



Outlook for the Mexican Economy



BANCO DE MÉXICO

March 21, 2010



Outline

1. External Conditions

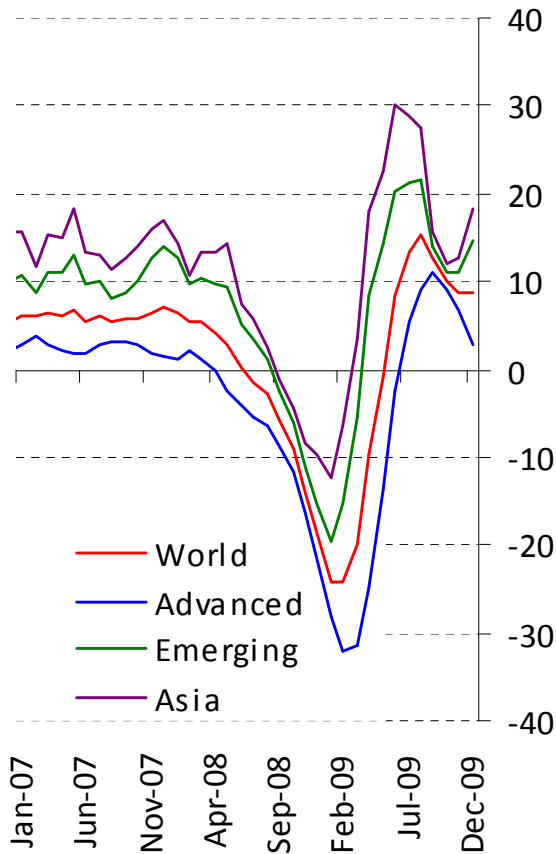
2. Economic Activity in Mexico

3. Final Remarks



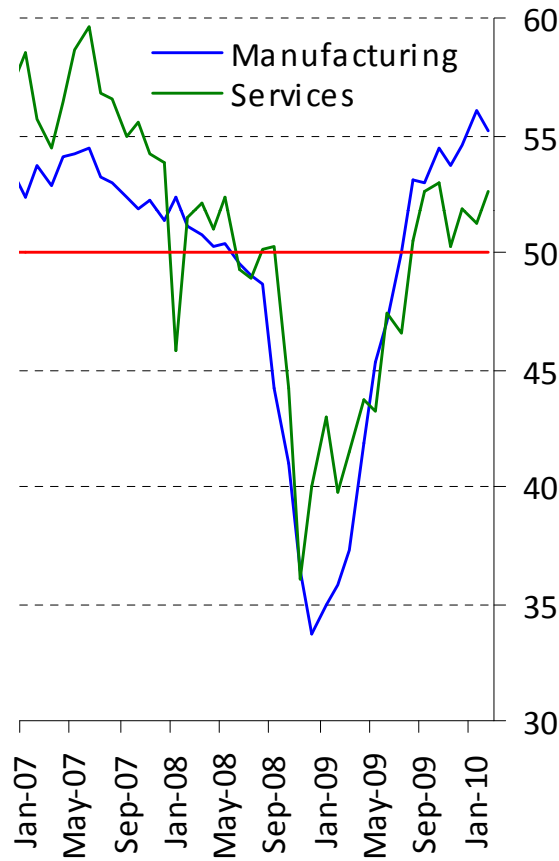
1. External Conditions

Industrial Production
(Annualized 3-month % change
over 3-month m.a.; s.a.)



m.a./ Moving average.
s.a./ Seasonally adjusted.
Source: CPB Netherlands.

**Global Manufacturing and
Services PMI**
(Index)



Source: JP Morgan.

World Trade Volume
(Index 2000=100, s.a.)

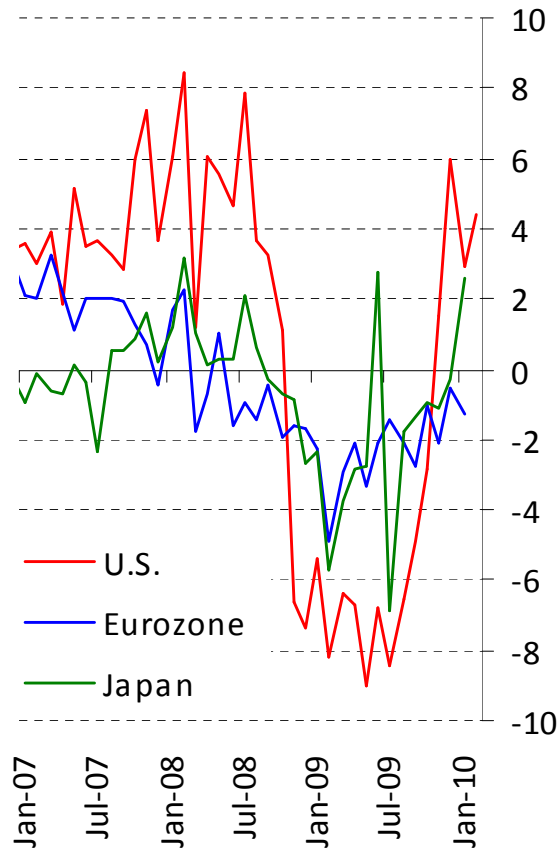


s.a./ Seasonally adjusted.
Source: CPB Netherlands.



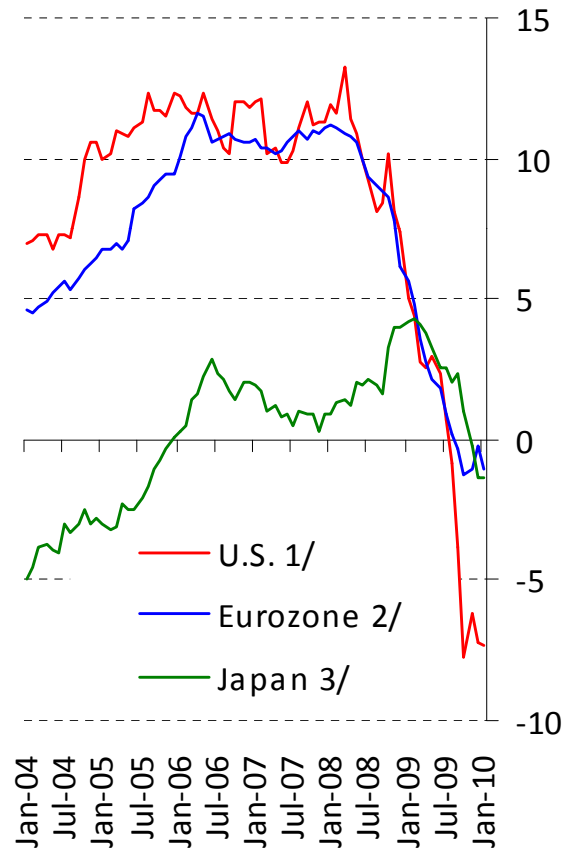
1. External Conditions

Retail Sales Exc. Automobiles in Advanced Economies
(Annual % change)



Source: Census Bureau, Eurostat and Ministry of Economy, Trade and Industry.

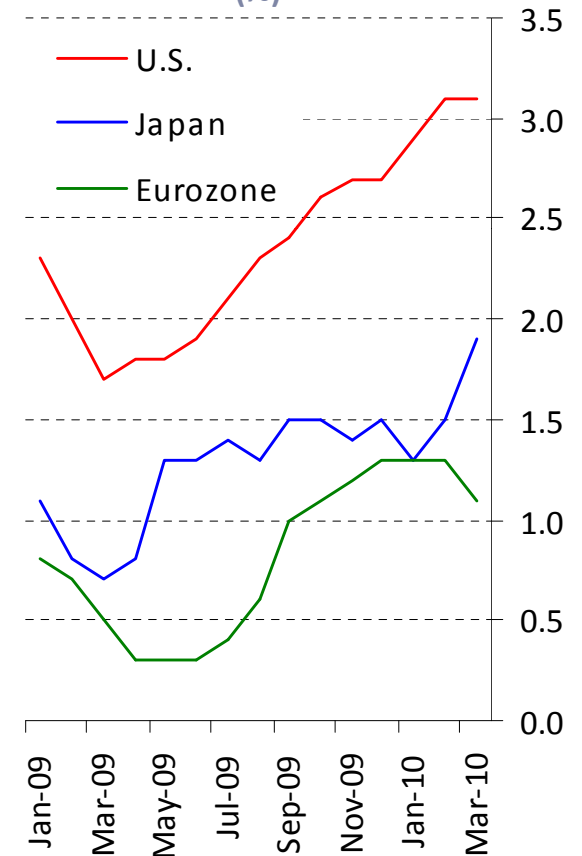
Bank Credit to the Non-financial Private Sector
(Annual % change)



1/ Commercial, industrial, mortgage and consumer loans.
2/ Loans to the non-financial private sector.
3/ Total loans to the private sector.

Source: Federal Reserve, ECB and Bank of Japan.

Evolution of 2010 GDP Growth Forecasts for Advanced Economies
(%)

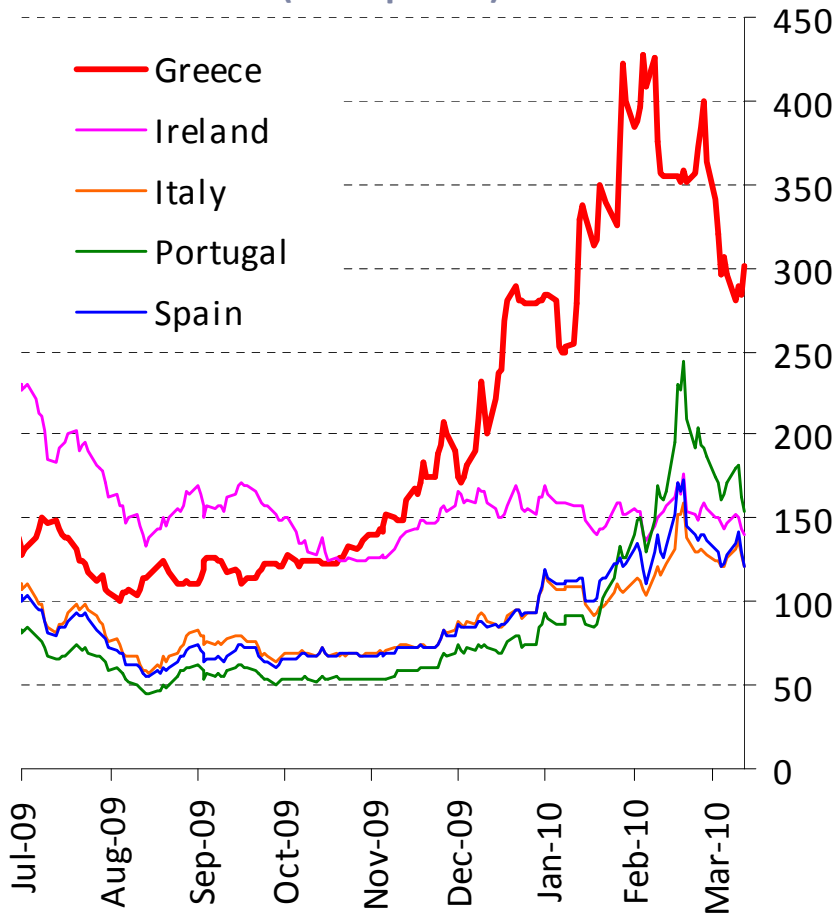


Source: Consensus Forecasts.



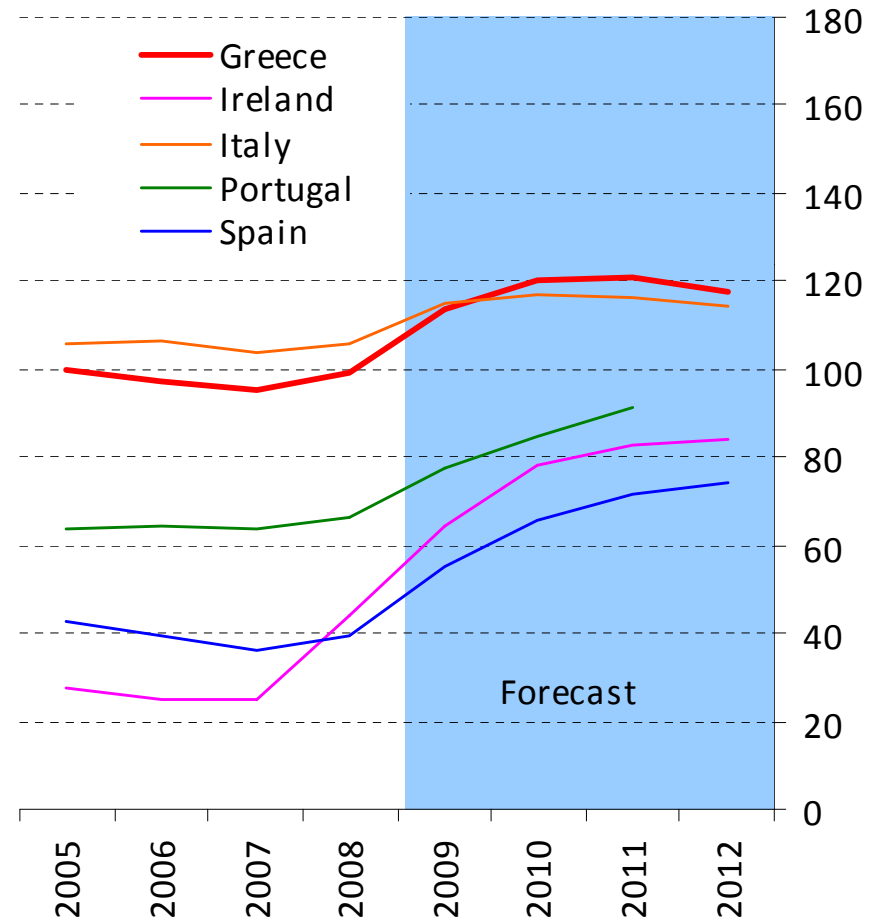
1. External Conditions

**Credit Default Swaps (CDS)
of Selected Economies**
(Basis points)



Source: Bloomberg.

Government Debt ^{1/}
(% of GDP)



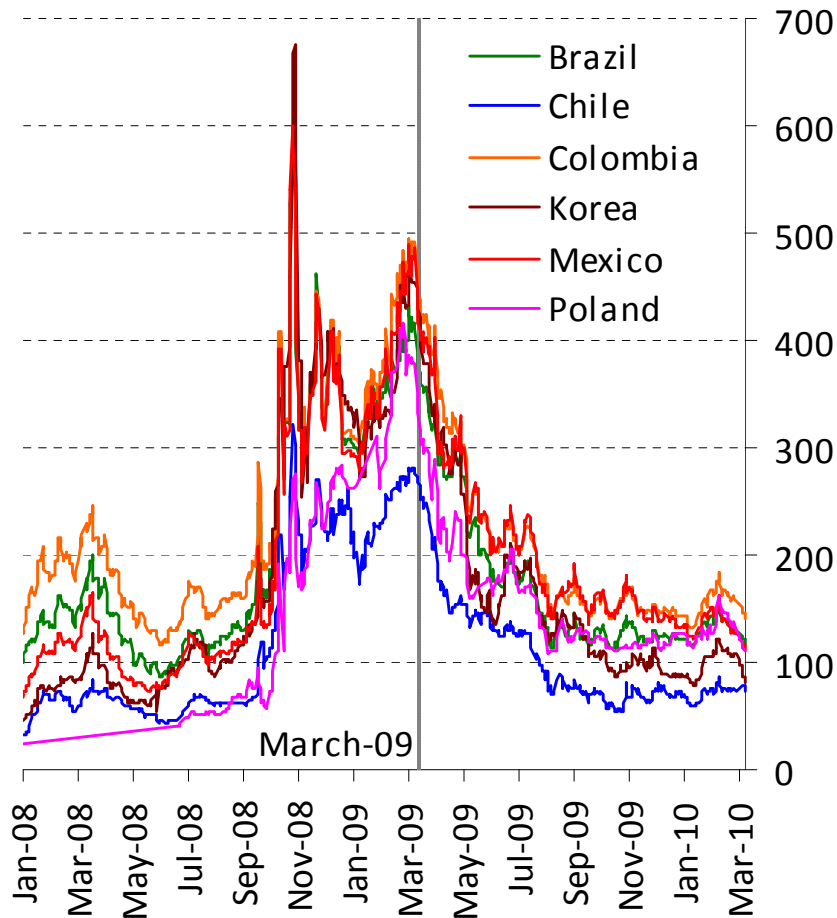
1/ With the exception of Portugal, includes the latest updates to the stability programs.

Source: European Commission and ECB.



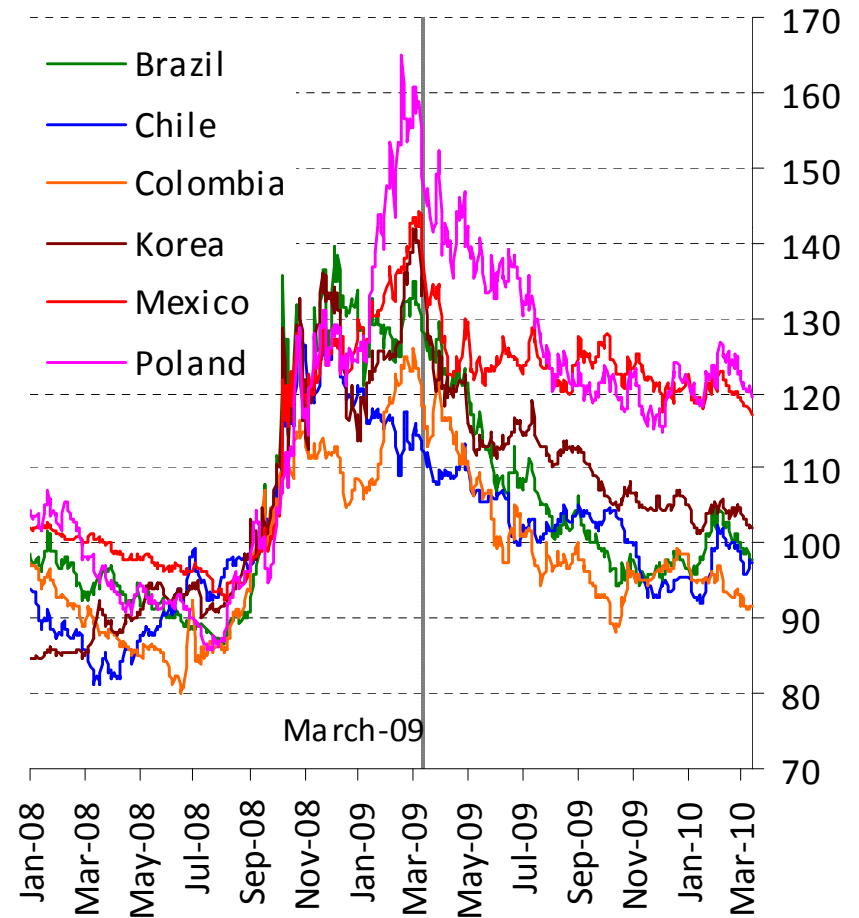
1. External Conditions

**Credit Default Swaps (CDS)
of Selected Economies**
(Basis points)



Source: Bloomberg.

**Exchange Rates
of Selected Economies**
(Index 15-Sep-2008 = 100)



Source: Bloomberg.



1. External Conditions

- *Currently, the scenario for the global economy is relatively more favorable, with economic activity rebounding and improving global financial conditions. So far, emerging market economies have benefited from increased external demand, capital inflows and more orderly conditions in international financial markets.*
- *Nevertheless, there are four issues that may pose important challenges for the world economy in the future:*
 - ① *Withdrawal of Fiscal Stimulus.*
 - ② *Withdrawal of Monetary Stimulus.*
 - ③ *Debt refinancing and tighter financial markets.*
 - ④ *Health of the financial system.*



Outline

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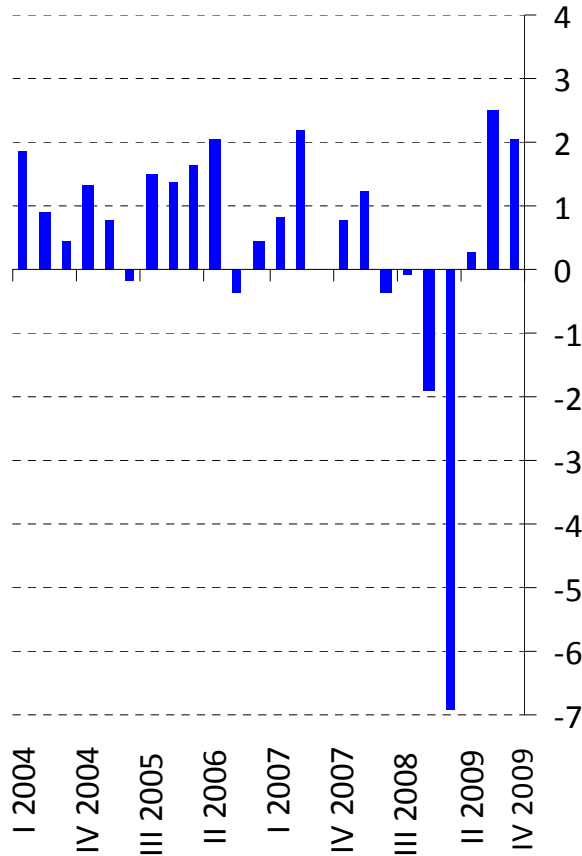
2. Economic Activity in Mexico

3. Final Remarks



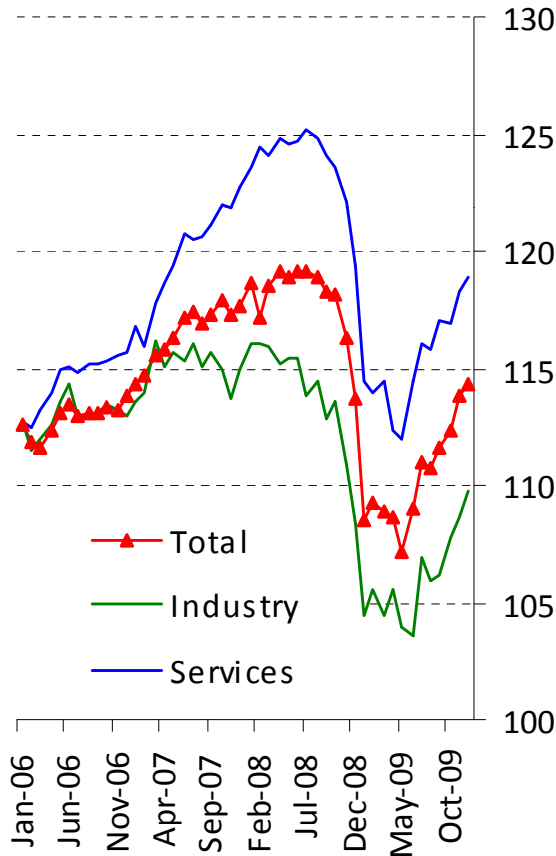
2. Economic Activity in Mexico

Gross Domestic Product
(Quarterly % change; s.a.)



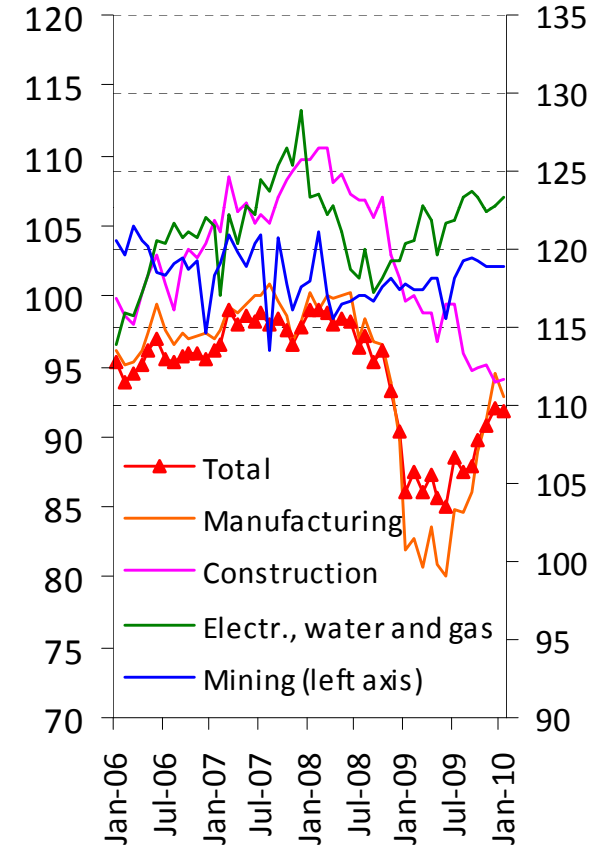
s.a./ Seasonally adjusted.
Source: INEGI.

Economic Activity Indicator
(Index 2003 = 100; s.a.)



s.a./ Seasonally adjusted.
Source: INEGI.

Industrial Production
(Index 2003 = 100; s.a.)

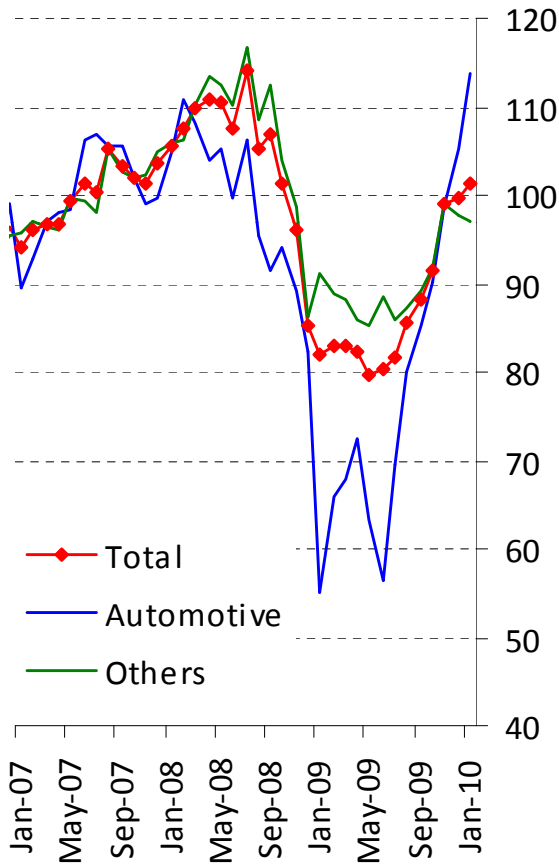


s.a./ Seasonally adjusted.
Source: INEGI.



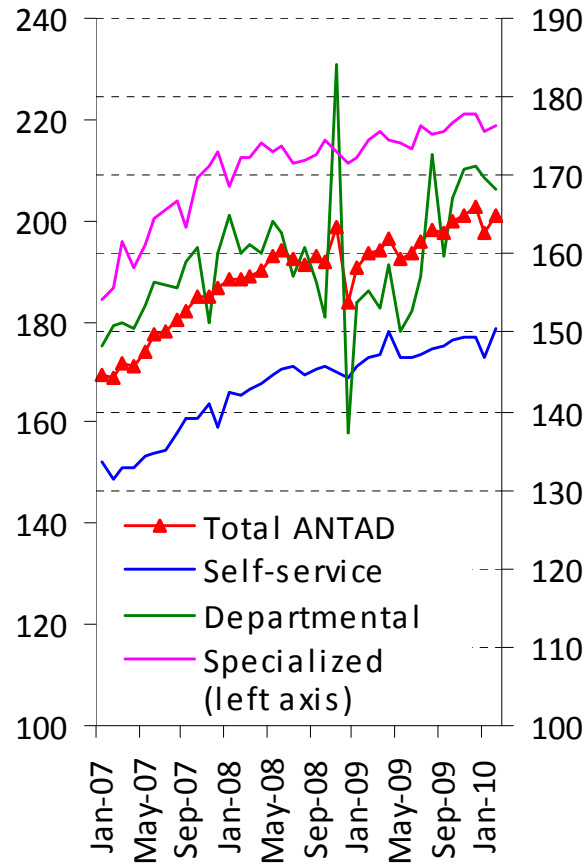
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Manufacturing Exports
(Index 2007 = 100; s.a.)



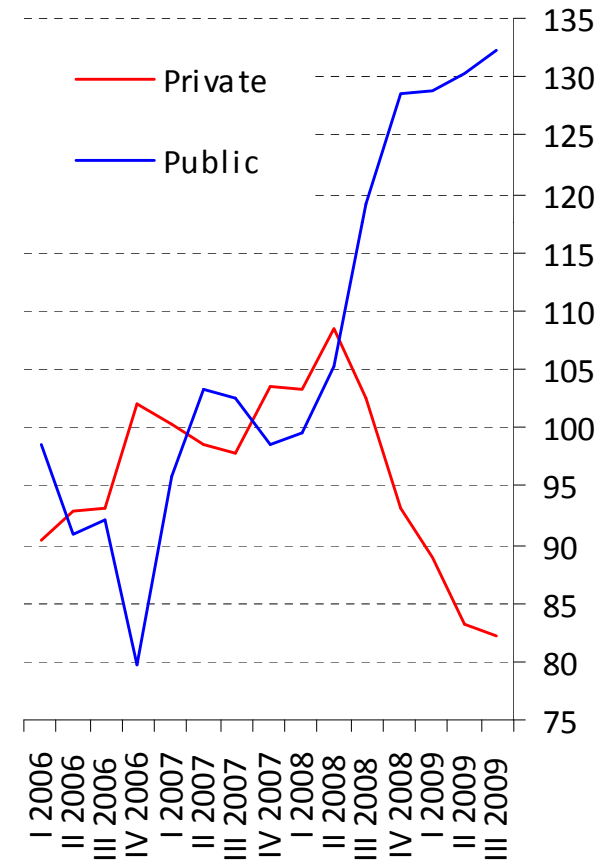
s.a./ Seasonally adjusted.
Source: Banco de México.

Consumer Goods Sales
(Index 2003=100; s.a.)



s.a./ Seasonally adjusted by Banco de México.
Source: ANTAD.

Gross Fixed Capital Formation
(Index 2007=100; s.a.)

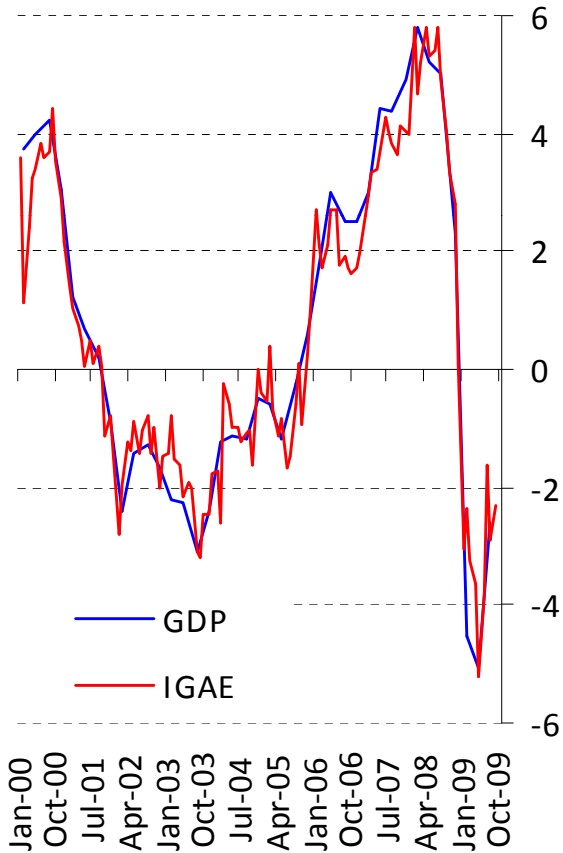


s.a./ Seasonally adjusted.
Source: INEGI.



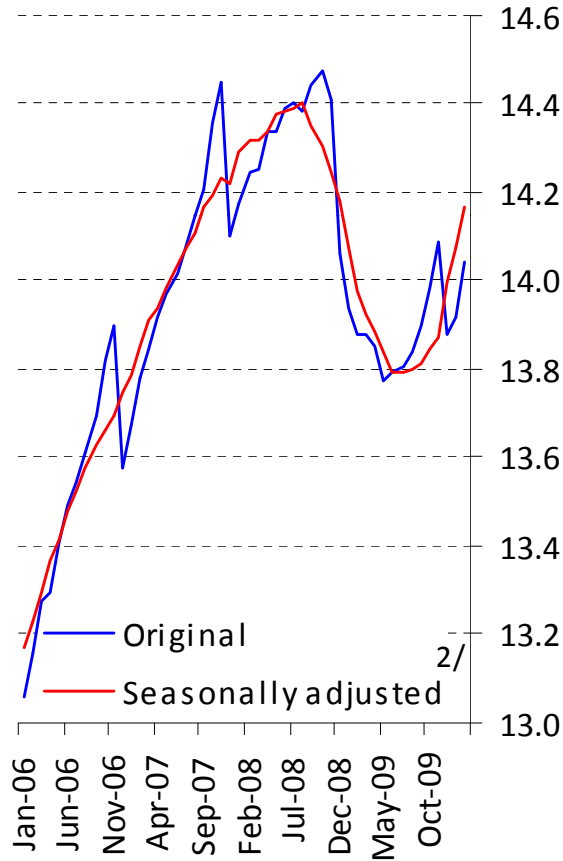
2. Economic Activity in Mexico

Output Gap Estimation ^{1/} (Annual % change)



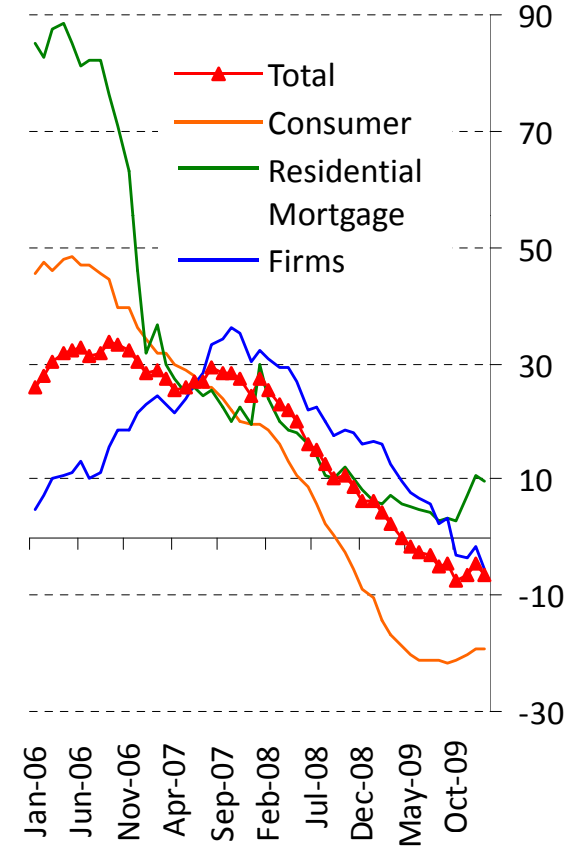
1/ The gap estimates were calculated using the Hodrick-Prescott (HP) with tail corrections method; see Banco de México (2009), "Inflation Report, April-June 2009", pp. 74.
Source: Banco de México.

IMSS-Insured Workers: Permanent and Temporary Workers in Urban Areas (Millions)



2/ Seasonally adjusted by Banco de México.
Source: IMSS.

Commercial Banks' Loans to the Non Financial Private Sector (Real annual % change)



Source: Banco de México.

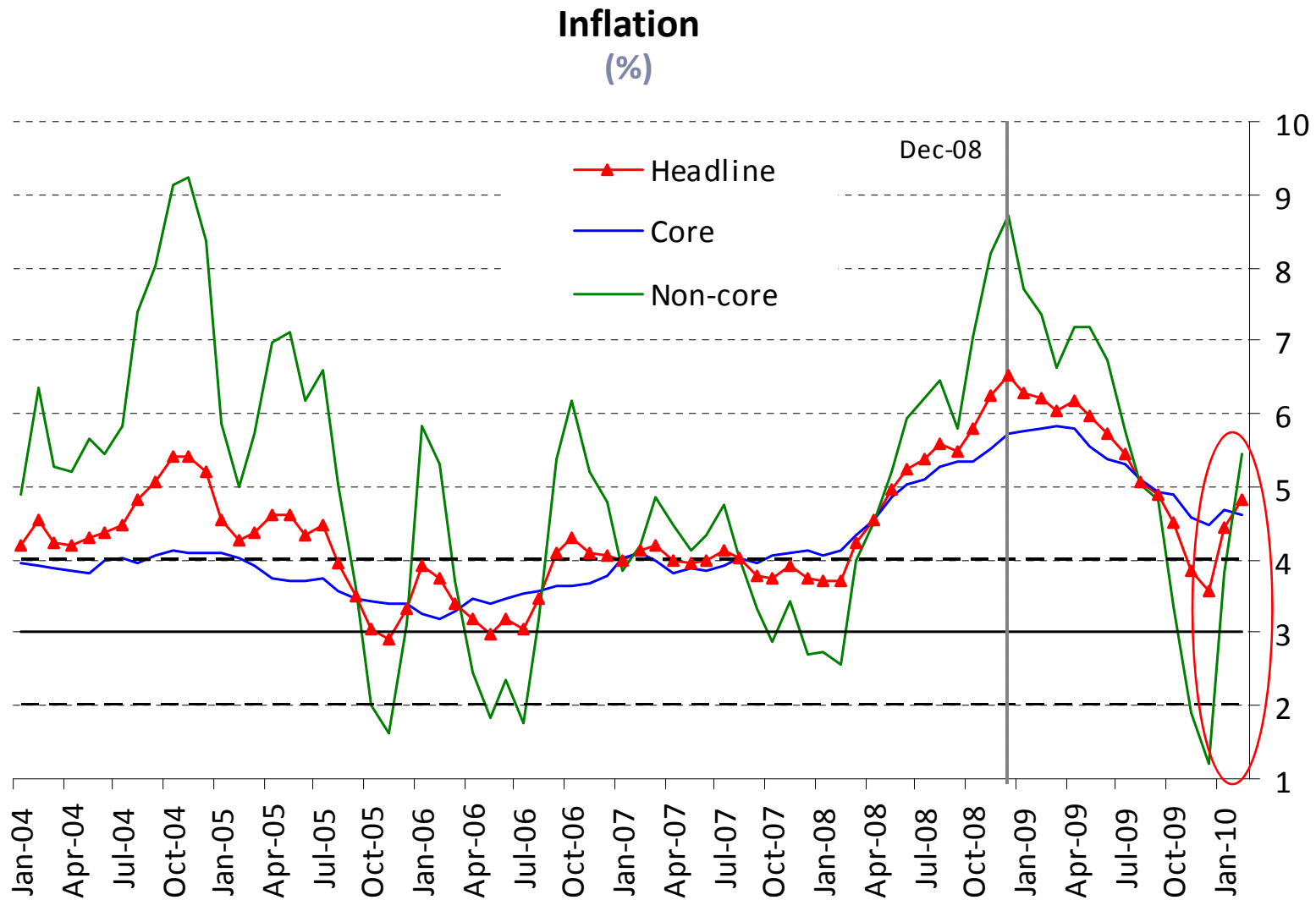


2. Economic Activity in Mexico

- *Inflation has rebounded in 2010 as a result of clearly identified factors:*
 - ✓ *The impact of tax changes on consumer prices.*
 - ✓ *The realignment of energy prices with their international benchmarks.*
 - ✓ *Increases in prices, tariffs and taxes determined by local governments.*
- *Inflation in January and February was affected by price increases in some fruits and vegetables as a result of adverse weather conditions.*
- *So far, medium and long-term inflation expectations have not been markedly affected.*
- *The observed increase in inflation in January and February 2010 is consistent with Banco de México's inflation forecast for the first quarter of the year.*



2. Economic Activity in Mexico



Source: Banco de México.



2. Economic Activity in Mexico

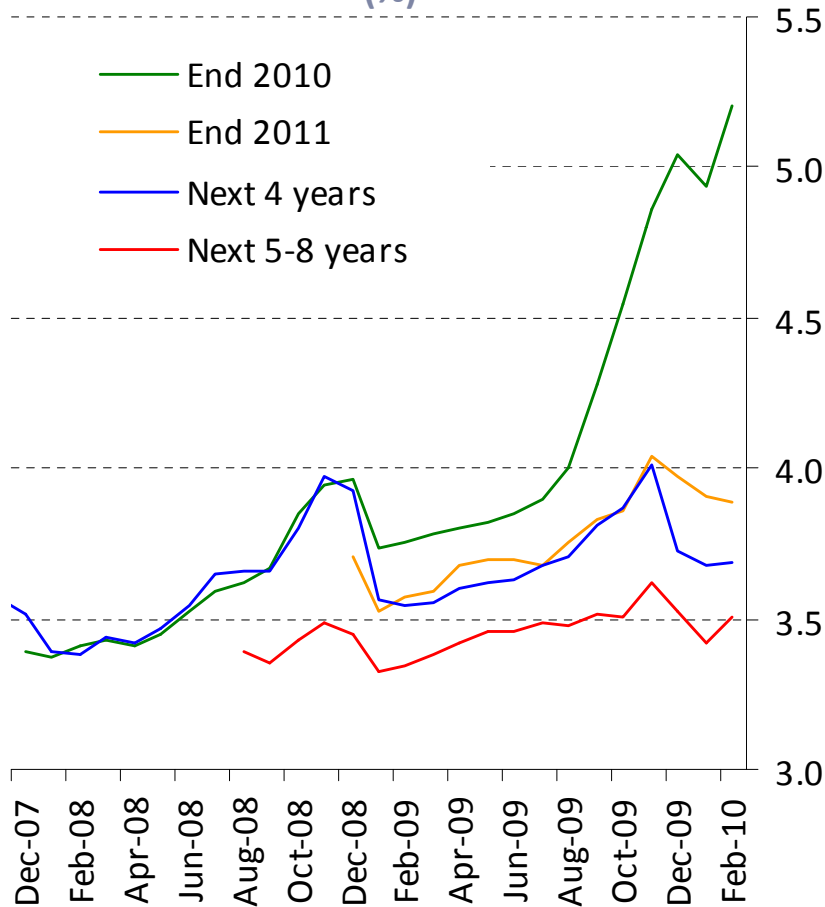
- In 2011, a downward inflation trend is anticipated due to:
 - ✓ *Most increases in prices during 2010, in particular, tax changes and adjustments in tariffs and duties determined by local governments, are expected to be once and for all. This implies that their effect on inflation will vanish in early 2011.*
 - ✓ *On the other hand, annual inflation of administered goods and services will not suffer the arithmetic effect related to a low comparison level as will occur in 2010.*
 - ✓ *As long as a considerable fraction of the anticipated adjustments in tariffs and duties set by local governments takes place this year, a lower rate of growth in these prices may be observed next year.*

- By the end of 2011, it is expected that inflation will be close to the 3 percent annual target.



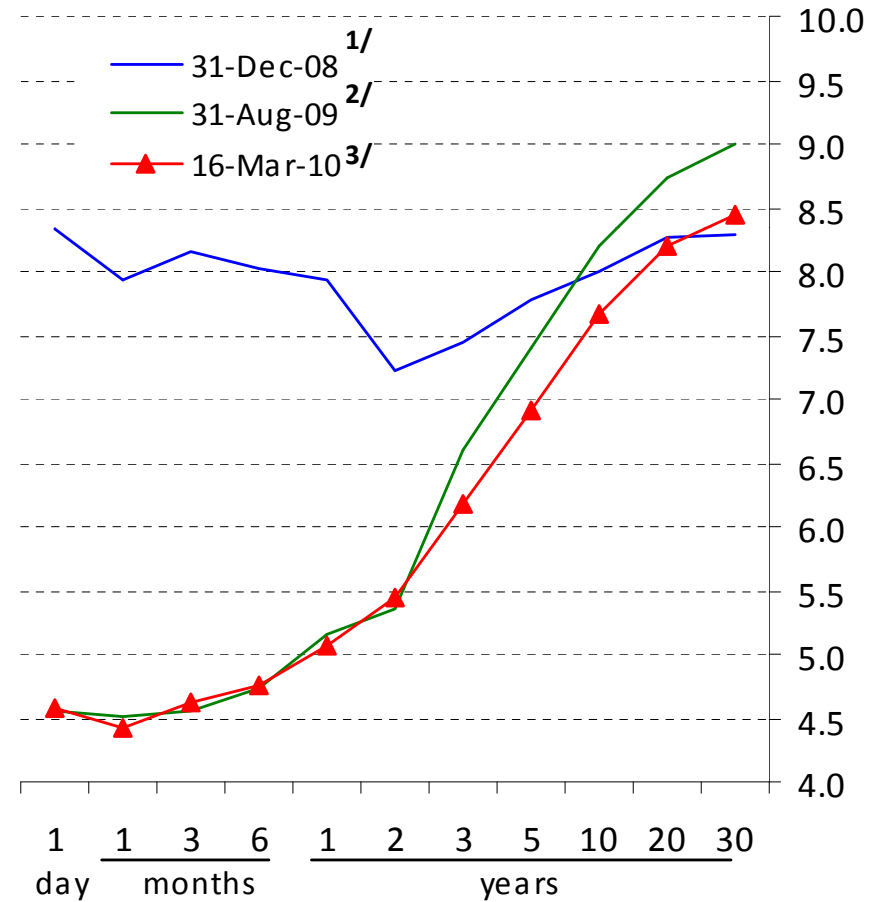
2. Economic Activity in Mexico

Headline Inflation Expectations for end of 2010, 2011, next 4 and next 5 – 8 years (%)



Source: Monthly survey of Banco de México.

Yield Curve in Mexico (%)



1/ End of the year.

2/ Before the presentation of the economic program.

3/ Last data.

Source: Banco de México and Proveedor Integral de Precios.



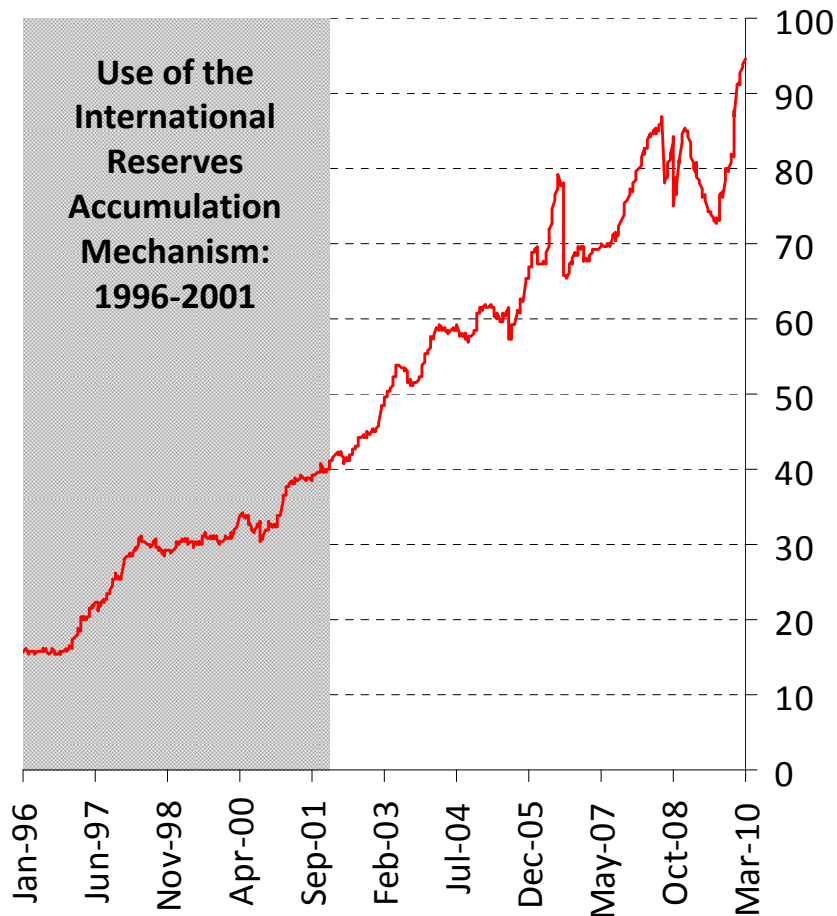
2. Economic Activity in Mexico

- *Current macroeconomic conditions are conducive to accumulating international reserves.*
- *International reserves are important in emerging economies given their relative vulnerability to changes in capital flows.*
 - ✓ *A level of international reserves that is perceived to be adequate improves investor confidence in the country's payment capacity.*
 - ✓ *The latter implies lower risk premia and lower probability of unanticipated capital outflows.*
- *Moreover, when the economy is facing adverse external shocks, international reserves help to carry out a gradual and orderly adjustment of the economy, with lower costs in terms of inflation and activity.*



2. Economic Activity in Mexico

Mexico: International Reserves (Billion USD)



Source: Banco de México.

Intervention Mechanisms

International Reserves Accumulation

- *US dollar options auctions of 600 million dollars each month.*
 - *Holders may sell US dollars to Banco de México at the reference interbank exchange rate (Fix) of the previous day, as long as it does not exceed the Fix average of the twenty preceding business days.*
- ➔ *The free float regime does not change.*

Sale of International Reserves

- *The minimum price auction mechanism is maintained.*

Outline

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3. Final Remarks

- ① *The recovery of economic activity in Mexico might be gaining momentum, although domestic spending still remains weak. The consensus forecasts of GDP growth for 2010 and 2011 have been revised upwards.*
- ② *The rebound in inflation in 2010 is associated with tax measures and with increases in public prices and tariffs. Inflation expectations for long-term horizons have not been adversely affected.*
- ③ *This scenario, together with the recent improvement of public finances, has led to significant capital inflows to the country.*



3. Final Remarks

- ④ *Although external and domestic conditions have been conducive to raising capital inflows to Mexico, there is a risk that conditions in international markets might change.*

- ⑤ *Mexico has been preparing for such an eventuality:*
 - ✓ *Fiscal policy has strengthened.*
 - ✓ *Monetary policy has led to accommodative conditions, although the central bank will continue vigilant that the upturn in inflation does not contaminate inflation expectations.*
 - ✓ *A mechanism to increase the speed of international reserves accumulation has been launched.*