OUTLOOK FOR THE MEXICAN ECONOMY AND CHALLENGES AHEAD

September 26, 2006
OUTLINE

I. EXTERNAL ENVIRONMENT

II. AGGREGATE SUPPLY AND DEMAND

III. INFLATION AND MONETARY POLICY

IV. GLOBALIZATION AND COMPETITIVENESS

V. FINAL REMARKS
I. EXTERNAL ENVIRONMENT

1. The recent development and prospects for the world economy continue to be positive.

2. However, risks regarding a greater slowdown of the U.S. economy have increased.

3. Albeit global inflationary pressures remain, energy prices have started to moderate and long-term inflation expectations are well-anchored.
# I. EXTERNAL ENVIRONMENT

## GDP Forecasts

(Annual % Change)

<table>
<thead>
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<td>3.4</td>
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<td>3.2</td>
<td>3.5</td>
<td>2.6</td>
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<tr>
<td>Japan</td>
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<td>2.6</td>
<td>2.8</td>
<td>2.2</td>
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<td>1.5</td>
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<td>0.9</td>
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<td>10.2</td>
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<td>4.2</td>
<td>4.7</td>
<td>4.0</td>
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</table>

¹ Average of 79 countries.

*Observed.


## U.S.: Industrial Production

(Quarterly Annualized % Change; Seasonally Adjusted)

I. EXTERNAL ENVIRONMENT

West Texas Intermediate Price
(Dollars per Barrel)

Regular Gasoline Average Rack Price
(Dollars per Gallon)

Source: Bloomberg.

Source: Bloomberg.
I. EXTERNAL ENVIRONMENT

EMBI Global: Sovereign Spreads
(Basis Points)

10-Year Interest Rate in Local Currency
(\%)

Source: Bloomberg.
I. **EXTERNAL ENVIRONMENT**

II. **AGGREGATE SUPPLY AND DEMAND**

III. **INFLATION AND MONETARY POLICY**

IV. **GLOBALIZATION AND COMPETITIVENESS**

V. **FINAL REMARKS**
II. AGGREGATE SUPPLY AND DEMAND

Domestic Demand
(Annual % Change; Seasonally Adjusted)

Source: INEGI.
II. AGGREGATE SUPPLY AND DEMAND

Oil and Non Oil Exports
(Annual % Change; Seasonally Adjusted)

Source: INEGI.

Manufacturing Exports
(Annual % Change; Seasonally Adjusted)

Source: INEGI.
II. AGGREGATE SUPPLY AND DEMAND

Gross Domestic Product
(Annual % Change)

Mexico and U.S. Manufacturing Production
(Index June 2001=100; Seasonally Adjusted)

Source: INEGI.

Source: Banco de México and Federal Reserve.
II. AGGREGATE SUPPLY AND DEMAND

Mexican and U.S. Production Indicators
(Annual % Change)

Source: Banco de México.

Mexico’s GDP Growth Expectations:
Private Sector Survey
(Density Function)


Source: Banco de México.
I. External Environment
II. Aggregate Supply and Demand
III. Inflation and Monetary Policy
IV. Globalization and Competitiveness
V. Final Remarks
III. Inflation and Monetary Policy

CPI and Components
(Annual % Change)

Source: Banco de México.
III. INFLATION AND MONETARY POLICY

Merchandise Index and Components
(Annual % Change)

Source: Banco de México.

Core, Non Core, and Fruits and Vegetables Index
(Annual % Change)

Source: Banco de México.
III. INFLATION AND MONETARY POLICY

Inflation Expectations

(%)  

Source: Banco de México.

Inflation Expectations

(%)  

Source: Banco de México.
III. INFLATION AND MONETARY POLICY

Overnight Interest Rate
(Annual %)

Source: Banco de México.

Mexico’s Yield Curve
( %)

Source: Banco de México.
I. External Environment

II. Aggregate Supply and Demand

III. Inflation and Monetary Policy

IV. Globalization and Competitiveness

V. Final Remarks
Global integration has intensified considerably and economic and technological changes are creating the potential for continued improvements in productivity and living standards.

The combination of these factors is creating a unique opportunity for developing economies.

However, a series of structural reforms are needed in order to boost Mexico’s competitiveness and exploit its comparative advantages.
IV. GLOBALIZATION AND COMPETITIVENESS

Competitiveness Index; Quality of Public Institutions (2005-2006 Score)

Competitiveness Index Position (WEF 2005-2006)

Competitiveness Index Position (IMCO 2005)

Source: IMCO.
IV. GLOBALIZATION AND COMPETITIVENESS

Key elements to boost competitiveness:

1. **Fostering competition.** Particularly regarding the supply of basic production inputs:
   - Inputs supplied through networks.
   - Other basic inputs.

2. **Flexibilizing fundamental markets,** such as the labor market.

3. **Improving the institutional framework.**
IV. GLOBALIZATION AND COMPETITIVENESS

Consequences of loss of competitiveness

1. Lack of competition
2. Market rigidities
3. Inappropriate institutional framework

✓ Weak institutions
✓ Suboptimal infrastructure levels
✓ High prices
✓ Low investment and innovation efforts
✓ Low flexibility for the efficient allocation of resources
✓ Weak public finances

Low competitiveness

- Insufficient growth
- Low employment opportunities
- High income inequality
OUTLINE

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Economic growth for 2006 is expected to be between 4.0 and 4.5 percent. For 2007, it is expected that the economy will grow at a lower pace, influenced mainly by the anticipated slowdown of the U.S. economy.

Recent increases in some agricultural prices has pressured headline inflation. However, medium-term inflation expectations have not been affected.

To improve the long-term economic performance of the Mexican economy several structural reforms are needed to make the economy more flexible and competitive.