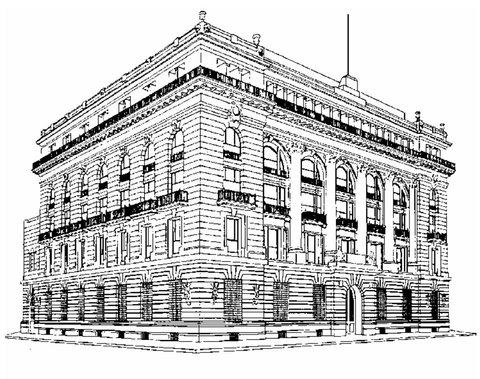
Inflation Report

January – March 2006



BANCO DE MEXICO

APRIL 2006

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FOREWARNING

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Unless otherwise stated, this document has been prepared using data available as of April 24, 2006. Figures are preliminary and subject to change.

CONTENTS

Inflation Report January-March 2006

1. Introduction

The performance and prospects for the world economy continue to be favorable. During the first quarter of the year, the U.S. economy rebounded, after having slowed in the fourth quarter of 2005 as a result of transitory factors. The U.S. economy is expected to grow by around 3.4 percent during 2006. In Europe and Japan growth is expected to pick up during the year, while the dynamism of the economic expansion in China and in the rest of the Asian countries is expected to continue unabated. Strong growth has led to new surges in oil prices in a context of constraints on the expansion of oil supply and various geopolitical risks. The latter factor gained relevance in April, leading to additional considerable increases in oil prices.

Despite these developments, world inflationary pressures are relatively contained. In particular, core inflation rates remain at moderate levels, therefore contributing to curb inflation expectations. In this environment of well anchored inflation expectations, risk premia for long-term fixed income securities have remained low compared with their historic levels. Among other factors, this has contributed to maintain low long-term interest rates. As a result, international financial markets continue to exhibit relatively benign conditions.

This performance has been subject to some adjustments, as recent data point to a higher than expected world economic expansion, in particular of the U.S. economy. Greater monetary astringency on the part of the central banks of the main advanced economies is also expected. This has prompted an increase in long-term interest rates in international financial markets. Furthermore, expectations of increases in interest rates in some advanced economies, particularly in Japan, have contributed to revert certain leveraged positions in the currencies of such countries which were held in order to finance holdings of assets in other currencies. The convergence of such factors has affected the value of asset prices and exchange rates in emerging market economies, which experienced some depreciation of their currencies and higher volatility towards the end of the first quarter. Nonetheless, access to financing in international capital markets for these countries continues to be, overall, relatively easy.

Economic activity in Mexico exhibited a favorable performance during the first quarter of the year. The growth of manufacturing exports, especially those related with the automotive industry, contributed significantly to this result. Together with the positive performance of exports, domestic expenditure has remained vigorous. It is important to mention that both consumption and investment continue to benefit from revenues from workers' remittances and crude oil exports. Under this setting, GDP is expected to grow around 5.2 percent during the first quarter of the year. This figure will also be influenced by seasonal factors, because, unlike 2005, the Easter holiday took place in the second quarter of 2006. The rate of growth of economic activity during the first quarter and the outlook for the rest of the year allow for anticipating GDP growth to be between 3.5 and 4 percent during 2006.

As expected in the previous Inflation Report, in January 2006, annual headline inflation rebounded due to the volatility of both fruits and vegetables' prices and their annual variations. This was an effect of the unusual reduction in the prices of these items in January 2005, contributing to raise their annual variations during the first months of this year. Nonetheless, in March, headline inflation returned to levels (3.41 percent) close to those recorded at the end of 2005 (3.33 percent). As for core inflation, which is a good indicator of the medium-term trend of headline inflation, it remained around 3 percent.

The improvement of inflation conditions has contributed to a downward adjustment in private sector analysts' inflation expectations for both headline and core inflation for all terms. Banco de México expects headline inflation to be between 3 and 3.5 percent for the end of 2006, and core inflation to remain close to 3 percent for the remainder of the year.

The abovementioned inflationary outlook and a mostly benign global financial environment, created the conditions for Banco de México's Board of Governors decision to continue to reduce during the first quarter of the year part of the monetary restriction adopted up to mid-2005. In its April press release on monetary policy an additional reduction in monetary conditions was announced, stating that there is no space for an additional loosening of monetary conditions in the near future.

It is important to point out that although significant improvements in disinflation and in the outlook for inflation have been observed, the base scenario is subject to risks. In particular, inflation expectations are still above the 3 percent target set by Banco de México, prices of energy and other commodities remain high and volatile, services inflation remains relatively high, and volatility in international financial markets has increased. Under such context, monetary policy will continue to be oriented towards fostering and consolidating the convergence of inflation to its target.

2. Recent Developments in Inflation

2.1. Inflation

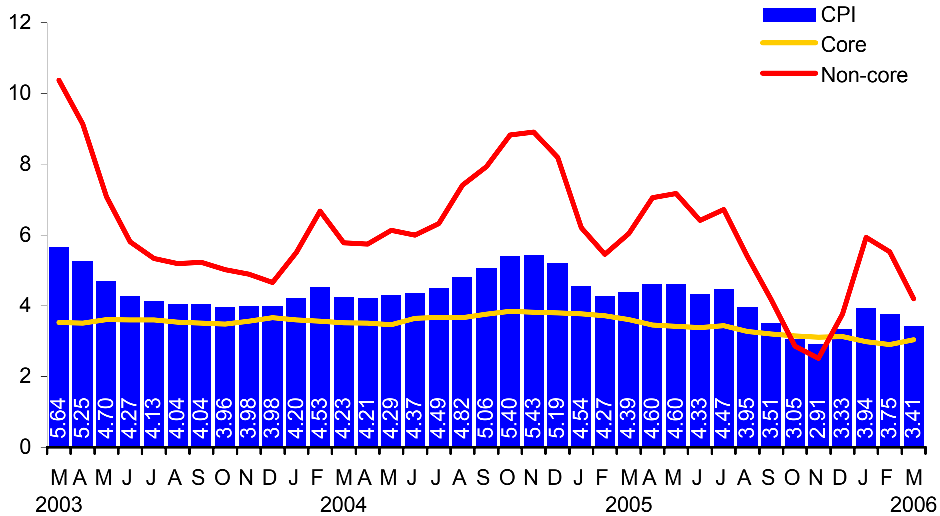
As it was expected in the previous Inflation Report, during the first months of 2006, annual headline inflation rebounded. After reaching 3.33 percent in December 2005, it rose to 3.94, 3.75 and 3.41 percent in January, February and March 2006, respectively (Table 1). Core inflation exhibited more stability, recording during the referred months 2.98, 2.90 and 3.04 percent.

Table 1
CPI Components
Annual percentage change

	Dec-2004 (a)	Dec-2005 (b)	Jan-2006 (c)	Feb-2006 (d)	Mar-2006 (e)
CPI	**5.19**	**3.33**	**3.94**	**3.75**	**3.41**
Core	**3.80**	**3.12**	**2.98**	**2.90**	**3.04**
Merchandise	**3.87**	**2.82**	**2.76**	**2.67**	**2.70**
Food	7.04	3.69	3.61	3.61	3.61
Other	1.69	2.19	2.15	1.99	2.04
Services	**3.72**	**3.46**	**3.22**	**3.15**	**3.40**
Housing	3.70	2.55	2.65	2.69	3.04
Other	3.74	4.55	3.90	3.71	3.83
Non-core	**8.20**	**3.76**	**5.93**	**5.52**	**4.20**
Agriculture	**10.11**	**-0.18**	**7.42**	**6.32**	**1.47**
Fruits and Vegetables	**6.43**	**-1.86**	**19.52**	**17.62**	**5.29**
Tomato	23.24	-23.18	106.36	112.74	12.02
Other	2.51	4.12	8.17	6.39	4.26
Livestock	**12.69**	**0.93**	**0.43**	**-0.18**	**-0.83**
Administered and Regulated	**7.51**	**4.76**	**5.11**	**4.85**	**4.76**
Administered	**10.02**	**7.13**	**8.22**	**8.00**	**7.95**
Low-octane gasoline	5.42	4.47	5.99	6.03	6.24
High-octane gasoline	8.47	4.39	4.27	4.37	4.54
Electricity	9.15	4.27	3.71	5.89	5.97
Residential-use gas	18.27	14.79	17.65	13.85	13.26
Regulated	**5.13**	**2.43**	**2.04**	**1.76**	**1.62**
Education	**7.50**	**6.63**	**6.31**	**6.44**	**6.47**

During the first quarter of 2006, annual headline inflation posted higher levels than at the end of 2005, albeit falling within the variability interval of minus/plus one percentage point around the 3 percent target (Graph 1). This result was due mainly to the path followed by the non-core price subindex. On the contrary, annual core inflation was around 3 percent. In March, annual headline inflation and core inflation were 3.41 and 3.04 percent, respectively (figures for December 2005 were 3.33 and 3.12 percent).

Graph 1
Consumer Price Index
Annual percentage change



During the first quarter of the year, the annual variation of the non-core price subindex rose in January and decreased in the following months. As a result, this indicator moved from 3.76 percent in December 2005 to 5.93 percent in January, 5.52 percent in February and 4.20 percent in March 2006 (Table 1). This development mainly resulted from variations in the prices of fruits and vegetables, particularly tomato prices, which during the same period of the last year reached very low levels (on this occasion, this behavior did not repeat). In addition, adjustments in the administered prices subindex contributed to the non-core inflation increase exhibited at the beginning of the year.[1] On another front, during the quarter, the annual variation of both livestock goods' prices and regulated prices fell (Graph 2).

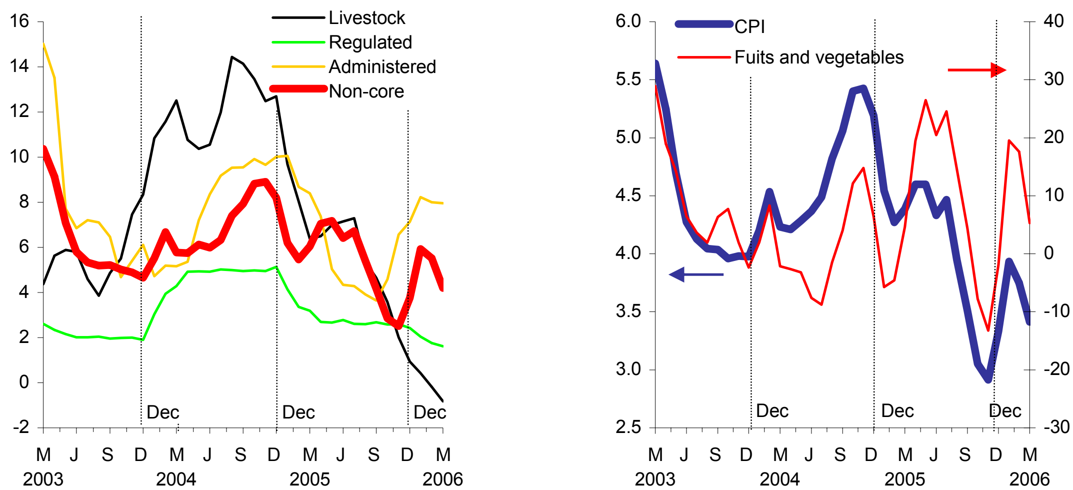
At the end of the first quarter of 2006, annual core inflation was 3.04 percent, 0.08 percentage points below its level of December 2005. In March, the annual variations of the core merchandise and services subindexes were below those recorded at the end of the year (of both, merchandise prices fell the most). Regarding both groups that comprise the merchandise subindex (food and rest of merchandises), both recorded slight reductions in their annual variations (Graph 3). As for the services subindex, the annual variations of the two groups that comprise it moved in opposite directions. On the one hand, the annual growth rate of non-housing services decreased. On the other, price increases in certain construction materials such as rod, copper pipe and cement fostered an upturn in the annual growth rate of prices of housing-related services.

[1] For a definition of the components of this subindex, see section 3.3 of this Report.

Graph 2
Non-core Price Index and Components

a)) Non-core and Components
Annual percentage change

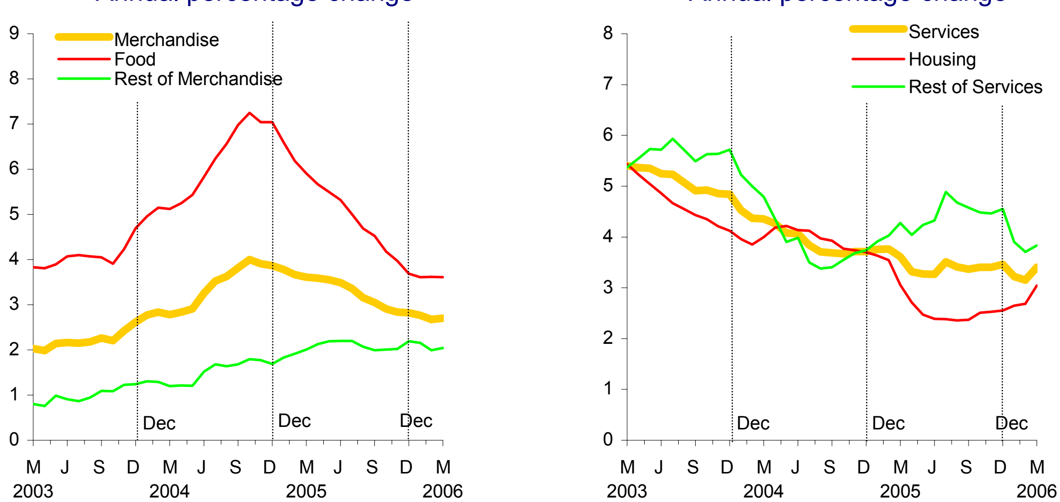
b) CPI and Fruits and Vegetables
Annual percentage change



Graph 3
Core Merchandise and Services Subindexes

a) Merchandise
Annual percentage change

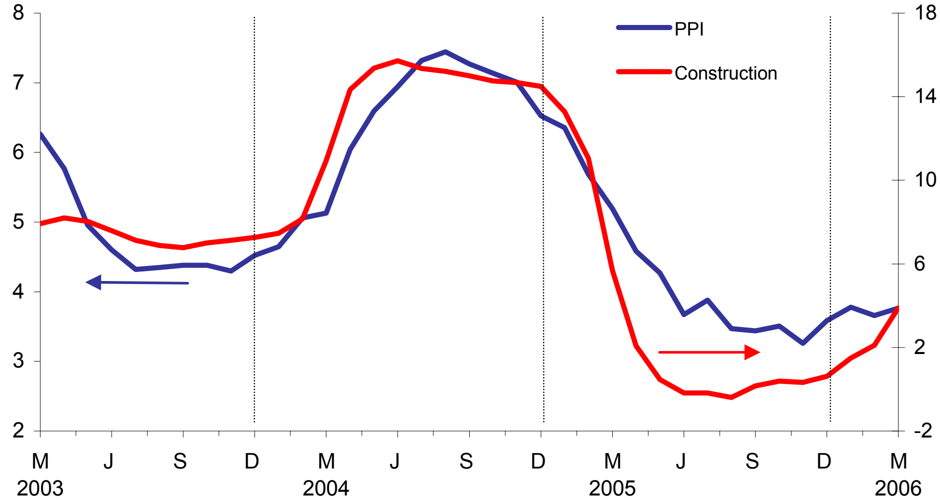
b) Services
Annual percentage change



2.2. Producer Price Index

At the end of the first quarter of 2006, the Producer Price Index (PPI) excluding oil grew at an annual rate of 3.76 percent (in December 2005, it did so by 3.59 percent). Such increase was due mainly to the upward movement in the annual variation of the construction subindex, from 0.61 percent in December 2005 to 3.90 percent in March 2006 (Graph 4). Price increases of construction materials were mitigated by the decline in the annual variation rates of the agriculture, forestry, fishing, and transport and communications price subindexes.

Graph 4
Producer Price Index Excluding Oil, Merchandise and Final Services
Annual percentage change



3. Main Determinants of Inflation

3.1. International Environment

During the first quarter of 2006, world economic activity seems to have rebounded, after having slowed down in the last months of the previous year. Timely indicators suggest a significant strengthening of domestic demand in the U.S., which had been affected at the end of 2005 by the impact of the hurricanes in the Gulf of Mexico, among other factors. Economic activity in the euro area is expected to have strengthened, while the recovery in Japan continued. On another front, inflation has remained low despite the surge in oil prices, the recent increase in other commodity prices and the higher degree of capacity utilization in several economies. Nonetheless, the monetary authorities of the main advanced economies have continued to express their concerns about inflationary risks. In this regard, it is worth noting the further increases in interest rates in the U.S. and a new increase in the euro area. In Japan, the apparent end of deflation has motivated the end of the policy of quantitative objectives for the monetary aggregates, and has created the expectation that the central bank of that country will abandon its policy of zero interest rates. Despite these developments, global financial conditions continued to be favorable.

3.1.1. Global Economic Activity

Available information suggests that during the first quarter of 2006, the global economy exhibited more dynamism as compared with the last quarter of the previous year. Such rebound is mainly explained by the acceleration of economic activity in the U.S. and Europe, the recovery in Japan, and high sustained growth in China. The higher rate of growth, partly associated with the strengthening of industrial activity in the advanced economies, apparently has led to a rebound in international trade flows.

In the U.S., during the last quarter of 2005, GDP grew by 1.7 percent on an annualized quarterly rate basis (3.2 percent at an annual rate), less than during the previous quarter. Nonetheless, the slowdown was due to transitory factors, such as the effects of the hurricanes in the Gulf of Mexico. On the other hand, the trade deficit continued to increase and the current account balance reached new record highs (7 percent of GDP).

According to available indicators, the economy grew more vigorously during the first quarter of 2006, as a result of the recovery of consumption and investment, and despite certain signals pointing to a weakening of real estate markets. For example, during February new home sales were 21 percent below the maximum level attained in July 2005, while the rate of increase of the price of houses slowed down. On another front, the industrial sector continued to grow at high rates, as a result of the return of normal production conditions after the hurricanes, the greater dynamism of exports, and the expansion of firms' outlays on capital goods, among other factors. After increasing at an annual rate of 3.0 percent during the period October-December 2005, industrial production rose at an annual rate of 3.2 percent during the period January-March 2006. In the light of these developments, private sector economic analysts estimate that GDP will grow by 4.6 percent at an annualized quarterly rate (3.4 percent at an annual rate) during the latter period, and 3.4 percent on average during the year.

In the euro area, economic activity slowed down unexpectedly during the last quarter of 2005, growing 1.3 percent on an annualized quarterly basis (1.8 percent at an annual rate), after having expanded 2.8 percent during the third quarter (1.6 percent at an annual rate). This was due to the weakening of private consumption and to exports growing by less than imports. Nonetheless, timely information points to a strengthening of economic activity during the period January-March, boosted by investment growth and a rebound in consumption. In Japan, economic activity accelerated significantly during the period October-December by growing at an annualized quarterly rate of 5.4 percent (4.3 percent at an annual rate). Industrial production and retail sales, among other indicators, suggest that the dynamism of economic activity continued throughout January-March, and that the expansion will consolidate in the coming quarters.

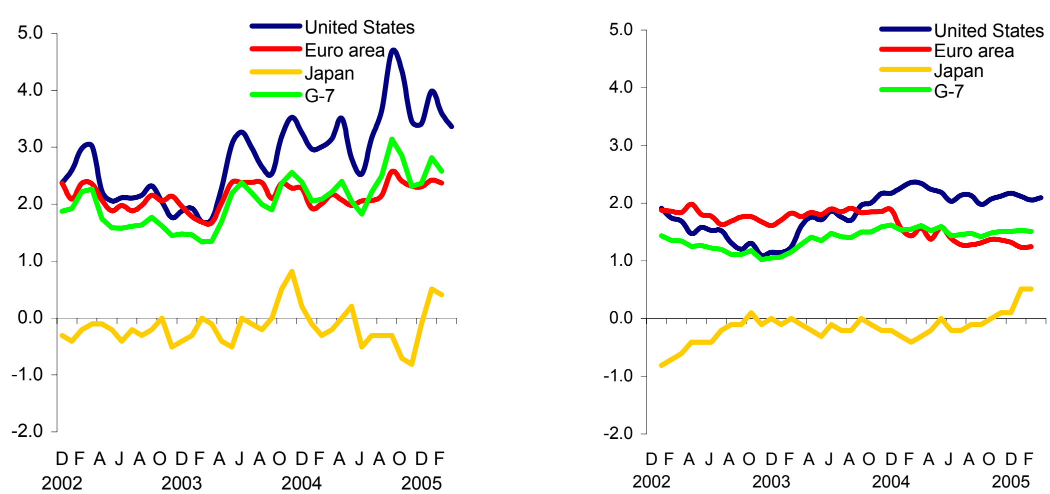
Emerging market economies have continued to exhibit solid growth in recent months. In China, GDP grew at an annual rate of 9.9 percent during the fourth quarter of 2005, and at an even higher rate during the first quarter of 2006 (10.2 percent at an annual rate). In Latin America, growth remained strong during the period October-December 2005, but continued to expand at rates below those observed in the first half of the year. In Brazil, GDP growth fell short of expectations at the end of 2005, although a rebound is anticipated in 2006. Economic activity in Argentina remained strong, while in Chile it slowed slightly, due to a less vigorous growth of exports.

3.1.2. General Trends of Inflation

Despite the strength of global economic activity, the persistence of high oil prices, and the significant increase in the prices of several non-oil commodities in international markets, the outlook for world inflation is still benign (Graph 5).

Graph 5
Consumer Price Index 1/
Annual percentage change

a) Total b) Core



Source: Bureau of Labor Statistics, Eurostat, Statistics Bureau, Statistics Canada and National Statistics.

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After the surge observed during the first quarter of 2005, mainly as a result of the hurricanes in the Gulf of Mexico, international prices of crude oil fell during the fourth quarter, helping to contain inflationary pressures. At the beginning of 2006, international prices of crude oil rebounded once more, despite the high inventories of crude oil and refined products in the U.S., which exceeded by far their average for the last 5 years; the gradual recovery of production in oil refineries in the South East Coast; and expectations of an increase in the supply from non-OPEC countries. Such increase in crude oil prices reflected the strength of global demand and political uncertainty in some oil producing countries (mainly Iran and Nigeria). The price per barrel of the WTI averaged 63.4 US dollars during the first quarter, some 3 dollars above the average recorded during the previous quarter.[2]

The upward trend in the prices of non-oil commodities gained strength during the first quarter. As a result, risks of inflationary pressures from this source increased (Table 2). As a whole, the prices of these commodities rose 39.3 percent in annualized quarterly terms, above the figure observed during October-December (15.1 percent). The most significant increases were recorded in metal prices (70.5 percent at an annualized quarterly rate) but increases were also observed in food, beverages, and agricultural raw materials, after these items had shown declines during the previous quarter.

Table 2
Commodity Prices
Annual percentage change

	I 05	II 05	III 05	IV 05	I 06
Total (100.0)					
Annual variation	29.08	27.81	33.71	26.16	25.74
Annualized quarterly change	33.14	31.01	59.69	-9.07	31.41
Energy (47.8)					
Annual variation	41.00	38.83	44.65	31.29	30.85
Annualized quarterly change	30.17	44.86	89.18	-16.71	28.43
Total Non-oil (52.2)					
Annual variation	8.78	7.35	10.40	14.61	14.47
Annualized quarterly change	40.01	3.97	3.00	15.09	39.31
Food (21.7)					
Annual variation	-2.00	-5.84	1.38	6.03	4.78
Annualized quarterly change	25.68	5.20	-3.46	-0.97	19.85
Beverages (3.1)					
Annual variation	29.41	32.65	14.96	8.46	1.33
Annualized quarterly change	118.48	-7.66	-28.11	-4.58	66.41
Agricultural Raw Materials (11.3)					
Annual variation	0.69	0.61	1.01	4.20	4.50
Annualized quarterly change	7.66	2.61	7.97	-1.16	8.92
Metals (16.1)					
Annual variation	24.31	25.60	25.72	29.72	30.21
Annualized quarterly change	67.91	4.92	11.96	43.55	70.49

Source: IMF Commodities Unit of the Research Department.
Note: Figures in parentheses refer to weights in the general index.

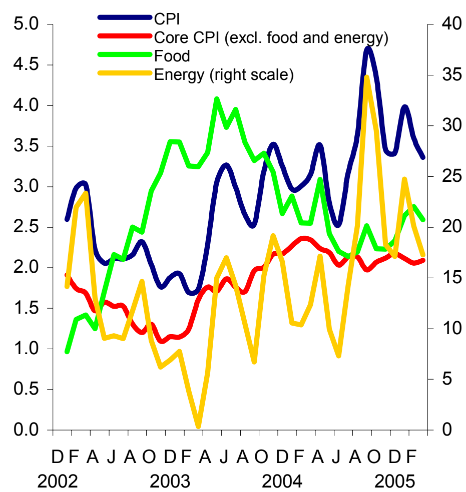
[2] During the second half of April, international prices of crude oil reached new record highs. On April 21, the price per barrel of WTI oil rose to 73.67 US dollars.

Headline inflation in the U.S. remained contained during the first quarter of 2006. Consumer prices grew at an annual rate of 3.4 percent in March, the same recorded at the end of 2005 (Graph 6). The annual variation of the personal consumption deflator moved from 2.8 percent in December to 2.9 percent in February. CPI core inflation remained around 2 percent during the quarter, in a context of low wage pressures. Long-term inflation expectations remained around 2.5 percent. It is important to note that during the quarter, cost-related pressures that could pass on to headline inflation were observed. For example, the annual rate of producer price inflation for raw materials (excluding food and energy) rose from 4.8 percent in December to 13.3 percent in March.

Annual inflation in the euro area remained above the European Central Bank's reference value, reaching 2.2 percent in March. Nonetheless, core inflation (armonized index excluding energy, food, alcohol and tobacco) followed a slight downward trend, from 1.4 percent on annual terms in December, to 1.3 percent in March. On another front, Japan exhibited further signs pointing to an end of deflation. Both headline and core inflation showed positive annual variations in February (after having fallen 0.1 percent in December, the CPI recorded an annual variation of 0.4 percent). In China, annual inflation reached once more the low levels exhibited at the beginning of 2006 (in fact, below 1.0 percent in March). Inflationary pressures also decreased in several Latin American countries.

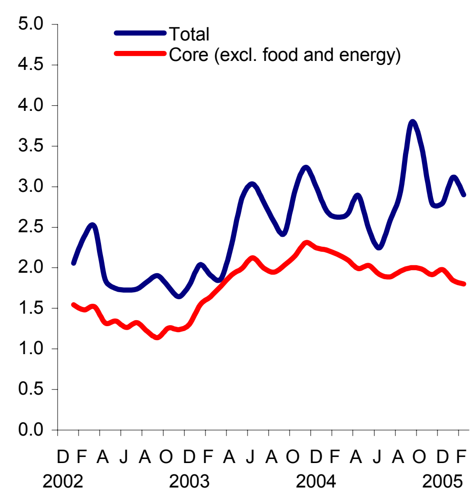
Graph 6
U.S.: Price Indexes
Annual percentage change

a) Consumer Prices [1/]



Source: BLS.

b) Personal Consumption Deflator [2/]



Source: BEA.

3.1.3. Financial Markets

Despite moderation in global inflation, the monetary authorities of some of the main advanced economies have continued to express concern regarding inflationary risks in the short term, therefore leading to adjustments in their policy rates.

In the U.S., the Federal Reserve continued its policy of gradual increases in the target for the federal funds rate. The target was raised by 25 basis points in January and again in March, reaching 4.75 percent, its highest level since April 2001. The monetary authorities have expressed concern about the likely inflationary pressures that could originate from a higher level of resource utilization and from surging prices of energy and other commodities. In its press releases at the beginning of the year, the Federal Open Market Committee (FOMC) mentioned that it would continue to tighten its policy stance, depending on the economic outlook. The futures curve for the federal funds rate points to a level of 5 percent towards mid-year.

The yield for the 10-year U.S. Treasury bond was 4.85 percent at the end of the first quarter, above that recorded at the end of the fourth quarter of 2005 (4.39 percent). Despite the continuous increase in short-term interest rates, and further increases in long-term interest rates during the month of April, the latter remain low, a factor that has fostered favorable conditions in international financial markets.

On the other hand, after having increased its policy rates in December 2005 –the first increase in five years- the European Central Bank raised them once more in March. The main reference interest rate reached 2.5 percent. This decision was based on the authority's perception of risks surrounding price stability, originating from the additional increases in crude oil prices, increases in administered prices and indirect taxes, the high levels of liquidity, and price and wage increases originated as lagged effects from the recent surge in oil prices. The authorities also consider that economic activity will strengthen throughout the year. At the end of March and the beginning of the second quarter, markets began to anticipate a faster tightening of the monetary policy stance. Following the same line, the Bank of Japan decided at the beginning of March to end its "quantitative easing" policy and started to withdraw surplus liquidity from the financial system. Nonetheless, it kept its target rate close to zero.

Sovereign spreads in emerging markets (EMBI Global) followed a downward trend throughout the quarter, reaching historically low levels at the end of February. However, a rebound was observed in March.[3] Such upward adjustment mainly reflected the prospect of further increases in the Federal Reserve's policy rate, which created some volatility and correction in asset prices and currency values in emerging economies. Net flows of private capital to these economies, estimated by the IMF to have been 226.5 billion US dollars in 2005 (its highest nominal level to date), remained vigorous during the first two months of 2006.

In foreign exchange markets, the trend towards an appreciation of the US dollar -observed since the second quarter of 2005- reverted during the first quarter. This partly reflects both the change in Japan's monetary policy and higher interest rates in Europe. Nonetheless, the US dollar not only depreciated against the euro, and, to a lesser extent, against the yen, but also showed weakness against the currencies of certain emerging market economies, particularly of East Asia. Therefore, during the period January-March, the US dollar effective nominal exchange rate with respect to the main currencies depreciated by 1.0 percent in

[3] Interest rate spreads fell once more to historically low levels. On April 21, 2006 the EMBI Global reached 184 basis points.

relation to the previous quarter. Measured with a broader index (which includes several emerging market economies), it depreciated 1.4 percent.

3.1.4. Outlook

The outlook for solid growth worldwide in 2006 remains practically unchanged. The global economy is expected to grow at a rate similar to that recorded in the past three years, which is above the average of the two past decades (particularly in the case of emerging market economies). In addition, greater balance in the sources of world growth is anticipated: the pace of expansion in the U.S. and China is expected to moderate as compared with 2005; while the euro area would experience a rebound and Japan a slight upturn. Analysts expect the pace of growth of the U.S. economy to moderate gradually during the year. Nonetheless, the industrial sector is anticipated to continue strengthening, as the effect of the hurricanes dissipates completely. Industrial production in 2006 is expected to expand at a faster pace than during the previous year.

On the other hand, although expectations of a benign scenario for inflation prevail, risks have increased. In the U.S., despite the absence of significant wage pressures, inflationary pressures could escalate if the degree of resource utilization continues to increase in an environment of high energy prices. According to the European Central Bank, the risk persists that inflation in 2006 will surpass, once more (although by a modest margin) the 2 percent ceiling. As for Japan, consumer prices are expected to record in 2006 their first positive annual variation in 7 years.

The base scenario continues to face risks emanating from current accounts imbalances (particularly in the U.S.); the high prices of real estate assets in several economies; the potential deterioration in financing conditions in international capital markets; the high oil prices; and a possible additional hike in those prices deriving from geopolitical events.

3.2. Aggregate Demand and Supply

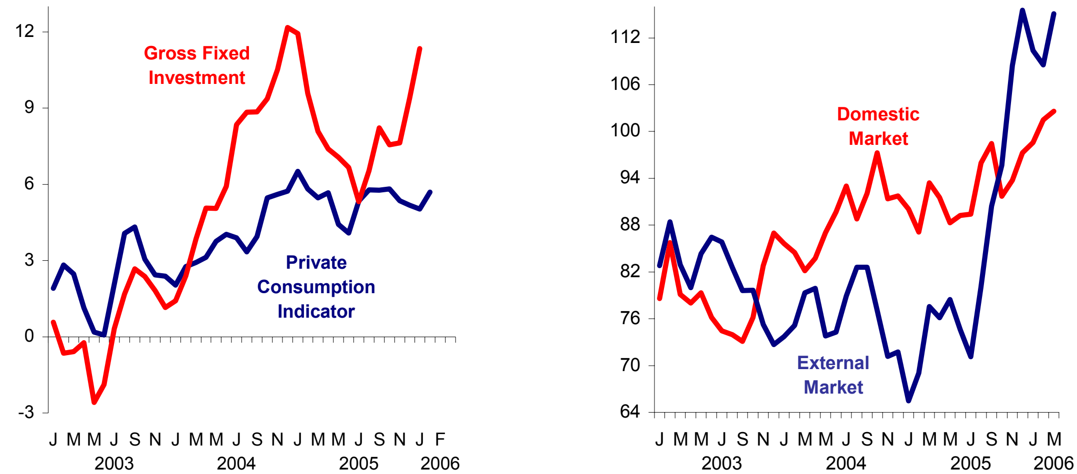
3.2.1. Indicators of Aggregate Demand and Supply

During the first quarter of 2006, aggregate demand and GDP continued to recover just like in the second half of 2005, after having slowed during the first half of that year. During the first three months of 2006, the behavior of both aggregate demand and production was influenced upward by the statistical effects associated with the Easter holiday. This led to an increase in the number of working days during the first quarter of 2006 as compared with the corresponding quarter of the previous year, and will create an opposite effect during the second quarter of the year. Consequently, the annual rates of both aggregate demand and GDP were influenced upward during the first quarter and will have a downward contribution during the second quarter.

Graph 7
Domestic Demand and Production Indicators

a) Domestic Demand
Annual percentage change of seasonally adjusted data and 2-month moving average

b) Vehicle Production for Domestic and External Markets
October 2000=100 and 2-month moving average of seasonally adjusted data



Source: INEGI for Gross Fixed Investment and Banco de México for the Private Consumption Monthly Indicator. Seasonal adjustments by Banco de México.

Source: Prepared by Banco de México with data from AMIA and ANPACT.

The main aspects characterizing the behavior of aggregate demand during the first quarter of 2006 were as follows: i) consumption expenditure grew at an annual rate close to that recorded during 2005 (Graph 7a);[4] ii) investment grew at higher annual rates than in the fourth quarter of 2005 and for that year as a whole, mainly mirroring the growth exhibited by its components of imports of capital goods and construction;[5] and, iii) the recovery of exports of goods and services during the second half of 2005 strengthened further during the first months of 2006.

During the first quarter of 2006, and just as in the previous two years, external conditions affected aggregate demand and domestic production favorably. On the one hand, external demand exhibited a positive behavior, therefore contributing to the greater dynamism of non-oil exports. Automotive exports increased considerably, after the main car assembly companies invested significantly in modernizing their production lines for new models. The positive external environment also led to new increases in the oil trade surplus and in revenues from workers' remittances. As a result, these additional resources continued to support expenditure in private consumption and to boost investments. As for workers' remittances, they are expected to represent, for the

[4] Private consumption indicators reveal that retail sales grew at an annual rate of 3.1 percent, as compared with 1.7 and 3.6 percent during the previous quarter and during the entire 2005, respectively.

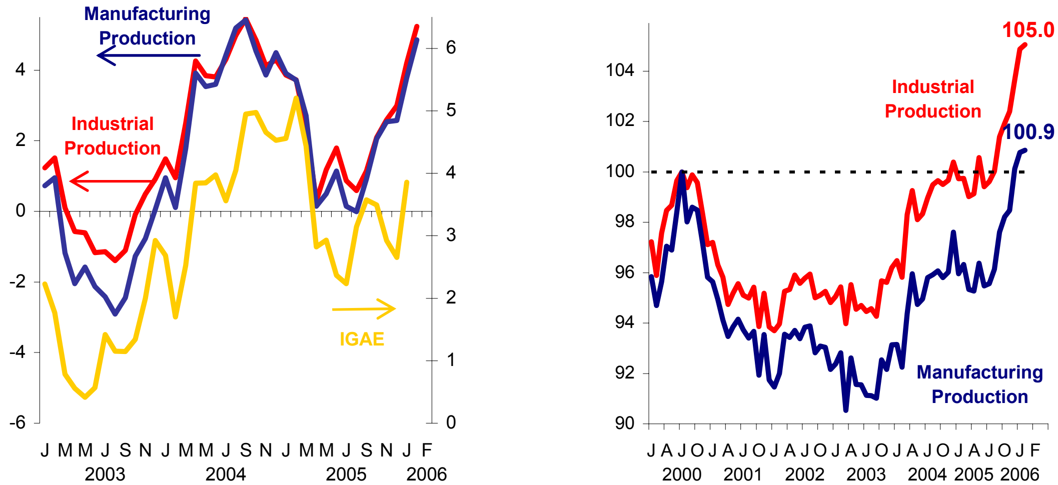
[5] According to investment indicators, investment is expected to have grown at an annual rate of 11.2 percent during the January-February 2006 period, figure above those recorded during both, the fourth quarter of 2005 (8.5 percent) and the entire 2005 (7.6 percent). During the first two months of 2006, the annual increase of expenditure in construction investment was 7.7 percent, while in the first quarter of the year imports of capital goods measured in current US dollars grew 19.5 percent. During the fourth quarter of the previous year and during the entire 2005, the latter rose 14.6 and 16 percent, respectively.

year as a whole, 4 percentage points of the country's private consumption expenditure.

Graph 8
Production Indicators

a) Production
Annual percentage change of seasonally adjusted data and 2-month moving average

b) Seasonally adjusted series
July 2000=100



Source: INEGI. Seasonal adjustments by Banco de México.

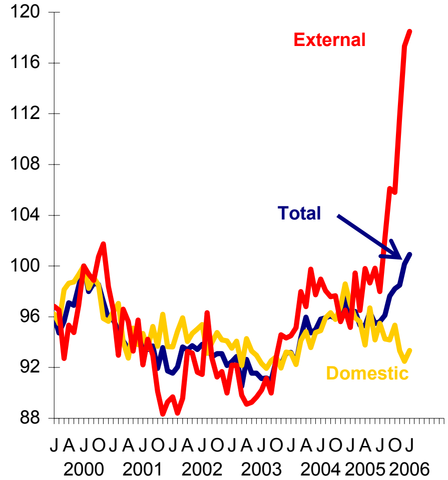
During the first quarter of 2006, aggregate supply was characterized by higher annual growth of both GDP and imports of goods and services, than that recorded during the last quarter of 2005 and during the entire 2005. Such expansion was also more balanced among sectors as industrial, agricultural and services activities grew significantly in annual terms. Such result contrasts with previous year figures, when the agriculture sector contracted on an annual term basis and the industrial sector grew modestly.

The rebound exhibited by industrial production during the first months of 2006 was due to increased activity in its four sectors (mining, manufacturing, construction and electricity), being the most significant improvement that observed in manufacturing (Graph 8).[6] The improvement in manufacturing began at the end of 2005, as a result of higher growth of export-related production, while production for the domestic market remained weak (Graph 9a). The higher growth of export-related production continued to reflect the recovery of exports in many sectors, preventing the gap between U.S. and Mexican manufacturing production from widening further (Graph 9b).

[6] During the first two months of 2006, industrial and manufacturing production grew at an annual rate of 5.7 and 5.5 percent, respectively, while in 2005 they did so by 1.6 and 1.2 percent. Vehicle production (Branch 56) rebounded considerably during the same period (41.1 percent).

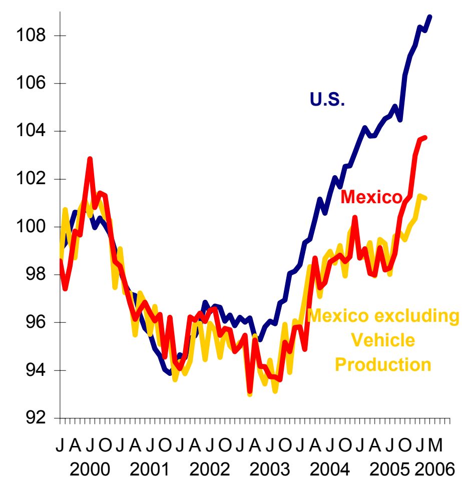
Graph 9
Manufacturing Production

a) For Domestic and External Markets
Seasonally adjusted data
(Figures to January 2006)
July 2000=100



Source: INEGI. Measurement of domestic and external markets and seasonal adjustments by Banco de México.

b) In Mexico and U.S.
Seasonally adjusted data
2000=100



Source: INEGI. Federal Reserve Board for U.S. data. Seasonal adjustments for the series Mexico excluding vehicle production by Banco de México.

Based on the aforementioned, as well as on the performance of other indicators of economic activity, GDP is expected to have grown nearly 5.2 percent in annual terms during the first quarter of 2006. Both GDP growth and domestic expenditure growth were influenced upward by the statistical effect of the Easter holiday, which resulted in more working days in the first quarter of the year than in the same quarter of 2005. The development of GDP and domestic expenditure during the first quarter of the year did not create significant pressures on production capacity, considering that: i) most of GDP growth stemmed from two sectors, agriculture and manufacturing. Regarding the former, its improved performance was basically due to the positive changes in weather conditions. As for manufacturing, after having recorded modest results during the previous year, its expansion responded to the greater dynamism of external demand in several sectors, together with the strong recovery of automobile exports (see Box 1); ii) despite progress in manufacturing production, its level during the first quarter barely surpassed the previous maximum level observed in mid-2000; and, iii) gross capital formation, an indicator of the economy's production capacity, has grown for more than two years at a significant annual rate.

Box 1
Recent Developments in Mexico's Automotive Industry *

A sector of significant relevance for the Mexican economy due to its production value, the employment it creates, and its effect on Mexico's foreign trade, is the automotive industry. This activity is particularly relevant for the external sector due to the value of automotive exports and imports, its significant trade surplus, and the fact that it is a recipient of foreign investment.

The automotive industry in Mexico has been characterized by the following: a) the recovery of vehicle production during the period 2005-2006, after several years of continued weakness; b) such improvement initially responded to an increase in export units, albeit units for the domestic market have also increased recently; c) most of automotive enterprises specialized in vehicle production have recorded positive vehicle production figures, as clearly evidenced by the production of new models; d) during 2005 and 2006, retail car sales have grown moderately in the domestic market, after having increased considerably in 2004; e) imported vehicles still have a high share in domestic sales; and f) the automotive trade agreement between Mexico and Brazil and Argentina has led to unfair trade, considering the high number of units imported from both countries and the reduced number of exported units.

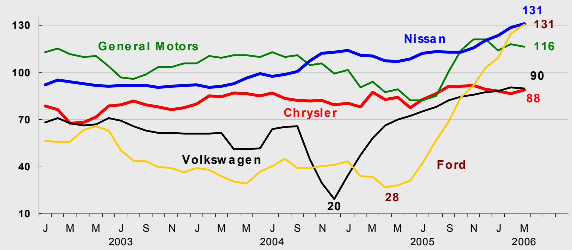
i) **Weak Production during the Period 2001-2004.** During this period, the number of Mexican manufactured vehicles fell 18.5 percent (356,254 units) in relation to its maximum level of 2000 (Table 1). Such result is attributed to the fact that different models that were manufactured in the country started to lose profitability in external markets, particularly in the U.S., due to strong competition from Asian brand vehicles in that market and the fact that certain exported models had reached the end of their useful life.

Table 1
Mexico: Automotive Production and Sales (2000-2006)

	2000	2003	2004	2005	2006 IQ	Variation 2000 - 2005
	Units					
Production	**1,923,427**	**1,585,695**	**1,567,173**	**1,697,616**	**533,607**	**-225,811**
For the Domestic Market	490,430	415,492	466,938	479,848	134,114	-10,582
For the External Market	1,432,997	1,170,203	1,100,235	1,217,768	399,493	-215,229
	Annual percentage change					
Production	**25.41**	**-12.48**	**-1.17**	**8.32**	**51.49**	**-11.74**
For the Domestic Market	7.42	-15.63	12.38	2.76	19.38	-2.16
For the External Market	33.03	-11.31	-5.98	10.68	66.52	-15.02

ii) **Recovery of Vehicle Production during the Period 2005-2006.** During 2005, and especially during the second half of that year, vehicle production in Mexico began to recover, mainly as a result of an increase in production for external markets (Graph 1). Such progress was due to the fact that the main vehicle-manufacturing companies established in Mexico had previously done significant investments to modernize their production lines in order to increase the supply of new models. Such improvement prevailed in the first months of 2006. In fact, during the first quarter of this year, the number of Mexican-manufactured vehicles increased by 52 percent in annual terms. Units manufactured by Ford, Volkswagen and General Motors rose by 266,114 (34 percent), while those of Nissan, Chrysler and the rest of vehicle-manufacturing companies did so by 21, 11 and 29 percent.

Graph 1
Vehicle production
2000=100; seasonally adjusted data and 3-month moving average



iii) **Consumer Behavior in the U.S. Market.** In recent years, U.S. consumers have exhibited, at the margin, a greater preference for Asian brand vehicles. As a result, Asian-origin vehicle manufacturing companies have increased their share in U.S. car sales from 33 percent in 2002, to 39 percent in the first quarter of 2006. Consequently, the share of U.S. vehicle manufacturing companies in total U.S. car sales decreased, from 60 percent in 2002 to 55 percent during the first quarter of this year (the remaining shares correspond to European vehicle manufacturing companies; Table 2). This trend affected significantly vehicle production in Mexico during the period 2001-2004. Nonetheless, as previously mentioned, the demand for new Mexican manufactured models has changed favorably in the U.S. market.

Table 2
U.S.: Sale of Light Weight Vehicles
By Origin of Vehicle Manufacturing Enterprises' Capital

	2002	2004	2005	IQ 2005	IQ 2006
	Units				
Total Sales	16,834,535	16,913,239	16,993,737	3,894,656	3,936,109
From Asian Vehicle Manufacturing Enterprises	5,550,903	6,055,087	6,415,182	1,457,134	1,527,352
From European Vehicle Manufacturing Enterprises	1,168,176	1,148,126	1,118,070	235,434	259,977
From U.S. Vehicle Manufacturing Enterprises	10,115,456	9,710,026	9,460,485	2,202,088	2,148,780
	Percentage structure				
Total Sales	100.0	100.0	100.0	100.0	100.0
From Asian Vehicle Manufacturing Enterprises	33.0	35.8	37.8	37.4	38.8
From European Vehicle Manufacturing Enterprises	6.9	6.8	6.6	6.0	6.6
From U.S. Vehicle Manufacturing Enterprises	60.1	57.4	55.7	56.5	54.6
Models in which Mexico participates 1/					
Units	3,980,221	3,907,626	3,680,872	801,322	848,624
Annual percentage change	n.a.	-2.4	-5.8	-0.4	5.9

1/ Models demanded by U.S. consumers in which Mexico covers part of the demand.
Source: Prepared by Banco de México with data from AUTOMOTIVE NEWS.

iv) **Specialization of Vehicle Production.** Most vehicle-producing companies in Mexico followed a strategy some years ago of both specializing in a small number of models, mainly for the export market, and increasing the domestic supply of vehicles through imported units. Currently, 75 percent of manufactured vehicles are exported and 63 percent of domestic sales are imported units (Graph 2). The main destination of Mexican exported vehicles is the NAFTA countries, while imported units are mainly from the NAFTA region and from Argentina and Brazil (Graph 3).

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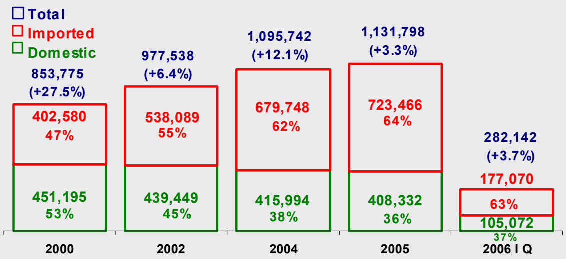
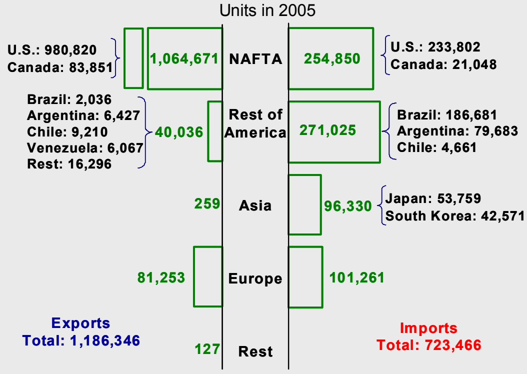
* Table 1 and graphs 1, 2, 3 and 5 were prepared by Banco de México with data from both the Mexican Automotive Industry Association (*Asociación Mexicana de la Industria Automotriz, A.C., AMIA*) and the National Association of Bus, Truck and Trailer Manufacturers (*Asociación Nacional de Productores de Autobuses, Camiones y Tractocamiones, A.C., ANPACT*).

Graph 2
Domestic Sales of Vehicles (Retail)
Units



v) **Recent Development of Domestic Sales.** During 2005 and the first quarter of 2006, automobile retail sales grew moderately in the domestic market, 3.3 and 3.7 percent, respectively, after having increased 12.1 percent in 2004 (Graph 2). A factor that had affected domestic sales of vehicles favorably was the significant fall in their relative prices. Nonetheless, this trend moderated in 2005 and 2006 (Graph 4).

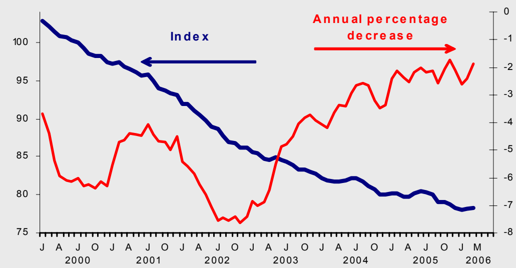
Graph 3
Exports and Imports of Vehicles by Region
Units in 2005



vi) **Mexico's Automobile Trade with Brazil and Argentina.** In September 2002, Mexico signed an Automotive Trade Agreement with Mercosur member countries (known as ACE-55). Such agreement established annual bilateral import quotas that increased through the years. Nonetheless, automobile trade with both countries has not been fair, in fact, very unbalanced for Mexico. During the period from 2002 to the first quarter of 2006, Mexico imported 953 thousand vehicles from these two countries (700 thousand from Brazil and 253 thousand from Argentina), while it exported only 31 thousand to both of them (Graph 5). As a result, during the last years the trade deficit between Mexico and Argentina and Brazil, as a whole, has widened. Such deficit increased from 2.469 billion US dollars in 2002 to 4.954 billion in 2005. From this last figure, the automotive trade deficit of Mexico with both countries amounted to 2.519 billion US dollars (51 percent).

vii) **U.S. Automotive Industry Situation.** In the last years, the world automotive industry has been affected negatively by price increases in some of its production inputs (steel and energy) and by the higher prices of gasoline. The latter has relatively favored the demand for gasoline-saving vehicles. Some automotive enterprises in the U.S. have faced severe financial problems, due, among other factors, to the lesser relative strength of demand for their vehicles, the adoption of certain price policies, and high labor costs. Increased labor costs have stemmed from pension programs and medical care services in very favorable conditions for workers. As a result, some of the main automotive corporations in that country are undergoing significant restructuring programs that will include the closing of certain car assembly plants as well as a reduction in their work force in both the U.S. and Canada.

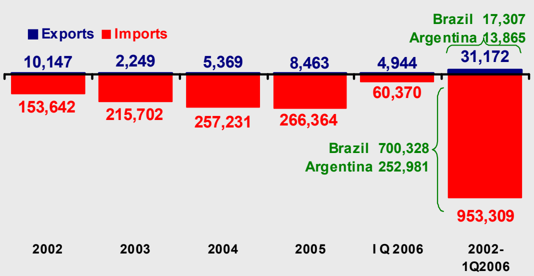
Graph 4
Relative Price of Car Purchases in Mexico *
2000=100 and annual percentage decrease



* Ratio of new car sale prices to CPI.

viii) **The Outlook for Mexico's Automotive Industry in the Short Term.** The scenario described in the previous paragraph contrasts with the current conditions of Mexico's automotive industry, considering that in the last years automotive companies in the country have invested significantly in expanding and modernizing their production capacities, and, even recently, have announced the construction of new plants. In fact, such enterprises foresee that they will have a positive performance for the remainder of the year.

Graph 5
Mexico: Foreign Trade of Vehicles with Brazil and Argentina
Units

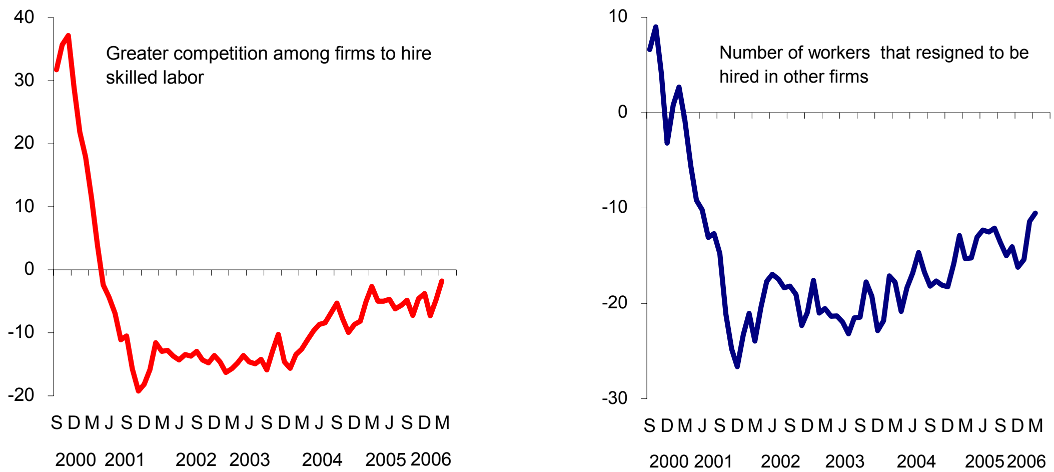


Last, it is important to point out that the positive performance recently exhibited by vehicle production and exports in Mexico is not exempt of risks, considering that in the first quarter of the year, total car sales in the U.S. rose only 1.1 percent (variations of -0.9, 1.4 and 0.5 percent in 2003, 2004 and 2005, respectively). This implies that the increase in Mexican export car units to the U.S. market has led to some manufacturing substitution between both countries, which, at present, cannot be regarded as a long lasting phenomenon.

3.2.2. Employment

Several indicators show that in the first quarter of 2006, employment followed a mixed trend. On the one hand, formal employment improved. On the other, some labor market indicators, such as the national unemployment rate (which recorded a slight increase) weakened (Graph 14). Available information suggests that employment growth was not reflected in a greater shortage of skilled labor. In fact, Banco de México's monthly indicators of the manufacturing sector show that in the first quarter of the year, firms did not face difficulties to recruit and hire skilled labor for their production, sales and management areas (Graph 10). During the same period, results from Banco de México monthly survey of private sector analysts' forecasts show that both skilled labor and labor costs were hardly mentioned as factors that could hinder, at the margin, economic activity in the country [7]

Graph 10
Labor Market Indicators
Manufacturing Sector: Labor Shortage Indicators
2-month moving average of balance of responses



Source: Results from Banco de México's Monthly Survey of Economic Conditions in the Manufacturing Sector. Balance of responses refers to the weighted average of enterprises mentioning to have faced greater competition from other firms to hire skilled labor (or enterprises mentioning that the number of workers that resigned to be hired in other firms increased) less those mentioning to have faced less competition from other firms to hire workers.

During the first quarter of 2006, the labor market was characterized by the following: a) higher annual growth of formal employment, measured by the number of workers insured by the IMSS; b) formal employment growth concentrated more in temporary jobs in urban areas than in permanent jobs; c) the number of workers insured by the IMSS rose in most sectors, including manufacturing; d) the national open unemployment rate increased slightly; and, e) the percentage of workers employed considered as underemployed or working in informal-related activities remained high.

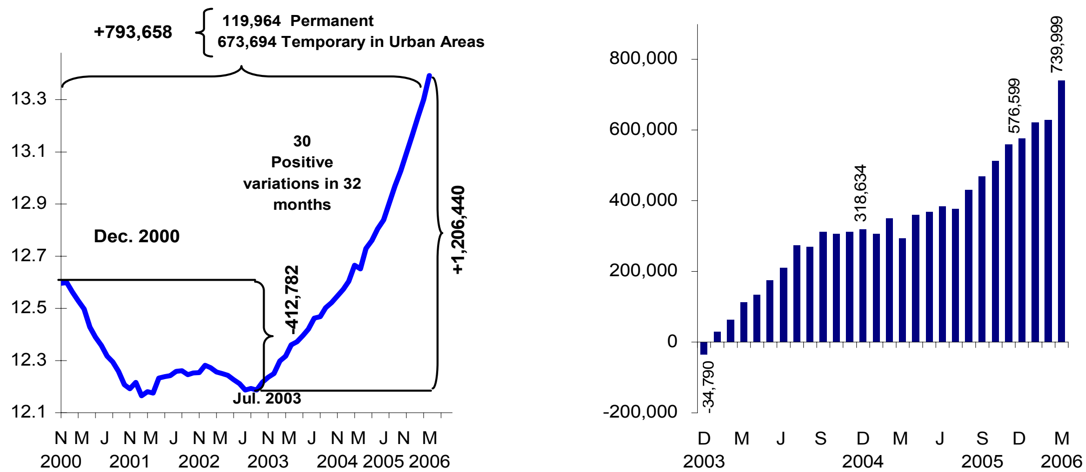
[7] See results of Banco de México Survey of Private Sector Analysts' Forecasts for the period January-March 2006.

At the end of first quarter of 2006, the number of workers insured by the IMSS increased by 739,999 in annual terms (5.9 percent growth) (Graph 11). Such increase was the highest recorded by this indicator in the last 67 months (since August 2000)[8] and comprised 259,603 permanent jobs (2.4 percent growth) and 480,396 temporary jobs in urban areas (27.7 percent growth). Therefore, temporary jobs in urban areas accounted for almost two thirds of the increase. This trend can likely be explained by the fact that enterprises are currently facing labor cost rigidities and therefore are trying to flexibilize their productive processes by hiring temporary workers.

Graph 11
Workers Insured by the IMSS: Permanent and Temporary in Urban Areas

a) Million Workers Insured
Seasonally adjusted data

b) Number of Workers Insured by the IMSS
Annual variation of original data



Source: IMSS. Seasonal adjustments by Banco de México.

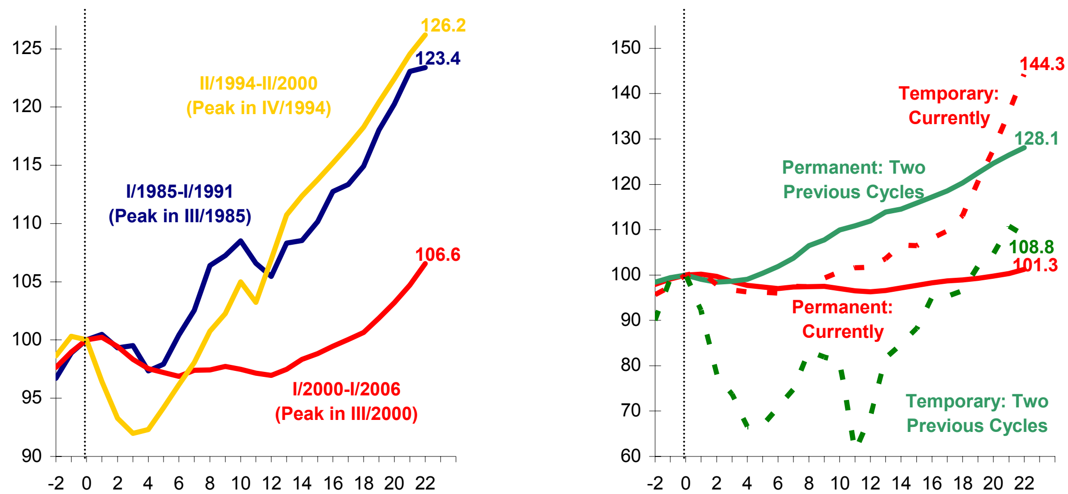
As for formal employment measured on a seasonally adjusted basis, from August 2003 to March 2006, this indicator rose by 1,206,440 workers, 793,658 workers above its maximum level reached at the end of 2000 (Graph 11). Nonetheless, it is important to mention that the recovery of formal employment throughout the current business cycle has been less significant than that observed in previous cycles (Graph 12a). Moreover, the improvement of this indicator during the current cycle has concentrated more on temporary jobs, while in previous cycles on permanent jobs (Graph 12b).

[8] As previously mentioned, the increase in the number of workers insured could also be reflecting the results of greater fiscalization efforts by the IMSS.

Graph 12
Workers Insured by the IMSS in Different Business Cycles
Índex = 100 in GDP's peak in each cycle
Seasonally adjusted quarterly data

a) Total Workers Index

b) Index of Permanent and Temporary Workers in the Current Cycle and its Average in the Previous Two Cycles



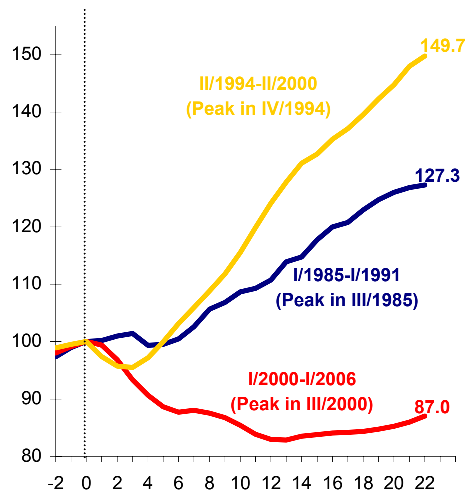
Source: Prepared with data from IMSS. Seasonal adjustments by Banco de México.

The improvement in formal employment during the first quarter of the year comprised all sectors of economic activity, being particularly significant in construction (153,568 workers and 16.6 percent), the tertiary sector, especially in trade activities (143,752 workers and 5.9 percent), and in other services (267,038 workers and 6.3 percent).[9] Manufacturing employment also improved considerably (125,406 workers and 3.3 percent). Manufacturing employment continued to improve during the period 2004-2006, after three consecutive years of contraction. Nonetheless, formal employment in the manufacturing sector has been characterized recently by two aspects: a) it has improved less during the present economic cycle than in previous cycles (Graph 13a). On a seasonally adjusted basis, and up to end of March 2006, the total number of manufacturing workers insured by the IMSS fell by 585,439 (13 percent) as compared with its level in October 2000 (Graph 13b); and, b) the improvement in manufacturing employment has only included temporary positions in urban areas. In fact, during the current cycle, the number of permanent workers in this sector declined significantly.

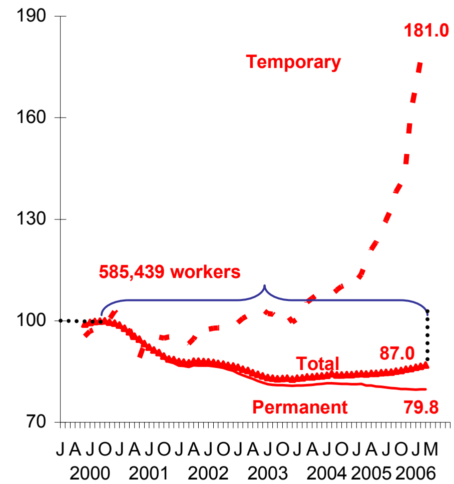
[9] The sector Other Services includes services for enterprises and individuals, as well as social and community services.

Graph 13
Manufacturing Workers Insured by the IMSS
Seasonally adjusted data

a) In Different Business Cycles
Index = 100 in quarterly GDP's peak of each cycle



b) Índex of Permanent and Temporary Workers in Urban Areas
October 2000= 100

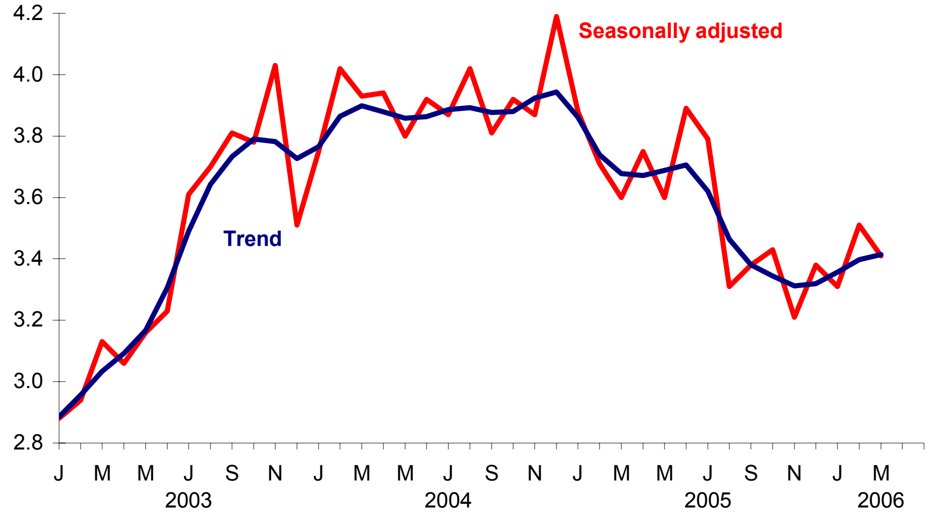


Source: Prepared with data from IMSS. Seasonal adjustments by Banco de México.

According to the Occupation and Employment Survey (*Encuesta Nacional de Ocupación y Empleo,* ENOE) conducted by INEGI, during the first quarter of 2006, the national unemployment rate rose slightly. On a seasonally adjusted basis, this indicator was 3.41 percent during the period, after having recorded 3.34 percent in the fourth quarter of 2005. In March of this year, the percentage of working population which considered themselves as underemployed was 6.66 percent, while the working population in informal-related activities was 28.7 percent during the fourth quarter of 2005.[10] Although formal employment increased significantly, its share in the economic active population and in the working population is still relatively small.

[10] According to the Occupation and Employment Survey, the underemployed population is made up of individuals that need to work and are available for working more hours than the number of hours they are currently working. As for the working population in the informal sector, it includes individuals participating in economic market activities operating with their own household resources, but not established as enterprises with a status independent from households. In such production units there are no accounting practices and no distinction is made between household and enterprise wealth.

Graph 14
National Unemployment Rate
Percentage in relation to economically active population



Source: INEGI. Seasonal adjustments and trend series by Banco de México.

3.2.3. External Sector

At the end of the first quarter of 2006, the trade balance and the current account recorded a surplus (smaller in the case of the latter). This, in spite of the higher growth rate (in annual terms) exhibited by aggregate demand and GDP as compared with the fourth quarter of the previous year and the entire 2005, with the consecutive increase in the demand for imports of goods and services. Under such context, such increase was offset by three factors that raised net revenues in the trade and current account balances significantly: a higher surplus in the oil trade balance, the recovery of automobile exports (trade account), and, the higher inflow of workers' remittances (current account).

During the first quarter of 2006, the current account of the balance of payments and its main items were characterized by the following aspects:

a) A higher growth of non-oil exports, resulting from a more favorable behavior of external demand in different sectors. The recovery of automotive exports (as a result of significant investments in this sector that raised vehicle production) also added to such results.[11]

b) A significant increase in oil exports. The value of oil exports (9.9 billion US dollars) as well as the average price of the Mexican crude oil export mix reached historically high levels during the quarter.

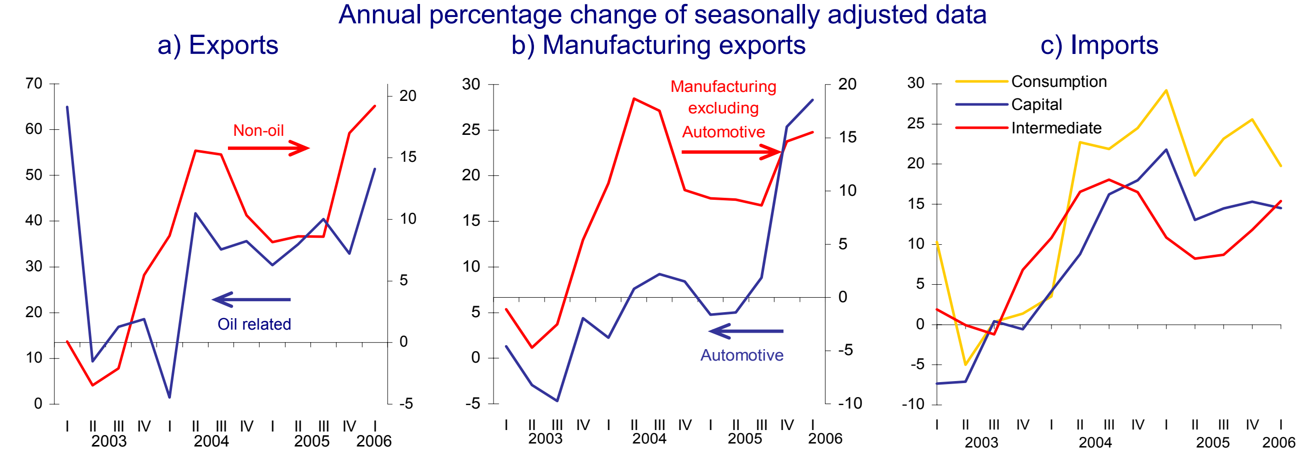
[11] During the first quarter of 2006, merchandise exports rose 25.8 percent in annual terms, in response to increases in oil (52.3 percent) and non-oil (21.6 percent) exports. Within non-oil exports, manufacturing exports (both maquiladora and non-maquiladora) grew 20.9 percent, as a result of annual increases in the automotive (33 percent) and rest of manufacturing (16.7 percent) sectors.

c) The loss of U.S. market share of Mexican exports stopped during the first two months of the year, mainly as a result of increases in oil and automotive exports.

d) Merchandise imports grew at a higher annual rate than in the previous four quarters.

e) A reduction in the non-oil trade deficit, despite the fact that domestic expenditure grew at a higher annual rate than GDP. Such result is due to the considerable recovery of automotive exports. The latter implied that, in annual terms, the trade surplus of automotive products increased approximately by 1.7 billion US dollars.

Graph 15
Merchandise Exports and Imports
Annual percentage change of seasonally adjusted data



Source: Banco de México.

During the first two months of 2006, the performance of Mexican exports in the U.S. market improved. During such period, Mexican exports to the U.S. grew 21.5 percent in annual terms, above total annual sales of the rest of the U.S. trading partners (13.8 percent) (Table 3). This implied that Mexican exports gained share in U.S. imports, from 10.08 percent during the first two months of 2005 to 10.69 percent during the same period of 2006. Such improvement in annual terms is completely attributed to the favorable performance of oil and automotive exports.[12] Excluding such products from total Mexican exports to the U.S., the rest of the products did not gain market share, considering that exports of the rest of the products grew 12.18 percent in annual terms during both months, practically the same as that recorded by exports of the rest of the U.S. trading partners (12.17 percent).

[12] Mexican products gained market share in the U.S. during the last two months of 2005, due to the positive results of oil and automotive exports. Previous to such period, Mexican products had gained market share in the U.S. during the last two months of 2003.

Table 3
U.S. Imports
Percent

	Share				Annual Percentage Change: January February 2006				
	2004	2005	Jan-Feb 2005	Jan-Feb 2006	Total	Oil	Total excluding Oil	Automotive	Total excluding Oil and Automotive
Total	**100.00**	**100.00**	**100.00**	**100.00**	**14.55**	**40.30**	**11.97**	**10.96**	**12.17**
Total excluding Mexico	**89.39**	**89.81**	**89.92**	**89.31**	**13.77**	**36.05**	**11.62**	**8.46**	**12.17**
Total excluding Mexico and China	**76.01**	**75.24**	**75.74**	**75.32**	**13.92**	**35.74**	**11.38**	**8.46**	**12.02**
1. Canada	17.44	17.23	17.77	18.16	17.07	53.00	14.29	6.40	17.25
2. China	13.38	14.57	14.18	13.99	12.97	170.84	12.76	--	12.76
3. Mexico	**10.61**	**10.19**	**10.08**	**10.69**	**21.50**	**68.92**	**15.24**	**22.90**	**12.18**
4. Japan	8.83	8.26	8.63	8.00	6.24	--	6.24	15.37	1.00
5. Germany	5.26	5.08	5.07	4.85	9.63	--	9.63	3.62	12.46
Total 5 countries	55.52	55.32	55.73	55.69	14.47	61.47	12.29	11.96	12.39

Source: Prepared by Banco de México with data from the Census Bureau (U.S. Department of Commerce).

The small surplus in the current account during the first quarter of 2006 mainly resulted from higher surplus in both oil and automotive trade balances. In the former case, such positive balance moved from 3.004 billion US dollars during the first quarter of 2005 to 5.307 billion during the same quarter of 2006, while in the second case, it rose from 3.798 billion U.S. dollars during the first period to 5.488 billion during the second. The other item that significantly affected the current account balance was workers' remittances. During the first quarter of this year, such item totaled 5.185 billion US dollars, 1.120 billion (27.5 percent) more than in the same period of 2005.

During the first quarter of 2006, the current account of the balance of payments recorded a small surplus of approximately 0.3 billion US dollars, which contrasts with the 3 billion deficit recorded during the same quarter of 2005.[13] The capital account (including errors and omissions) recorded a deficit of 1.5 billion US dollars, as a result of private sector net inflows from foreign investment, both direct and portfolio, PIDIREGAS projects, and assets' outflows. The latter mainly reflected Mexican companies' investments abroad and an increase in commercial banks' foreign resources. During the first quarter, Banco de México's net international reserves decreased by 1.182 billion US dollars. Thus, at the end of March, the stock of international reserves recorded 67.487 billion US dollars.

3.3. Costs and Prices

3.3.1 Wages and Unit Labor Costs

During the first quarter of 2006, contractual wages negotiated by enterprises under federal jurisdiction recorded, on average, a 4.3 percent increase, 0.2 percentage points below that observed during the same period of the previous year (Table 4). This reduction was due, mainly, to the slower rate of

[13] The current account of the balance of payments also recorded a surplus during the second quarter of 2005, influenced by the higher values of oil exports, revenues from workers' remittances, and the seasonality of interest paid abroad. Previous to such period, the current account had not exhibited a surplus since the second quarter of 1996. However, at that time the Mexican economy faced very different conditions than today (the referred surplus reflected the adjustment of the economy to the crisis at the end of 1994).

growth of wages in private enterprises, which was, on average, 4.4 percent (during the first quarter of 2005 it recorded 4.7 percent). In contrast, the annual variation of wages in public enterprises rose (4.0 percent during the analyzed quarter and 3.6 percent during the same period of 2005). During the reference period, public enterprise workers under wage negotiations accounted for 19 percent of the total.

Table 4
Contractual Wage Average Increases and Number of Workers Benefited by Type of Enterprise

	2005					2006			
	I	II	III	IV	Jan-Dec	Jan	Feb	Mar	Jan-Mar
Contractual Wage Increase (percent)[1/]									
Total	4.5	4.4	4.4	4.2	4.4	4.4	4.2	4.2	4.3
Public Enterprises	3.6	4.0	4.1	4.0	4.0	4.0	4.0	4.0	4.0
Private Enterprises	4.7	4.6	4.7	4.7	4.6	4.5	4.3	4.3	4.4
Number of Workers Benefited (percentage share)									
Total	100	100	100	100	100	100	100	100	100
Public Enterprises	19	22	46	72	41	19	11	24	19
Private Enterprises	81	78	54	28	59	81	89	76	81

1/ Average weighted by number of workers benefited during the period.
Source: Prepared by Banco de México with data from the Ministry of Labor.

During 2005, unit labor costs in the non-maquiladora manufacturing industry fell. Nonetheless, such reduction in annual terms was below that observed in 2004. ULC in the maquiladora industry and in the retail sector grew during 2005, as compared with the negative growth rates recorded during the previous year (Table 5). Information of January 2006 indicates reductions in the ULC of the non-maquiladora manufacturing industry and the retail sector, and a slightly positive variation in the maquiladora industry.

Table 5
Earnings, Labor Productivity and Unit Labor Costs by Sectors
Annual percentage change

	Non-maquiladora Manufacturing Industry			Maquiladora Industry			Retail [1/]		
	Labor Productivity	Real Average Earnings	ULC	Labor Productivity	Real Average Earnings	ULC	Labor Productivity	Real Average Earnings	ULC
2004									
Jan-Dec	**7.1**	**0.3**	**-6.3**	**2.5**	**-0.2**	**-2.6**	**8.7**	**-0.3**	**-8.3**
2005									
Jan	2.5	-0.4	-2.9	-2.1	-2.2	-0.1	3.0	-1.8	-4.7
Feb	3.7	0.0	-3.5	-1.5	-2.0	-0.5	1.2	6.8	5.5
Mar	-4.5	0.2	4.9	-0.5	0.0	0.5	-1.3	4.6	6.0
Apr	7.4	-1.8	-8.6	-4.2	-3.4	0.8	2.8	2.7	-0.2
May	4.2	0.1	-4.0	-4.7	1.0	6.0	0.8	3.1	2.3
Jun	1.0	1.3	0.3	1.3	1.2	-0.1	-0.7	4.7	5.4
Jul	-1.2	-1.5	-0.4	-2.3	0.2	2.5	-1.0	2.4	3.5
Aug	2.3	0.4	-1.8	1.5	4.2	2.6	2.2	2.3	0.1
Sep	1.0	-0.8	-1.8	-1.4	2.0	3.5	3.2	5.9	2.6
Oct	2.8	0.6	-2.1	-1.4	-0.2	1.2	0.1	-15.0	-15.1
Nov	3.2	1.3	-1.9	2.2	4.0	1.8	-2.0	-4.6	-2.7
Dec	1.6	-0.7	-2.3	-0.1	0.6	0.7	-1.4	-0.8	0.6
Jan-Dec	**2.0**	**-0.1**	**-2.0**	**-1.1**	**0.4**	**1.6**	**0.6**	**0.9**	**0.3**
2006									
Jan	6.5	0.3	-5.8	0.9	1.2	0.2	1.0	-4.7	-5.6

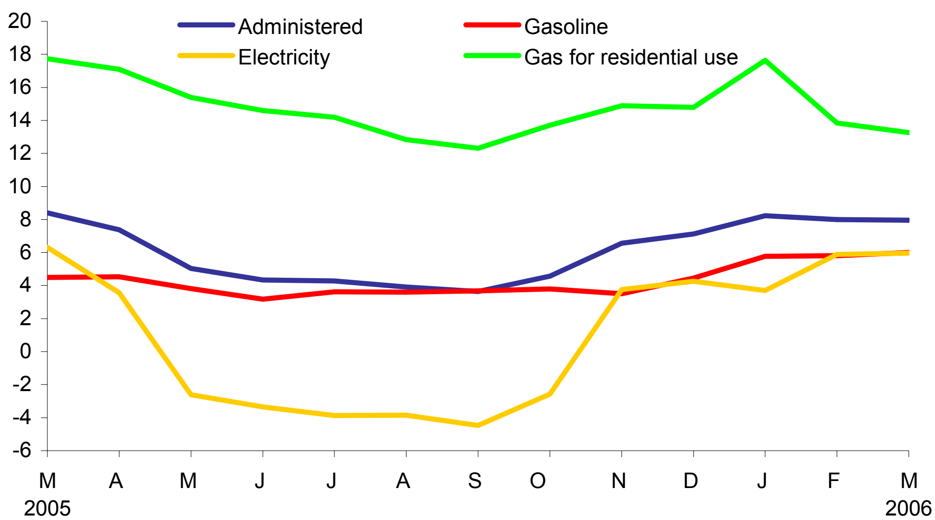
1/ Retail data was obtained from the new methodology of the Monthly Survey of Retail Stores (*Encuesta Mensual sobre Establecimientos Comerciales*,EMEC), published by INEGI in 2006.
Source: Prepared by Banco de México with data from INEGI.

3.3.2 Administered and Regulated Prices of Goods and Services

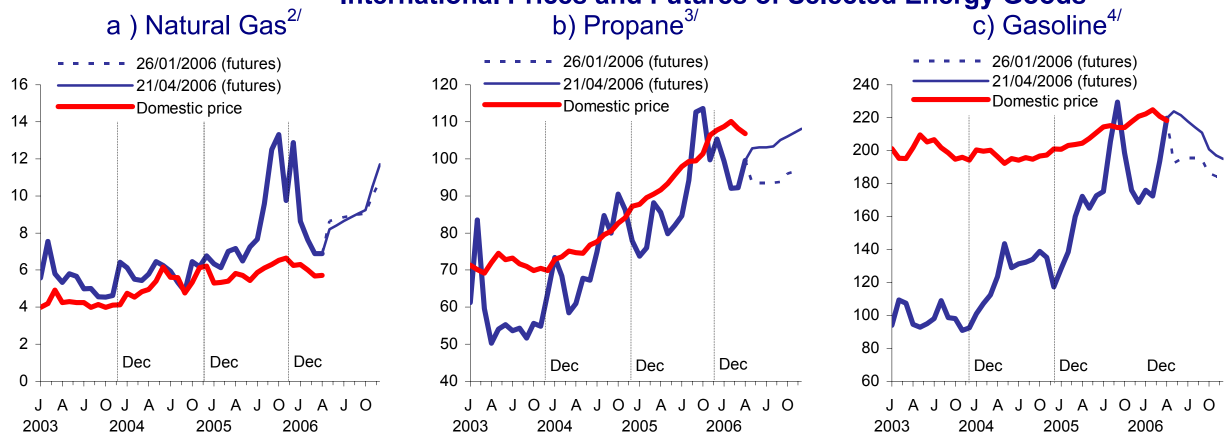
The annual growth rate of administered prices was, at the end of the first quarter of 2006, 7.95 percent (in December 2005 it was 7.13 percent). Such increase was induced by two factors: first, by a higher rate of growth of gasoline prices at border cities and, second, by an increase in the annual growth rate of electricity prices. As for the latter, such increase was due to the unusual fall observed in 2005, given that in the first quarter of that year, the second bracket for high consumption residential electricity tariffs (*tarifas domésticas de alto consumo,* DAC) was eliminated. On another front, the rate of growth of prices of residential consumption gas exhibited high volatility, influenced by the behavior of natural gas prices, given that propane prices fluctuated according to a rate of change compatible with an annual growth rate of 4 percent (Graph 16).

During the first quarter of the year, administered prices exhibited less volatility than that observed in international markets (Graph 17). This result is explained by the effect of the measures adopted by the federal government. In this regard, the decision to update propane prices, low-consumption electricity tariffs, and gasoline prices in non-border cites at an annualized rate of 4 percent, deserves mention. The federal government also announced that starting April 25, 2006, gasoline prices at northern border cities would not exceed the level reached during the week of April 11-17, 2006, therefore reducing the effects associated with possible additional increases in the prices of this fuel in such cities.

Graph 16
Administered Prices Subindex
Annual percentage change



Graph 17
International Prices and Futures of Selected Energy Goods 1/



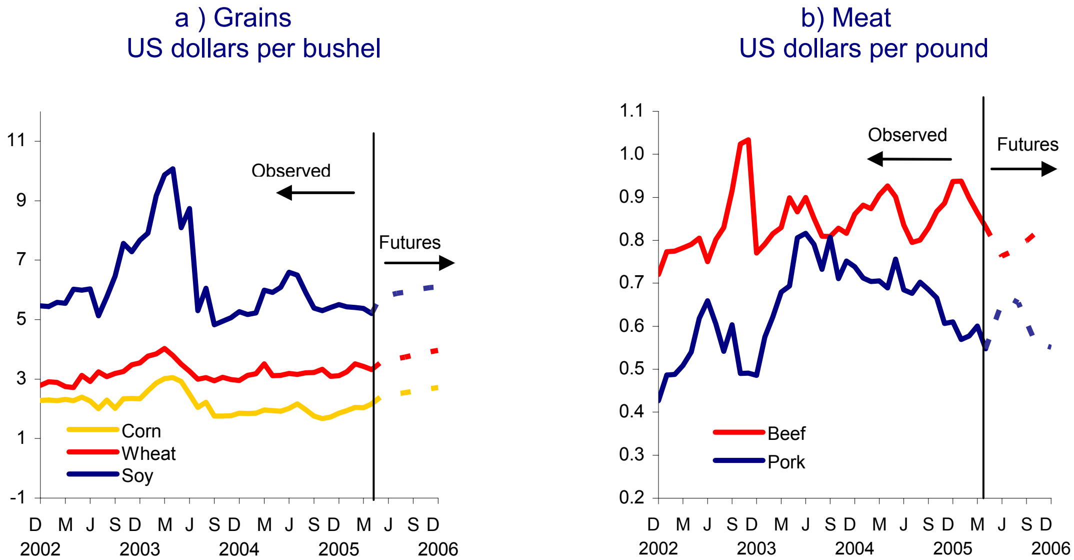
1/ Futures prices of January 26 and April 26, 2006.
2/ Tetco, Tx. US dollars per MMBtu.
3/ Mont Belvieu, Tx. US cents.
4/ Texas. US cents per gallon.

The annual variation of the regulated prices subindex continued to follow a downward trend during the first quarter of 2006, reaching in March 1.62 percent (in December it recorded 21.43 percent). This decrease was due mainly to the significant reduction in the car ownership tax and the slower growth rate of prices of the following items: public transportation, intercity bus services, water usage fees, taxi, property taxes, and parking fees.

3.3.3 Metals and Food Raw Materials

International prices of grains and meats directly affect the domestic prices of these products, and indirectly the production costs of different processed foodstuffs. During the first quarter of 2006, international prices of grains increased moderately. The behavior of their futures suggests that for the remainder of the year they could follow an upward trend. During the analyzed period, international prices of beef fell and future contracts reveal that these could decrease further during the second quarter. In contrast, international prices of pork meat increased slightly in March, and futures suggest that they could follow a downward path in the following months, although this trend would revert afterwards (Graph 18). In both cases, futures prices from April to December 2006 remain, on average, below those observed in 2005.

Graph 18
International Prices of Food Commodities 1/



1/ Futures prices of April 21, 2006.
Source: U.S. Department of Agriculture.

As for steel prices, during the first quarter of 2006, domestic prices of steel-related products rose significantly at an annual rate, due to certain speculation in the retail sector. The price of this metal and its by-products has remained stable in the U.S. market. Steel prices are particularly relevant in the CPI due to their incidence on the costs of construction materials and its effect on the determination of high consumption electricity tariffs. In addition to the above, copper prices have increased, mainly affecting the costs of certain construction materials.

3.4. Monetary and Credit Aggregates

3.4.1. Monetary Base, Net Domestic Credit and International Assets

At the end of the first quarter of 2006, the stock of the monetary base was 353 thousand million pesos. During such period, this aggregate grew at an average annual rate of 12.2 percent, 2.6 percentage points below its previous year figures.[14] This suggests, as mentioned in previous reports, that the process by which the monetary base has increased as a percentage of GDP (remonetization) has lost strength. [15]

At the end of the first quarter of 2006, international assets rose by 1.931 billion US dollars. Thus, the stock of international assets accumulated by March 31st was 76.046 billion US dollars.[16] The monetary base decreased by 26,990

14 Variations calculated based on the average of daily stocks.
15 Historical evidence confirms that in low inflation economies: i) shocks on income and interest rates are reflected more slowly on the demand for money; and ii) such demand tends to become more sensitive to changes in interest rates. See Inflation Report April-June 2003.
16 For a definition of international assets and international reserves refer to the glossary of the weekly press release on Banco de México's balance sheet. Banco de México's broad credit position vs. the domestic

million pesos. As a result, Banco de México's net domestic credit declined by 48,051 million pesos during the quarter (Table 6).

Table 6
Monetary Base, International Assets and Net Domestic Credit
Millions

	Stocks		Flows in 2006
	At Dec.31, 2005	At Mar.31, 2006	Accumulated at Mar.31, 2006
(A) Monetary Base (Pesos)	380,034	353,044	-26,990
(B) Net International Assets (Pesos) [1/ 2/]	788,167	828,410	21,062
Net International Assets (US dollars) [2/]	74,115	76,046	1,931
(C) Net Domestic Credit (Pesos) [(A)-(B)] [1/]	-408,133	-475,366	-48,051
(D) International Reserves (US dollars) [(E)-(F)] [3/]	68,669	67,487	-1,182
(E) Gross Reserves (US dollars)	74,110	76,024	1,914
PEMEX			6,420
Federal Government			-3,556
Sale of US dollars to banks [4/]			-1,407
Other [5/]			456
(F) Liabilities with less than six months to maturity (US dollars)	5,441	8,537	3,096

1/ Net international assets' cash flows in pesos are estimated based on the exchange rate applied to each transaction.
2/ Net international assets are defined as gross reserves plus credit agreements with foreign central banks with more than six months to maturity, minus total liabilities payable to the IMF and credit agreements with foreign central banks with less than six months to maturity.
3/ As defined by Banco de México's Law.
4/ Daily sales of US dollars according to the mechanism to reduce the pace of international reserve accumulation (see Exchange Commission's Press Release of March 20, 2003).
5/ Includes yields on net international assets and other transactions.

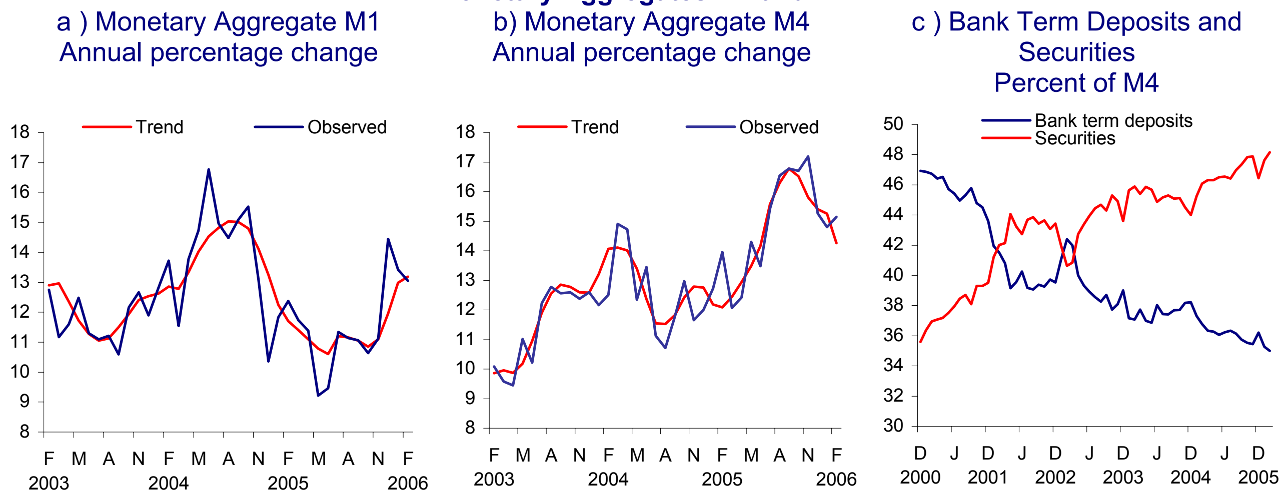
3.4.2. Monetary Aggregates and Financing

The reduction in interest rates since mid-2005 has contributed to a more dynamic performance of the narrow monetary aggregates. In particular, the monetary aggregate M1 grew at a higher annual rate, from 11.1 percent in September 2005 to 13 percent in February 2006 (Graph 19a).

Broad monetary aggregates continued to grow vigorously (the monetary aggregate M4 grew at an annual rate of 15.1 percent in February 2006), although slower than in mid-2005 (Graph b). As for savings instruments, bank term deposits continue to have less share in total financial savings (Graph 19c), thus reflecting the importance of securities issues, which have gained strength as an alternative source of financing.

market (net domestic credit) is obtained after deducting international assets from the monetary base; i.e., financing granted or received domestically by Banco de México. The international reserves definition excludes Banco de México's short-term foreign currency liabilities (less than six months).

Graph 19
Monetary Aggregates M1 and M4



The greater supply of domestic financial resources has been coupled by an increase in foreign inflows. Regarding financial resources' uses, the significant revenues from oil and lesser financial costs, among other factors, have allowed the public sector to reduce its financial borrowing requirements (Table 7). This has increased considerably the availability of additional resources for households and firms, which accounted for 2.8 percent of GDP in 2005.

Total resources available for the non-financial private sector have increased significantly. Such trend is even more evident when analyzing commercial banks' direct performing loans. This type of financing, which does not include loans related to financial support programs, mainly reflects the granting of new loans by commercial banks. In February 2006, direct performing loans to the private sector grew 32.5 percent, thus recording an annual flow of 201.2 thousand million pesos (Graph 20a). Households received 80 percent of this amount (159.6 thousand million pesos) while firms received the remaining 20 percent (41.6 thousand million pesos). In February 2005 households received 51 percent (79.1 thousand million pesos) and firms, 49 percent (76.9 thousand million pesos).

As for commercial banks' financing to households, consumption credit continued to grow vigorously, while that granted to housing increased considerably. Thus, in February of this year, commercial banks' annual increase in direct performing mortgage loans amounted to 67 thousand million pesos, while in February 2005 such flows totaled 19.7 thousand million pesos (Graph 20b).[17]

[17] Includes the purchasing of portfolio from mortgage SOFOLES.

Table 7
Total Financial Resources of the Economy (Uses and Sources)
GDP percentage

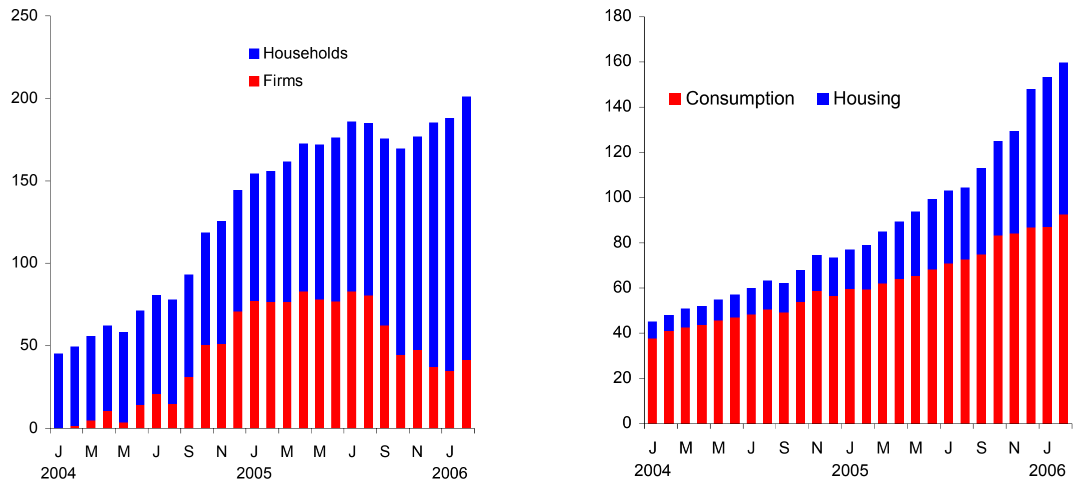
	Annual Flows			Stock in 2005	
	2003	2004	2005	% GDP	% Structure
Total sources	**5.4**	**5.9**	**7.7**	**73.4**	**100.0**
M4	5.5	5.4	7.2	53.8	73.2
Held by residents	5.4	4.8	6.8	52.1	71.0
SAR	1.8	1.4	1.9	12.0	16.4
Other	3.6	3.3	4.8	40.1	54.6
Held by non-residents	0.1	0.7	0.5	1.6	2.2
Financing abroad	-0.1	0.5	0.5	19.7	26.8
Public sector [1/]	0.5	0.7	0.2	12.6	17.2
Commercial banks [2/]	-0.1	0.1	-0.2	0.3	0.4
Private sector [3/]	-0.5	-0.4	0.5	6.8	9.2
Total uses	**5.4**	**5.9**	**7.7**	**73.4**	**100.0**
International reserves [4/]	1.5	0.6	0.9	8.7	11.9
Public sector (SHRFSP) [5/]	2.6	1.9	1.4	39.0	53.1
Domestic	2.1	1.2	1.2	26.4	36.0
External	0.5	0.7	0.2	12.6	17.2
States and municipalities [6/]	0.3	0.2	0.1	1.6	2.2
Private sector	0.9	2.0	2.8	27.9	37.9
Households	1.2	1.9	1.9	12.4	16.9
Consumption	0.5	0.9	1.2	3.7	5.1
Housing [7/]	0.7	1.0	0.7	8.7	11.8
Enterprises	-0.3	0.1	0.9	15.4	21.0
Credit granted by financial intermediaries [6/]	-0.3	0.2	0.3	6.7	9.1
Private securities in circulation	0.5	0.2	0.0	2.0	2.7
External financing	-0.5	-0.4	0.5	6.8	9.2
Other concepts [8/]	0.1	1.3	2.5	-3.8	-5.1

1/ Includes net external indebtedness from the federal government, public enterprises and institutions, and PIDIREGAS placed abroad, as reported by the Ministry of Finance.
2/ Commercial banks' net external liabilities. Excludes non-residents' bank deposits.
3/ Includes loans and securities issued abroad by the private sector.
4/ As defined by Banco de México's Law.
5/ Historical stock of Public Sector Borrowing Requirements (SHPSBR) and flow of Public Sector Borrowing Requirements (PSBR), as reported by the Ministry of Finance. In 2004, it excludes the effect of the redemption of FOBAPROA promissory notes.
6/ Total portfolio of financial intermediaries. Includes debt-restructuring programs.
7/ Total portfolio of financial intermediaries and of the National Employees' Housing Fund (*Instituto del Fondo Nacional de la Vivienda para los Trabajadores,* INFONAVIT*)*.
8/ Refers to non-sectorized assets, capital accounts and results, technical reserves' accounts, capital reserves, financial intermediaries' physical assets, preventive reserves, equity investment, commercial banks' external assets, financing to non-residents, INFONAVIT liabilities excluding resources from workers' contributions, liabilities of non-banking financial intermediaries, trusts net position with banks, difference in domestic financing of development banks to the private sector and financial intermediation, and changes in IPAB non-financial liabilities, among other concepts.

Graph 20
Commercial Bank Performing Loans Portfolio

a) For the Private Sector
Annual flows in thousand million pesos

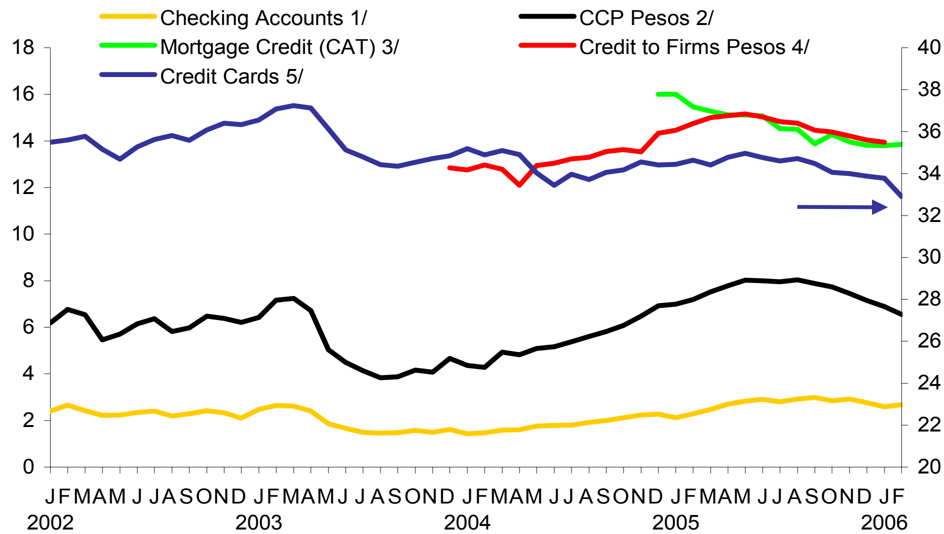
b) For Households
Annual flows in thousand million pesos



A few years ago, households and small and medium firms faced significant credit constraints, which have been decreasing gradually. Nonetheless, since households are still in the process of increasing their consumption patterns, they are probably less sensitive to credit costs. In this regard, it is important to mention that, in general terms, lending interest rates are still high, and have not fully reflected the fall in deposit interest rates originated by the reduction of inflation (Graph 21). Furthermore, the significant increase in household loans and the relative stagnation in lending to firms have affected both households and firms' sources of income. While in 2000, revenues from credit portfolio stemmed mainly from interests from firms' credit portfolio, in 2005, such revenues originated from consumption credit (Graph 22a).

The expansion of credit and the increasing share of lending to households have been reflected in higher interest revenues for commercial banks. These revenues have been above interests paid on bank term deposits. This has widened commercial banks' financial margin, even after adjusting for credit-risk provisions (Graph 22b).

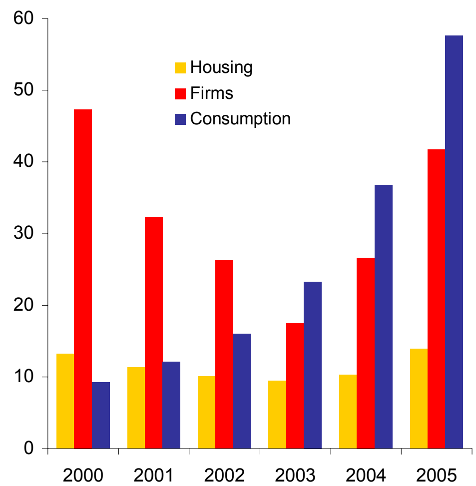
Graph 21
Commercial Banks Deposit and Lending Interest Rates in Pesos
Annual percent



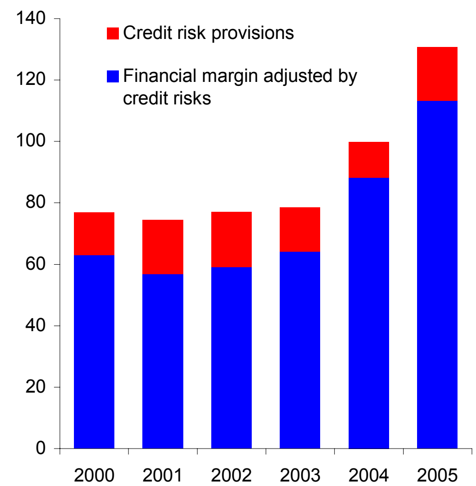
1/ Monthly average of payable rates (individuals and enterprises) before income tax deductions.
2/ Includes term liabilities of banks in pesos, except liabilities from: subordinate obligations to be converted to capital, granting of guarantees, and operations among credit institutions.
3/ Indicator's average which equalizes the present value of all commitments, future or existing agreed upon by the creditor and the borrower including interest rates, commissions, obligatory insurance and other charges due to financial services. Simple average of nominal rates of credits in pesos granted during the period.
4/ Simple average nominal rate of credits in pesos granted during the period.
5/ Simple average rate, excluding VAT, charged by banks including all traditional credit card products according to the report "*Bancos: tasas de interés de tarjetas de crédito*" by INFOSEL.

Graph 22
Revenues from Commercial Banks Financial Intermediation

a) Revenues from Credit Portfolio Interests
Annual flows in thousand million pesos



b) Financial Margin
Annual flows in thousand million pesos



Source: National Banking and Securities Commission (*Comisión Nacional Bancaria y de Valores,* CNBV).

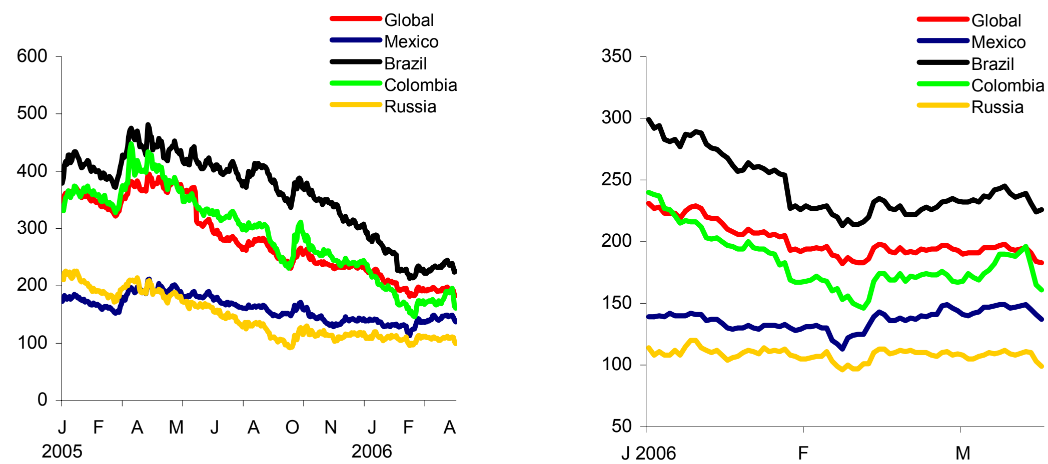
4. Monetary Policy

Domestic monetary conditions have been significantly affected by conditions prevailing in international markets. In this regard, although there is slack in global financial conditions, the stronger expansion of the U.S. economy has led to a rebound in long-term interest rates in international financial markets, which, at the margin, has also generated lower appetite for emerging economies' instruments (Graph 23). As a result, the value of assets and currencies in such economies tended to depreciate, and exhibited higher volatility towards the end of the first quarter.

Emerging economies' access conditions to financing continue to be, in general terms, favorable. This mainly responds to the fact that despite the trend towards greater monetary astringency by the main advanced economies' central banks, interest rates for longer terms are still low compared to historic levels. It is clear that emerging economies' financial conditions are highly dependant on the behavior of long-term yields in international financial markets. Under such context, as these rates are adjusted upwards, access to financing for these economies could deteriorate.

Graph 23
Interest Rate Spreads (Several Countries vs. U.S.) 1/
Basis points

a) 2005-2006 b) January-March 2006



1/ EMBI global sovereign spread.
Source: Bloomberg.

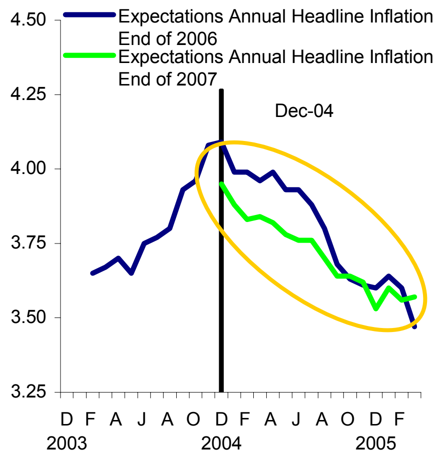
On another front, Mexico's inflationary environment continues to be favorable. In particular, core inflation remained around 3 percent during the first quarter of the year. Annual headline inflation rebounded during the first months of 2006 as expected due to the volatility of the fruits and vegetables' price subindex. Nonetheless, this effect disappeared rapidly as headline inflation returned to levels close to those recorded at the end of 2005. These results enabled inflation expectations for different terms to follow a downward trend. Thus, in March, private sector economic analysts' forecasts for headline inflation reported by Banco de México for the end of 2006, 2007 and 2008 were 3.47, 3.57, and 3.53

percent, respectively (Graph 24). In the same survey, expectations for core inflation for the end of 2006 were 3.11 percent, in contrast with 3.27 percent recorded in December 2005.

Graph 24
Inflation Expectations: Banco de México Survey

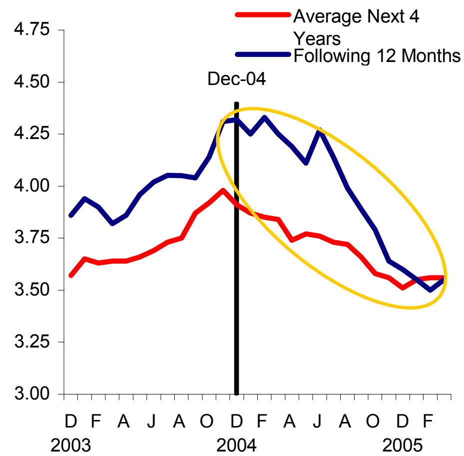
a) End of 2006 and 2007

Annual percentage



b) Following 12 months and Average for the Next 4 Years

Annual percentage

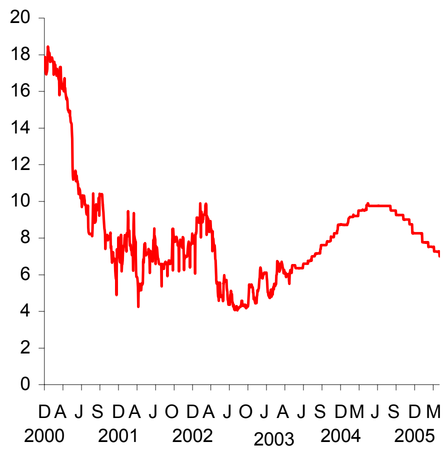


Summing up, the outlook for inflation has evolved favorably. Up to now, the different risks faced by the disinflation process have had limited effects on wage negotiations and, in general terms, on the price determination process. Thus, inflation continues to converge to its target.

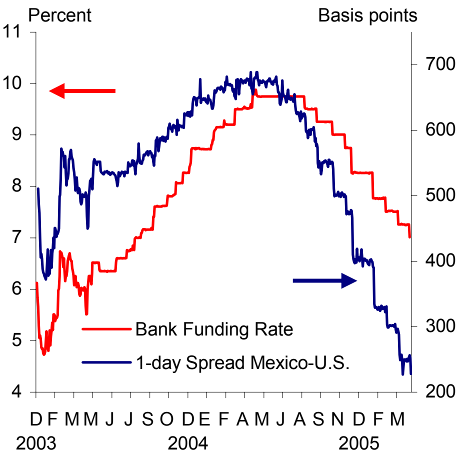
The concurrence of the above factors fostered conditions that enabled the Board of Governors of Banco de México to continue to reduce the monetary restriction during the first quarter of the year. In particular, the Board of Governors allowed for a loosening of domestic monetary conditions of no more than 50 basis points in January, and no more than 25 basis points each time in February and March. In its monetary policy press release of April, the Board of Governors allowed for a further loosening of monetary conditions of no more than 25 basis points, but stated that no space is available to ease further monetary conditions in the foreseeable future. As a result, the 1-day bank funding rate decreased to a level of 7.0 percent on April 21, 2006 (Graph 25).

Graph 25
Bank Funding Interest Rates

a) Bank Funding Interest Rates
Annual percent



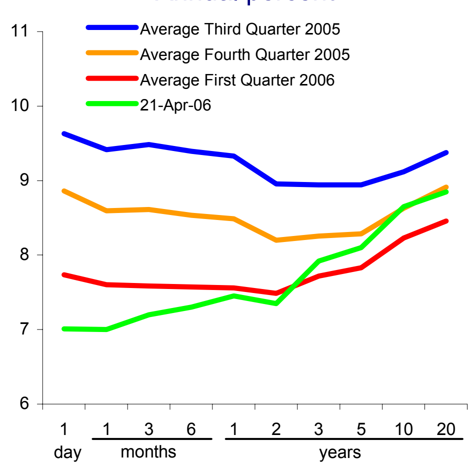
b) Bank Funding Interest Rate and Spread
Mexico – U.S.



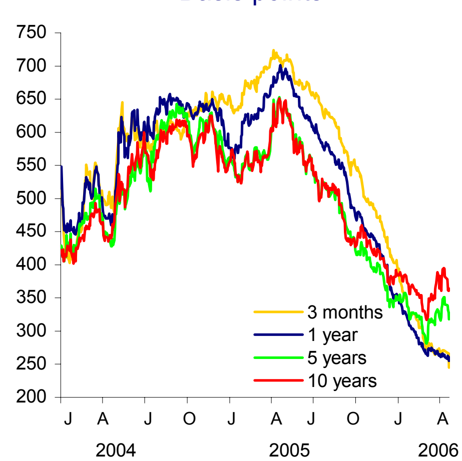
The reduction in short-term interest rates together with the relative slack in international financial markets, led to a decline in the yield curve for all terms (Graph 26a) during the first quarter, therefore prompting a reduction in interest rate spreads between Mexico and the U.S. (Graph 26b). Nonetheless, as already mentioned, this process has been subject to certain adjustments. In particular, the transition to an environment of tighter global monetary conditions and the higher volatility in international financial markets observed towards the end of the first quarter and beginning of the second, fostered an upward adjustment in long-term domestic interest rates. As a result, the yield curve steepened.

Graph 26
Yield Curve in Mexico and Interest Rate Spread between Mexico and the U.S.

a) Yield Curve in Mexico
Annual percent



b) Spread Mexico – United States
Basis points



5. Balance of Risks and Final Remarks

Banco de México's expected scenario for 2006 is based on the following assumptions:

a) A favorable outlook for world economic growth. The main analysts anticipate the U.S. economy to grow, on average, nearly 3.4 percent, close to its potential rate. Industrial growth is expected to be slightly above GDP growth.

b) In general terms, world inflationary pressures are expected to remain contained. In this regard, it is important to mention that, to date, price increases of energy and other commodities have had limited effects on the core inflation indicators of the main advanced economies. In addition, some central banks are concerned about the possibility that demand-related pressures on inflation might arise.

c) Mexico's external accounts are expected to continue to have high revenues from oil exports and from workers' remittances. In general terms, a relative slack in international financial market conditions is also anticipated. Nonetheless, emerging economies financial conditions could be affected by the likely increases in long-term interest rates in international financial markets.

Based on the above mentioned macroeconomic environment and on most recent information regarding the development of the Mexican economy, Banco de México's baseline scenario for 2006 is as follows:

GDP Growth: GDP growth is expected to be between 3.5 and 4 percent.

Employment: Approximately 700 thousand jobs are expected to be created in the formal sector (number of workers insured by the IMSS).

Current Account: The current account deficit of the balance of payments is expected to be around 0.8 percent of GDP.

Inflation: Core inflation is expected to remain around 3 percent for the remainder of the year. Annual headline inflation is anticipated to be between 3 and 3.5 percent at the end of the year, exhibiting certain volatility from its non-core component.

In this regard, the following should be highlighted:

a) A slight rebound in core inflation is anticipated to take place in April, due to the effect of the Easter holiday (which took place in a different month of 2005 with respect to 2006) on the prices of tourism-related services. This effect is anticipated to disappear in the following months.

b) A small rebound in the annual variation of the housing-services price subindex is expected due to the unusual fall of this subindex in the same months of the previous year, associated with the reduced costs of several construction materials. Nonetheless, its impact on core inflation will be compensated by the expected reduction in the prices of the rest of services and merchandises.

c) Although the international prices of energy remain high, they are expected to affect headline inflation only moderately, due partly to the policies adopted by the Federal Government to determine prices of goods and services administered by the public sector. [18]

d) As for the rest of the components of CPI's non-core index, no significant inflationary pressures are expected.

The outlook for inflation has improved. Nonetheless, the following risks must be considered:

i) International prices of energy continue to be a source of likely inflationary pressures. In particular, growing geopolitical uncertainty has fostered a new rebound in these prices. The magnitude and duration of this adjustment represents a considerable risk for world inflation.

ii) Futures prices of certain grains have increased. This could represent an obstacle for the reduction of processed food prices annual variation and, therefore, affect livestock products' prices.

iii) Price increases of certain metals could affect the value of construction materials.

iv) The growth rate of services prices, particularly of non-housing related services, remains high.

v) Considerable increases in the prices of certain fruits and vegetables should not be discarded.

vi) Inflation expectations for different horizons are above the 3 percent target.

Considering the base scenario for inflation and the balance of risks, the Board of Governors of Banco de México allowed in April for a loosening of monetary conditions, establishing that no space is available to ease further monetary conditions in the foreseeable future.

Further risks which could affect the outlook for growth established in the baseline scenario prevail.

[18] The Federal Government announced that low consumption electricity tariffs in 2006 would be adjusted according to an annual rate of 4 percent, while high consumption electricity tariffs are expected to fluctuate according to the formula used in the last years (see Inflation Report July-September 2004). Propane prices will increase at an annual rate of 4 percent at the end of the year. Natural gas prices are subject to both changes in their international reference prices and to the rules established to limit their volatility (see *Diario Oficial de la Federación* May 16, 2005). As for gasoline prices, these are anticipated to increase during the year 4 percent in non-border cities, while in northern border cities the price will be determined according to the level reached by this fuel in the nearest U.S. border cities. In the northern border, gasoline prices are determined according to their levels in the nearest U.S. cities. Nonetheless, the Federal Government announced that starting April 25, 2006 these prices cannot exceed the level recorded during the week 11-17 April, 2006.

First, demand-side inflationary pressures could arise in the U.S. In such case, U.S. monetary authorities could increase their reference rates more or for a longer period than currently expected by financial markets. This scenario can lead to increases in long-term interest rates in US dollars, which would, in turn, reduce appetite for risk and raise volatility in financial markets.

Another risk related to external factors is that the high current account deficit in the U.S. could become unsustainable. Although this is a medium-term risk factor, if materialized it could have significant effects worldwide, particularly for the Mexican economy.

Moreover, as mentioned repeatedly by the Central Bank, the continued displacement of Mexican manufacturing production by China and other economies in international markets is a significant risk that has already affected the Mexican economy. Such risk has increased due to the lack of progress in making the economy more competitive, wasting the opportunities for growth created by a particularly favorable international environment. Other emerging economies have advanced decisively in implementing reforms and in modernizing their economies, allowing them to grow vigorously. Should this competitiveness slump in Mexico's economy continue, the opportunities for growth and the creation of more and better-paid jobs in the country could be affected significantly.

Finally, political uncertainty associated with Mexico's electoral process of 2006 could arise. Certain analysts have pointed out that this could lead to higher volatility in financial markets. In this regard, it is important to point out that the implementation of prudent macroeconomic policies has allowed Mexico to be, at present, in a much better position to face these risks.

An assessment of the above mentioned risks reveals the importance of the economy's macroeconomic anchorage, and the key role played by monetary policy. This highlights the need for an autonomous central bank, which, in the case of Mexico, has price stability as a constitutional mandate. Such a mandate looks forward to assure on a permanent basis –beyond particular circumstances- an environment of certainty that allows to face external and domestic risks and to take advantage of the country's growth potential.