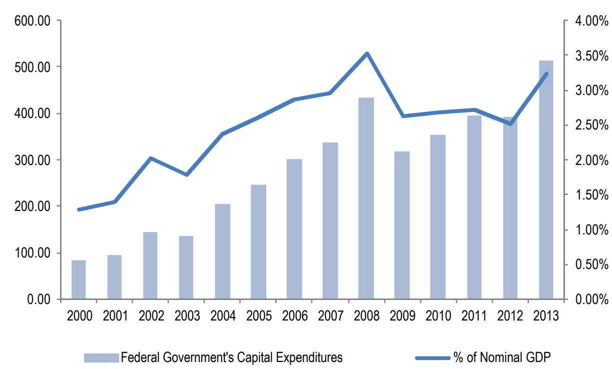
Since 2009, the government has been focusing on infrastructure investments as a means to foster GDP growth. As of the end of former President Calderon's administration, public sector fixed investments represented c.4.4% of nominal GDP. That figure increased to over 4.6% in 2013. Excluding Pemex and other state-owned entities, The federal government's capital expenditures in 2012 were Mx$392.3 trillion, increasing 31% in 2013 (in nominal terms) to Mx$512.7 trillion.

Figure 315: Public Sector Fixed Investments
Mx$ in trillion / % of nominal GDP



Source: J.P. Morgan, INEGI, SHCP. *Public sector includes Federal Government + state-owned companies (Pemex + CFE+ CONAGUA).

Figure 316: Federal Government's Capital Expenditures
Mx$ in trillion (left axis) / % of nominal GDP (right axis)



Source: J.P. Morgan, INEGI, SHCP.

Investments will become a more significant part of the federal government's budget, according to its 2014-19 plan defined in the Federal Budget for 2014. As of 2013, investment expenditures ex. Pemex represented 14% of total programmable expenditures, while the rest was classified as current expenditures. By 2019, the government expects investments to represents c. 25% of total programmable expenditures.

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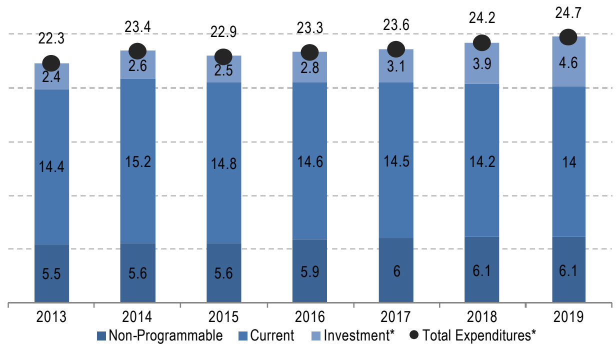
Figure 317: Federal Government Planned Total Expenditures, 2013-2019 Breakdown

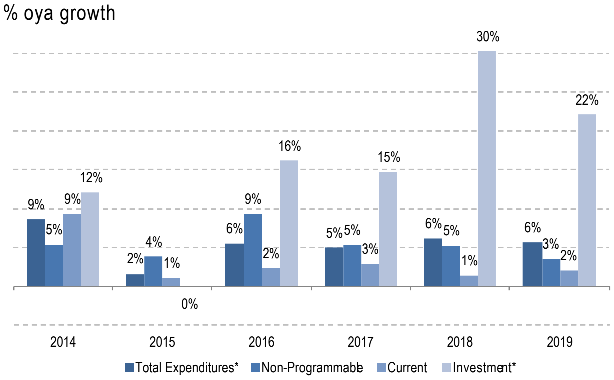
% of GDP



Source: J.P. Morgan, SHCP. Real GDP used was SHCP's long-term estimates without reforms (Escenario Inercial, Criterios de Política Económica). *Excludes Pemex's expenditures (c.2% of GDP).

Figure 318: Federal Government Planned Total Expenditures, 2013-2019 Breakdown

% oya growth

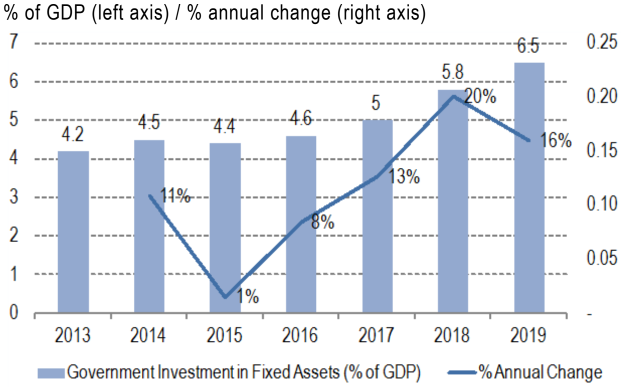


Source: J.P. Morgan, SHCP. Real GDP used was SHCP's long-term estimates without reforms (Escenario Inercial, Criterios de Política Económica). *Excludes Pemex's expenditures (c.2% of GDP).

Fixed capital public investments, including Pemex, are expected to grow at an 11% in average for the next 5 years.

Figure 319: Fixed Capital Investments by the Public Sector*

% of GDP (left axis) / % annual change (right axis)

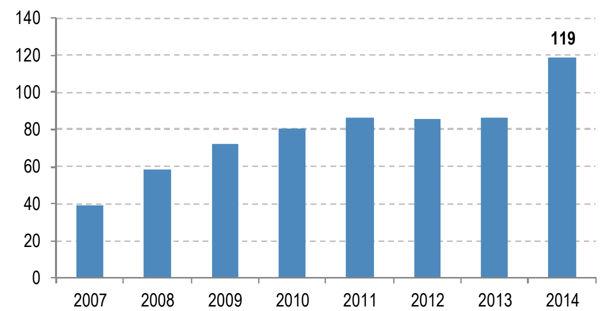


Source: SHCP. *Includes Pemex, CFE and Water Commission.

For 2014, the Federal Budget approved by Congress includes a c.40% increase to the Ministry of Communications and Transportation's budget. Despite the increase, the Ministry's budget represents only 3.4% of the federal government's total budget.

Figure 320: Historical Evolution of the Ministry of Communication and Transportation's Budget

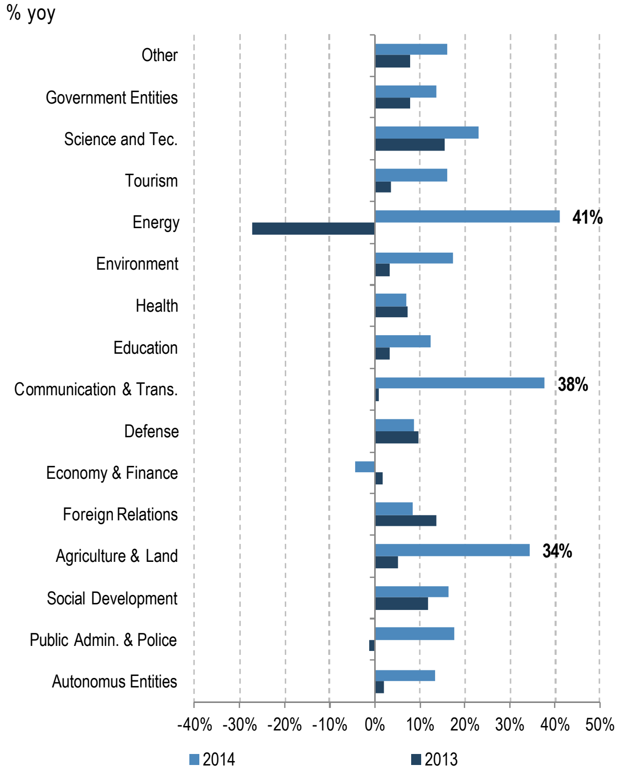
Mx$ in billion



Source: SHCP.

Figure 321: Change in Public Expenditures 2013 vs. 2012 & 2014 vs. 2013.

% yoy



Source: SHCP, Official Gazzete, Cámara de Diputados. Government Entities include: PEMEX, CFE, IMSS and ISSTE. Autonomous Entities include: Legislative and Judicial entities, IFE, INEGI, CNDH, IFT, CFC. Other includes: Contributions to social security and states and municipalities.

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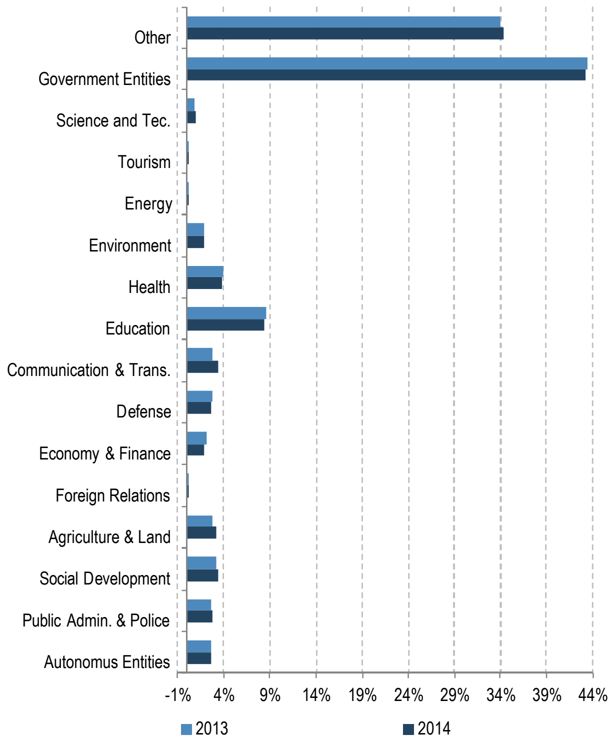
Figure 322: Federal Budget Breakdown by Ministry, 2013 & 2014.
% of programmable budget



Source: SHCP, Official Gazzete, Cámara de Diputados. Government Entities include: PEMEX, CFE, IMSS and ISSTE. Autonomous Entities include: Legislative and Judicial entities, IFE, INEGI, CNDH, IFT, CFC. Other includes: Contributions to social security and states and municipalities.

The Construction Industry Mexican Chamber unveiled a list of what constitutes, in its view, the most important projects to be developed before Peña's term ends. It includes several passenger trains and the modernization of ports, which will require an investment of over Mx$165bn

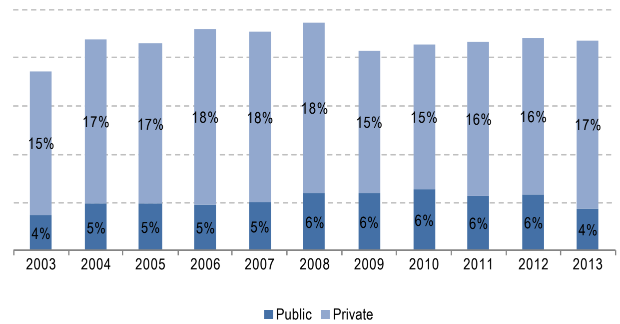
Table 78: CMIC's Main Infrastructure Projects (2013-18)

Potential Infrastructure Projects	Est. Cost (Mx$ Bn.)
Queretaro - Mexico City rapid train	73,000
Veracruz new port	21,213
Mexico City - Toluca commuter train	20,000
Oaxaca Isthmus Highway	18,285
Merida - Quintana Roo train	15,400
Guaymas port modernization	7,245
Lazaro Cardenas specialized termina	5,795
Expansion of urban train in Guadalajara	5,000
Total	**165,939**

Source: CMIC. *Includes SCT, SENER, Pemex, CFE, IMSS & ISSTE.

Private participation in the development of the country's main infrastructure projects has been paramount in terms of the evolution of investments in the sector. In 2013, private investments in infrastructure represented c.80% of the total infrastructure investments during the year, representing 17% of GDP.

Figure 323: Public vs. Private Investments in Infrastructure
% of GDP



Source: J.P. Morgan, INEGI.

In Mexico, public-private projects can take different modalities. Past projects have been taken using the following models:

- **Service Providing Projects,**
- **Concessions,**
- **Asset Exploitation, and**
- Long-term productive infrastructure projects (**PIDIREGAS**) – solely used for Pemex and CFE.

In January 2012, the Public-Private Association Law was approved. Public-Private Associations (APPs) are long-term investment schemes to share and distribute risks and resources between the government and private investors. Its focus is to develop large, long-term productive infrastructure and services related to it. The main advantages set forward by this law for private investors include:

- **a clear definition of responsibilities** between the government and private investors. Government takes over risks related to strategic planning and regulatory concerns while privates focus on technical issues, development and financing of the projects;
- **the possibility for project delays** when these are due to unexpected and unforeseen circumstances;
- **the option of arbitrage** between government and private investor to resolve technical/economical differences;
- **the allowance for private investors to present “unsolicited” proposals,** letting them identify needs and important projects not previously identified by the government;

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- **allowing for the participation of foreign companies** with no preference for one or the other in the auction processes, with the ruling going for the best technical and financial proposal;
- **establishing requirements from executive projects to come from government entities launching the projects,** including explanations on why an APP would be the most efficient scheme.

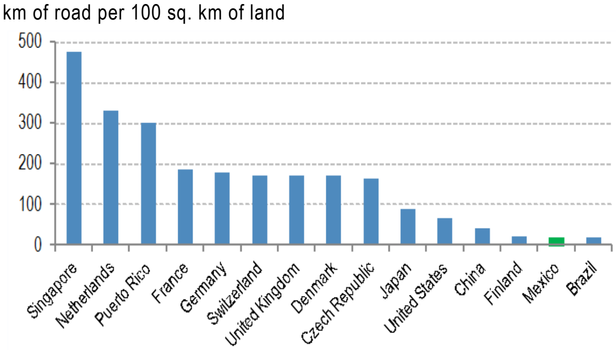
There are **9 listed companies in Mexico with exposure to the infrastructure sector.** Only 7 of them have over $1bn in market cap, and of these, only 4 are fully dedicated to construction and/or operation of infrastructure projects: Ideal, OHL, Pinfra and Ica.

Roads

Mexico compares poorly vs. other economies in terms of road density. It's road density is 18.93 km per 100 sq. km of land area, slightly above the LatAm average of 16.92, but way below the OECD average of 40.41. This puts Mexico in 71st place, above Brazil (18.6), out of 105 countries assesed by the World Bank during 2011. The largest road density is held by Monaco with 3,850 road km per sq. km of land area.

Figure 324: Road Density Across Major Economies

km of road per 100 sq. km of land



Source: World Economic Forum.

The current administration plans to invest Mx$386 billion for the next five years in 149 different projects, adding around 5,500km to the existing network of highways and rural roads. This figure doesn't take into account the Mx$173 billion planned investments for maintenance of highways and rural roads. In 2014's Federal Budget, planned investments in roads improvement, conservation and maintenance are among the main infrastructure projects accounting for more than Mx$10 billion.

Table 79: Road Infrastructure Projects 2013-18

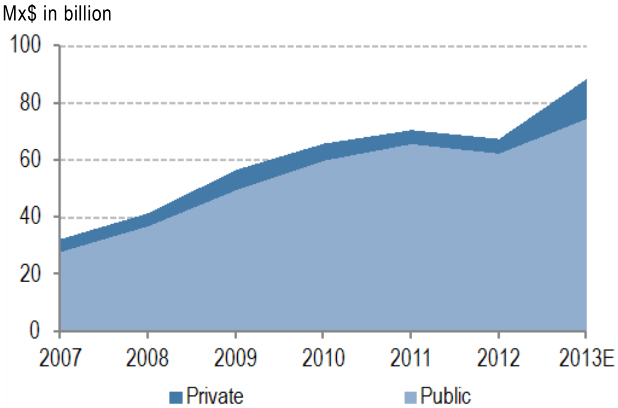
Project	# of Projects	Km	Est. Cost (Mx$ bn)
Highway	34	1,792	101,330
Roads	49	2,734	45,562
Bypasses	33	884	50,354
Bridges	22	N/A	11,580
Rural Roads	9	655	4,229
Maintenance in Highways	1	40,710	103,000
Maintenance in Rural Roads	1	12,600	70,200
Total Road Infrastructure	**149**	**5,410**	**386,255**

Source: SCT.

In 2012, public investment in roads declined 5% yoy, while private investments increased almost in the same magnitude. The Ministry of Communications and Transportation estimated that public investments increased 20% yoy and private investments increased over 150% yoy in 2013.

Figure 325: Public & Private Investments in Road Infrastructure, 2007-13

Mx$ in billion



Source: SCT.

At the time of writing of this report, two important highway projects had been auctioned by the current administration: a section of the *Siglo XXI* highway and the *Atizapán-Atlacomulco* highway. The *Siglo XXI* auction was won by a consortium formed by Aldesa, GBM, and Pinfra. The full highway will run from Veracruz to Acapulco, connecting the Gulf and Pacific coasts of Mexico. The *Atizapán-Atlacomulco* was won by OHL. This strech is of great importance for connectivity between Mexico City and Guadalajara (Mexico's third largest city).

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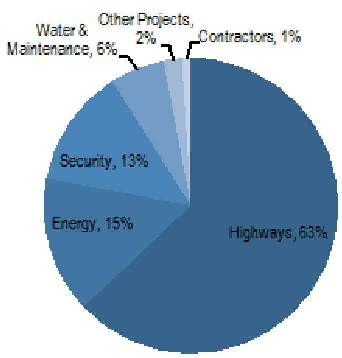
Figure 326: Selected Highway Projects in the Pipeline

Project	Status
Cardel - Poza Rica Highway	Bidding (Proposal presentation on May 6th)
Atizapán - Atlacomulco Highway	Granted (OHL)
Guanajuato - San Miguel de Allende Highway	In Process
Siglo XXI Highway	Granted (Pinfra, Aldesa & GBM)
Mexico - Toluca Railway	Announced

Source: J.P. Morgan, SCT.

Banobras, a state-owned development bank for infrastructure projects, has been increasing its credit portfolio for infrastructure investments reaching its highest value at Mx$72.5 billion in 2013. According to its annual report, 63% of the portfolio was allocated to highway projects.

Figure 327: Banobras Credit Portfolio Composition



Source: Banobras.

In order to foster further investments for road infrastructure development the government has structured three different strategies:

- **Concessions** – financed by toll revenue, with Banobras providing some financing support. Maximum concession time is 30 years.
- **Highway Assets Utilization Model** – or the 'FARAC' model, packaging brownfield modernization and greenfield projects to pool risks.
- **Service Provisions (PPS)** – same with the UK's Private Finance Initiative, using public funds for private tenders to upgrade toll-free roads.

Figure 328: Road Estimates for 2012

Source: Plan Nacional de Infraestructura.

Airports

Mexico has 78 significant airports divided among 4 large operators and individual private concessionaries. Before 1965, the *Dirección General de Aeronáutica Civil* (DGAC) was in charge of the administration, operation, and maintenance of all airports in Mexico. In June 1965, the government created *Aeropuertos y Servicios Auxiliares,* a state-owned company that took over the management of all airports.

The Airports Law was published in 1995, establishing the possibility of the government to grant airport management concessions to private operators. Of the 58 airports managed by ASA, 35 were offered to the private sector on the basis of a "build-operate-transfer" (BOT) concession for a 50-year period with an option to renew. In 1997 the federal government privatized some airports, dividing them into four main regions granted to different concessionaires:

- **Grupo Aeroportuario del Sureste** (ticker: ASUR) was the first company to acquire a package concession, spanning the southeast group that contained 9 airports including Cancun City Airport – Mexico's most popular tourist destination (~35% of international arrivals). In September 2000 ASUR went public, and today it trades on the Mexbol and NYSE. The company is part of the MEXBOL index.
- **Grupo Aeroportuario del Pacífico** (ticker: GAP) obtained the second package granted by the government. The bundle includes the northwest Pacific region consisting of 12 airports and includes Guadalajara City Airport (Mexico's 3rd largest city). GAP went public in 2006 and trades on the Mexbol

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and NYSE. It is the biggest public airport company and is part of the MEXBOL index.

- **Grupo Aeroportuario del Centro Norte** (ticker: OMAB) obtained in 2000 the concession to operate the central/north package around Monterrey City Airport, the country's major business destination after Mexico City. It went public in 2006, and though it trades on the Mexbol and NASDAQ, it is not part of the current MEXBOL index sample.

- **State-owned ASA now operates 19 airports, including Mexico City** (AICM), the largest airport in terms of passenger traffic. In 2013 AICM reported 31.5 million passengers, up from 28.7 million in 2012. The 34 airports managed by ASUR, OMA and GAP reported traffic of 57.6 million passengers in 2013, up from 52.7 million passengers in 2012.

Figure 329: Airports in Mexico by Company

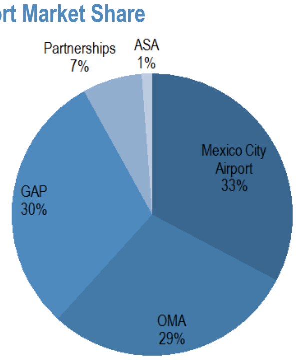
Source: Company Data.

Table 80: Airports Operator Comparison

Company	Million Passengers	Number of Airports
AICM	31.5	1
ASUR	21.1	9
GAP	23.2	12
OMA	13.3	13

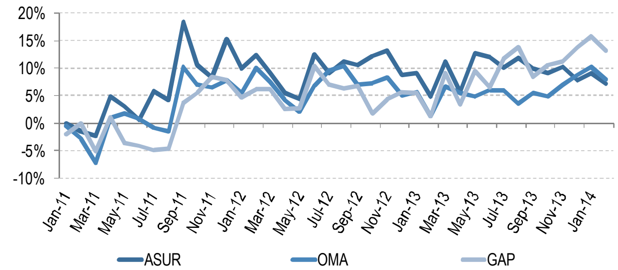
Source: DDE, J.P. Morgan.

Figure 330: Airport Market Share



Source: SCT.

Figure 331: Mexican Public Airport Companies' Monthly Traffic Performance



Source: J.P. Morgan, company data.

Mexico's City international airport is facing severe saturation. Experts estimate saturation point could be reached in 2014, considering historical passenger growth and traffic. During 2013's vacation periods, Mexico's City airport managed 1,100 daily take-offs and landings while its maximum capacity is 1,000. Saturation has led to tariffs for routes originating or ending in Mexico City to be 40% to 80% higher to the neighboring airport of Toluca (operated by OHL).

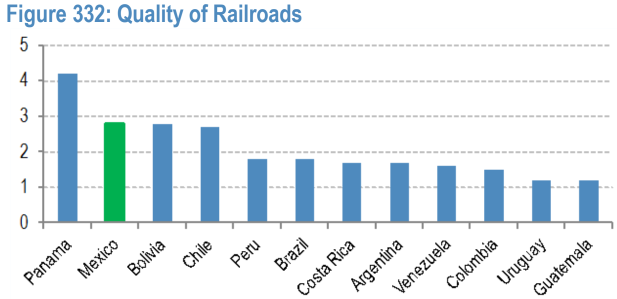
One of the most important infrastructure projects in Peña Nieto's administration is the construction of the new Mexico City International Airport. The original plan was presented in 2006, but due to social protests, the plan was delayed. Though there is no specific deadline, it has been signaled as one of this administration's strategic projects.

As stated in the 1995 Airport Law, foreign investment in airport companies is capped at 49%. The National Foreign Investments Commission needs to grant a special permit for this percentage to go up.

Railroads

According to the World Economic Forum, Mexico is the 60th country (out of 148) in railroads infrastructure. Compared with other LatAm countries, Mexico is ranked 3rd, behind Panama (best ranked at 30th out of 148).

Figure 332: Quality of Railroads



Source: World Economic Forum.

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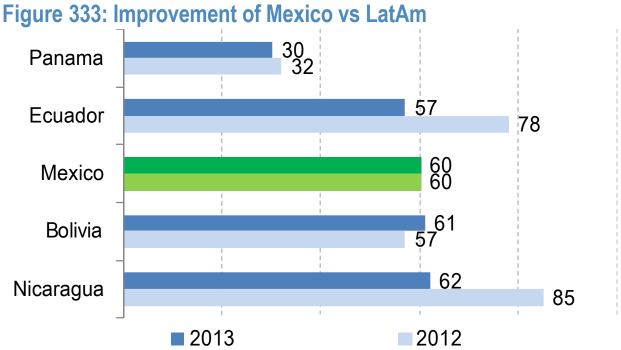
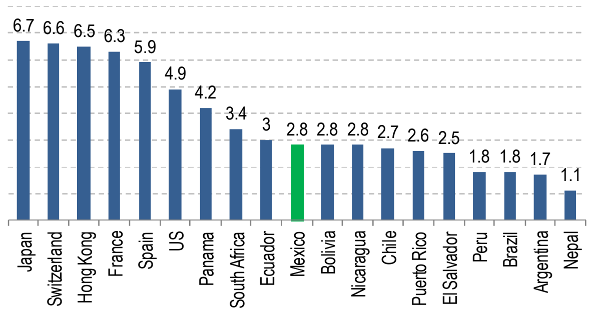
Figure 333: Improvement of Mexico vs LatAm



Source: World Economic Forum.

Figure 334: Quality of Railroad Infrastructure Score for Selected Countries

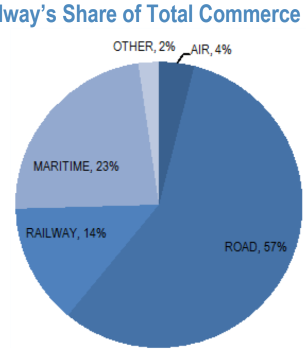
1 = extremely underdeveloped; 7 = extensive and efficient.



Source: WEF Competitiveness Report 2013-2014.

The railway infrastructure represents one of the most important logistics assets in Mexico with almost 27k kms of tracks covering a large portion of the Mexican territory. However, according to the Ministry of Communications and Transportation, only ~22k kms are operational. As of November '13, 14% of total load movement in Mexico was done through railroads, representing more than 7 million tons shipped each month. Passenger transportation is done 96% by road and only 1.2% through railroads. Growth in passenger traffic has been close to 0% since 2010.

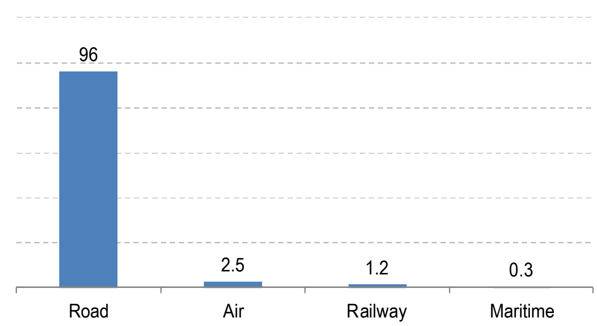
Figure 335: Railway's Share of Total Commerce Transportation



Source: INEGI.

Figure 336: Railway's Share of Total Passenger Transportation

%

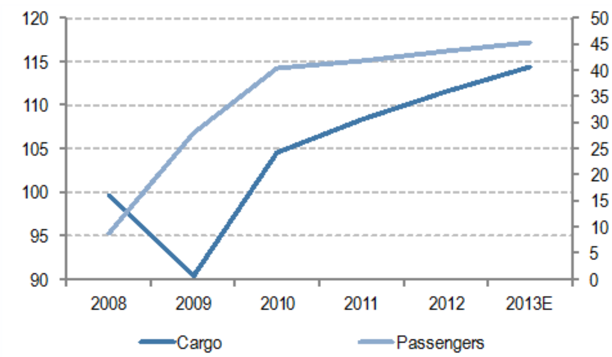


Source: SCT.

Figure 337: Cargo & Passenger Load Transported by Railroad Network, 2007-2013

million tons

million passengers

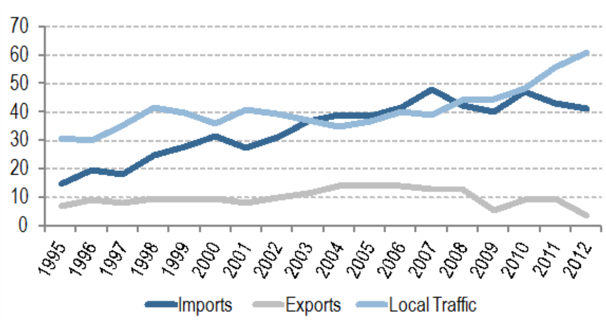


Source: SCT.

The major use of railroads in Mexico is to transport goods locally and carry imports into the country. Cargo still represents the most important load for trains, being 14% of total load moved in 2013. Domestic transportation of goods has been gaining market share in railroads' cargo load as of 2008. The main product transported is industrial goods followed by agricultural goods.

Figure 338: Foreign Trade & Railroad Transportation

bn tons



Source: SCT. Data as of 2012.

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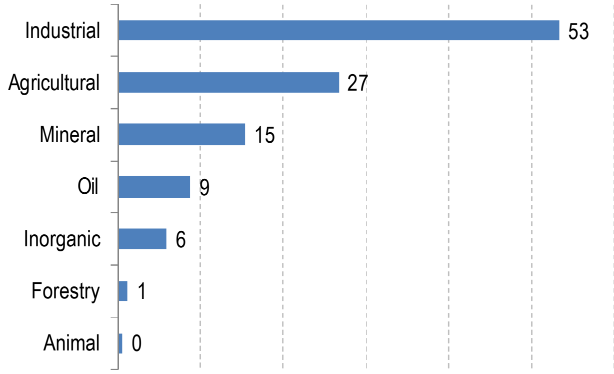
Figure 339: Main Products Transported through Railroads
thousand tons

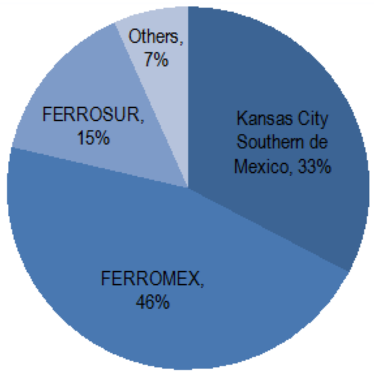


Source: SCT.

As part of former President Zedillo's National Development plan, railroads in Mexico were privatized in 1995. *Ferrocarriles Nacionales de México* was vertically divided into seven private companies that were granted concessions by the government. With this, three major private companies emerged and now control almost 98% of the market:

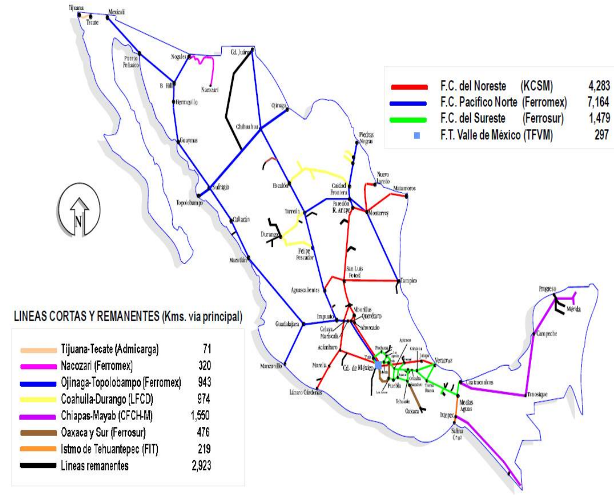
- **Ferromex,** which is majority owned by Grupo Mexico, is the biggest railroad company with 8,500km of railroad network (c.32% of the national railroad network). It covers the northwest, west and central parts of Mexico.
- **Kansas City Southern de México** covers 4,200km, approximately 16% of the national railroad network. The company covers the center and northeast part of Mexico.
- **Ferrosur,** also majority owned by Grupo Mexico, covers 1,500km, mainly in the southeast part of the country.

Figure 340: Market Share per Railroad Operator
by cargo/traffic



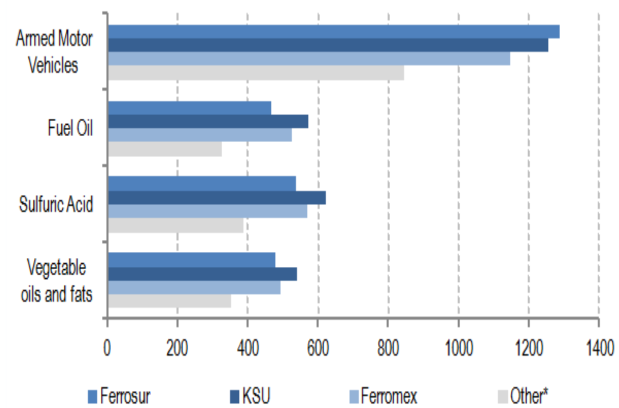
Source: SCT.

Figure 341: Railroad Network in Mexico



Source: SCT.

Figure 342: Comparable Tariffs among Railway Concessionaries
500 Km per ton fee in Mx$



Source: SCT. Comparable tariffs are established upon a minimum cargo weight in Kg. for all companies compared. Minimum weight cargo (in Kg) for armed motor vehicles is 30k, for fuel and oil is 25k, for sulfric acid is 10k, and for vegetables oil and fats is 60k. *Other in fuel oil, sulfuric acid, and vegetable ouls and fats categories is calculated with the average comparable tariffs established by Coahuila-Durango and Istmo de Tehuantepec concessionaires. * Other in armed motor vehicles category includes comparble tariffs established by Istom de Tehuantepec concessionaire. Tariffs for KSU are applicable for 2014, wich local media reported to have increased by 8%yoy. Tariffs for Ferrosur, Ferromex and Others are from 2013.

Since 1995, when railroads were privatized, the public sector has invested very little in existing infrastructure. The Mexican Railroad Association states on its webpage that its members have invested over $5bn in the development and infrastructure of trains in Mexico. Official figures as of mid-2012 show that c.70% of the total investments in railroad infrastructure since 1995 have been done by private investors.

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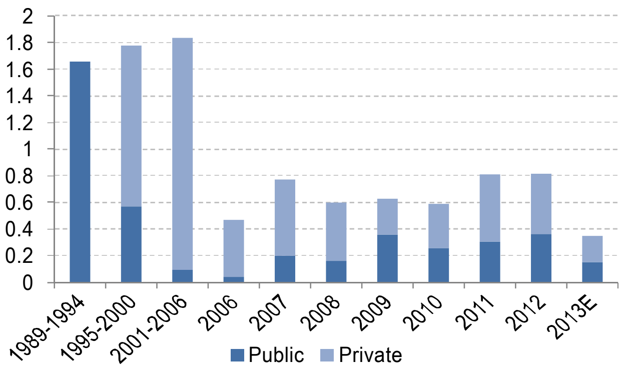
Figure 343: Public & Private Investments in Railroad Infrastructure

$ million

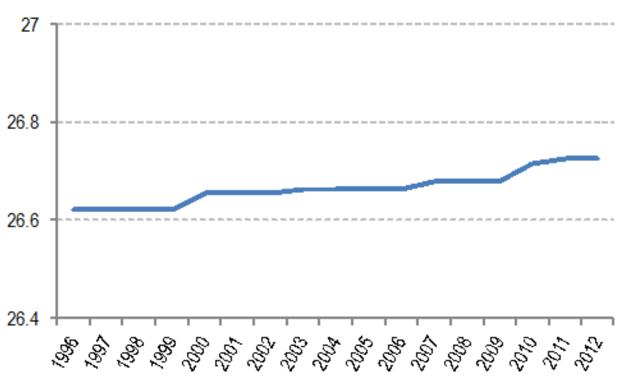


Source: SCT.

Nonetheless, the length of the network's tracks has not grown significantly in the past 18 years. In 2003 it spun 26,662km. In 2011 that was 26,727km.

Figure 344: Railroad Extension Evolution

thousand km.



Source: SCT.

Ferromex, Ferrosur, Kansas City Southern Mexico, and Istmo de Tehuantepec released their infrastructure investment plans for 2014 totaling nearly $300 million. Of this amount, almost 65% of the investments will be done by Grupo Mexico's subsidiaries, Ferromex and Ferrosur, and 28% by Kansas City Southern Mexico.

One of the government's main objectives in this administration, in terms of railway infrastructure, is to establish the passenger trains as a viable means of transportation. In this regard, the Ministry of Communications and Transportation has announced its intention to auction three passenger train projects: the Mexico City-Toluca, the Mexico City-Queretaro and the Transpeninsular Train (Merida-Quintana Roo). These three projects account for more than 50% of the infrastructure investments budgeted for railways.

Table 81: Railway Infrastructure Investments for 2013-2018

Project	# of Projects	Km	Est. Cost (Mx$ bn)
Passenger Trains	3	567	49,155
Cargo Trains	8	322	15,668
Railway signs*	1	N/A	2,000
Total Railway Infrastructure	**12**	**889**	**66,823**

Source: SCT. *National Project, not accounted in regional distribution.

In November 2013 the Lower Chamber in Congress approved significant changes to the Railway Service Law. These amendments focus in three main areas: concession removal, tariff regulation, and interconnectivity guarantee. According to the Mexican Railroad Association, the law poses risks to efficiencies of the railroad system and damps confidence for investing in Mexico. The bill is currently under discussion in the Senate and is still pending final approval.

Main points of the draft under discussion:

- **Interconnectivity Guarantee**. The law will explicitly seek to foster fair competition in the sector. This will be done by ensuring railroad concessionaires guarantee interconnectivity among railways. The law will also allow for the construction and installation of railway spurs and short lines that connect with another concessionaire's main line, without requiring the Ministry of Communications and Transportation's approval.
- **Concession Revoking**. Increases the amount of cases under which concessions can be revoked, to include actions that avoid or limit interconnectivity or any other action that fails to procure the railway system functions as a continuous communication route, as well as failure to provide adequate maintenance to the tracks.
- **Tariff Regulation**. The Ministry of Communications and Transportation will have discretion to rule on tariffs in case parties involved in the negotiation of interconnectivity do not reach an agreement in 60d. For this, the Ministry will consider the National Antitrust Commission's opinion in the matter. The draft also mandates that concession holders must establish procedures to share awarded railways in all contact points. If the involved parties do not reach an agreement in 60d, then the Ministry will rule upon the appropriate tariffs, based on guidance from the

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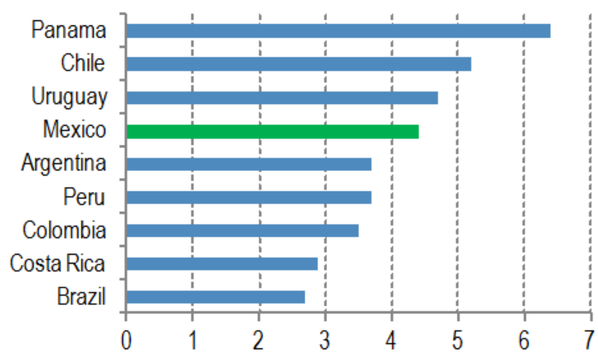
National Antitrust Commission. It allows concessionaires to freely establish tariffs as long as the Ministry does not consider these to be fostering monopolistic practices or hampering effective competition, including ruling on these when they are proved to be non-homogeneous (similar tariffs for similar services). All tariffs will be required to be previously registered in the Ministry and published on its website.

- **New Obligations Imposed.** Establishes the obligation of concessionaires to guarantee signaling, alert and obstruction systems while establishing restrictions on sound and pollution.
- **Fines**. Draft establishes a 20,000x minimum wage fine if tariffs differ from those registered at the Ministry or if applied unfairly among users.

Ports

According to the World Economic Forum, Mexico's score on port infrastructure quality – 4.4 – is above the global average of 4.2, where 1 is extremely undeveloped and 7 is well developed and efficient by international standards. Countries like Panama (6.4), Chile (5.2), and Uruguay (4.7) are better ranked, but still Mexico has a more competitive port infrastructure than Brazil (2.7), Costa Rica (2.9) or Colombia (3.5). Within LatAm, Mexico is also above the average.

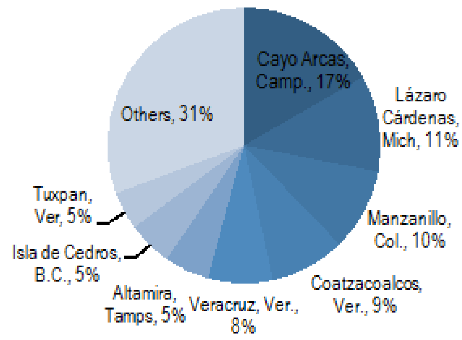
Figure 345: Mexico's Port Infrastructure vs. LatAm
Out of 7



Source: World Economic Forum.

Mexico had 117 ports and enabled terminals as of 2013. Manzanillo is the country's largest container port, followed by Veracruz and Altamira. Cayo Arcas in Campeche is the port with the largest load movement in Mexico, followed by the Coatzacoalcos port, which specializes in oil and petrochemical products.

Figure 346: Load Movement by Port



Source: SCT. Data as of December 2013.

Figure 347: Ports in the Mexican Pacific Coast

Source: SCT.

Figure 348: Ports in the Gulf of Mexico

Source: SCT.

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Figure 349: Ports in the Mexican Caribbean

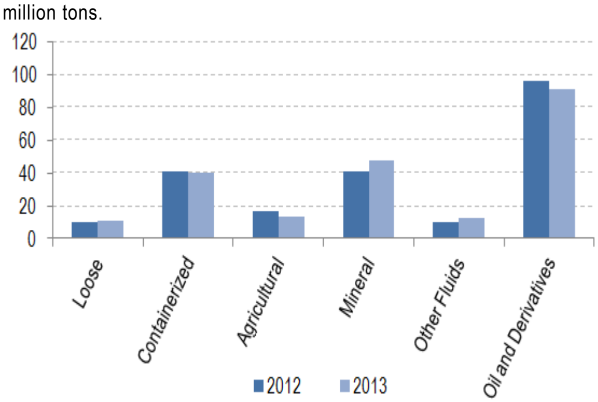
Source: SCT.

Ports in Mexico are divided by navigation type into:

- **Altitude**: Ports that serve ships, people, and merchandise between ports and/or national or international spots. In 2013, altitude ports accounted for 75% of national cargo movement.
- **Cabotage**: Ports that only serve ships, people, and merchandise between national ports or spots. Shipments in cabotage ports represented 25% of national cargo movement in 2013.

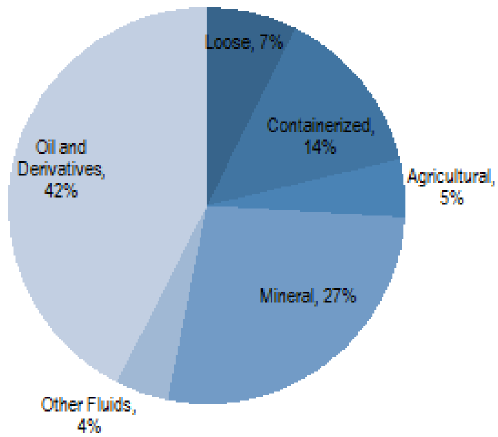
Figure 350: Yearly National Movement by Cargo Type

million tons.



Source: SCT.

Figure 351: Share of Total National Movement by Cargo Type in 2013

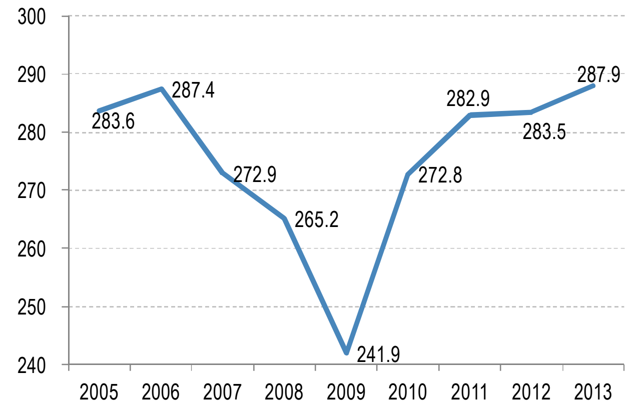


Source: SCT.

Mexican ports moved 288 million national loads in 2013, growing 1.6% from 2012. They move 23% of total Mexican exports and 26% of Mexican imports. Mexico's largest trading partner remains the US, receiving over 60% of Mexico's exports by sea. China receives 7% and Spain 5% of total Mexican exports by sea.

Figure 352: Total Load Moved by Sea

million tons



Source: SCT.

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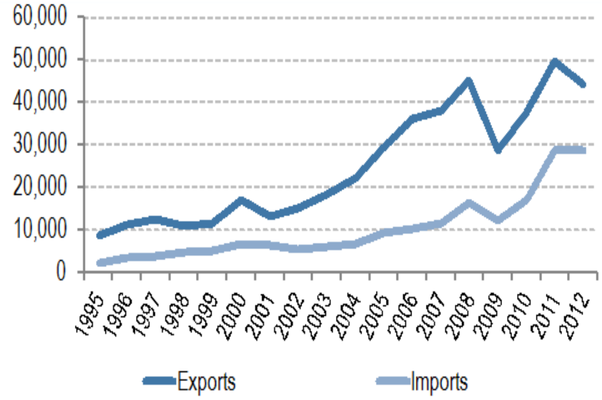
Figure 353: Water Traffic Between Mexico and US

$ in million



Source: North American Transportation Statistics Database.

According to the National Development Plan, the government will invest ~Mx$62 billion in port-related infrastructure. The most important projects are the new port in Veracruz, the modernization of the Lazaro Cardenas Port Terminal, and the modernization of the Guaymas Port.

Table 82: Port Infrastructure Projects – SCT

Mx$ millions

Project	# of Projects	Est. Cost (Mx$ bn)
New Ports	3	29,773
Modernization	5	14,994
Specialized Terminals	12	17,614
Total Port Infrastructure	**20**	**62,381**

Source: SCT.

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Appendix 1: Mexico Pension Funds' Investment Regime Summary

			Limits by Type of Pension fund[1]			
			4	3	2	1
		Age=	-36	37 to 45	46 to 59	60 +
Market Risk		Value at Risk [VaR $_{historical}$(1-α=95%, 1day)]	2.1%	1.4%	1.1%	0.7%
Market Risk		Equity[2]	40%	30%	25%	5%
Market Risk		Foreign currency	30%	30%	30%	30%
Market Risk		Derivatives: Interest rates, Fx and equity (credit derivatives not allowed)	yes	yes	yes	yes
Concentration Risk	Local[4]	mxBBB to mxAAA rated securities or BB to AAA in authorized currencies[3]	5%	5%	5%	5%
Concentration Risk	Local[4]	mxBB to mxBBB- rated securities or B+ to BB- in authorized currencies	1%	1%	1%	1%
Concentration Risk	Foreign	A-rated foreign securities from one issuer or counterpart	5%	5%	5%	5%
Concentration Risk		Holdings of an issuance[5]	Maximum of 35% or MXN 300 million of the issuance			
Other Limits		Foreign securities (if fixed-income, minimum rate is A-)	20%	20%	20%	20%
Other Limits		Securitizations[6]	30%	20%	15%	10%
Other Limits		Structured securities[7]	20%	20%	15%	0%
Other Limits		Inflation-linked bonds (minimum limit)	no limit	no limit	no limit	min 51%
Other Limits		Commodities	10%	10%	5%	0%
Conflict of interests		Securities endorsed by related parties	15%	15%	15%	15%
Conflict of interests		Securities endorsed by parties with control group related to the Afore[8]	5%	5%	5%	5%
Other vehicles		Mutual Funds	yes	yes	yes	yes
Other vehicles		Investment Mandates	yes	yes	yes	yes

[1] All limits expressed as percentages of assets under management, expect the maximum ownership of one issue. All limits are maximums except the inflation protected bonds.

[2] Includes authorized equity indices listed on the Mexican Stock Market (BMV), individual stock that belong to authorized equity indices listed on the BMV, Mexican issuers mandatory debt and large market capitalization IPO's.

[3] Issuer or endorser in the percentage it guarantees. Counterparty exposure in repos and derivatives is added to the permitted limit.

[4] The Risk Analysis Committee (CAR) will determine credit rates below "A" for debt securities (including subordinated debt) with a maximum limit of 1% for the funds 2 through 5 and 0% for fund 1.

[5] It is the maximum percentage of the outstanding that all funds (Siefores) operated by the same fund manager (Afore) can hold.

[6] Securitizations must comply with Circular 15-19 appendix K for the SPV to be considered as an independent issuer and thus lay in the bucket of securitizations.

[7] Includes CKDes, IPO's of small market capitalization, individual stocks that are not included in any authorized equity index, and Mexican REITs (FIBRAS)

[8] Limit is established in the SAR law, Art. 48, Paragraph X. Under exceptional circumstances it could be increased up to 10%. For parties whose board members belong to the Afore's board or have influence on it this limit is 0%.

Source: CONSAR

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Appendix 2: Mexico's Government Debt Instruments

Table 83: Debt instruments

Instrument	Type	Coupon	Index	Day-count	Maturities
CETES	Fixed rate	Zero-coupon	-	Linear, Act/360	28, 91, 182, and 364-day
BONOS	Fixed rate	Semiannual	-	Bond, Act/360	3, 5, 10, 20, and 30-year
BONDES D	Floater	28-day	28-day TIIE	Linear, Act/360	3 and 5-year
UDIBONOS	Linker	Semiannual	UDIS	Bond, Act/360	3, 10, 20, and 30-year

Source: J.P. Morgan.

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Appendix 3: Mexico Dashboard Data

Figure 354: Mexico Economic Heatmap: Selected Indicators

Mar 2012 - up to date

		Mar-12	Apr-12	May-12	Jun-12	Jul-12	Aug-12	Sep-12	Oct-12	Nov-12	Dec-12	Jan-13	Feb-13	Mar-13	Apr-13	May-13	Jun-13	Jul-13	Aug-13	Sep-13	Oct-13	Nov-13	Dec-13	Jan-14	Feb-14	Mar-14
CONSUMER	Non-Manufacturing PMI Index, SA	53.34	53.30	54.64	53.43	52.15	54.27	54.50	54.32	53.58	52.90	52.52	51.93	51.28	51.41	50.92	51.55	51.38	50.20	50.38	50.55	51.42	53.19	52.99	52.23	51.22
	Consumer Confidence Index, SA	94.87	96.19	96.75	95.33	96.32	95.77	93.11	96.62	96.85	98.76	98.83	97.20	95.83	95.77	95.41	93.25	95.28	95.48	93.36	92.72	91.19	89.28	83.57	86.31	90.39
	Walmex Same Store Sales, SA	2.70%	2.90%	4.20%	1.90%	2.90%	4.40%	4.60%	4.00%	6.80%	-2.10%	5.10%	1.00%	4.60%	-4.20%	-1.70%	-1.30%	-0.90%	-2.70%	-2.60%	-3.20%	-2.50%	-1.40%	-2.30%	-0.90%	-5.40%
	ANTAD Same Stores Sales	6.30%	1.30%	5.40%	7.90%	3.50%	4.70%	8.80%	0.60%	7.00%	2.40%	0.50%	0.20%	5.90%	-3.20%	-0.20%	1.60%	-2.30%	1.20%	-3.10%	-2.00%	3.40%	-0.40%	-1.70%	-0.20%	
	Retail Sales Gen. Index Growth (% yoy)	0.43%	1.38%	5.27%	5.38%	4.04%	3.29%	1.17%	4.99%	1.46%	-3.05%	7.46%	2.88%	0.73%	6.69%	6.95%	-1.06%	4.40%	-0.32%	-2.47%	2.70%	1.32%	1.82%	-0.68%		
	Formal Job Creation, SA (% yoy)	4.61%	4.54%	4.51%	4.73%	4.76%	4.75%	4.72%	4.76%	4.80%	4.63%	4.38%	4.24%	3.75%	4.08%	3.95%	3.48%	3.24%	3.11%	2.98%	2.90%	2.93%	2.88%	2.74%	2.75%	
	Remittances Growth (% yoy)	1.74%	8.01%	8.02%	3.65%	-2.31%	-11.86%	-20.34%	-7.39%	-5.24%	-4.57%	-2.95%	-11.22%	-15.24%	-6.38%	-13.17%	-7.19%	-1.17%	0.96%	8.14%	4.88%	-0.08%	4.72%	8.77%	5.65%	
	Food, Beverages & Tobacco Inflation	6.08%	4.43%	6.07%	8.08%	8.22%	8.52%	10.06%	9.75%	8.87%	7.20%	5.33%	5.61%	7.96%	8.88%	8.15%	5.70%	3.75%	4.06%	2.97%	2.68%	3.79%	4.11%	5.19%	4.97%	
	Credit for Consumption Growth (% yoy)	24.20%	23.43%	23.33%	23.08%	22.75%	22.66%	21.72%	21.30%	20.81%	19.08%	18.61%	17.81%	17.06%	16.10%	15.59%	15.17%	14.82%	14.25%	13.20%	12.60%	11.39%	10.62%	9.85%	9.74%	
	NPL Ratio Consumer Portfolio	4.30%	4.37%	4.68%	4.46%	4.62%	4.59%	4.47%	4.74%	4.67%	4.93%	5.06%	5.07%	5.27%	5.30%	5.66%	5.22%	5.37%	5.24%	5.39%	5.51%	5.20%	5.19%	5.27%	5.08%	
	Gov. Current Expenditure Growth (% yoy)	24.68%	1.50%	10.82%	15.71%	14.97%	-4.13%	-1.15%	7.09%	10.42%	4.97%	-10.50%	-0.06%	-10.89%	15.38%	4.54%	7.77%	-0.05%	6.30%	24.42%	18.20%	-7.07%	2.97%	20.72%		
ECONOMIC / MONETARY/ FINANCIAL	GDP Growth (%yoy)	4.82%	4.43%	4.43%	4.43%	3.11%	3.11%	3.11%	3.34%	3.34%	3.34%	0.61%	0.61%	0.61%	1.59%	1.59%	1.59%	1.39%	1.39%	1.39%	0.67%	0.67%	0.67%			
	IGAE Total Activity Growth (% yoy)	3.97%	4.70%	3.92%	4.92%	3.77%	3.23%	3.15%	2.39%	4.13%	2.96%	2.16%	1.66%	1.93%	0.60%	1.26%	0.48%	1.31%	1.56%	0.86%	1.34%	0.14%	0.56%	0.91%		
	Headline Inflation	3.73%	3.41%	3.85%	4.34%	4.42%	4.57%	4.77%	4.60%	4.18%	3.57%	3.25%	3.55%	4.25%	4.65%	4.63%	4.09%	3.47%	3.46%	3.39%	3.36%	3.62%	3.97%	4.48%	4.23%	
	Credit Growth (% yoy)	14.98%	13.86%	15.96%	15.99%	14.97%	14.43%	13.08%	13.58%	13.09%	11.62%	12.29%	12.35%	11.13%	11.37%	9.87%	10.02%	10.10%	10.89%	9.83%	10.12%	9.81%	9.55%	8.98%	8.71%	
	NPL Ratio Total Portfolio	2.27%	2.30%	2.34%	2.27%	2.28%	2.35%	2.30%	2.25%	2.26%	2.26%	2.33%	2.33%	2.37%	2.48%	2.80%	2.72%	2.97%	2.98%	3.14%	3.18%	3.11%	3.07%	3.12%	3.08%	
	Reference Rate	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.50%	4.00%	4.00%	4.00%	4.00%	4.00%	4.00%	3.75%	3.50%	3.50%	3.50%	3.50%	3.50%	3.50%
	Gov. Spending Growth (%yoy)	19.07%	10.42%	6.04%	8.88%	21.30%	0.84%	-0.76%	9.70%	10.13%	-8.42%	-5.60%	-9.17%	-6.52%	9.83%	7.60%	9.83%	-1.79%	4.77%	31.79%	14.85%	-6.72%	24.94%	24.64%	23.69%	
	Tax Transfers Growth (% yoy)	0.57%	2.85%	6.07%	-20.06%	11.01%	8.83%	0.83%	2.40%	-1.15%	-2.32%	-7.39%	-10.71%	11.21%	2.99%	6.53%	39.51%	8.10%	15.95%	12.45%	16.90%	7.02%	8.17%	17.83%	22.86%	
INDUSTRIAL	Manufacturing PMI Index, SA	51.95	52.20	53.27	55.40	52.93	52.75	51.03	51.74	51.98	52.66	52.54	51.47	50.85	49.92	48.12	46.87	48.89	49.54	50.53	48.54	50.50	50.57	50.37	50.43	52.72
	Industrial Production, SA - Manufacturing (% yoy)	4.19%	5.45%	3.94%	5.14%	3.49%	2.82%	4.11%	1.24%	2.20%	0.74%	0.60%	1.45%	1.11%	0.07%	0.32%	0.76%	2.53%	3.95%	0.65%	3.61%	1.67%	0.46%	2.13%		
	Total Manufacturing Exports Growth (% yoy)	3.03%	13.88%	10.37%	4.39%	13.48%	1.13%	1.01%	16.80%	4.54%	8.94%	1.23%	-1.48%	2.02%	6.84%	1.98%	3.10%	5.63%	6.22%	11.82%	5.01%	3.17%	4.30%	1.49%	5.75%	
	AMIA Total Car Production (NSA) (%yoy)	9.39%	30.74%	2.82%	13.88%	17.68%	12.27%	12.50%	17.30%	14.68%	0.24%	19.81%	1.60%	-11.21%	15.63%	12.03%	-0.76%	0.49%	4.13%	-4.62%	1.04%	-3.51%	-9.07%	2.70%	0.74%	
	Industrial Production, SA - Construction Growth (% yoy)	4.00%	3.70%	3.46%	2.75%	3.99%	1.82%	0.66%	-0.59%	0.87%	-1.20%	-3.27%	1.43%	0.89%	-4.51%	-4.79%	-5.19%	-6.63%	-5.94%	-7.10%	-6.92%	-5.06%	-3.05%	-1.76%		
	Formal Job Creation Construction Activities Growth (% yoy)	5.19%	6.48%	6.29%	6.66%	8.14%	7.84%	7.46%	7.25%	5.77%	4.88%	4.82%	3.97%	1.09%	2.62%	1.12%	0.06%	-0.53%	-0.89%	-1.22%	-0.23%	1.61%	2.05%	2.18%	3.39%	
	Housing Credit Growth (%yoy)	10.78%	10.28%	10.80%	10.89%	11.07%	11.08%	11.20%	10.69%	10.42%	10.25%	10.26%	8.81%	8.59%	8.83%	9.02%	7.81%	7.97%	8.25%	7.90%	7.66%	8.03%	7.71%	7.42%	8.55%	
	Credit for Construction Companies Growth (%yoy)	10.59%	10.68%	17.42%	19.42%	19.30%	18.18%	16.90%	18.83%	16.72%	18.21%	18.96%	18.77%	15.66%	14.48%	4.75%	1.16%	-1.43%	-2.85%	-1.94%	-4.27%	-1.64%	-6.19%	-6.05%	-6.15%	
	NPL Ratio Housing Portfolio	3.49%	3.52%	3.34%	3.34%	3.40%	3.47%	3.53%	3.18%	3.20%	3.27%	3.25%	3.30%	3.34%	3.37%	3.52%	3.59%	3.63%	3.63%	3.71%	3.86%	3.86%	3.71%	3.72%	3.66%	
	Housing Starts Growth (%yoy)	-8.36%	-24.67%	-12.81%	-25.07%	-20.49%	-32.19%	-23.50%	-12.40%	-5.35%	-38.17%	3.59%	-15.64%	-36.34%	-1.80%	-46.19%	-20.43%	-20.60%	3.53%	-29.06%	-43.38%	-20.50%	57.23%	-14.60%	21.09%	
	Public Infrastructure Investment ex. Energy Growth (% yoy)	-9.73%	57.87%	11.36%	7.72%	-19.12%	18.46%	-3.47%	15.49%	-3.12%	-56.43%	1.14%	-34.91%	-21.67%	-22.46%	-1.09%	-7.17%	36.64%	-1.93%	121.10%	2.28%	15.64%	68.30%	9.04%	94.89%	
	Industrial Production, SA - Mining (% yoy)	-0.02%	0.09%	0.77%	0.72%	1.29%	1.34%	2.51%	-1.14%	1.64%	0.12%	0.21%	-0.13%	-2.32%	-1.63%	-2.32%	-2.08%	-2.17%	-2.09%	-1.28%	0.54%	-2.26%	-1.39%	0.00%		
	Industrial Production Growth, SA (% yoy)	3.01%	3.58%	2.89%	3.68%	2.98%	2.21%	2.42%	0.38%	1.89%	0.03%	-0.49%	0.18%	0.35%	-1.43%	-1.26%	-1.47%	-0.90%	-0.11%	-1.45%	0.31%	-1.01%	-0.25%	0.81%		

Source:: J.P. Morgan, INEGI, SHCP, RUV, AMIA, IFT, CNBV.

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Figure 355: Sector Performance Index vs. Economic Aggregate: Consumer Discretionary

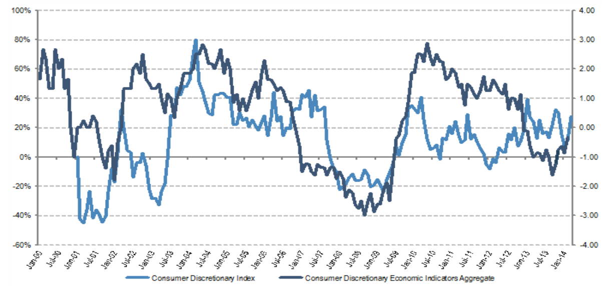


Figure 356: Sector Performance Index vs. Economic Aggregate: Consumer Staples

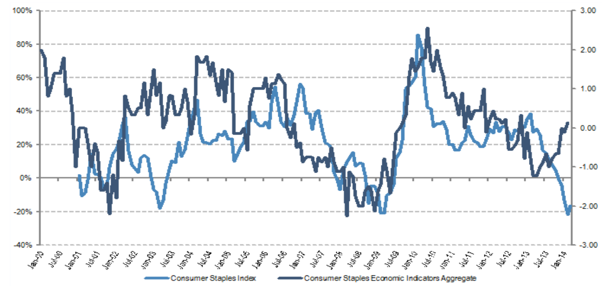


Figure 357: Sector Performance Index vs. Economic Aggregate: Healthcare

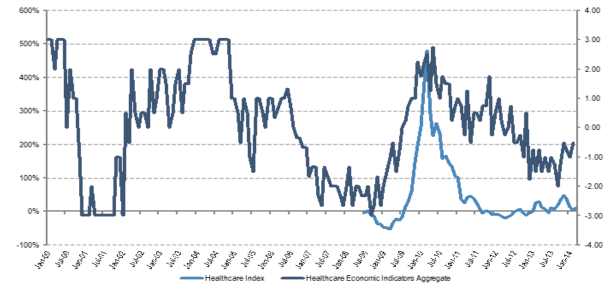


Figure 358: Sector Performance Index vs. Economic Aggregate: Financials

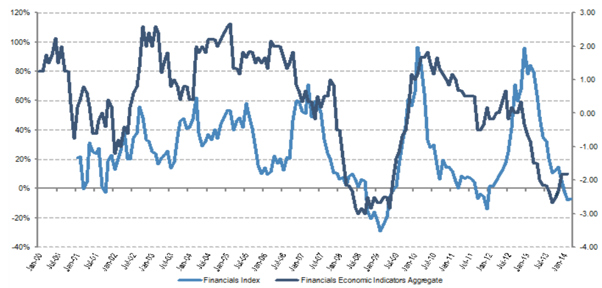


Figure 359: Sector Performance Index vs. Economic Aggregate: Industrials

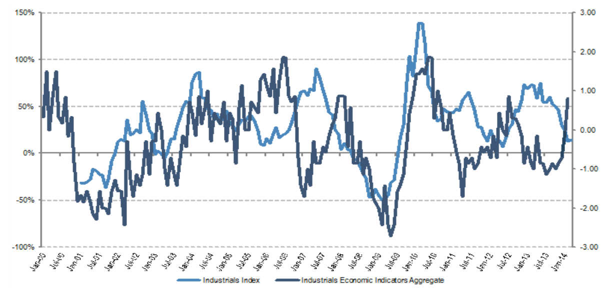


Figure 360: Sector Performance Index vs. Economic Aggregate: Materials

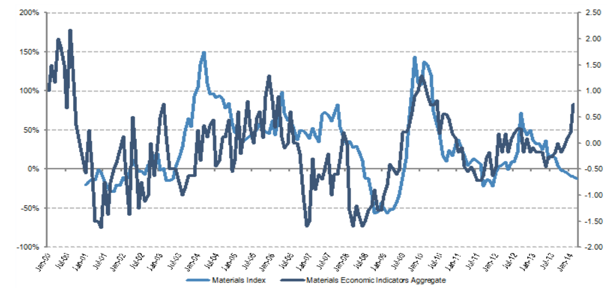
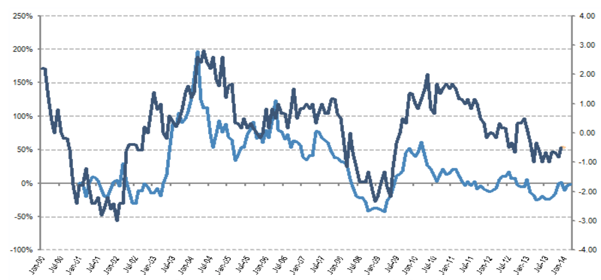


Figure 361: Sector Performance Index vs. Economic Aggregate: Telecom



Source: J.P. Morgan, INEGI, SHCP, Banxico, RUV, AMIA, IFT, CNBV, Bloomberg. February data incomplete so aggregate is preliminary. (Darker Blue is Economic Indicators Aggregate). For more information on calculation of the sector composite indices please refer to our introductory note Mexico Equity Strategy: Reading the Economy – Introducing our Mexico Economic Heatmap.

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MSCI Mexico: Market Performance and Valuation by Sectors and Stock

Sector/Stock	Total Mkt. Cap	ADTV*	Trailing Consensus Estimates			LC Performance					US$ Performance				
	US$ Mn	US$ Mn	PE	PB	DY (%)	1M	3M	6M	YTD	12M	1M	3M	6M	YTD	12M
Consumer Discretionary	**33531**	**27.3**				**6.0%**	**8.0%**	**16.3%**	**8.3%**	**27.1%**	**7.1%**	**8.7%**	**17.8%**	**8.2%**	**18.8%**
GRUPO TELEV	19004	22.5	31.9	3.6	0.40	5.7%	9.0%	18.0%	9.8%	31.1%	6.8%	9.7%	19.6%	9.7%	22.6%
LIVERPOOL	14528	4.8	24.9	3.5	1.05	8.7%	-0.3%	1.8%	-4.4%	-6.8%	9.8%	0.3%	3.1%	-4.5%	-12.9%
Consumer Staples	**135752**	**123.9**				**8.3%**	**-1.6%**	**-4.5%**	**-5.8%**	**-15.4%**	**9.5%**	**-1.0%**	**-3.2%**	**-5.9%**	**-20.9%**
ARCA CONTINENTAL	9440	7.9	20.6	3.2	1.96	6.7%	-2.5%	-6.7%	-6.4%	-23.2%	7.8%	-1.9%	-5.4%	-6.5%	-28.2%
COCA-COLA FEMSA	22072	8.7	25.6	2.5	2.09	9.7%	-9.8%	-14.9%	-12.0%	-32.8%	10.8%	-9.2%	-13.8%	-12.1%	-37.2%
CONTROLA COM-UBC	4494	4.6	15.9	2.0	0.69	1.5%	3.6%	-0.3%	-3.4%	22.9%	2.6%	4.3%	1.0%	-3.5%	14.9%
FEMSA	31695	29.1	27.9	2.7	2.46	8.9%	0.0%	-3.7%	-3.6%	-14.6%	10.1%	0.7%	-2.4%	-3.7%	-20.2%
GRUPO BIMBO	13062	7.7	39.1	3.7	1.42	4.1%	-2.2%	-10.7%	-9.9%	-8.9%	5.2%	-1.6%	-9.5%	-10.0%	-14.9%
CHEDRAUI	2832	2.5	22.2	1.7	0.63	-4.1%	-9.0%	-1.6%	-16.9%	-11.6%	-3.1%	-8.4%	-0.3%	-17.0%	-17.4%
KIMBERLY-CLARK	8401	11.3	24.4	13.1	3.72	7.3%	0.7%	-4.0%	-2.9%	-14.5%	8.5%	1.4%	-2.7%	-3.0%	-20.0%
WALMEX	43755	52.1	25.6	4.0	2.84	10.9%	-1.6%	-0.4%	-5.5%	-17.0%	12.0%	-0.9%	1.0%	-5.6%	-22.4%
Financials	**60845**	**83.6**				**3.0%**	**-4.6%**	**3.7%**	**-6.4%**	**-6.6%**	**4.0%**	**-4.0%**	**5.0%**	**-6.5%**	**-12.7%**
COMPARTAMOS	2888	7.5	16.6	4.3	2.45	-4.1%	-3.7%	-6.7%	-6.4%	1.3%	-3.1%	-3.0%	-5.4%	-6.5%	-5.3%
FIBRA UNO	5682	16.8	27.8	1.4	4.17	-7.7%	-5.7%	15.4%	-2.0%	-6.3%	-6.8%	-5.1%	17.0%	-2.1%	-12.4%
GF BANORTE	18244	46.9	15.6	2.0	0.92	2.7%	-4.8%	4.8%	-6.1%	-7.0%	3.7%	-4.1%	6.2%	-6.2%	-13.1%
INBURSA	17592	9.2	14.1	2.8	5.37	11.5%	-0.8%	6.3%	-6.8%	-1.8%	12.7%	-0.1%	7.7%	-6.9%	-8.2%
SANTANDER	16440	10.7	11.3	2.3	9.72	5.5%	-8.9%	-11.1%	-11.0%	-15.7%	6.6%	-8.3%	-9.9%	-11.1%	-21.2%
Industrials	**42133**	**53.4**				**6.3%**	**3.1%**	**8.4%**	**0.7%**	**16.0%**	**7.4%**	**3.8%**	**9.9%**	**0.6%**	**8.5%**
ALFA	13238	19.4	29.1	3.1	1.16	8.4%	-6.7%	-4.0%	-8.3%	10.7%	9.5%	-6.1%	-2.7%	-8.4%	3.4%
GAP	3256	4.7	18.9	1.9	3.01	9.0%	11.2%	10.2%	8.5%	-2.9%	10.2%	11.9%	11.7%	8.3%	-9.2%
ASURB	3721	5.5	21.1	3.0	2.72	4.8%	3.7%	7.6%	-0.9%	-5.3%	6.0%	4.4%	9.1%	-1.0%	-11.5%
GRUPO CARSO	12145	2.6	11.4	3.2	6.79	5.5%	4.4%	2.6%	-0.4%	3.0%	6.6%	5.1%	4.0%	-0.5%	-3.7%
OHL	4488	7.7	8.3	1.2	NA	-1.2%	3.6%	0.0%	1.1%	-3.9%	-0.1%	4.3%	1.4%	1.0%	-10.2%
PINFRA	5286	13.5	32.1	7.9	NA	5.9%	16.7%	41.4%	16.3%	71.1%	7.0%	17.4%	43.3%	16.1%	59.9%
Materials	**64843**	**102.0**				**3.6%**	**3.3%**	**6.7%**	**2.1%**	**-6.9%**	**4.7%**	**4.0%**	**8.1%**	**2.0%**	**-13.0%**
CEMEX	15118	43.3	NA	1.5	NA	1.2%	12.4%	21.4%	12.7%	16.9%	2.2%	13.2%	23.0%	12.6%	9.3%
GRUPO MEXICO	24820	32.5	13.9	2.6	2.19	3.2%	-0.2%	5.1%	-3.8%	-14.2%	4.3%	0.5%	6.5%	-3.9%	-19.8%
INDUS CH	2394	3.2	18.7	1.1	NA	-4.6%	-15.2%	-6.2%	-18.6%	-31.6%	-3.6%	-14.7%	-4.9%	-18.6%	-36.1%
PENOLES	9964	5.1	27.3	3.1	4.48	3.4%	2.2%	-13.3%	0.9%	-42.1%	4.5%	2.9%	-12.1%	0.8%	-45.9%
MEXICHEM	7663	16.1	35.3	2.3	1.81	11.8%	-13.4%	-14.2%	-11.5%	-24.4%	13.0%	-12.9%	-13.0%	-11.5%	-29.4%
MINERA FRISCO	4884	1.8	281.9	4.1	NA	19.6%	-2.6%	-26.1%	-7.1%	-52.5%	20.8%	-2.0%	-25.2%	-7.1%	-55.6%
Telecom	**72136**	**80.1**				**3.2%**	**-7.5%**	**3.3%**	**-12.2%**	**6.4%**	**4.3%**	**-6.9%**	**4.7%**	**-12.3%**	**-0.6%**
AMERICA MOVIL	72136	80.1	12.6	4.7	1.64	3.2%	-7.5%	3.3%	-12.2%	6.4%	4.3%	-6.9%	4.7%	-12.3%	-0.6%
Health Care	**2613**	**11.2**				**-2.9%**	**-4.7%**	**-1.0%**	**-11.6%**	**6.5%**	**-1.9%**	**-4.1%**	**0.3%**	**-11.7%**	**-0.4%**
GENOMMA LAB	2613	11.2	19.4	3.9	NA	-2.9%	-4.7%	-1.0%	-11.6%	6.5%	-1.9%	-4.1%	0.3%	-11.7%	-0.4%
MSCI Mexico	**411854**	**481.4**				**5.1%**	**-0.9%**	**3.8%**	**-3.6%**	**-0.7%**	**6.2%**	**-0.2%**	**5.2%**	**-3.7%**	**-7.2%**

Source: Bloomberg, MSCI, Datastream, J.P. Morgan. Note:* ADTV is the 6 month average daily traded value

Pricing as of April 8, 2014

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IPC Bolsa: Market Performance and Valuation by Sectors and Stock

Sector/Stock	Weights	Total Mkt. Cap	ADTV*	Trailing Consensus Estimates			LC Performance					US$ Performance				
	(%)	US$ Mn	US$ Mn	PE	PB	DY (%)	1M	3M	6M	YTD	12M	1M	3M	6M	YTD	12M
Consumer Discretionary	**11.7%**	**46987**	**43.0**				**5.6%**	**5.7%**	**13.5%**	**5.6%**	**20.7%**	**6.7%**	**6.4%**	**15.0%**	**5.5%**	**12.8%**
ALSEA	0.6%	2437	5.1	46.7	7.3	1.08	15.2%	9.8%	24.9%	13.3%	25.2%	16.4%	10.6%	26.6%	13.2%	17.0%
GRUPO ELEKTRA	1.2%	6989	8.3	193.5	2.0	0.60	-0.4%	-9.5%	-7.7%	-13.6%	-21.1%	0.6%	-8.9%	-6.4%	-13.7%	-26.2%
GRUPO SANBORNS	0.3%	4029	2.3	16.3	2.0	3.40	-5.4%	-15.0%	-14.2%	-19.3%	-21.8%	-4.4%	-14.4%	-13.0%	-19.4%	-26.9%
LIVERPOOL	1.1%	14528	4.8	24.9	3.5	1.05	8.7%	-0.3%	1.8%	-4.4%	-6.8%	9.8%	0.3%	3.1%	-4.5%	-12.9%
GRUPO TELEV	8.5%	19004	22.5	31.9	3.6	0.40	5.7%	9.0%	18.0%	9.8%	31.1%	6.8%	9.7%	19.6%	9.7%	22.6%
Consumer Staples	**27.3%**	**139415**	**133.5**				**8.3%**	**-1.3%**	**-3.2%**	**-5.1%**	**-12.3%**	**9.5%**	**-0.7%**	**-1.9%**	**-5.2%**	**-18.0%**
ARCA CONTINENTAL	1.2%	9440	7.9	20.6	3.2	1.96	6.7%	-2.5%	-6.7%	-6.4%	-23.2%	7.8%	-1.9%	-5.4%	-6.5%	-28.2%
GRUPO BIMBO	1.7%	13062	7.7	39.1	3.7	1.42	4.1%	-2.2%	-10.7%	-9.9%	-8.9%	5.2%	-1.6%	-9.5%	-10.0%	-14.9%
CHEDRAUI	0.3%	2832	2.5	22.2	1.7	0.63	-4.1%	-9.0%	-1.6%	-16.9%	-11.6%	-3.1%	-8.4%	-0.3%	-17.0%	-17.4%
CONTROLA COM	1.0%	4494	4.6	15.9	2.0	0.69	1.5%	3.6%	-0.3%	-3.4%	22.9%	2.6%	4.3%	1.0%	-3.5%	14.9%
FEMSA	10.6%	31695	29.1	27.9	2.7	2.46	8.9%	0.0%	-3.7%	-3.6%	-14.6%	10.1%	0.7%	-2.4%	-3.7%	-20.2%
GRUMA	0.8%	3664	9.6	13.7	3.7	NA	1.6%	8.1%	43.0%	11.8%	108.1%	2.7%	8.9%	44.9%	11.7%	94.5%
KIMBERLY-CLARK	2.1%	8401	11.3	24.4	13.1	3.72	7.3%	0.7%	-4.0%	-2.9%	-14.5%	8.5%	1.4%	-2.7%	-3.0%	-20.0%
COCA-COLA FEMSA	2.8%	22072	8.7	25.6	2.5	2.09	9.7%	-9.8%	-14.9%	-12.0%	-32.8%	10.8%	-9.2%	-13.8%	-12.1%	-37.2%
WALMEX	6.9%	43755	52.1	25.6	4.0	2.84	10.9%	-1.6%	-0.4%	-5.5%	-17.0%	12.0%	-0.9%	1.0%	-5.6%	-22.4%
Financials	**13.9%**	**55365**	**74.5**				**4.6%**	**-5.0%**	**1.8%**	**-7.1%**	**-7.8%**	**5.7%**	**-4.4%**	**3.2%**	**-7.2%**	**-13.8%**
BOLSA	0.4%	1181	4.5	20.1	2.8	4.16	-0.6%	-13.5%	-14.6%	-13.2%	-26.8%	0.4%	-12.9%	-13.5%	-13.3%	-31.6%
INBURSA	2.3%	17592	9.2	14.1	2.8	5.37	11.5%	-0.8%	6.3%	-6.8%	-1.8%	12.7%	-0.1%	7.7%	-6.9%	-8.2%
BANORTE	8.6%	18244	46.9	15.6	2.0	0.92	2.7%	-4.8%	4.8%	-6.1%	-7.0%	3.7%	-4.1%	6.2%	-6.2%	-13.1%
BANREGIO	0.3%	1909	3.2	17.4	3.1	1.78	7.7%	-4.4%	3.7%	-2.2%	10.1%	8.9%	-3.8%	5.0%	-2.3%	2.9%
SANTANDER	2.3%	16440	10.7	11.3	2.3	9.72	5.5%	-8.9%	-11.1%	-11.0%	-15.7%	6.6%	-8.3%	-9.9%	-11.1%	-21.2%
Industrials	**10.5%**	**31007**	**59.7**				**6.0%**	**0.3%**	**5.4%**	**-1.7%**	**13.2%**	**7.1%**	**0.9%**	**6.8%**	**-1.8%**	**5.8%**
ALFA	5.2%	13238	19.4	29.1	3.1	1.16	8.4%	-6.7%	-4.0%	-8.3%	10.7%	9.5%	-6.1%	-2.7%	-8.4%	3.4%
ASURB	1.3%	3721	5.5	21.1	3.0	2.72	4.8%	3.7%	7.6%	-0.9%	-5.3%	6.0%	4.4%	9.1%	-1.0%	-11.5%
GAP	0.9%	3256	4.7	18.9	1.9	3.01	9.0%	11.2%	10.2%	8.5%	-2.9%	10.2%	11.9%	11.7%	8.3%	-9.2%
ICA	0.5%	1019	8.9	38.5	0.7	NA	-7.8%	-17.3%	-22.0%	-18.8%	-45.1%	-6.8%	-16.7%	-20.9%	-18.9%	-48.7%
OHL	0.9%	4488	7.7	8.3	1.2	NA	-1.2%	3.6%	0.0%	1.1%	-3.9%	-0.1%	4.3%	1.4%	1.0%	-10.2%
PROMOTORA	1.7%	5286	13.5	32.1	7.9	NA	5.9%	16.7%	41.4%	16.3%	71.1%	7.0%	17.4%	43.3%	16.1%	59.9%
Materials	**18.3%**	**63741**	**103.9**				**2.9%**	**3.3%**	**8.2%**	**2.1%**	**-4.4%**	**4.0%**	**3.9%**	**9.6%**	**2.0%**	**-10.7%**
ALPEK	0.4%	3782	3.7	194.1	2.1	4.25	0.3%	-21.6%	-16.4%	-21.6%	-20.6%	1.3%	-21.1%	-15.3%	-21.6%	-25.8%
CEMEX	7.8%	15118	43.3	NA	1.5	NA	1.2%	12.4%	21.4%	12.7%	16.9%	2.2%	13.2%	23.0%	12.6%	9.3%
GRUPO MEXICO	6.5%	24820	32.5	13.9	2.6	2.19	3.2%	-0.2%	5.1%	-3.8%	-14.2%	4.3%	0.5%	6.5%	-3.9%	-19.8%
INDUS CH	0.4%	2394	3.2	18.7	1.1	NA	-4.6%	-15.2%	-6.2%	-18.6%	-31.6%	-3.6%	-14.7%	-4.9%	-18.6%	-36.1%
MEXICHEM	1.8%	7663	16.1	35.3	2.3	1.81	11.8%	-13.4%	-14.2%	-11.5%	-24.4%	13.0%	-12.9%	-13.0%	-11.5%	-29.4%
PENOLES	1.3%	9964	5.1	27.3	3.1	4.48	3.4%	2.2%	-13.3%	0.9%	-42.1%	4.5%	2.9%	-12.1%	0.8%	-45.9%
Telecom	**15.9%**	**72136**	**80.1**				**3.2%**	**-7.5%**	**3.3%**	**-12.2%**	**6.4%**	**4.3%**	**-6.9%**	**4.7%**	**-12.3%**	**-0.6%**
AMERICA MOVIL	15.9%	72136	80.1	12.6	4.7	1.64	3.2%	-7.5%	3.3%	-12.2%	6.4%	4.3%	-6.9%	4.7%	-12.3%	-0.6%
Health Care	**1.0%**	**2613**	**11.2**				**-2.9%**	**-4.7%**	**-1.0%**	**-11.6%**	**6.5%**	**-1.9%**	**-4.1%**	**0.3%**	**-11.7%**	**-0.4%**
GENOMMA LAB	1.0%	2613	11.2	19.4	3.9	NA	-2.9%	-4.7%	-1.0%	-11.6%	6.5%	-1.9%	-4.1%	0.3%	-11.7%	-0.4%
Utilities	**0.6%**	**5855**	**5.2**				**12.3%**	**25.8%**	**30.1%**	**26.9%**	**55.8%**	**13.5%**	**26.6%**	**31.8%**	**26.7%**	**45.6%**
INFRAESTRUCTURA	0.6%	5855	5.2	39.0	2.5	1.99	12.3%	25.8%	30.1%	26.9%	55.8%	13.5%	26.6%	31.8%	26.7%	45.6%
IPC Bolsa	**99.2%**	**417119**	**511.1**				**5.3%**	**-0.9%**	**3.7%**	**-3.4%**	**0.0%**	**6.4%**	**-0.2%**	**5.1%**	**-3.5%**	**-6.5%**

Source: Bloomberg, J.P. Morgan. Note:* ADTV is the 6 month average daily traded value (3 month average daily traded value if not available)

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Value: Regional, Countries and Sector Valuations

Country / Sector	P / E Current Trailing	P / E Consensus 12M Forward	P / E 10Y Hist. Average	P / E Implicit 12M Earn. Growth	P / B Current Trailing	P / B 10Y Hist. Average	ROE % Current Trailing	ROE % 10Y Hist. Average	Div Yield Current Trailing	Div Yield 10Y Hist. Average
World	16.7	14.1	13.2	19%	2.1	2.0	14.9	14.7	2.5	2.7
Developed World	17.4	14.7	13.5	18%	2.2	2.0	14.7	14.5	2.5	2.7
United States	18.1	15.5	14.1	17%	2.7	2.4	17.6	16.6	2.1	2.2
Euro zone	16.8	13.9	12.0	21%	1.8	1.8	13.3	14.8	3.1	3.5
Japan	14.5	13.0	16.1	11%	1.3	1.4	9.7	8.6	2.5	1.8
Emerging Markets	12.5	10.2	10.8	23%	1.6	1.8	15.5	16.5	2.7	2.8
Emerging Asia	12.5	10.7	11.5	16%	1.6	1.8	15.1	15.4	2.5	2.6
Emerging Europe	6.9	5.3	8.3	29%	0.9	1.4	16.7	16.6	3.9	2.9
LatAm	17.4	12.0	10.9	45%	1.8	2.0	15.1	17.8	2.5	3.2
Argentina	8.1	7.4	9.2	10%	1.7	1.7	22.5	18.0	1.3	2.8
Brazil	15.4	9.9	9.6	55%	1.5	1.8	15.5	18.4	3.2	3.9
Chile	21.0	15.3	16.2	37%	1.9	2.1	12.1	12.3	1.7	2.3
Colombia	19.7	16.1	13.6	23%	1.8	1.7	11.0	13.1	2.3	3.1
Mexico	22.1	17.9	13.9	24%	2.9	2.7	16.1	19.1	1.5	1.9
Peru	18.1	12.9	12.8	40%	2.4	3.2	18.2	25.5	1.6	3.8
LatAm Energy	10.7	8.2	8.7	30%	0.8	1.6	10.2	19.9	4.9	3.6
LatAm Materials	15.7	10.5	9.4	50%	1.3	1.8	12.1	19.8	3.4	3.6
LatAm Industrials	24.7	17.8	15.1	39%	2.8	2.4	15.7	15.6	1.8	2.2
LatAm Financials	12.4	10.8	10.8	15%	1.8	2.0	16.7	18.6	3.0	3.4
LatAm Cons. Discretionary	24.4	19.2	15.6	27%	3.7	3.1	19.2	19.2	1.1	1.6
LatAm Cons. Staples	27.7	20.8	17.8	33%	3.4	2.9	16.5	15.9	2.2	2.7
LatAm Inf. Technology	27.0	22.3	15.2	21%	19.9	18.7	89.3	118.7	3.5	3.3
Health Care LatAm	43.2	20.6	23.2	110%	4.5	4.0	22.0	17.6	0.9	0.8
LatAm Telecom, Media, Tech	12.5	9.4	11.6	33%	2.8	2.8	30.1	24.1	3.2	3.1
LatAm Utilities	23.8	10.9	11.1	118%	1.1	1.0	10.2	8.9	4.6	4.8
China	9.8	8.7	11.8	13%	1.5	2.0	17.2	16.5	3.7	2.8
Korea	10.6	8.9	9.4	19%	1.1	1.3	12.6	14.0	1.1	1.7
Taiwan	18.0	14.7	13.9	23%	2.0	1.9	13.7	13.7	3.2	3.8
India	17.3	14.8	15.0	17%	2.8	3.0	18.9	19.9	1.5	1.4
South Africa	18.2	14.2	11.1	28%	2.8	2.3	19.8	20.7	2.8	3.3
Russia	4.8	3.5	7.3	39%	0.6	1.3	18.0	17.1	4.6	2.4
Turkey	10.5	10.2	9.6	3%	1.7	1.6	16.4	16.7	3.0	3.3

Source: Bloomberg and J.P. Morgan

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Value: Consensus Forward P/E for Countries and Sectors

Consensus Forward P/E	Global	USA	Japan	Europe	EMF	EMF Asia	EMEA	LatAm	Brazil	Mexico	Chile	Colombia	Peru	Argentina
Energy	11.5	14.0	9.7	11.1	5.5	9.1	3.5	8.2	7.5	-	18.3	10.9	-	9.9
Materials	14.3	16.2	12.1	14.2	12.0	13.0	13.7	10.5	7.2	28.0	15.7	36.4	14.0	-
Industrials	15.3	16.2	12.2	15.5	14.4	14.1	11.8	17.8	17.3	18.9	16.0	-	-	-
Financials	12.0	13.4	12.2	11.6	8.7	8.1	9.3	10.8	9.7	14.8	11.8	15.2	12.2	5.8
Consumer Discretionary	15.1	18.2	11.1	13.8	11.7	9.6	19.5	19.2	14.2	26.7	21.8	-	-	-
Consumer Staples	17.5	17.3	18.1	17.0	21.1	21.8	19.6	20.8	20.0	22.3	17.1	27.8	-	-
Information Technology	14.7	14.9	16.3	19.1	11.8	11.7	-	22.3	18.5	-	-	-	-	-
Health Care	16.5	16.7	21.5	15.9	19.1	19.7	18.3	20.6	21.2	15.5	-	-	-	-
Telecommunication Services	14.1	14.5	13.9	15.2	12.1	13.4	12.0	9.4	6.5	10.8	11.9	-	-	7.5
Utilities	14.8	16.3	13.8	14.2	11.4	12.1	9.6	10.9	8.6	-	14.9	19.6	-	-
Region / Country	14.1	15.5	13.0	13.9	10.2	10.7	7.5	12.0	9.9	17.9	15.3	16.1	12.9	7.4
Sector Neutral to GEMs								12.2	11.7	14.0	11.9	9.7	10.2	NA
Sector Neutral to Global								14.6	14.4	15.2	14.9	13.8	13.6	NA

Note: Calculation for industry-neutral P/Es: (sector weight of each respective countries) * (consensus fwd PEs for the consensus fwd P/Es for the respective countries, GEMs and Global) Pricing as of April 8, 2014

Source: Bloomberg and J.P. Morgan

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Value: Mexico Sector Valuations

	P / E				P / B		ROE %	Div Yield	
	Current	Consensus	10Y Hist.	Implicit 12M	Current	10Y Hist.	Current	Current	10Y Hist.
Country / Sector	Trailing	12M Forward	Average	Earn. Growth	Trailing	Average	Trailing	Trailing	Average
Materials	65.1	28.0	13.0	132%	2.0	1.7	7.0	1.4	2.7
Industrials	18.3	18.9	14.6	-3%	2.9	1.7	15.2	1.2	1.6
Financials	18.2	14.8	12.6	23%	2.2	2.5	14.7	2.2	1.2
Consumer Discretionary	27.1	26.7	17.2	1%	3.6	3.3	13.6	0.5	1.5
Consumer Staples	22.2	22.3	18.5	0%	3.2	3.3	14.6	1.7	1.6
Telecommunication Services	12.8	10.8	12.4	18%	4.7	4.9	43.6	1.6	1.7
Region / Country	22.1	17.9	13.9	24%	2.9	2.7	16.1	1.5	1.9

Source: Bloomberg and J.P. Morgan

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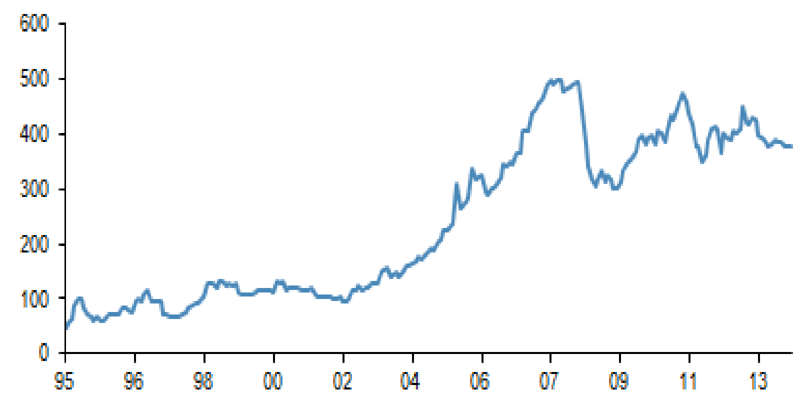
Mexico Earnings expectations

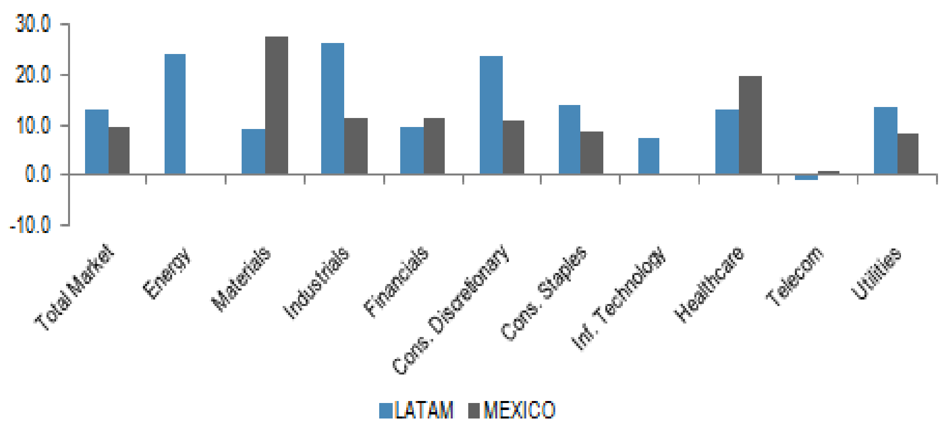
Earnings Growth (USD %)

MEXICO	MCap.	J.P. Morgan		Consensus	
USD	Weight	2014	2015	2014	2015
Total Market	100%	9.8	8.0	9.4	9.9
Materials	11%	17.6	18.1	27.7	36.9
Industrials	14%	18.3	5.0	11.2	15.6
Financials	18%	-9.0	17.1	11.3	20.1
Cons. Discretionary	13%	10.7	10.6	11.1	16.6
Cons. Staples	23%	12.0	10.9	8.8	-1.9
Healthcare	1%	19.1	22.9	19.8	21.7
Telecom	19%	17.9	-6.0	0.9	0.2
Utilities	1%	NA	NA	8.1	11.4

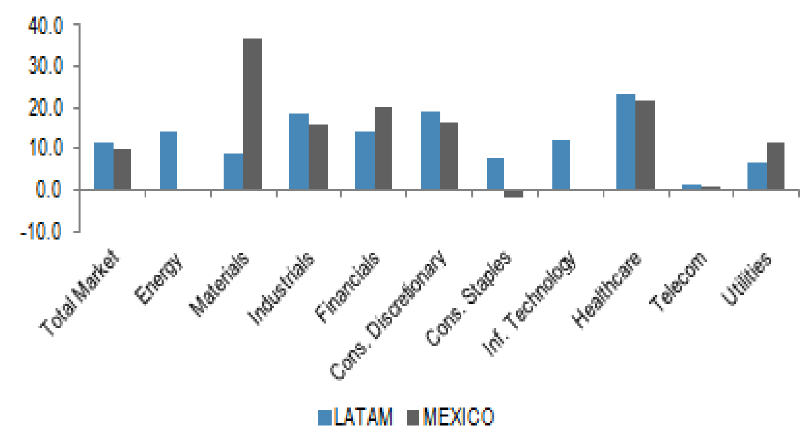
12 Month Forward Earnings Revisions



LatAm vs. Mexico: 2014 Earnings Growth expectations



LatAm vs. Mexico: 2015 Earnings Growth expectations



Source: Bloomberg and J.P. Morgan

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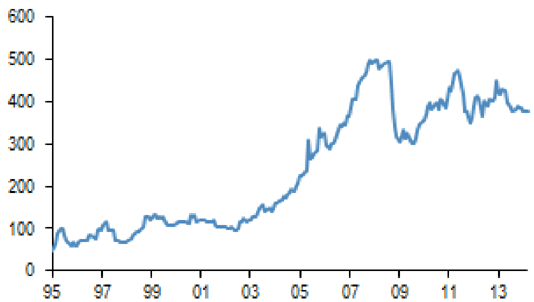
Mexico Sectors: 12 months Forward Earnings Revisions

Mexico



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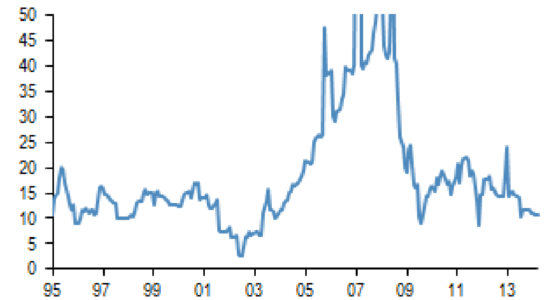

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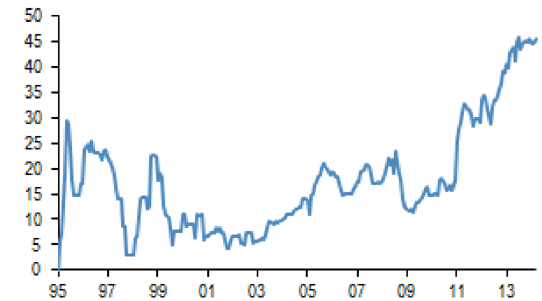

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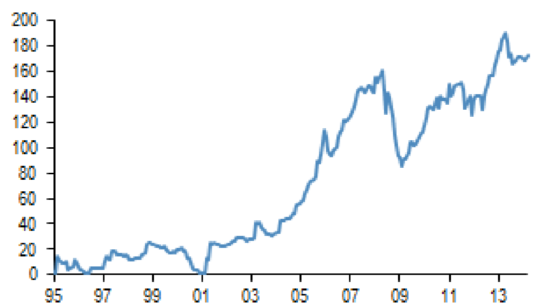

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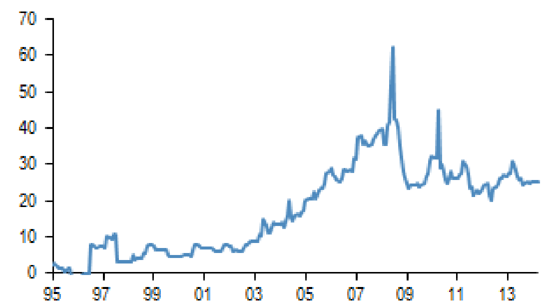

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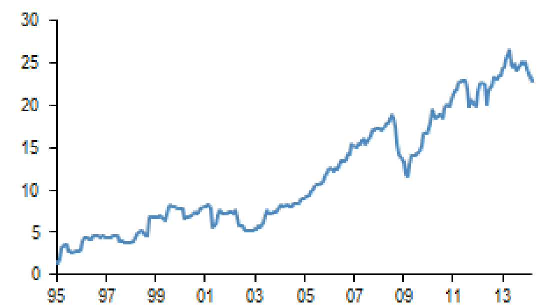

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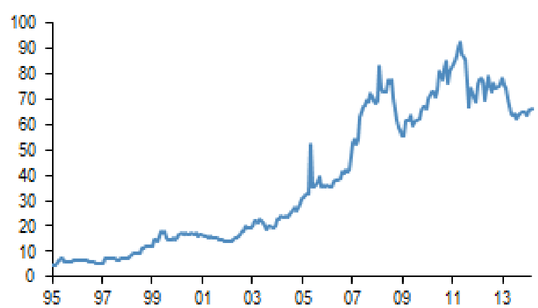

Source: Bloomberg and J.P. Morgan

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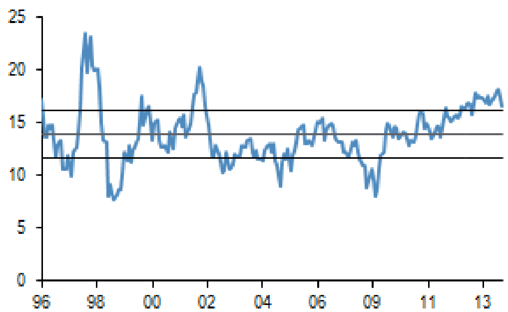
Mexico Sectors: 12 months Forward Price to Earnings

Mexico



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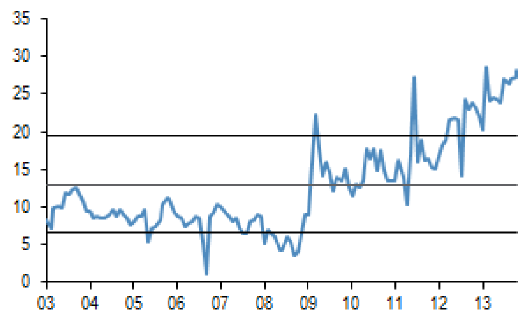

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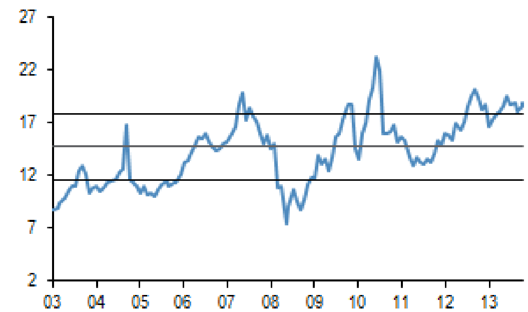

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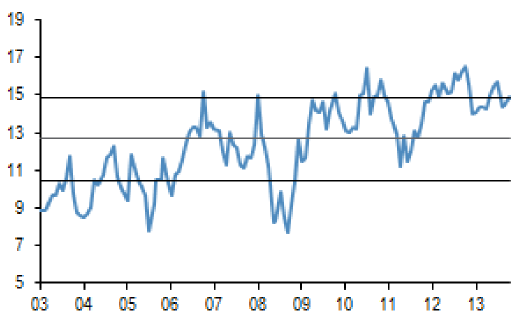

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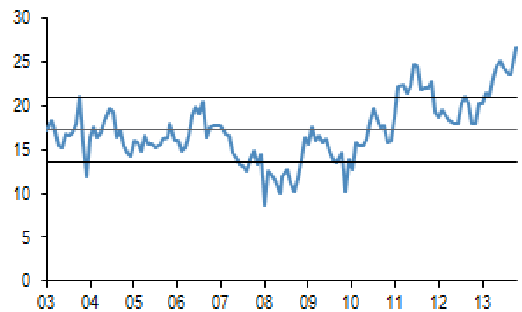

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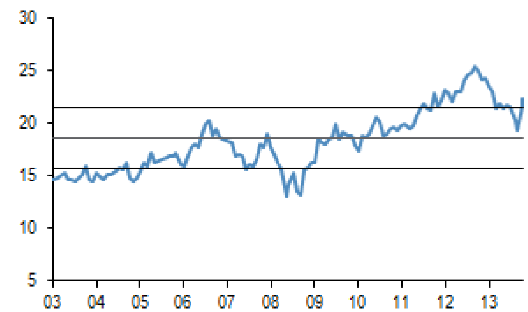

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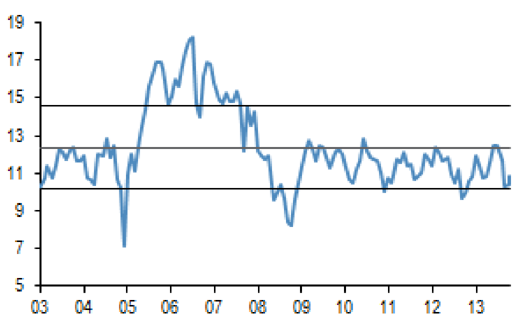

Source: Bloomberg and J.P. Morgan

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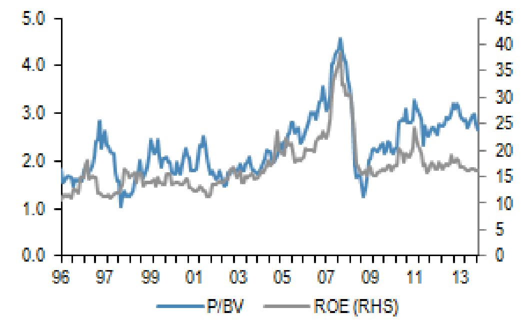
Mexico Sectors: Price to Book vs. Return on Equity

Mexico



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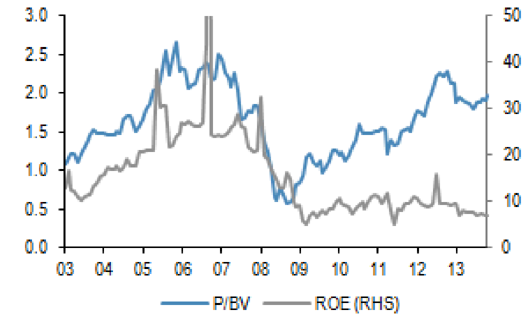
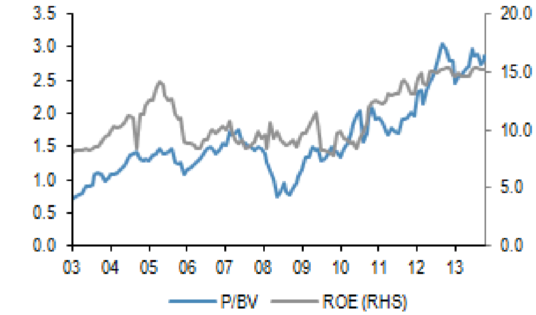


Industrials



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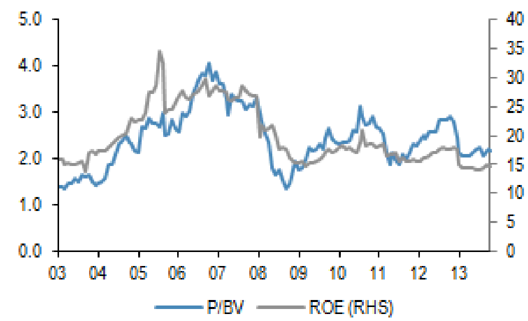

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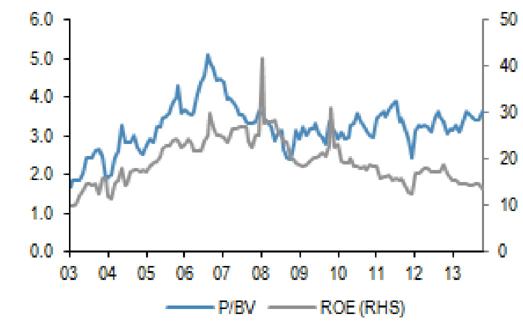

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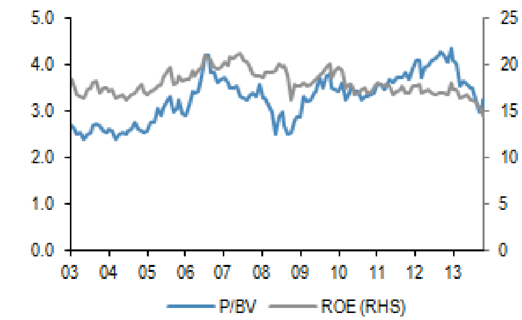
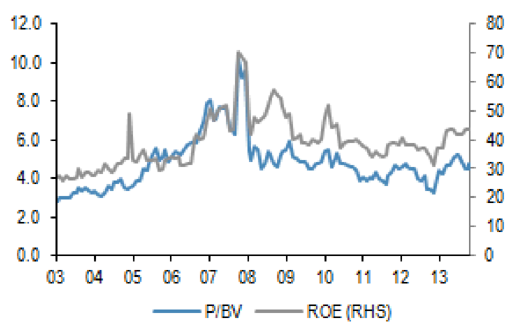


Telecom



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J.P. Morgan Mexico Stock Coverage

Name	Ticker	JPM Rating	Price (US$) 4/8/2014	Mkt. Cap. US$ mn.	% Price Change (local) 1d	1w	1m	3m	YTD	P/E 13e	14e	EV/EBITDA 13e	14e	P/B 13e	14e	Dividend Yield (%) 13e	14e	EPS Growth (%) 13e	14e	ROE (%) 13e	14e	Covering Analyst
Arca Continental	AC* MM	N	76.4	9,491	0.8%	-1.8%	6.9%	-3.0%	61.3%	20.7	19.3	10.9	10.0	3.2	3.1	3.9%	0.0%	18.2%	7.3%	15.5%	16.3%	Teixeira, Andrea
Grupo Alfa	ALFAA MM	N	33.6	13,179	-0.2%	0.9%	7.6%	-7.8%	85.4%	25.2	17.9	8.3	8.0	3.0	2.7	0.8%	1.1%	-33.3%	41.2%	12.5%	15.9%	Lucin, Cassio
Alpek	ALPEKA MM	N	23.3	3,850	0.3%	1.6%	1.8%	-18.5%	0.0%	37.6	20.5	-	-	1.8	1.7	8.1%	2.2%	-70.1%	83.3%	4.7%	8.6%	Dos Santos, Felipe
America Movil	AMX US	N	267.4	70,976	-0.1%	4.6%	6.1%	-7.5%	-21.5%	12.9	10.7	5.5	5.4	4.9	4.0	0.1%	0.1%	-12.3%	20.7%	29.9%	40.5%	Baggio, Andre
Consorcio Ara	ARA* MM	UW	5.7	582	-2.2%	-1.4%	14.3%	14.3%	-3.0%	12.6	13.1	8.1	7.6	0.7	0.7	1.9%	2.0%	2.0%	-3.7%	6.0%	5.6%	Huerta, Adrian E
Grupo Aeroportuario del Sureste SA	ASURB MM	N	161.8	3,603	-1.8%	-2.5%	1.2%	1.7%	85.0%	20.4	20.3	14.4	12.7	2.9	2.8	5.4%	3.4%	10.7%	0.4%	14.0%	13.9%	Abdalla, Fernando
Grupo Bimbo	BIMBOA MM	N	36.2	12,959	1.4%	1.7%	3.0%	-6.2%	17.6%	38.4	29.0	10.2	9.1	-	-	1.4%	0.0%	116.1%	32.4%	10.4%	13.1%	Teixeira, Andrea
Bolsa Mexicana	BOLSAA MM	N	26.0	1,161	0.6%	-1.1%	-2.6%	-16.6%	37.6%	19.8	19.7	-	-	2.7	2.6	5.1%	5.2%	8.9%	0.4%	13.9%	13.9%	Falavina, Domingos
Santander Mexico ADR	BSMX US	UW	158.0	16,174	-0.6%	-2.9%	5.3%	-10.5%	0.0%	10.0	13.6	-	-	2.2	1.9	12.2%	3.5%	19.7%	-26.9%	17.0%	15.1%	Martinez, Saul
Comerci	COMERUBC MM	UW	54.0	4,483	1.1%	-1.1%	1.0%	1.6%	74.9%	15.8	28.0	14.5	12.6	1.8	1.6	0.3%	0.4%	-49.0%	-43.8%	13.4%	6.4%	Teixeira, Andrea
Credito Real	CREAL* MM	OW	21.3	611	0.2%	-1.3%	-2.9%	11.6%	0.0%	7.9	6.9	-	-	1.8	1.5	2.5%	2.5%	0.6%	13.9%	25.2%	23.7%	Delgado, Christopher A
Cultiba	CULTIBAB MM	UW	22.0	1,242	-0.4%	-0.6%	13.9%	-12.7%	0.0%	235.1	47.6	7.4	6.1	-	-	0.8%	0.7%	-86.5%	393.6%	2.3%	5.2%	Teixeira, Andrea
Cemex	CX US	OW	172.2	14,423	-2.7%	4.6%	1.8%	13.3%	-50.9%	-49.9	85.6	10.8	8.7	0.9	0.9	0.0%	0.0%	-68.0%	-158.3%	-1.9%	1.1%	Huerta, Adrian E
Fibra Danhos	DANHOS13 MM	OW	26.4	2,694	-0.3%	0.3%	2.6%	5.7%	0.0%	6.8	28.0	23.1	27.3	0.9	0.9	1.5%	5.9%	NA	-75.8%	14.3%	3.3%	Huerta, Adrian E
Fibra Macquarie	FIBRAMQ MM	N	23.7	1,089	-0.6%	-4.3%	1.0%	-3.5%	0.0%	10.1	12.1	19.8	14.6	1.1	1.1	8.6%	7.8%	0.9%	-16.4%	11.3%	8.8%	Huerta, Adrian E
Fibra Hotel	FIHO12 MM	OW	21.3	817	0.4%	-3.5%	-1.7%	0.7%	0.0%	37.7	24.1	20.6	17.9	1.0	1.0	3.0%	4.8%	7.1%	56.7%	2.4%	3.7%	Huerta, Adrian E
FEMSA Local	FEMSAUBD MM	N	121.8	32,687	0.4%	-2.3%	6.2%	-3.6%	0.0%	27.2	23.2	-	-	1.9	1.8	3.1%	0.0%	-24.1%	17.3%	7.2%	7.9%	Teixeira, Andrea
FEMSA	FMX US	N	1,218.3	32,630	0.4%	-2.2%	7.5%	-3.4%	23.6%	26.6	23.1	8.2	7.6	1.8	1.6	3.2%	0.0%	-22.7%	15.5%	6.8%	7.3%	Teixeira, Andrea
Fibra Uno	FUNO11 MM	N	41.0	5,743	3.5%	-2.3%	-7.0%	-3.7%	0.0%	25.2	18.7	31.6	18.5	1.4	1.4	4.3%	4.9%	58.3%	34.7%	7.7%	7.7%	Huerta, Adrian E
Grupo Aeroportuario del Pacifico SA	GAPB MM	N	75.7	3,279	-0.2%	-0.3%	9.5%	15.6%	55.0%	19.0	22.5	12.0	10.5	1.9	1.9	2.8%	4.0%	26.8%	-15.6%	10.3%	8.5%	Abdalla, Fernando
Compartamos	GENTERA* MM	OW	22.9	2,867	-1.9%	-4.6%	-4.5%	-7.1%	13.9%	16.3	14.8	-	-	4.0	3.4	6.7%	2.1%	14.6%	10.4%	25.8%	25.6%	Delgado, Christopher A
Grupo Financiero Inbursa	GFINBURO MM	UW	34.4	17,396	1.3%	1.0%	9.9%	-4.8%	54.0%	13.9	18.6	-	-	2.8	2.4	6.5%	1.9%	85.3%	-25.5%	20.3%	13.6%	Martinez, Saul
Banorte	GFNORTEO MM	N	85.8	16,254	1.0%	-2.5%	2.4%	-5.9%	94.3%	20.2	14.8	-	-	2.2	2.0	1.4%	1.1%	-9.6%	37.0%	11.1%	14.2%	Martinez, Saul
Banregio	GFREGIO MM	N	75.9	1,894	-0.7%	-0.7%	6.6%	-6.1%	0.0%	17.2	15.6	-	-	3.1	2.7	1.8%	0.9%	19.1%	10.1%	18.9%	18.4%	Delgado, Christopher A
Grupo Mexico	GMEXICOB MM	N	3.2	24,659	0.9%	-0.1%	2.2%	-0.4%	24.3%	14.1	15.4	8.6	9.2	2.6	2.4	2.4%	2.6%	-26.8%	-8.2%	19.7%	16.1%	Angele, Rodolfo R
Grupo Modelo	GMODELOC MM	NR	119.1	20,092	1.2%	3.2%	-2.3%	-0.4%	32.2%	26.3	23.8	15.5	13.9	4.5	4.6	2.6%	2.8%	12.2%	10.7%	17.9%	20.4%	Ray, Sambuddha
Hoteles City	HCITY* MM	N	21.8	456	-0.3%	-0.4%	2.9%	-2.1%	0.0%	73.2	49.1	20.3	17.5	1.4	1.3	0.0%	0.0%	NA	49.0%	2.4%	2.7%	Huerta, Adrian E
HOMEX	HOMEX* MM	UW	3.2	81	-16.9%	-32.6%	-9.5%	31.8%	-34.8%	1.5	1.2	4.8	4.0	0.5	0.5	0.0%	0.0%	34.4%	21.4%	0.0%	12.9%	Huerta, Adrian E
ICA ADR	ICA US	NR	87.1	1,023	0.9%	2.3%	-6.4%	-18.4%	-51.5%	0.0	0.0	-	-	-	-	0.0%	0.0%	NA	NA	4.4%	4.9%	Huerta, Adrian E
ICA	ICA* MM	NR	21.9	1,028	0.7%	1.4%	-7.2%	-18.0%	90.9%	0.0	0.0	-	-	-	-	0.0%	0.0%	NA	NA	4.3%	4.8%	Huerta, Adrian E
Kimberly Clark Mexico	KIMBERA MM	OW	36.0	8,829	0.6%	5.0%	9.5%	1.7%	28.6%	25.0	22.8	12.8	12.1	-	-	4.1%	4.4%	11.4%	9.4%	53.7%	59.4%	Teixeira, Andrea
Coca-Cola Femsa	KOF US	N	1,388.9	21,463	-2.8%	-0.3%	6.6%	-14.0%	15.5%	24.3	21.9	11.7	10.9	2.5	2.5	2.1%	1.8%	-13.9%	10.9%	10.7%	11.2%	Teixeira, Andrea
Coca Cola FEMSA Local	KOFL MM	N	138.9	21,313	1.6%	-2.2%	6.1%	-14.2%	0.0%	24.6	22.0	12.0	11.0	2.5	2.4	2.1%	1.8%	-16.4%	12.0%	10.5%	11.1%	Teixeira, Andrea
Genomma Lab	LABB MM	N	32.4	2,579	-0.5%	-4.7%	-4.1%	-7.3%	0.0%	19.1	16.3	12.5	10.8	-	-	0.0%	0.6%	12.0%	17.1%	22.1%	21.0%	Teixeira, Andrea
Grupo Lala	LALAB MM	OW	27.5	5,212	-0.7%	0.8%	-2.7%	-4.9%	0.0%	24.3	20.2	11.4	10.4	-	-	4.3%	0.0%	35.0%	20.8%	20.3%	15.6%	Teixeira, Andrea
Liverpool	LIVEPOLC MM	N	142.5	14,548	0.2%	-1.4%	7.5%	-1.3%	0.0%	24.6	23.2	16.1	15.0	3.5	3.1	1.4%	0.7%	7.0%	5.7%	14.8%	14.1%	Teixeira, Andrea
Megacable	MEGACPO MM	OW	54.0	3,547	0.9%	1.2%	-0.1%	17.1%	12.1%	21.0	19.5	10.5	9.3	3.0	2.9	3.4%	3.6%	11.1%	7.9%	14.8%	15.3%	Baggio, Andre
Mexichem	MEXCHEM* MM	OW	3.7	7,534	1.8%	1.0%	9.6%	-13.2%	59.2%	31.8	21.0	128.4	110.1	2.3	2.1	0.0%	1.0%	-9.3%	51.6%	7.2%	10.4%	Carvalhal, Caio M
Grupo Aeroportuario del Centro Norte SA	OMAB MM	OW	49.3	1,499	-0.1%	2.7%	15.1%	11.3%	64.8%	17.2	20.6	11.6	10.8	3.1	3.0	0.0%	3.4%	38.4%	-16.3%	17.8%	14.7%	Abdalla, Fernando
Peñoles	PE&OLES* MM	N	327.0	9,862	1.3%	-5.4%	2.1%	-1.3%	0.0%	22.6	37.2	9.0	10.7	3.0	3.0	6.2%	2.5%	-42.4%	-39.2%	13.4%	8.0%	Manihani, Mandeep S
Pinfra	PINFRA* MM	OW	181.4	5,263	0.0%	2.2%	5.1%	17.6%	47.0%	37.0	35.7	18.0	17.3	8.2	6.6	0.0%	0.0%	1.8%	3.8%	24.8%	20.5%	Abdalla, Fernando
Santander Mexico	SANMEXB MM	UW	31.6	16,183	0.3%	-2.9%	3.7%	-10.6%	0.0%	10.1	14.2	-	-	2.2	2.1	12.2%	3.3%	17.2%	-28.7%	16.2%	15.1%	Martinez, Saul
Organizacion Soriana	SORIANAB MM	N	40.7	5,544	1.4%	-0.4%	2.2%	-11.4%	41.8%	23.1	17.1	10.4	9.6	1.7	1.5	0.0%	1.2%	-13.6%	35.4%	7.4%	9.4%	Teixeira, Andrea
Fibra Terrafina	TERRA13 MM	OW	25.3	744	2.1%	-2.7%	-6.1%	9.4%	0.0%	17.4	11.2	27.8	14.7	0.9	0.9	4.3%	7.3%	NA	55.4%	7.1%	8.2%	Huerta, Adrian E
Televisa	TV US	N	432.9	18,954	-2.4%	-0.7%	6.2%	8.8%	-23.1%	31.8	27.0	9.2	8.6	3.6	3.2	0.1%	0.0%	-12.0%	17.6%	12.0%	12.4%	Baggio, Andre
Vesta	VESTA* MM	OW	2.0	871	-1.0%	-1.3%	2.4%	17.6%	0.0%	12.9	24.1	18.7	17.2	1.1	1.1	1.2%	1.6%	-46.0%	-46.5%	10.5%	4.6%	Huerta, Adrian E
Wal-Mart de Mexico	WALMEXV MM	OW	32.4	42,384	1.6%	0.8%	6.9%	-6.5%	12.2%	24.2	22.4	12.5	11.5	3.9	3.7	2.9%	4.0%	-1.9%	8.2%	16.1%	16.7%	Teixeira, Andrea

Source: Bloomberg, J.P. Morgan.

Pricing as of April 8, 2014

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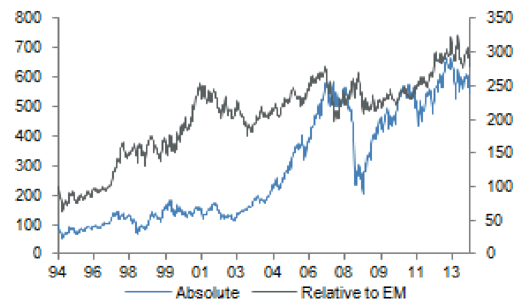
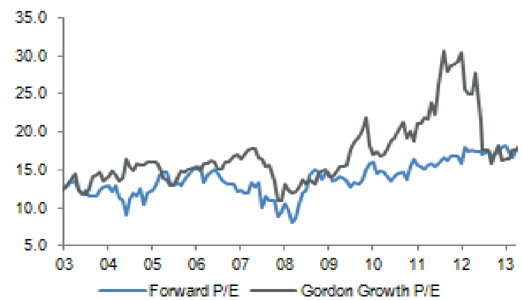
Mexico Market Indicators

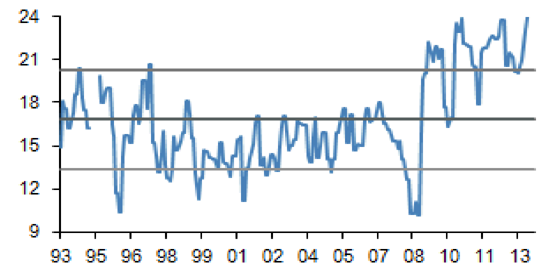
Mexico Performance



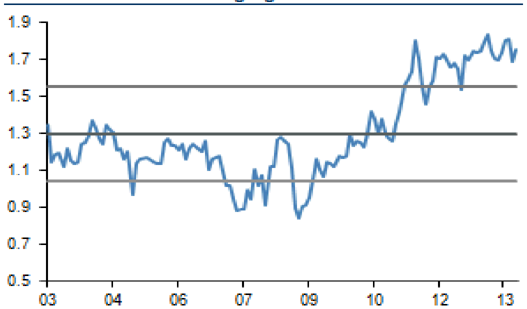
Gordon Growth P/E



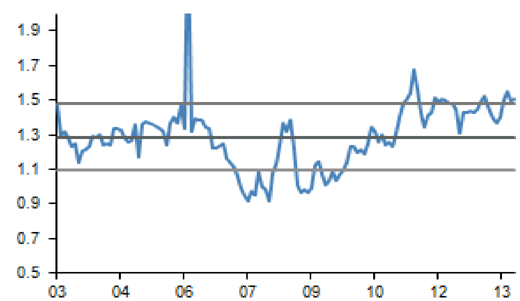
Mexico Trailing P/E



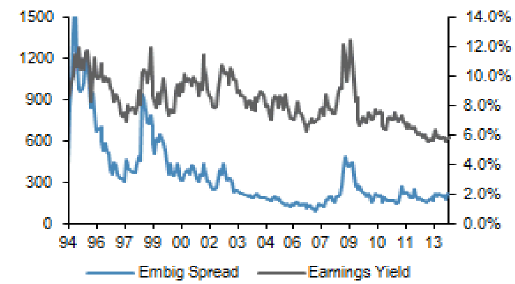
Mexico Premium to Emerging Markets*



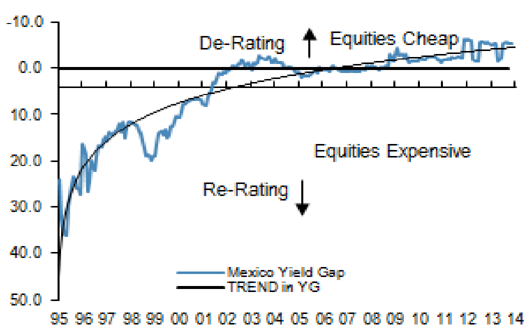
Mexico Premium to LatAm*



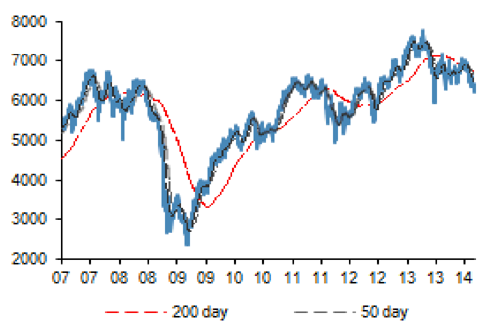
Mexico EMBIG Spread vs. Earnings Yield



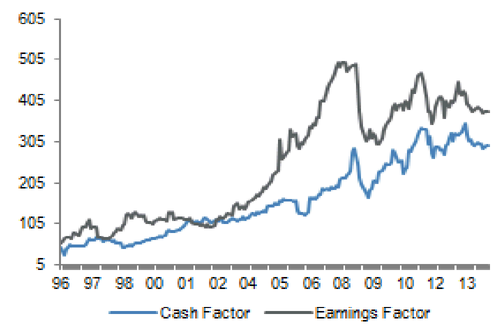
Mexico Yield Gap Model*



Moving Averages



Mexico Earnings vs. Cash Flow



Source: MSCI, IBES, Datastream, CEIC, Bloomberg, EPFR Global

Updated April 8, 2014

Note: Mexbol absolute and relative to MSCI EM is rebased to 100 since Jan 03.

Our Earnings Yield Gap model is defined as BY/EY. For Bond yield we take mexico 1 year cetes rates.

* Premium = (Mexico 12 month Fwd. P/E) / (Relevant 12 month Fwd. P/E)

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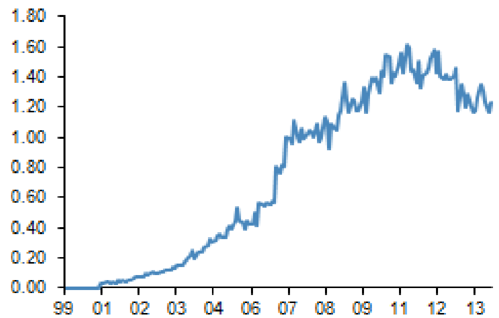
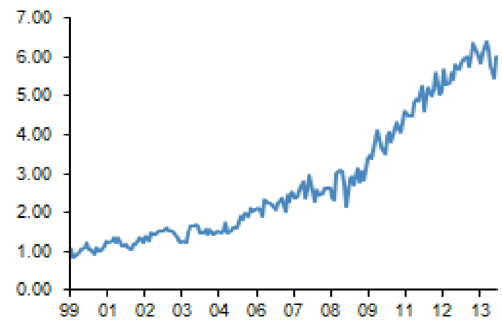
Mexico Stocks: 12 months Forward Earnings Revisions

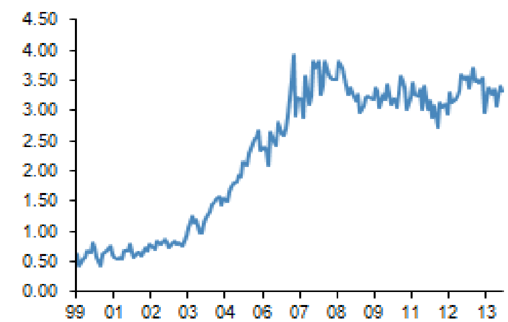
AMX



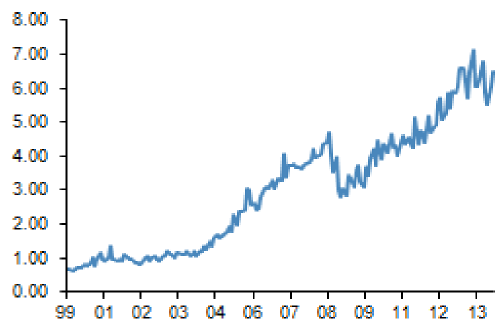
FEMSA



TELEVISA

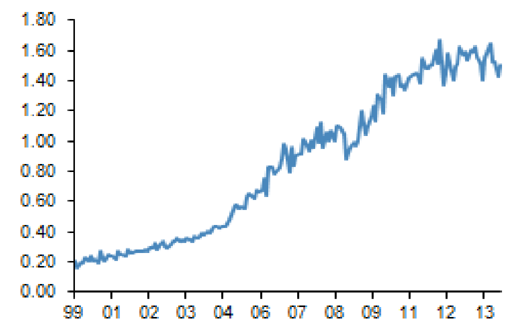


BANORTE

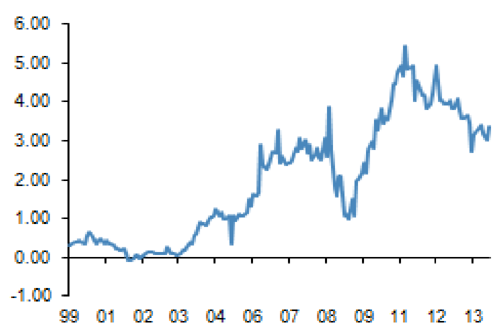


CEMEX

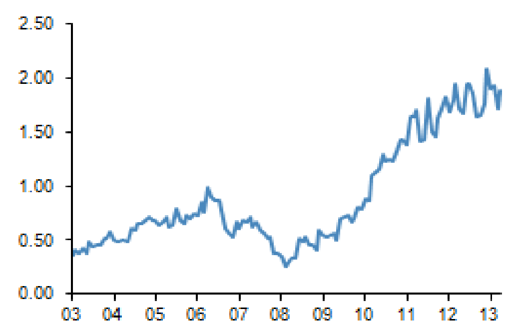
WALMEX



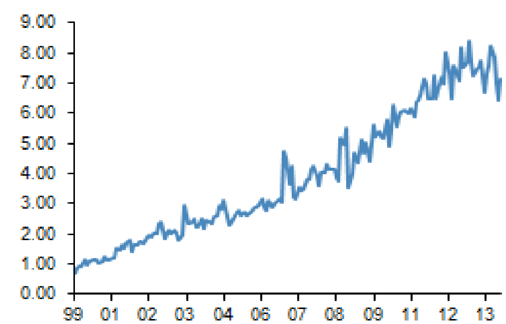
GMEXICO



ALFA



KOFL



Source: Datastream, IBES, J.P. Morgan

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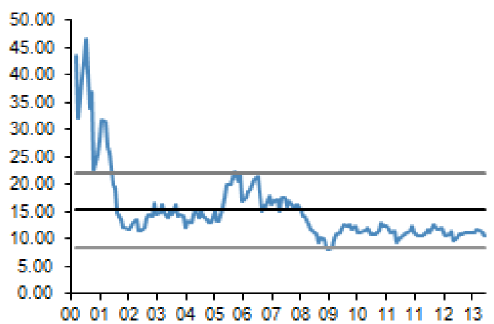
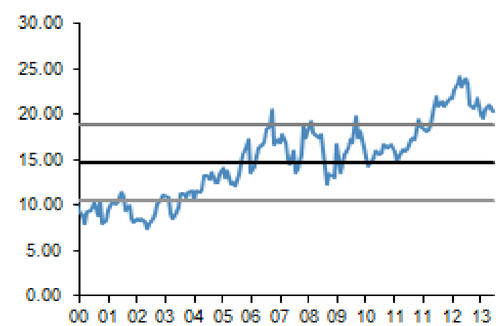
J.P.Morgan

Mexico Stocks: 12 months Forward Price to Earnings

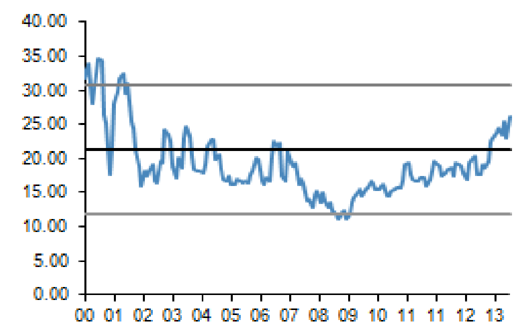
AMX



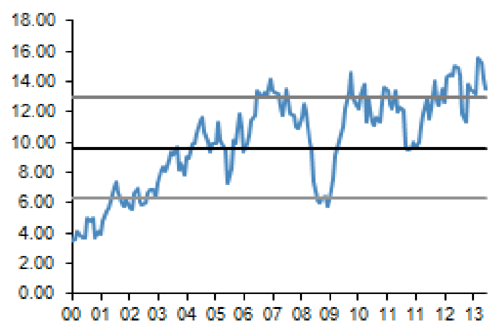
FEMSA



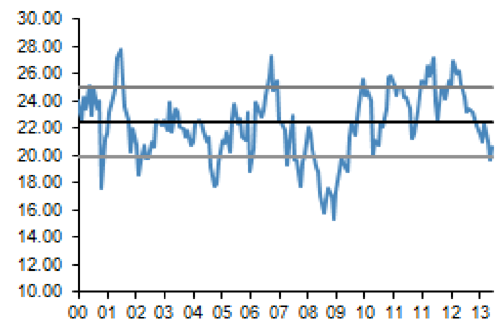
TELEVISA



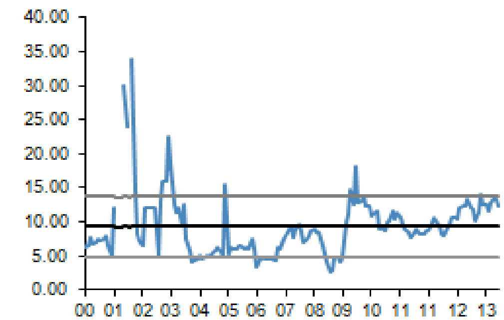
BANORTE



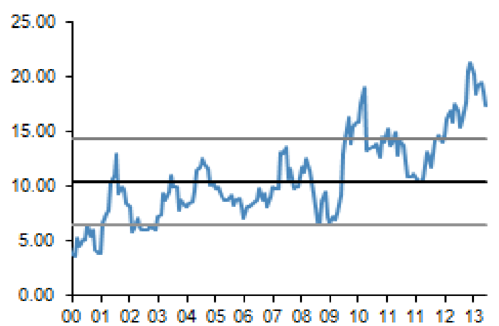
WALMEX



GMEXICO



ALFA



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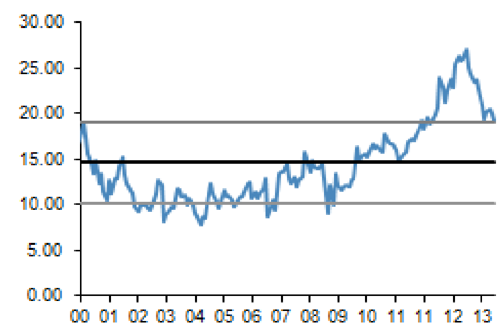

Source: Datastream, IBES, J.P. Morgan

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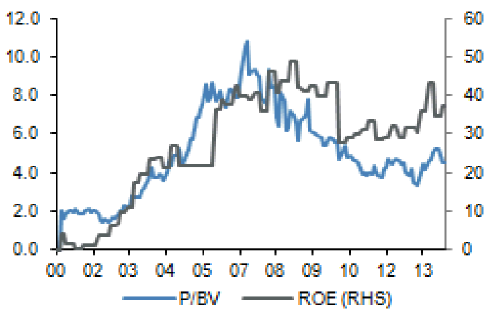
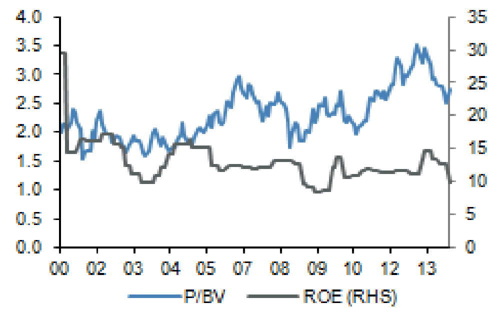
Mexico Stocks: Price to Book vs. Return on Equity

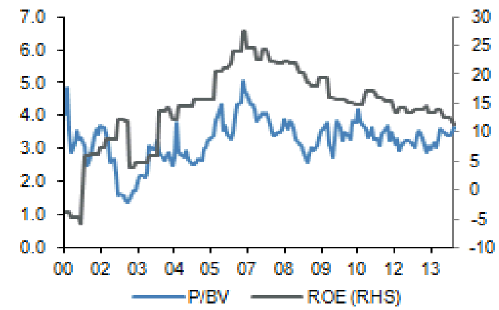
AMX



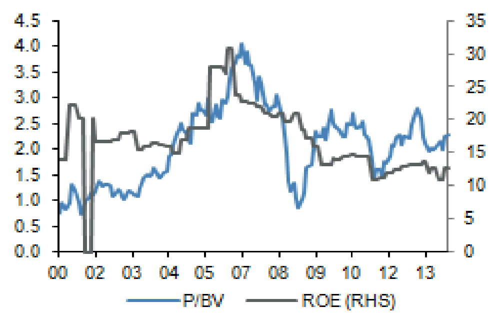
FEMSA



TELEVISA



BANORTE



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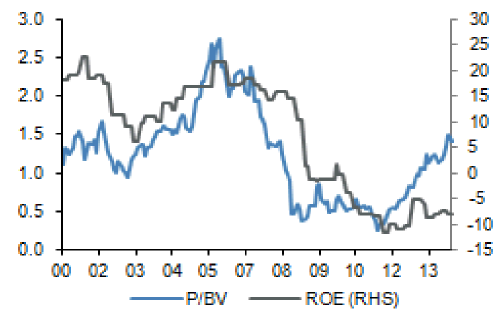

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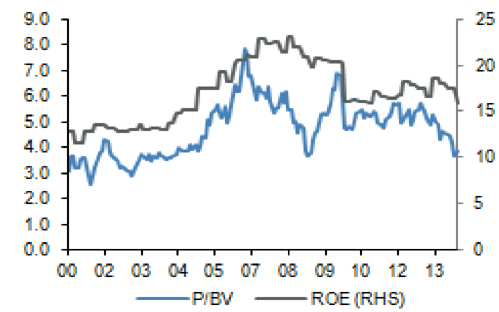
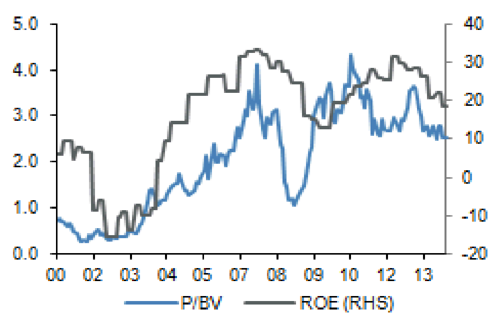


GMEXICO



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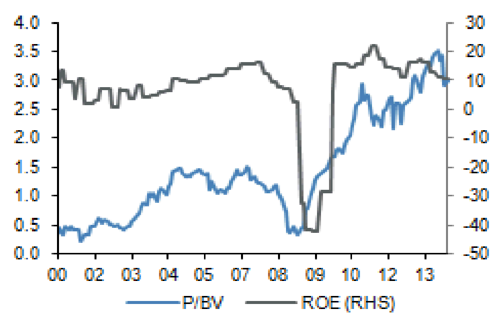

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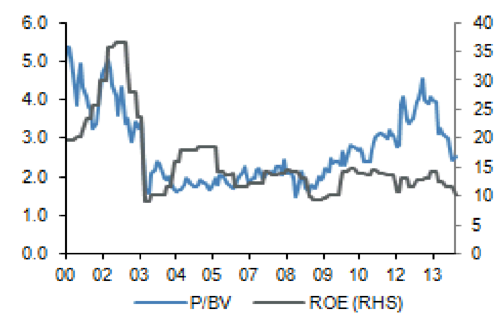

Source: Datastream, IBES, J.P. Morgan

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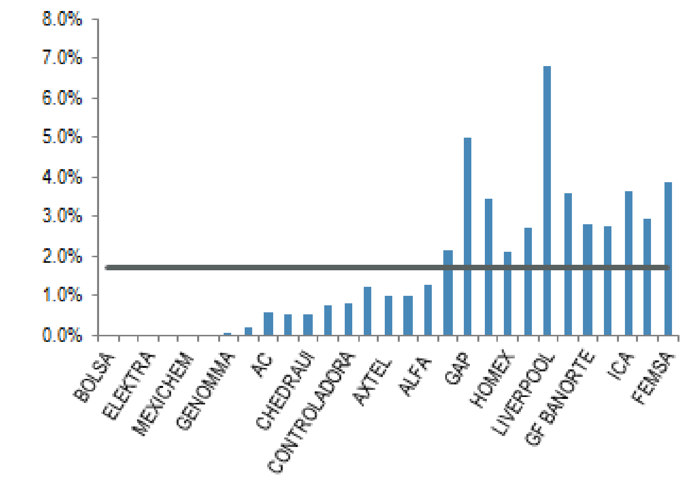
Dividend Yield

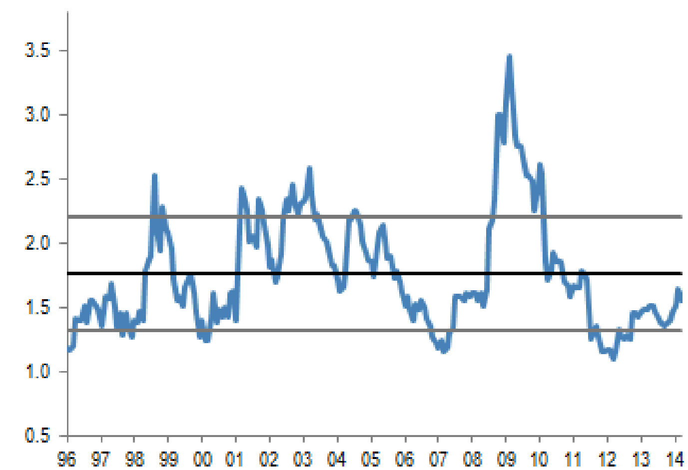
	Dividend Per Share			Dividend Yield		
Company Name	2012	2013 e	2014 E	2012	2013 e	2014 E
BOLSA	0.04	0.00	0.00	0.2%	0.0%	0.0%
GRUMA	0.00	0.00	0.00	0.0%	0.0%	0.0%
ELEKTRA	0.08	0.00	0.00	0.3%	0.0%	0.0%
PENOLES	0.00	0.00	0.00	0.0%	0.0%	0.0%
MEXICHEM	0.03	0.00	0.00	0.1%	0.0%	0.0%
OHL	0.00	0.00	0.00	0.0%	0.0%	0.0%
GENOMMA	0.08	0.04	0.04	0.2%	0.1%	0.1%
COMPARTAMOS	0.17	0.08	0.07	0.4%	0.2%	0.2%
AC	0.32	0.51	0.43	0.4%	0.6%	0.5%
KIMBERLY-CLARK	0.06	0.28	0.28	0.1%	0.5%	0.5%
CHEDRAUI	0.63	0.75	0.84	0.4%	0.5%	0.6%
MINERA FRISCO	0.21	0.30	0.26	0.6%	0.8%	0.7%
CONTROLADORA	0.15	0.29	0.25	0.4%	0.8%	0.7%
ARA	0.25	0.41	0.28	0.7%	1.2%	0.8%
AXTEL	0.70	0.86	0.77	0.8%	1.0%	0.9%
ASURB	0.61	0.71	0.70	0.9%	1.0%	1.0%
ALFA	0.21	0.17	0.19	1.6%	1.3%	1.4%
AMX	1.73	2.64	1.72	1.4%	2.2%	1.4%
GAP	23.10	16.24	5.16	7.1%	5.0%	1.6%
CONTROLADORA	0.33	1.19	0.72	1.0%	3.5%	2.1%
HOMEX	2.78	2.94	2.95	2.0%	2.1%	2.1%
GRUPO MEXICO	0.30	0.62	0.50	1.3%	2.7%	2.2%
LIVERPOOL	1.18	2.15	0.89	3.7%	6.8%	2.8%
BIMBO	3.55	5.81	4.77	2.2%	3.6%	2.9%
GF BANORTE	1.57	2.14	2.28	2.1%	2.8%	3.0%
CEMEX	0.55	0.90	1.11	1.7%	2.8%	3.4%
ICA	1.20	1.31	1.40	3.3%	3.7%	3.9%
TELEVISA	1.63	2.22	3.34	2.2%	2.9%	4.4%
FEMSA	1.36	1.59	1.95	3.3%	3.9%	4.8%
Simple Average				**1.3%**	**1.7%**	**1.4%**

Source: Bloomberg and J.P. Morgan

Dividend Yield: 2013 e



MSCI Mexico Dividend Yield



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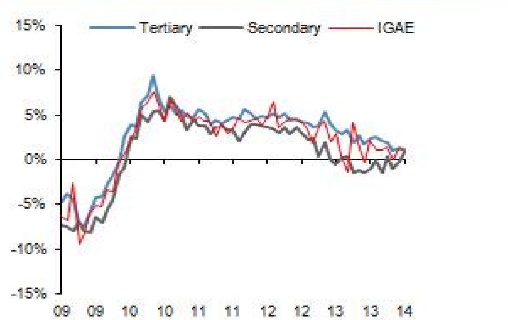
Key Economic Data

Real GDP (YoY %)

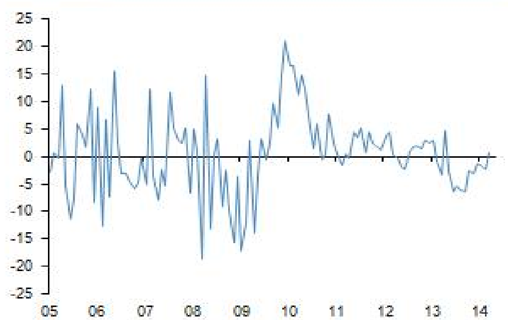
TRADE-WEIGHTED PARTNERS' REAL GDP (%Q/Q)

IP (OYA %)

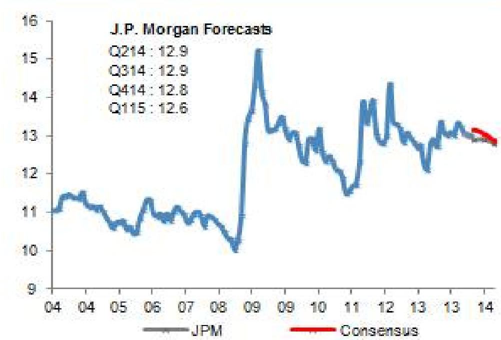
General Economic Activity Index (%oya)



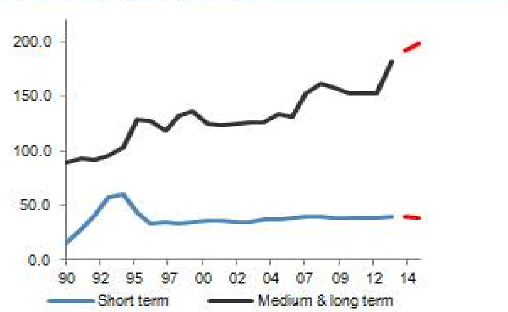
PMI (OYA %)



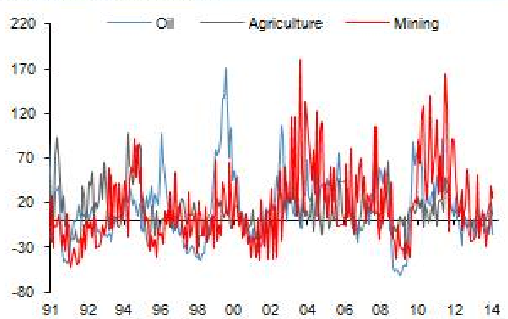
MEXICAN PESO (MXN)



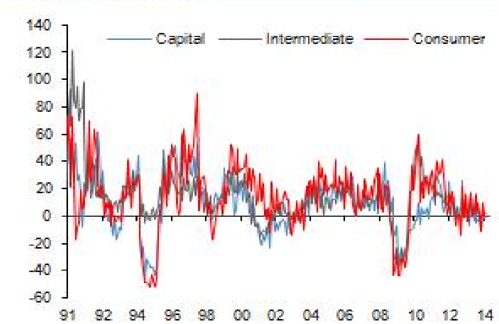
External Debt (US$ billions)



EXPORTS BREAKDOWN



IMPORTS BREAKDOWN



Source: J.P. Morgan Economics, Bloomberg, Datastream, INEGI, Banxico. Red line Refers to forecasted numbers

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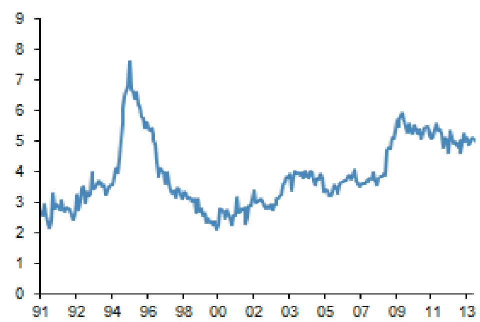
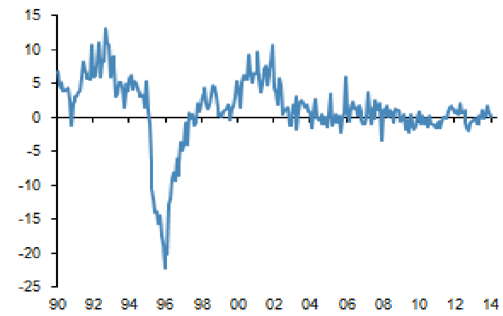
Key Economic Data

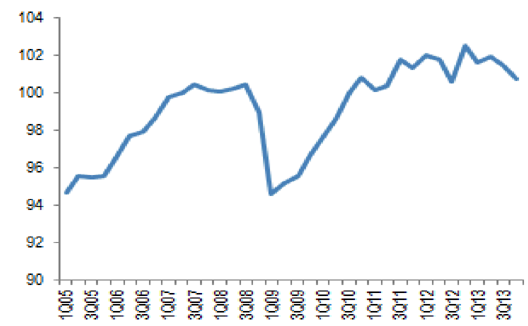
UNEMPLOYMENT RATE



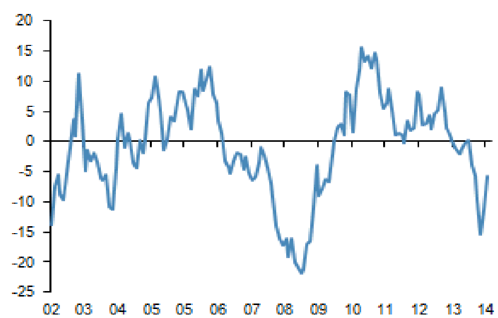
REAL WAGE GROWTH (OYA %)



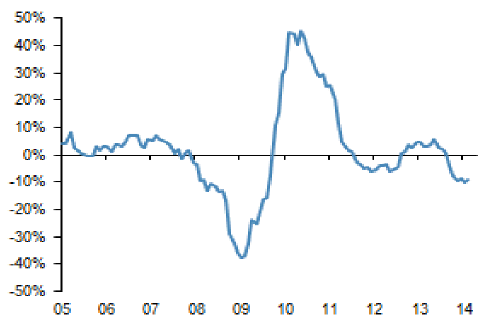
LABOR PRODUCTIVITY



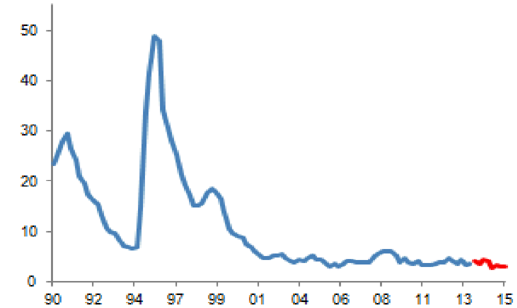
CONSUMER CONFIDENCE (OYA %)



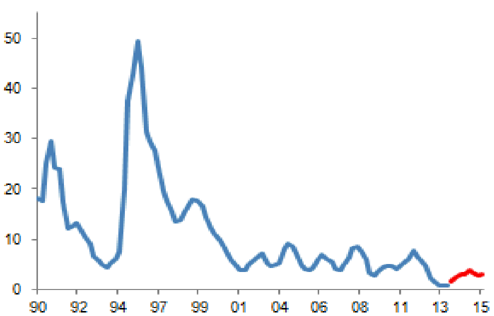
PRODUCER CONFIDENCE (OYA %)



CPI (OYA %)

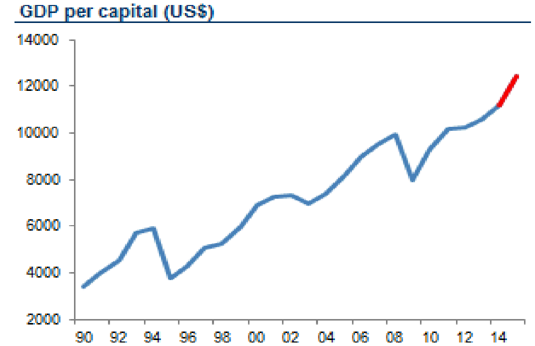


PPI (OYA %)



Banco De Mexico Repo Target Rate

GDP per capital (US$)



Source: J.P. Morgan Economics, Bloomberg, Datastream, INEGI, Banxico. Red line Refers to forecasted numbers

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Economic Forecast Tables

Mexico	Avg*	2010	2011	2012	2013f	2014f	2015f
Nominal GDP (US$, bil)	999.7	1,052	1,168	1,185	1,243	1,326	1,492
GDP per capita (US$)	9,039	9,273	10,178	10,213	10,592	11,193	12,464
Real GDP, % change	1.9	5.5	4.0	3.9	1.1	3.1	3.8
Contribution to growth of GDP.							
Consumption[1]	1.4	3.8	3.4	3.5	1.8	2.0	2.6
Investment[1]	0.4	1.5	0.5	0.3	-0.8	1.3	1.3
Net trade[1]	0.1	0.2	0.0	0.2	0.1	-0.1	-0.1
Consumer prices, %oya	4.4	4.2	3.4	4.1	3.8	4.1	3.0
% Dec/Dec	4.5	4.4	3.8	3.6	4.0	4.1	3.1
Producer prices, %oya	5.3	3.8	6.0	4.7	1.1	4.5	4.9
Government balance, % of GDP	-1.0	-2.8	-2.5	-2.6	-2.3	-3.5	-3.0
Manufacturing production	1,515	1,609	1609.0	1678.9	1704.1	1758.6	1827.2
Unemployment rate	4.2	4.5	4.5	4.5	4.6	4.3	4.1
Merchandise trade balance (US$ bn)	-8.2	-3.0	-1.5	0.0	-1.0	-5.0	-7.7
Exports	268.3	298.5	349.4	370.7	380.2	405.7	448.8
Imports	276.5	301.5	350.8	370.8	381.2	410.7	456.6
Current account balance	-9.1	-5.6	-9.7	-9.5	-14.4	-13.9	-17.7
% of GDP	*-0.9*	-0.5	-0.8	-0.8	-1.2	-1.0	-1.2
Note: Debt with original maturity of less than one year							
International reserves, (US$ bn)	87.1	113.6	142.6	162.6	176.6	186.6	194.1
Total external debt, (US$ bn)	190.1	211.6	191.4	191.3	221.0	230.9	237.8
Short term²	38.9	58.9	38.7	38.6	39.4	39.3	39.2
Total external debt, % of GDP	18.8	19.7	16.5	16.1	16.6	17.0	15.7
Total external debt, % of exports**	59.4	59.8	48.0	45.4	47.9	49.1	46.4
*Interest payments, % of exports***	*4.8*	3.7	4.4	4.8	5.1	4.5	4.3

* Avg is from 2007-11

Notes: 1. Contribution to growth of GDP,
2. Debt with original maturity of less than one year. 3. Exports of goods, services, and net transfers

Source: J.P. Morgan Economics

US	2010	2011	2012	2013e	2014f	2015f
Gross domestic product						
Real GDP	3.0	1.8	2.8	1.9	2.6	2.9
Final sales	1.4	2.0	2.6	1.7	2.6	3.0
Domestic	1.8	1.8	2.4	1.6	2.2	3.0
Consumer spending	2.0	2.5	2.2	2.0	2.4	2.9
Business investment	4.4	7.3	7.3	2.7	4.9	5.6
Equipment	14.6	7.6	7.6	3.1	5.5	6.1
Structures	-15.8	2.7	12.7	1.3	5.7	7.5
Residential investment	-4.3	-1.4	12.9	12.2	4.4	14.2
Government	0.7	-3.1	-1.0	-2.2	-0.4	-0.3
Exports (goods and services)	11.3	6.7	3.5	2.7	4.7	5.4
Imports (goods and services)	12.5	4.8	2.2	1.4	1.9	5.5
Contribution to real GDP growth (% pts):						0.0
Domestic final sales	1.9	1.9	2.5	1.6	2.2	3.0
Net exports	-0.5	0.1	0.2	0.2	0.4	-0.1
Inventories	1.6	-0.2	0.2	0.2	-0.1	-0.1
Consumer Price Index	1.6	3.1	2.1	1.5	1.6	1.9
Core	1.0	1.7	2.1	1.8	1.7	1.9
Producer price index (%ch saar)	4.2	6.0	1.9	1.3	1.6	1.9
Core	1.2	2.4	2.6	1.1	1.7	1.9
Productivity	0.2	0.7	1.5	0.5	1.8	1.6
Housing starts (mn units, saar)1	0.6	0.6	0.8	0.9	1.0	1.3
Industrial production, mfg.	5.4	4.3	4.1	2.6	2.3	3.0
Capacity utilization, mfg. (%)[1]	71.7	75.0	75.5	76.1	77.3	78.8
Light vehicle sales (mn units, saar)[1]	11.6	12.7	14.4	15.5	15.9	16.5
Unemployment rate[1]	9.6	9.0	8.1	7.3	6.4	5.9
Nominal GDP	4.2	4.0	4.6	3.4	4.1	4.4
Current account balance ($bn)[1]	-471	-466	-462	-379	-404	-503
% of GDP	-3.2	-3.1	-2.8	-2.3	-2.3	-2.8
Federal budget balance ($bn)[1]	-1,294	-1,297	-1,089	-680	-515	-475
% of GDP	-8.9	-8.6	-6.7	-4.0	-2.9	-2.8

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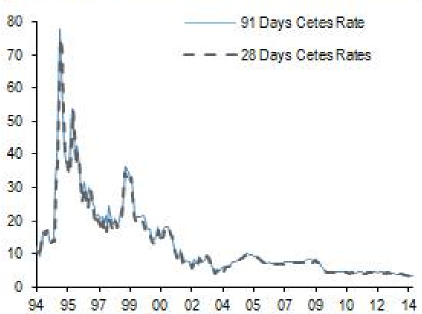
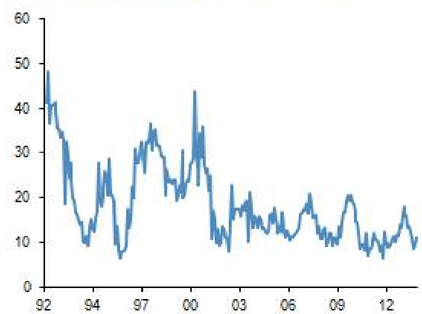
Financial Sector

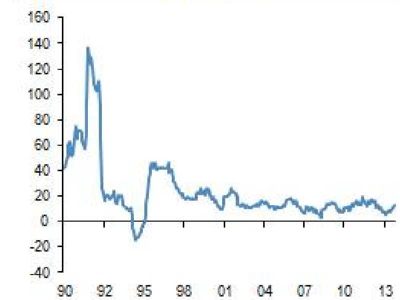
Cetes Rates



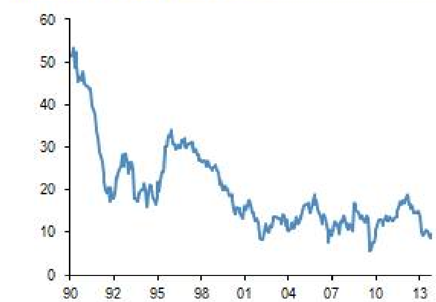
Change in Monetary base (% OYA)



M1 Money Supply (% OYA)

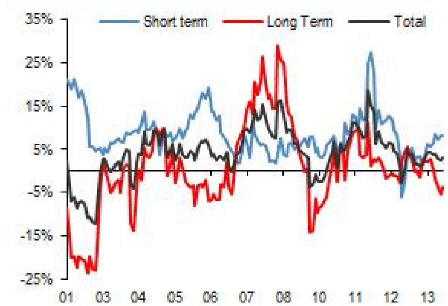


M3 Money Supply (% OYA)

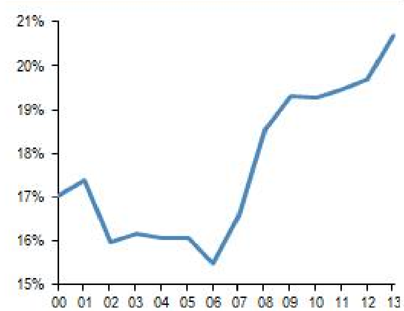


Real Credit Growth (% OYA)

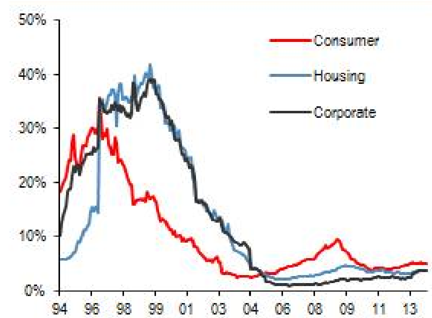
Deposit Growth (% OYA)



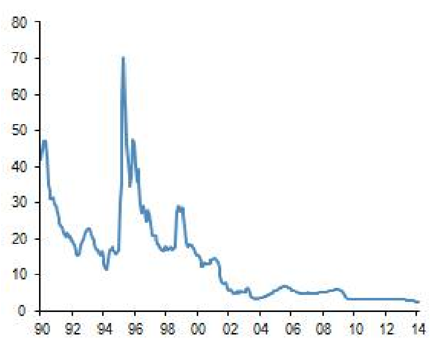
Total Deposits (MXN Bn)



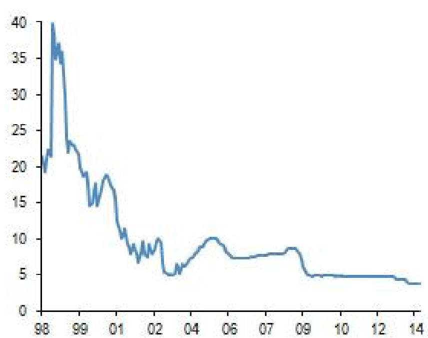
Deliquency Rates (% OYA)



Cost of Deposits (% OYA)



Interbank TIIE 28 Day



Total Loan Growth (% OYA)

Loan Growth Composition (% OYA)

Source: J.P. Morgan, Bloomberg, Datastream, Banxico, INEGI

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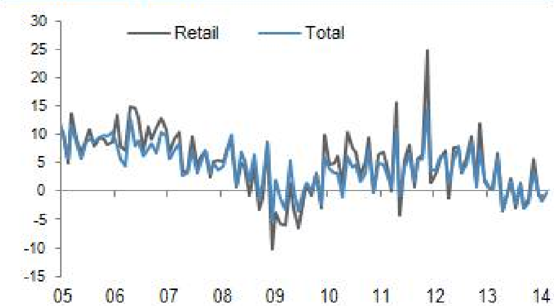
Related Sector Indicators

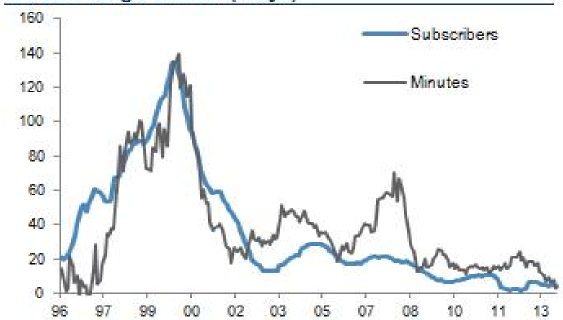
Wholesale/Retail Sales Index (% OYA)

Antad Sales (%oya)



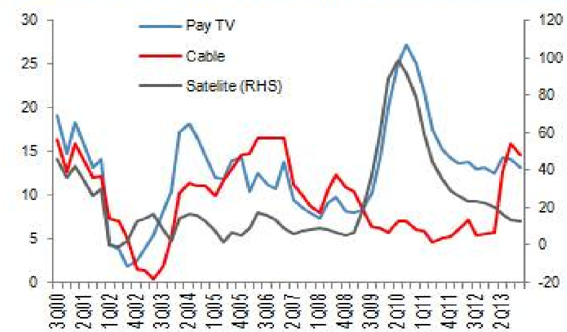
Workers Remittances USD MM (%oya)

Mobile Usage Growth (%oya)

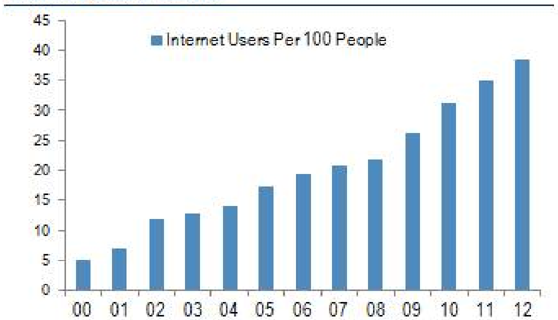


Fixed Lines Growth (%oya)

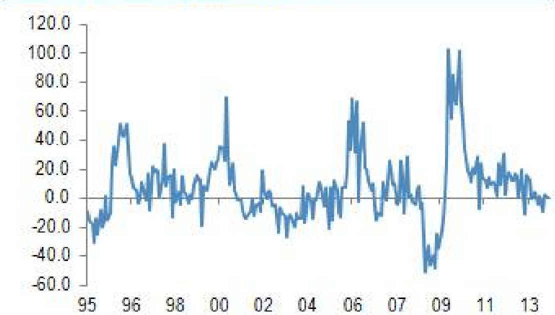
Cable TV and Satellite TV Growth (%oya)



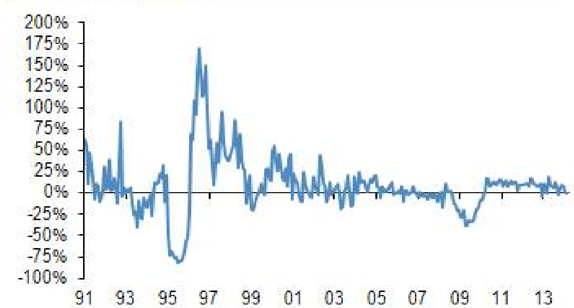
Internet Users Growth



Motor Vehicle Production (%oya)



Auto Sales (%oya)



Source: J.P. Morgan,Bloomberg, Antad, INEGI, IFT,Sociedad Hipotecaria Federal, World Bank

Updated as of Apr 2014

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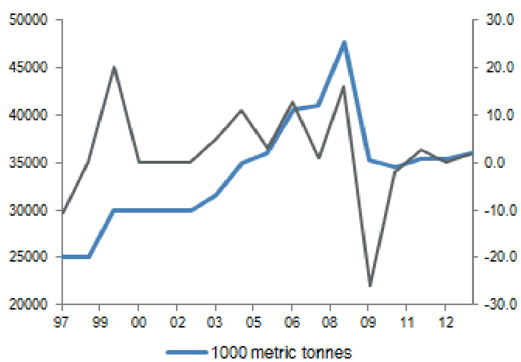
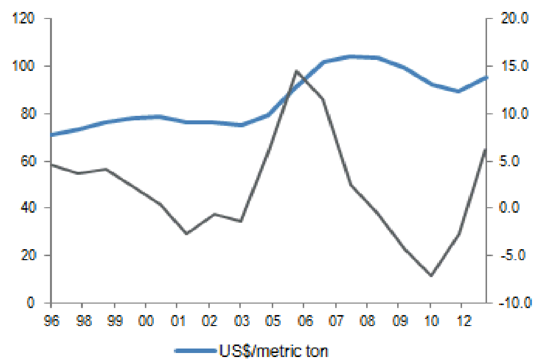
Related Sector Indicators

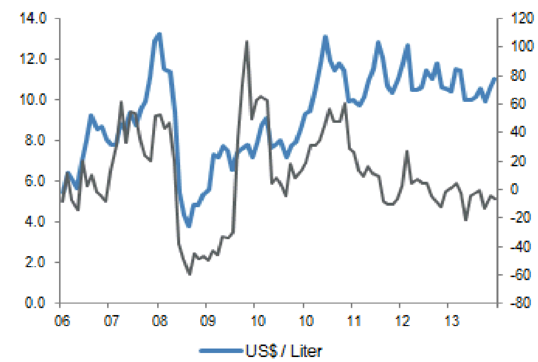
Cement Production Index



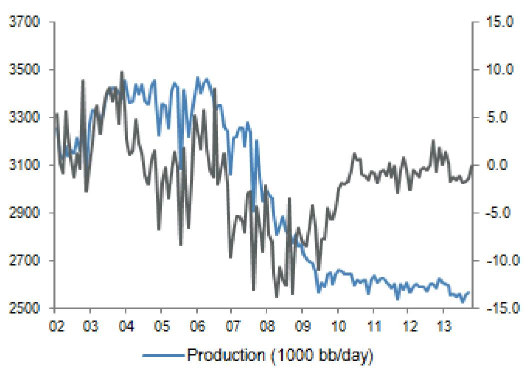
Cement Price Index



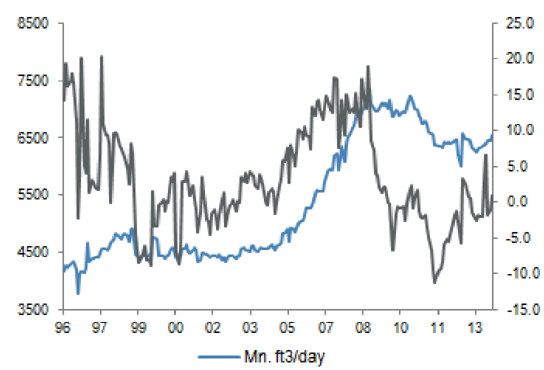
Gasoline Price



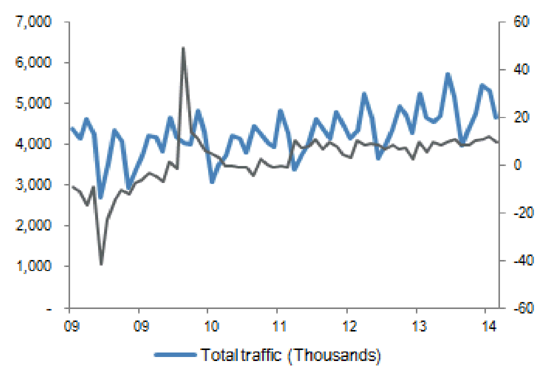
Crude Production



Natural Gas Production



Air Passenger Traffic



Source: J.P. Morgan, PEMEX, INEGI, DOE and Bloomberg. The Blue line shows the Production numbers and Grey Line Growth (%oya)

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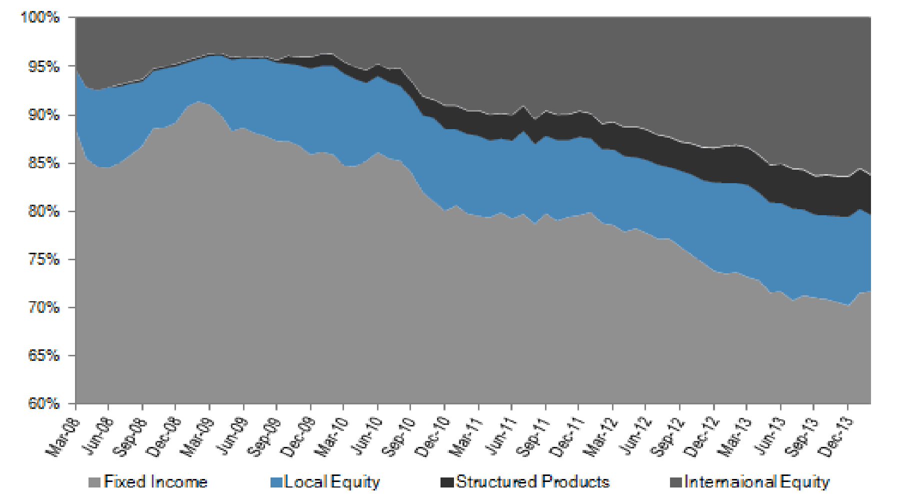
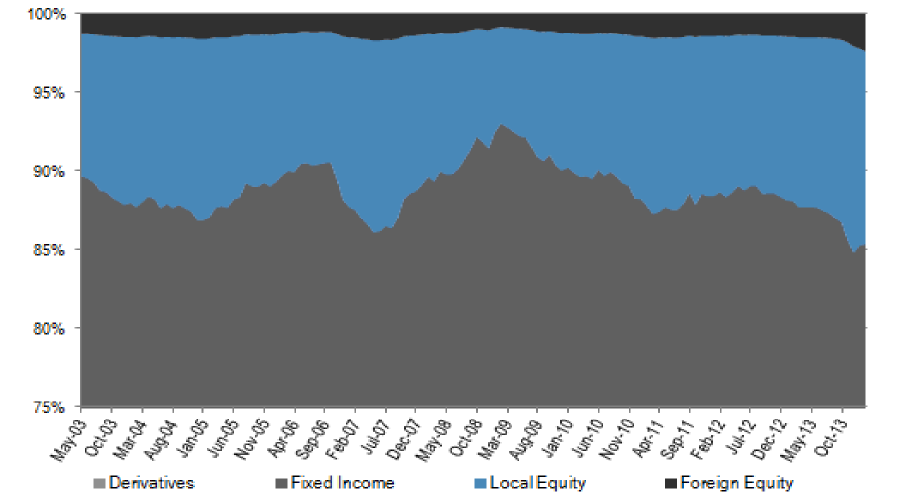
Flow of Funds

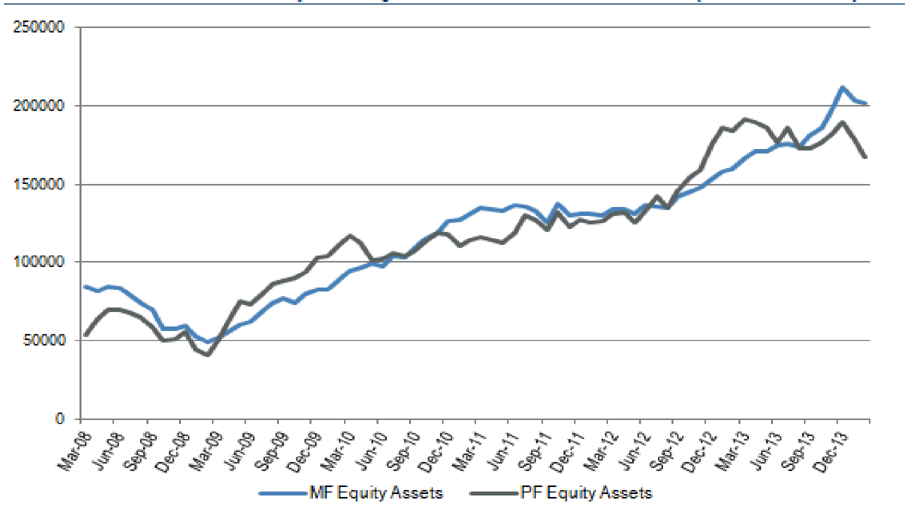
Mexico Pension Fund exposure (% of total investments)



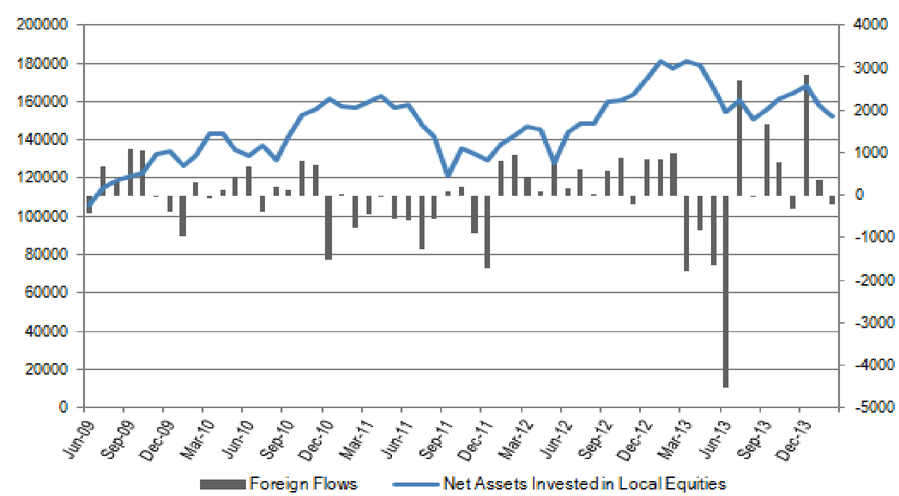
Mutual Fund Asset Allocation (% of total AUM)



Assets Invested in Local Equities by Pension and Mutual Funds (Mx.$ in billion)



Foreign Holdings & Flows to Local Equity Markets (US$ in billion)



Source: CONSAR, AMIB, CONSAR, CNBV, Banxico and J.P. Morgan (Note: *Local equity includes local listed and non-listed stocks, Warrants, FIBRAs)

Possible Risks of Investing in ETFs

The following is an incomplete list of possible risks of investing in ETFs. Not all of the risks will apply to each investment in ETFs and the applicable risks will depend on the particular ETFs invested in and the particular facts and circumstances and investment objectives of the individual investor.

Commodities Risk. Certain ETFs invest in commodities. The commodities industries can be significantly affected by the level and volatility of commodity prices; world events including international monetary and political developments; import controls and worldwide competition; exploration and production spending; and tax and other government regulations and economic conditions.

Concentration Risk. An ETF may, at various times, concentrate in the securities of a particular industry, group of industries, or sector, and when a fund is overweighted in an industry, group of industries, or sector, it may be more sensitive to any single economic, business, political, or regulatory occurrence than a fund that is not overweighted in an industry, group of industries, or sector.

Costs of Investing in Underlying ETFs. Certain ETFs invest in other ETFs, and will bear a pro rata portion of the underlying ETFs' expenses (including operating costs and management fees).

Credit Risk. An ETF could be subject to the risk that a decline in the credit quality of a portfolio investment could cause the ETF's share price to fall. The ETF could lose money if the issuer or guarantor of a portfolio investment or the counterparty to a derivatives contract fails to make timely principal or interest payments or otherwise honor its obligations.

Early Closing Risk. An unanticipated early closing of the exchange on which an ETF's shares trade may result in a shareholder's inability to buy or sell shares of the ETF on that day.

Emerging Markets Risk. There is an increased risk of price volatility associated with an ETF's investments in emerging market countries, which may be magnified by currency fluctuations relative to the U.S. dollar.

Equity Risk. The prices of equity securities in which an ETF may invest rise and fall daily. These price movements may result from factors affecting individual companies, industries or the securities market as a whole.

Fixed Income Risk. An ETF's investments in fixed income securities are subject to the risk that the securities may be paid off earlier or later than expected. Either situation could cause the ETF to hold securities paying lower-than-market rates of interest, which could hurt the ETF's yield or share price.

Foreign Currency Risk. Currency movements may negatively impact the value of an ETF's underlying securities, even when there is no change in the value of the security in the issuer's home country.

Foreign Securities Risk. An ETF's investments in securities of foreign issuers involve certain risks including, but not limited to, risks of adverse changes in foreign economic, political, regulatory and other conditions, or changes in currency exchange rates or exchange control regulations (including limitations on currency movements and exchanges). In certain countries, legal remedies available to investors may be more limited than those available with respect to investments in the United States. In addition, the securities of some foreign companies may be less liquid and, at times, more volatile than securities of comparable U.S. companies.

High Yield Risk. Certain ETFs may invest in high yield securities and unrated securities of similar credit quality (commonly known as "junk bonds"). High yield securities generally pay higher yields (greater income) than investment in higher quality securities; however, high yield securities and junk bonds may be subject to greater levels of interest rate, credit and liquidity risk than funds that do not invest in such securities, and are considered predominantly speculative with respect to an issuer's continuing ability to make principal and interest payments.

Income Risk. An ETF may derive dividend and interest income from certain of its investments. This income can vary widely over the short- and long-term. If prevailing market interest rates drop, distribution rates of an ETF's income producing investments may decline, which then may adversely affect the ETF's value.

Interest Rate Risk. An ETF's investments in fixed income securities are subject to the risk that interest rates rise and fall over time.

Investment Risk. An investment in an ETF is not a bank deposit and is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency.

Jurisdiction. US-listed ETFs may not be marketed to foreign investors in certain jurisdictions, and vice versa.

Liquidity Risk. The market for certain investments may become illiquid under adverse or volatile market or economic conditions, making those investments difficult to sell. The market price of certain investments may fall dramatically if there is no liquid trading market. The lack of liquidity in an ETF can result in its value being more volatile than its underlying portfolio securities.

Loss of Money. Loss of money is a risk of investing in an ETF.

Market Risk. Due to market conditions, an ETF's investments may fluctuate significantly from day to day. This volatility may cause the value of your investment in the Fund to decrease.

Strategy Risk. ETFs use different strategies, all of which are associated with different risks. For example, an equities-based ETF may use a large-capitalization, mid-capitalization, small-capitalization or other type of strategy.

Tracking Error Risk. Although many ETFs may seek to match the returns of an index, an ETF's return may not match or achieve a high degree of correlation with the return of its applicable index.

Trading Risks. An ETF faces numerous market trading risks, including the potential lack of an active market for its shares, losses from trading in secondary markets, and disruption in the creation/redemption process of the ETF. Any of these factors may lead to the ETF's shares trading at a premium or discount to net asset value ("NAV"), which may be material. In certain markets, ETF prices have dropped precipitously and experienced greater volatility than prices of other stocks.

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*Percentage of investment banking clients in each rating category.
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