The Mexican Economy: Now and in the Future
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## Index

1. **Structural strengths**

2. Recent developments and outlook

3. Long-term opportunities

4. Consolidation of price stability
Mexico has a large and well-diversified economy

- GDP of US$1.2 trillion
  - 11th largest economy in the world based on PPP
  - 2nd largest economy in Latin America
- Middle-income country
  - PPP-adjusted per-capita annual income of US$14,610
- Economy oriented to services and industry which respectively account for 65% and 30% of GDP
- Highly open economy, free trade agreements with 43 countries
- High productivity standards, especially in manufacturing

Note: Figures correspond to 2011. PPP at current international dollars for 2003-2005
Source: IMF (2012), World Economic Outlook, April and INEGI
Its youthful labor force and education potential represent a source of comparative advantage

- Working-age population accounts for 64% of the total

- Average schooling of 8.6 years

- Dependency ratio of 0.55, tending to boost savings and investment in human capital

Note: Figures correspond to 2010. “Working-age population” is defined as persons aged 15-64 years. “Dependency ratio” is an age-population ratio of those typically not in the labor force (ages under 15 and over 64) and those typically in the labor force (ages 15 to 64). “Average schooling” is the years of formal schooling received, on average, by persons over age 15.

Source: Working-age population and dependency ratio are based on data from INEGI and average schooling is directly from INEGI.
Mexico is a leading exporter of several manufacturing products such as automobiles and TV sets

Source: Trade Map, International Trade Centre UNCTAD/WTO (ITC)

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Mexico’s economic environment is business friendly

- Most sectors are open to private investment
- Government intervention in entrepreneurial activities is low
- Business and market regulation is moderate
- The macroeconomic context is stable
The pillars of macroeconomic stability are sound public finances, low inflation and a strong banking system.

<table>
<thead>
<tr>
<th>Metric</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public debt % of GDP</td>
<td>37.3%</td>
</tr>
<tr>
<td>Fiscal deficit % of GDP</td>
<td>2.5%</td>
</tr>
<tr>
<td>Annual inflation</td>
<td>3.4%</td>
</tr>
<tr>
<td>Net capital/RWA</td>
<td>15.7%</td>
</tr>
<tr>
<td>Non-performing loans/Total</td>
<td>2.5%</td>
</tr>
<tr>
<td>Provisions/NPL</td>
<td>189.6%</td>
</tr>
</tbody>
</table>

Note: Figures correspond to 2011, the average for inflation, and end-of-period for public debt and the banking system. Source: Banco de México and SHCP.
Mexico’s perceived sovereign risk has recently been lower than that of some developed countries

Credit Default Swaps
5 years, basis points

Source: Bloomberg
Yet, the task of stability is continuous and needs to be consolidated

- Fiscal reform
  - The efficiency of public revenues
  - Stabilization funds
  - Expenditures focused on public goods, e.g., security and infrastructure
- Convergence to inflation target
- Enhance regulatory and supervisory framework of the financial system
  - Basel-principle-based rules
Mexico is a significant recipient country of foreign direct investment

Foreign Direct Investment Stock
End 2011, trillions of dollars

Rank
1
2
3
4
5
12
15
16

US
China
France
UK
Germany
Brazil
Russia
Mexico

Source: CIA, World Fact Book
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After a sharp recession in 2009, Mexico has undergone a continuous process of economic recovery.

Economic Activity Indicators
2003 = 100, s.a.

1/ Figures correspond to the Global Economic Activity index which incorporates economic sectors with an 87.4% coverage of annual GDP. Therefore, growth rates can differ from those of GDP.

Source: INEGI

Manufacturing Production
2008=100; s.a.

Source: INEGI
A driving force has been the resurgence of external demand, especially through manufacturing exports.
Domestic demand has also posted significant growth rates.

**Commercial Establishment Sales**

2003 = 100, s.a.

- Wholesale
- Retail

**Gross Fixed Investment**

2003 = 100, s.a.

Source: INEGI
... which have been supported by job creation and the expansion of bank lending

Formal Employment*
Millions of workers

Real Commercial Banks’ Performing Loans
2007=100

Source: Banco de México

*/ Workers insured by the Mexican Social Security System (IMSS)
Source: IMSS
The improvement of global financial conditions has resulted in large capital inflows

**Government Securities Holdings***

Billions of nominal pesos

*Includes CETES and fixed-rate bonds

Source: Banco de México
... which partly explain downward shifts of the yield curve and the relative strengthening of the currency

**Mexico: Yield Curve**
End of year, %

<table>
<thead>
<tr>
<th>Period</th>
<th>2009</th>
<th>2010</th>
<th>2011</th>
<th>2012*</th>
</tr>
</thead>
<tbody>
<tr>
<td>1-day</td>
<td></td>
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</tr>
<tr>
<td>1-month</td>
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<tr>
<td>3-month</td>
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<td>6-month</td>
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<tr>
<td>1-year</td>
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<tr>
<td>2-years</td>
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<td>3-years</td>
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<td>5-years</td>
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<td>7-years</td>
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<tr>
<td>10-years</td>
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<tr>
<td>20-years</td>
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<tr>
<td>30-years</td>
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</tbody>
</table>

**Exchange Rate**
2008=100, Pesos/USD

Source: Banco de México

* May 4, 2012
Source: Banco de México
The Mexican economy is expected to continue growing at a stable, moderate pace

<table>
<thead>
<tr>
<th>GDP</th>
<th>Annual growth, %</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2011</td>
</tr>
<tr>
<td>World</td>
<td>3.9</td>
</tr>
<tr>
<td>U.S.</td>
<td>1.7</td>
</tr>
<tr>
<td>Mexico</td>
<td>4.0</td>
</tr>
</tbody>
</table>

Source: IMF (2012), World Economic Outlook, April
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However, Mexico could clearly increase its growth potential by enhancing its total factor productivity.

- Key elements behind lagging productivity
  - Insufficient competition in crucial economic areas
  - Widespread informality

  Inadequate levels of technology, investment and high-skilled labor, and inefficient allocation of resources

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The agenda for pending reforms is ample and promising

- Deregulate and simplify requirements for business operations
- Remove legal obstacles to labor market flexibility and competition in the markets for inputs and services, including education\(^1\)
- Strengthen the rule of law

Since 2001, monetary policy has adhered to a formal inflation targeting regime

- 3% inflation target measured by the headline CPI index
- Gradual stabilization process to minimize possible social costs
- Accountability in terms of the commitment to the target
- Stabilization of inflation expectations around the target is a challenge
- Transparency and communication by the central bank key to the effectiveness of monetary policy
The convergence of inflation to the target is a very close and attainable result

Headline Inflation
CPI annual change, %

Source: INEGI and Banco de México
Banco de México will continue to monitor risks to convergence toward the permanent 3% target

- Increased global financial volatility
- Upsurge of international prices of commodities and food
- Demand pressures
Conclusions

- Mexico has a large and diversified economy, young workers, high educational potential and a friendly business environment.
- Mexican financial stability, a continuous task, rests on sound public finances, low inflation and strong banks.
- Despite Mexico’s ongoing strong economic recovery, reform efforts are needed to overcome informality and obstacles to competition in order to enhance long-term growth potential.
- Convergence to the inflation target is very close and attainable.
- Banco de Mexico will continue to monitor risks to the permanent 3% target.
27Mejorar las perspectivas económicas mundiales