

Economic update

Despite recent headwinds due to the fall in the oil price and increased volatility in the peso's exchange rate against the dollar, there was a series of encouraging news regarding the Mexican economy throughout the week.

The development of the Mexican economy improved at the end of last year, with the aggregate supply & demand of goods and services expanding 3.9% year on year in the last quarter of 2014 4Q—the strongest pace in two years. On a quarter on quarter basis, the category climbed 1.0 per cent. The strengthening of private consumption, together with gross fixed investment's revival, was crucial for the 8-quarter high; while the former grew at its strongest pace in seven quarters 2.7% year on year, the latter reported its best performance since the first quarter of 2012, namely 5.7% year on year.

Furthermore, according to Mexico's National Institute of Statistics, the country's economic activity index increased by 0.2 per cent month on month in January and 2.6 per cent year on year. The most remarkable news was by far services' recovery, which not only was able to fully erase December's monthly setback (-0.2%) by reporting a 0.4% month on month gain, but managed to reach a 7-month high of 3.1% year on year.

Moreover, there were also moderate gains in the manufacturing index due to which employment in the sector increased 0.2 per cent in January in comparison to the month prior. In addition to this, another encouraging revelation in the country's manufacturing sector is that Toyota plans to open a new plant, making this the eighth new auto-manufacturing plant opened in Mexico since 2011.

Finally, inflation for the first two weeks of March was 2.97 per cent on an annual basis, which makes it the lowest such result in nine years and below Mexico's Central Bank target.

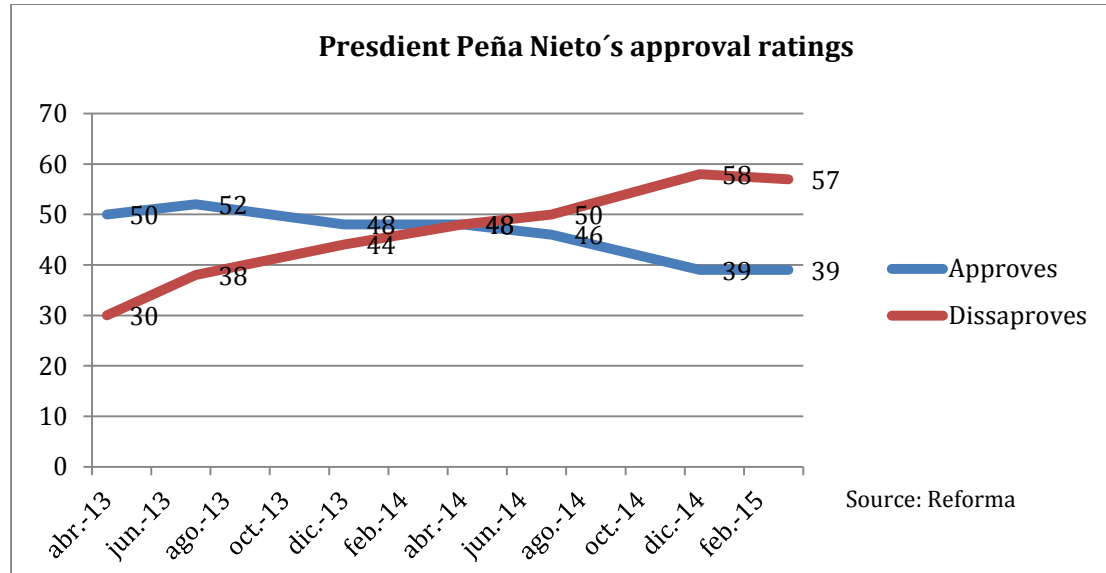
Countdown to mid-term elections

Its now three weeks into campaigns for Mexico's mid-term elections on June 7th and polls seem to indicate that it will be a three-tiered race, at least in what concerns the results for the Chamber of Deputies (the lower house of the legislative congress).

In the first tier, the PRI and the PAN are now close to being in neck and neck race. According to a poll by Parametría, the PRI has lost 16 points in electoral preferences from its highest point in May 2014 to its current 30 per cent. This is still 3 percentage points higher than the current runner up in polls the PAN.

It is likely that the disappearance of 43 students from Aytozinapa in the state of Guerrero and a recent series of conflict of interest scandals related to President Enrique Peña Nieto and his Secretary of Finance are keeping the PRI's popularity rates low, given the former's low approval ratings. However it should be noted

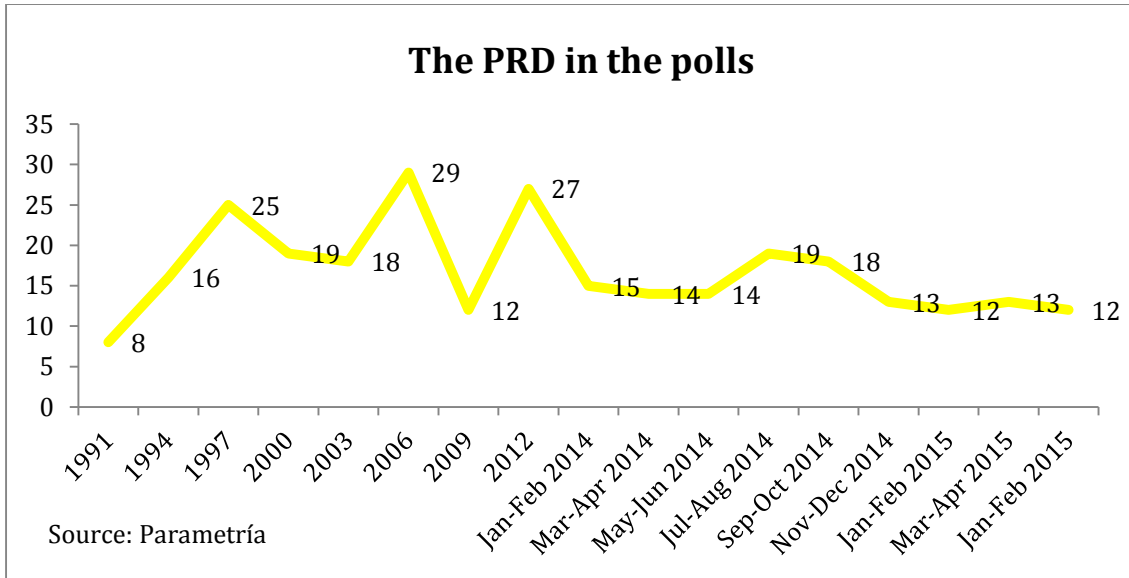
that the largest fall in the party in power's position in the polls occurred prior to these events, namely during the May-August period of last year when it dropped 13 percentage points in Parametría's poll in light of sluggish economic growth, an unpopular fiscal reform that hurt consumption and continued violence due to organized crime in certain regions of the country.



Notwithstanding the PRI's decline in the polls, the fact that it is allied with the Green Party adds another 10 percentage points to its real tally, given that the latter oscillates between the fourth and fifth ranking in the polls (see graph below).

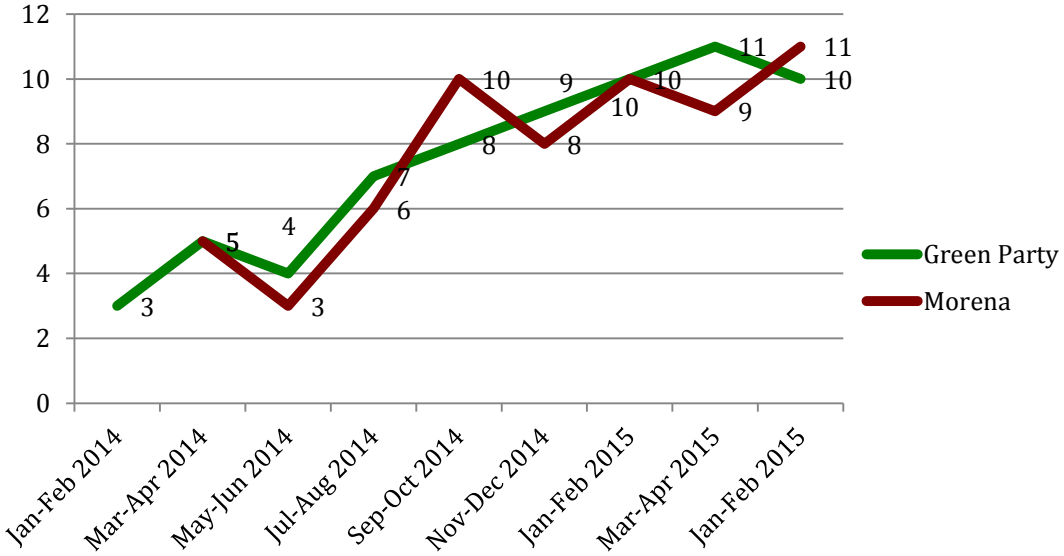
The PAN is the only one of the three main political parties to have maintained a stable position in the polls during the past year. Although it has also faced accusations of corruption during this period, these have had much less of an impact than in the case of the PRI and the PRD, potentially because it had less ties to the Ayotzinapa case and because, unlike the PRD, it doesn't have a rival and more recalcitrant party of its same political leaning eating at its heels.

Further to this point, the PRD has been severely hit by Ayotzinapa, given that the former mayor of Chilpancingo and member of the party is accused of having ordered the disappearance. But perhaps more importantly is the rise of Morena, a new political party slightly further to the left of the PRD. Morena is led by the PRD's two-time candidate for President, Andres Manuel Lopez Obrador, a controversial political figure that tends to cause either devotion or staunch opposition but never indifference. As can be seen in the graph below, the PRD's two highest points in the polls was when Lopez Obrador ran for President in 2006 and 2012.



Since its official registration as a party last year, Morena has consistently climbed up the rankings in electoral preferences, primarily due to Lopez Obrador's longstanding popularity within the working class. In doing so it has not only divided the left wing vote but has weakened the PRD by stealing both voters and political figures from its ranks, according to a poll by Laredo & Buendía two thirds of current PRD sympathizers view Lopez Obrador positively. Moreover in a matter of months, Morena has reached the position that the Green Party took years and millions of pesos to build.

If Morena maintains its current trajectory it is not too wild to entertain the possibility that it could displace the PRD as the third largest political force this year. Whether this is ultimately the case or not what seems certain is that Morena, and more specifically Lopez Obrador, will be a serious contender in the 2018 presidential elections.



Further below in the single digit zone there are five smaller parties that will fight to keep their registration as official parties, provided they reach a given threshold of votes.

One final piece of Mexico's electoral puzzle is the large proportion of undecided voters, which account for almost a third of the electorate. According to the Laredo & Buendía. This segment is divided in a similar proportion in the following categories: "independent-disillusioned", "undecided" and "alienated". The first of these might prove to be an important driver on June 7th, given that they account for 14 per cent of respondents, they have a high propensity to vote and 67 per cent of them disapprove of the President Peña Nieto's work so far. However they also tend to have either negative or neutral opinions on political parties in general. Whether any of the parties mentioned above are able to change their views is yet to be seen.