BBVA | RESEARCH

Economic Outlook

Mexico

Second quarter 2011
Economic Analysis

- The global economy continues growing strongly, spurred by the emerging economies, despite the rise in oil prices
- Mexico and the rise in oil prices: a benign impact that raises the outlook for growth and temporarily stops the convergence of inflation
- Monetary policy: wait, see and rise (slightly)
- Competition reform approved: hopefully, it will not remain alone

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Content

Closing date: May 12, 2011

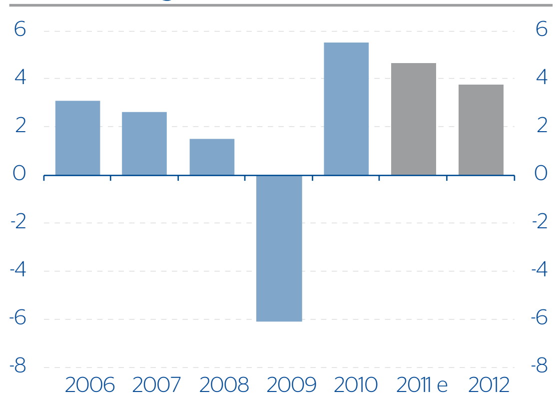
1. Summary

Expectations improve for the Mexican economy, in view of a "benign" increase in oil prices, although growth risks show a downward bias

The early months of 2011 have turned out to be better than expected for the Mexican economy in terms of economic growth, despite the global panorama, which continues to be favorable in general, but shows a certain loss of tone in the more developed economies. On one hand, demand from the United States has maintained the rhythm of manufacturing exports and improved that of yields, with the incipient change in trend with regard to migrants' remittances. On the other hand, the rise in prices of raw materials, particularly oil, although it supposes a downward risk for growth in the global cycle, is expected to be transitory, with prices that had already surpassed their maximum levels this year in a scenario of lower geopolitical risks in the Middle East and Northern Afrcia and a capacity to increase oil production if it were necessary. Finally, this shock is particularly favorable a priori for the Mexican economy, a net oil exporter, which should have, at least in 2011 a net increase in foreign revenue, compared to that initially projected, and public revenue surpassing that budgeted and therefore, consistent with an increase in public expenditures, current and capital. In the global scenario of BBVA Research, given continued growth in the U.S. of figures close to 3% for the second consecutive year and a very prudent drainage of the amount and the price of existing liquidity in the financial market, the net impact on Mexico should be positive in 2011. All things considered, it is reasonable to expect 4.7% growth in Mexico in 2011, 0.4 pp higher than foreseen three months ago. The outlook for 2012 remains unchanged, with GDP growth close to 4%, consistent with a cyclical phase in which no accelerations of external demand are foreseen and the support conditions of demand policies will be somewhat less favorable than they have been up to now.

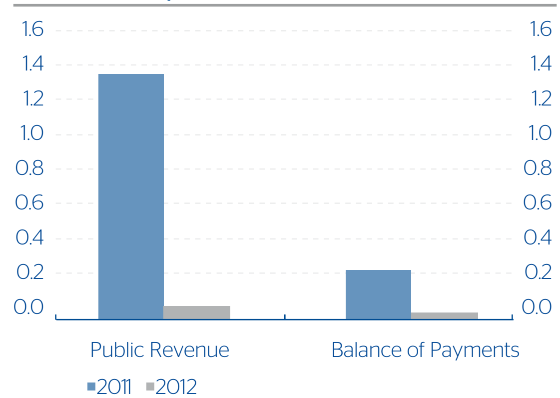
In any case, the balance of risks of this scenario shows a downward bias, as a consequence of the existing uncertainties regarding the final impact that the shock of oil prices has on global growth and therefore on foreign demand for Mexico, and with regard to the rhythm of withdrawal of the stimuli of demand, fiscal and monetary policies, after a period of exceptional laxity. A rhythm sufficiently slow in order to have the certainty that demand from the more developed economies is able to grow in a self-sustained manner, supported by private demand and without new events of financial crisis. But sufficiently rapid so that no undesired rebounds in inflationary expectations or new episodes of budget solvency crises emerge.

Graph 1
Mexico, GDP growth %



Source: BBVA Research

Graph 2
Mexico, impact of the upward review due to the rise in oil prices, % of GDP



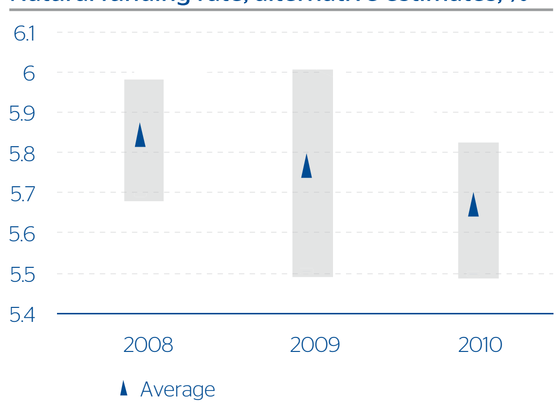
Source: BBVA Research

In terms of inflation, the change in the global scenario of raw material prices presumes greater pressure on consumer prices through the increase of import costs. However, we believe that the strength of the peso, domestic production of food raw materials and the fiscal margin that allows not altering increases in gasoline prices, despite the acceleration in international prices, are factors that together with the existing margin even in the domestic resource markets–employment and installed production capacity–allow ruling out a generalized increase in prices. We believe that in the next few months inflation will only temporarily interrupt its medium term convergence toward levels consistent with price stability, in line with the central bank's projection. However, in order to avoid the possibility that the coincidence of unfavorable base effects in the National Consumer Price Index and cost increases could affect medium-term inflation expectations, the central bank will initiate before the end of 2011, a cycle of increases in the funding rate, very limited when compared to the rebound in the previous monetary cycle. In this sense, the level of the neutral funding rate, that consistent with inflation close to the target of price stability and with the non-existence of an important gap between the actual and potential level of activity, is in the range of 5.5 - 6.0%, below previous estimates. Moreover, considering the expected moderation of the global cycle in which the Mexican economy evolves and the credibility of the central bank in the implementation of its monetary policy, in the prevision horizon, interest rates higher than this range does not seem reasonable.

Finally, as regards the financing conditions in which the Mexican economy will develop, the floor given by the yield on public debt assets will increase gradually with the rise in the premium on inflation and activity as the global cycle advances. All told, these increases will be historically tempered given the position of the relative strength of Mexican public finances: committed to stability, seeking annual budget equilibrium, favored by the entry of greater oil revenues and without latent risks due to supports to the financial system.

Graph 3

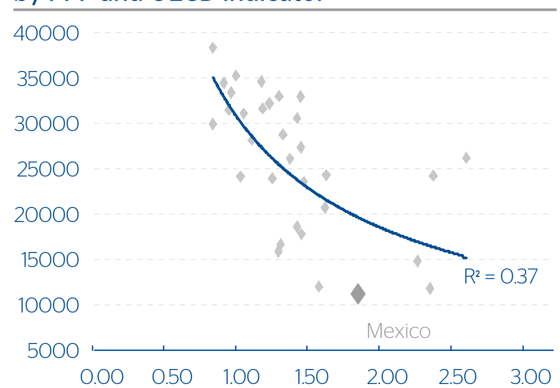
Natural funding rate, alternative estimates, %



Source: Banxico (the central bank) and BBVA Research

Graph 4

OECD. Per capita GDP and restrictions to competition, 2008. Constant dollars adjusted by PPP and OECD indicator[1]



[1] Indicator prepared by the OECD for countries in the area with a scale of 0 to 6, from lower to greater restrictions to competition. For more information regarding its preparation, go to: http://www.oecd.org/document/36/0,3746,en_2649_37463_35790244_1_1_1_37463,00.html

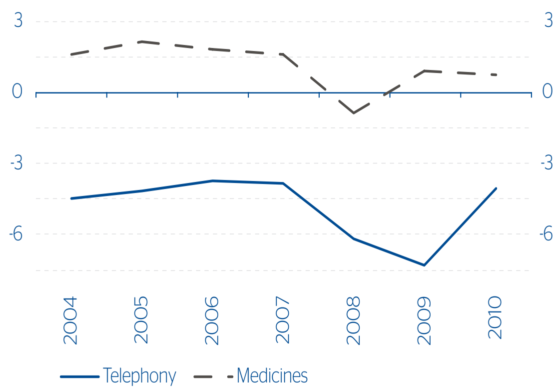
Source; BBVA Research with OECD data

Greater ambition in the process of reforms in the economy

In the scenario described, the panorama is favorable for the Mexican economy for the implementation of reforms that favor improved well-being of the population and strengthen the economy in view of potential adverse scenarios. In this sense, it is necessary to value positively the approval of the reform to the Federal Competition Law by the legislature. Although its actual entry into force is pending its respective regulation, the Law introduces substantive advances in the capabilites of investigation and sanctions by the Federal Competition Commission. A regulation aimed at strengthening competition among the economic agents has positive effects on the productivity and growth of the economy, at the same time that there is an increase in the provision of goods and services at better prices, thus allowing consumers to maximize the use obtained from disposable income. In Mexico, those activities in which the environment is more competitive, price increases were reduced and there were drops in the inflation rates, which should encourage us to consider the positive effect of reforms that favor competition.

Graph 5

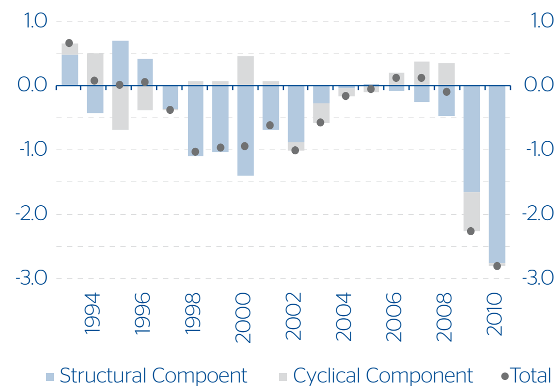
Mexico, real price change, discounting total inflation of the economy, %



Fuente: BBVA Research con datos Banxico

Graph 6

Budgetary Balance, impact of the cycle, % of GDP



Fuente: BBVA Research

Maintaining budgetary equilibrium year after year supposes, in times of cyclical expansion, and even more so with the help of greater oil revenues, a structural balance that is expanded; that is to say, an additional boost to growth from the public sector in periods in which the economy grows on its own and which, in an extreme case, could suppose, for example, an increase in inflationary tensions. In contrast, in times of low growth or even recession, the cyclical balance is less positive or more negative and forces the contraction of structural measures in order to maintain equilibrium. The continued commitment of Mexican institutions to fiscal consolidation made it possible in 2009 and 2010 to carry out counter-cyclical measures through an increase in public investment. However, it would be more ambitious to improve the role of fiscal policy as a stabilizer of the cycle and make more efficient use of the resources obtained. One way that could be explored to continue improving the counter-cyclical role of budgetary policy could be to expand the objectives and the provision of oil stabilization funds.

2. Global environment: recovery, shocks and vulnerabilities

The global economy will continue growing strongly, but risks are tilted to the downside

The global economy continues to grow at a robust pace, and is still expected to expand 4.4% both in 2011 and 2012, supported primarily by emerging economies (Chart 1). However, the threat coming from high commodity prices (especially oil) increases the uncertainty and introduces a risk to growth and inflation in most regions, even to some of those that might benefit directly from high commodity export prices. At the same time as this global shock develops, local risks identified in the previous issue of the Global Economic Outlook continue more or less unchanged. Financial stress in Europe is likely to continue, especially for Greece, Portugal and Ireland. The political noise around proposals to finally start the process of fiscal consolidation in the US will only add to uncertainty in the markets, even as we think that some form of fiscal adjustment will take place in the end. Finally, overheating pressures in emerging markets continue, although going forward probably they will be more of a concern in South America, given tailwinds from commodity prices.

High oil and other commodity prices represent a global risk but should be readily absorbed without affecting global growth too much

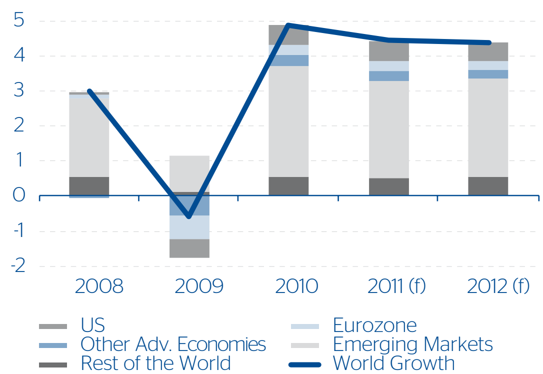
The greatest global risk stems from the rise in oil prices, caused, since the beginning of the year, mostly by political instability in the Middle East and North Africa (MENA). Although uncertainty is high and protests in the region are still unfolding, in our view, contagion to the point of disrupting oil production in other important oil producers beyond Libya will not occur. Thus, the geopolitical risk premium incorporated in oil prices will slowly but gradually be reduced, given still ample OPEC spare production capacity and OECD inventories, both above historical average. Nonetheless, oil prices would remain high at around 110-120 dollars per barrel during most of 2011, to slowly go down to around 100 dollars in 2012.

In this context, in which the price of other commodities such as food and metals has also increased, the main (negatively) affected regions will be the major developed countries and most of emerging Asia, the main importers of raw materials. On the other hand, the main beneficiaries of improved terms of trade would be the Middle East and Latin America, which will recycle part of this windfall revenue. However, a shock of this magnitude will be absorbed by the global economy without significantly affecting economic activity. This, together with relatively strong data in the first quarter of 2011, justifies relatively unchanged growth forecasts in most areas, as compared to our February **Economic Outlook Mexico**. The main exception is Mexico and South America, where strong data in the first three months of 2011 and better terms of trade imply a moderate upward revision of our growth forecasts for 2011. Europe will continue to grow mostly in core countries rather than the periphery, while risks to the U.S. growth forecast shift from being biased upwards three months ago to be more balanced by higher oil prices.

High oil prices will push up headline inflation, bringing forward expected central bank interest rate increases in most areas

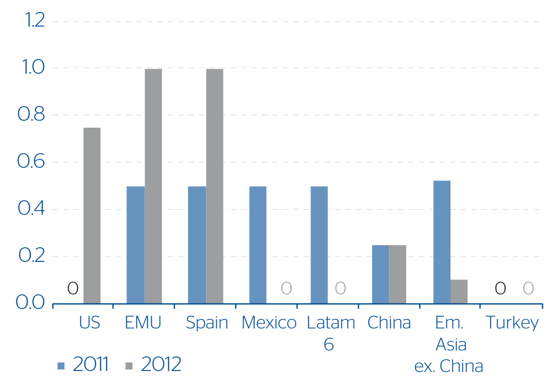
The main effect of the oil shock will be felt on prices. Higher inflation in most economies in 2011 and 2012 will prompt monetary authorities to bring forward and in some cases push for more aggressive paths of interest rate increases (Chart 2). Nevertheless, there is still a wide heterogeneity in central bank approaches to the risks stemming from high oil and other commodity prices. In particular, in the US and euro zone, central banks are shifting –at different degrees– their focus from supporting growth or preventing a tail risk scenario of very low growth and deflation, toward maintaining inflation expectations anchored, particularly considering that the monetary policy stance is very accommodative. As a consequence, the balance of risks has tilted towards a higher probability of earlier hikes. The timing of the first hike depends on the perceived need to react to potential risks of second-round effects. The ECB hawkish approach is to avoid any risk by being pre-emptive (and thus its first hike in April), and is not willing to look through the current oil price related rise in inflation. On the other hand, the Fed, focusing more on the lack of sustainability in the recovery, prefers to wait and act only if risks materialize. Between these two approaches, emerging economies seem open to more front-loaded hikes if needed, but with an eye also on not excessively encouraging capital inflows and exchange rate appreciation.

Graph 7
Global GDP growth and contributions



Source: BBVA Research and IMF

Graph 8
Changes in year-end expected official interest rates relative to February 2011



Source: BBVA Research

Financial tensions in peripheral Europe will remain high given lack of decisive action to deal with solvency concerns

In Europe the agreements reached during the March summits are useful for the medium term both in terms of economic reforms and to help prevent future crisis. In addition, the changes introduced to the EFSF/ESM are positive to address liquidity concerns. However, financial market tensions in the three peripheral countries with international support (Greece, Ireland and Portugal) will continue as long as doubts persist about the solvency of some countries and thus the risk of debt restructurings that include private investors. These lingering doubts will continue hindering the funding to these economies and sustaining high sovereign spreads and could spread to other countries, even those with high solvency credentials. Thus, a comprehensive approach to debt resolution in case of insolvency is urgently needed, but one that takes into account that undergoing a hard debt restructuring that includes haircuts to private investors has a very high risk of contagion to the rest of Europe, so it will have to be designed carefully.

For its part, Spain has been able to differentiate itself from these three peripheral countries given advances in fiscal consolidation and economic reform including, in particular, those aimed at the financial sector and the labour market. However, continued decoupling and a meaningful reduction in spreads will depend crucially on the satisfactory completion of the recapitalization of the financial system –with a prompt entry of private capital–, on continued fulfilment of fiscal consolidation targets –including in the regional governments– and continuing advancing reforms, especially in the labour market.

In the US, fiscal consolidation will likely be achieved, but after a protracted period of elevated political noise

In the U.S., the political process to reach a sustainable path for public debt involves difficult negotiations between two opposite approaches to deficit reduction. In the end, fiscal consolidation will have to come either from a reduction of entitlements or from higher tax revenues. In our opinion, both parties will reach an agreement that translates into lower deficits and a sustainable debt path, but the political noise until that agreement is reached will only add more uncertainty into the markets, especially as the discussion on the debt ceiling brings opportunities to harden the negotiations.

Overheating concerns continue in emerging economies, but going forward, they may become more acute in South America, given tailwinds from commodity prices

Emerging economies continue to show risks of overheating, but with marked heterogeneity. Some countries are beginning to confront these risks through more restrictive monetary policy and, in some cases, also fiscal tightening, for example, in the important cases of China and Brazil. We think overheating risks are manageable but, going forward, they will become more pronounced in South America, to the extent that a commodity price increase represents a tailwind for South America but cooling headwinds for emerging Asia. In addition, doubts about the true extent of the slowdown in Japan could slow down economic activity in most of Asia, given extensive trade links and integrated production chains. Furthermore, current account surpluses in much of Asia are a more comfortable buffer for countries in the region, as compared to South America.

3. Mexico and oil price hikes: a benign impact because it is transitory

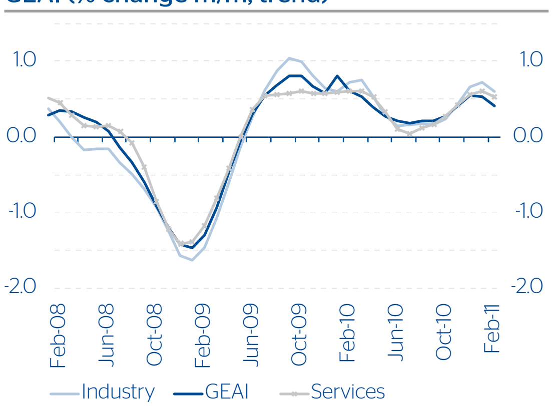
The improvement in activity is now generalized after the external boost, although there are still lags in investment and real wages

The evolution of the Mexican economy has been favorable in the first quarter of the year, even better than expected three months ago. Thus, the GEAI growth at an annual rate went from 4.6% on average in 4Q10 up to the average change of 5.3% in the first two months of 2011. Also, the improvement in activity has generalized throughout the various sectors, in contrast to what was observed a year before. At that time, growth was concentrated more on a few branches with greater dispersion, while now, as per the data known through the second month of the year, there is less dispersion and greater growth on average. Thus, a more favorable internal boost joined the external effect, characterizing growth in 2010 toward the end of that year and the early months of this year.

From the standpoint of external demand, its boost is reflected in some manufacturing exports, which grew 7.8% yr/yr in the first quarter of 2011, slightly below the 9.1% of the last quarter of 2010. As has been characteristic since the start of the recovery, the main stimulus has come from the manufacturing sector, hand in hand with demand from the U.S. industry and consumers. As of the start of the recovery in August of 2009, the correlation of the Mexican manufacturing branches with the corresponding branch of U.S. manufacturing increased in 18 of the 21 branches. Simultaneously, the variance in the greater part of the U.S. branches tended to decrease as of the start of the recovery, which is substantiated based on the lower standard deviation in 16 of the 21 branches.

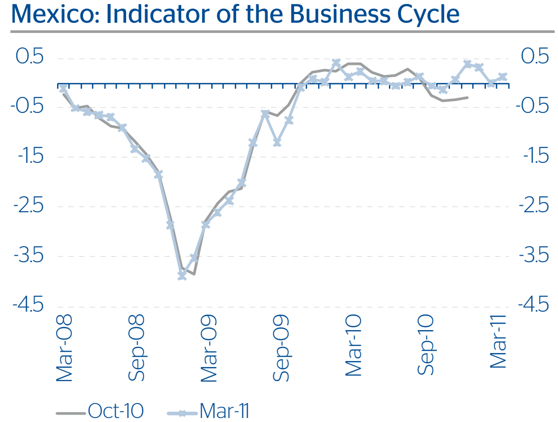
It is highly significant, however, that in five of the U.S. branches that have increased their volatility are some of the more relevant for Mexico: the manufacture of transportation equipment (18% of manufactures), basic metallic (5.4% of manufactures), apparatuses for the generation of electric energy (3.3%) where the variance not only did not decrease in the period of reference but is higher. This rise in volatility in the key branches implies that uncertainty increased in the most important manufacturing branches of Mexico, which in turn could be related to the recovery of demand profile in the U.S. where that of durable goods is recovering with a greater lag and volatility, subject to the fluctuations in the unleveraging process.

Graph 9
GEAI (% change m/m, trend)



Source: BBVA Research with INEGI data.

Graph 10
Mexico: Indicator of the Business Cycle



Source: BBVA Research with INEGI data.

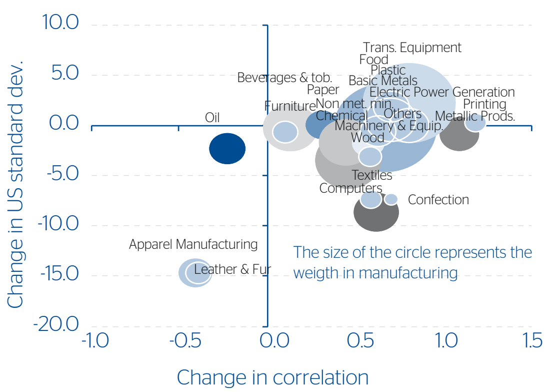
The good performance of Mexican exports implied that, during 2010, Mexico would stand out over the main exporters to the U.S. because it was the country that had a more intensive improvement in terms of its market share quota in that country, with a gain of 6.4% in durable goods between 2009 and 2010, the highest among the 10 main exporters to the U.S., while in manufactured non-durable goods, the increase was 2.9%, practically the same as China and Canada, although much below Ireland (7.9%). Certainly, the performance of the exchange rate in 2009 helped increase Mexico's market share in 2009 and 2010, but we believe that it is not the only determining factor, given that the differences in terms of a gain in market share among the different sectors show that those with higher increases in foreign investment are those that have the more relevant improvements in their market share.

For their part, oil exports have risen 15.3% in the first two months of this year, compared to the same period the previous year. The dynamics of oil exports benefited from the better oil price, 93.4 U.S. dollars per barrel (dpb), that is, close to 22 dpb higher than a year ago on average, as well as the increase in the export platform (around 134,000 barrels more daily than a year ago). Even so, revenues from oil exports have meant income of close to US$4.470 billion (in real terms, adjusted seasonally) in the first two months of 2011, 15.7% of Mexico's total exports.

As to revenues from services and remittances, in contrast with the manufacturing dynamics, these have tended to decline in the last year, measured in terms of real pesos, in part due to the gradual appreciation of the Mexican peso. The recovery of the labor market in the U.S. will surely support the improvement of both revenue entry flows to Mexico, as already reflected in the more recent data on remittances.

Graph 11

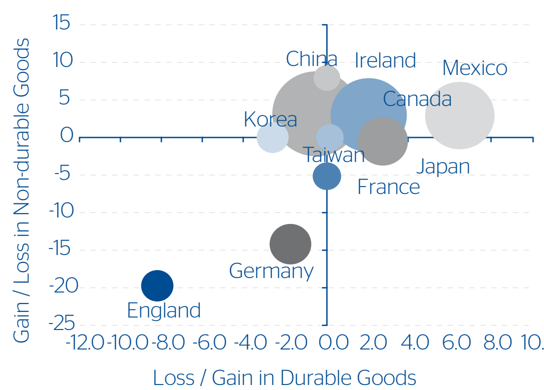
Correlation of Mexican manufacturing branches with those of the U.S. and U.S. variances [2/]



[2/] Shown on the graph is the change in the branch-branch correlation between Jan. 4-Jan. 08 vs. Aug. 9 and Feb. 11, thus avoiding the distortion of the most pronounced period of the recession and the recovery.
Source: BBVA Research

Graph 12

Quota of Mexican manufactures in the U.S. (Earnings / Loss 2010-2009, %)



Source: BBVA Research with INEGI data

Favorable evolution of the financing conditions of the economy and of employment

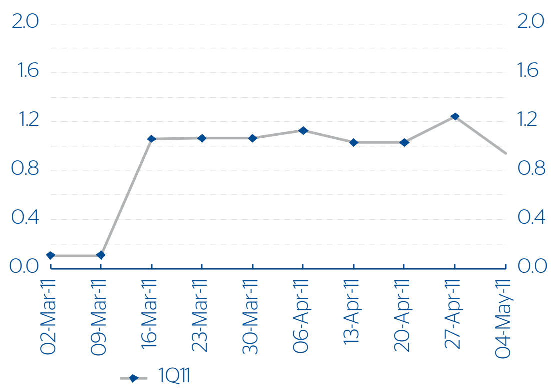
With regard to the less exogenous factors to the Mexican economy, these also tend to favor its performance, in particular investment, where the cost of financing faced by companies has tended downward. Gross fixed investment has undergone a substantial improvement, primarily in the machinery and equipment component. At an aggregate level, annual growth of this variable rose from an average of 6.8% in the last quarter of the previous year to 8.3% in January 2011. The monthly growth rates have tended to rise in the two components; however, it must be mentioned that this improvement is a long way from being sufficiently intensive to reach the levels prior to

the crisis. Both in the machinery and equipment component as in that of construction, the current investment levels are significantly distant from those seen in the middle of 2008, a sign that there is still space in installed capacity, sufficient for now, to attend the rises in demand.

In the determining factors for growth of the component of domestic demand with the greatest weight, private consumption, the performance of Private Formal Employment (in terms of registries in the Mexican Social Security Institute -IMSS for its Spanish initials) should be stressed, with exceptional growth, by which, in terms of level, it has by far surpassed that prior to the recession. It should be pointed out, however, that the recovery rate of the real wages continues to lag, with practically zero growth in 2008 and negative in 2009 and 2010. In the months with available data for 2011, the variation in real wages is beginning to be positive, helped by the drop registered in inflation.

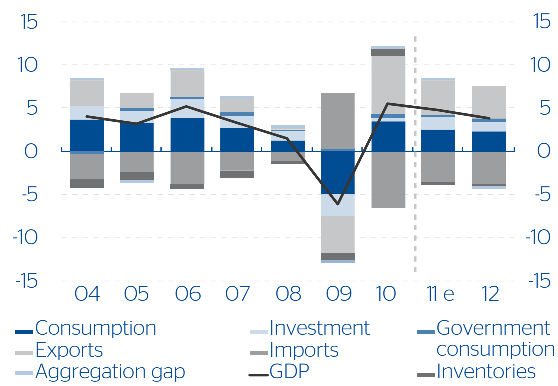
The determining factors affecting the components of domestic demand contributed to the fact that consumption in households grew at a rate of 1.1% q/q toward the end of last year (latest available data on national accounts), and 0.3% increase in total investment in equipment and construction boosted mainly by that of public origin. In contrast, exports and imports surprisingly tended downward in the same quarter, posting a drop of (-) 1.6% q/q y (-) 1.4% q/q.

Graph 13
Mexico, evolution of the growth outlook for GDP in 1Q11, %, q/q



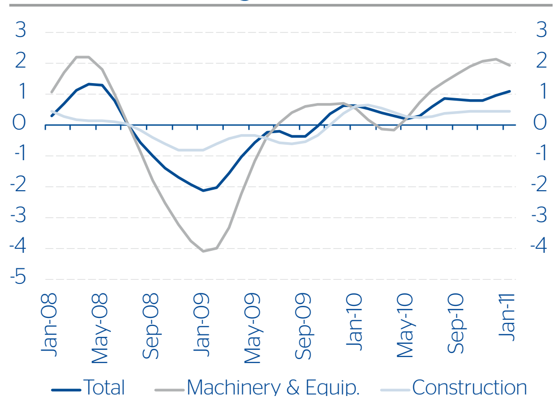
Source: BBVA Research

Graph 14
Mexico GDP (% chng.yr/yr and contribution)



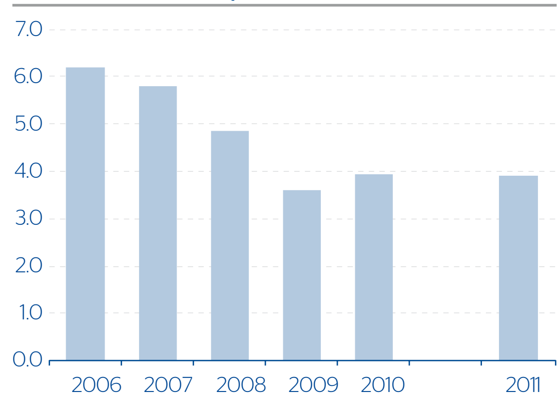
Source: BBVA Research

Graph 15
Investment (% change m/m, trend)



Source: BBVA Research

Graph 16
Difference between the implicit interest rate of bank credit to companies and Inflation (%)



Source; BBVA Research and CNBV

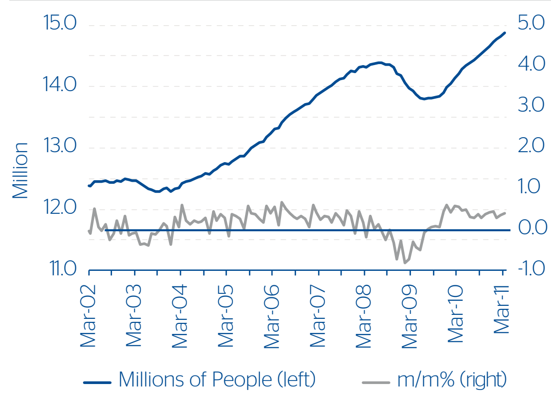
Financing cost downward and positive supply conditions

The improvement in growth expectations in the U.S. and in Mexico is the main factor behind the rise in interest rates on domestic government debt in an environment where inflation will rally in the coming months, and, therefore, the outlook for the end of the monetary pause in Mexico is approaching. The rate of the government 10-year bond has increased from levels of 7.0% in December 2010 to levels of 7.2% at the end of April, which has taken the slope of the curve between the one-day interbank interest rate and that of the 10-year bond to increase from levels of 2.3 pp to levels of around 2.7 pp at the beginning of May. It should be noted, however, that the most recent trend is of a drop in the yields from the levels seen in February and March consistently with signs of certain cyclical weakness in the U.S: and with no domestic inflation tensions that would alarm the market.

As regards corporate bond issues, the difference between their primary rate compared to that of government bonds maintains a descending trend which in general has been maintained since the second quarter of 2009. This favorable situation is due in part to the drop in credit risk as a result of greater external demand and recovering domestic demand. Also, loan conditions in general have returned to normal and the confidence crisis, present at the end of 2008, has been left behind.

Graph 17

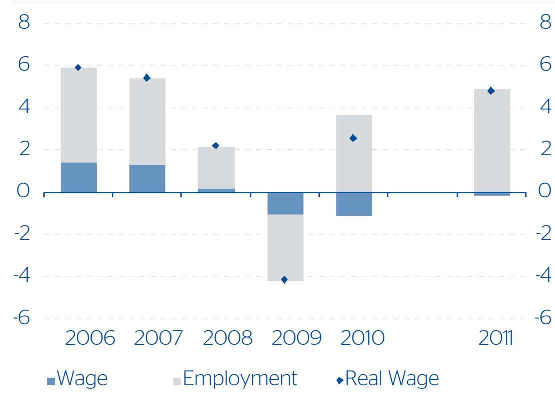
Formal Private Employment (% change. yr/yr, m/m)



Source: BBVA Research

Graph 18

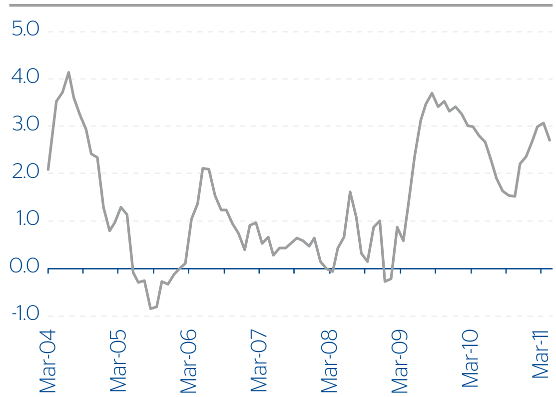
Total wages (% change yr/yr and contribution)



Source: BBVA Research with INEGI data

Graph 20

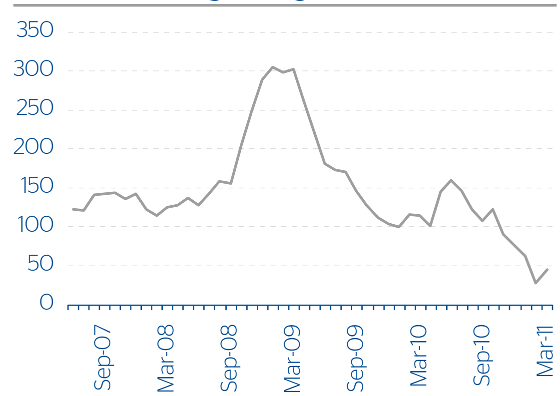
Difference between interest rate of the 10-year government bond and the interbank one-day interest rate (%)



Source: BBVA Research

Graph 21

Difference between the rate on corporate issues and the government rate (%), six-month moving average



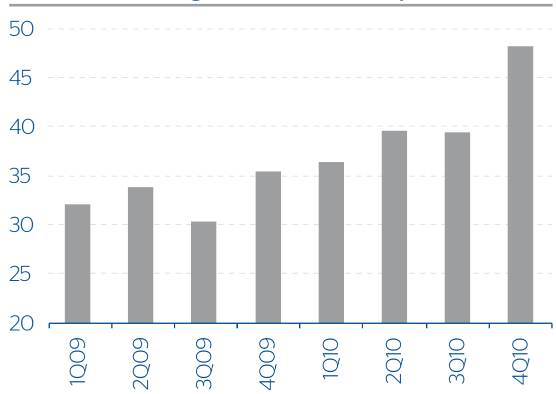
Source: BBVA Research with INEGI data

As to credit market conditions, it is observed that these are favorable. The data show a progressive reduction in the cost of credit to companies. The implicit monthly interest rate of this credit component dropped from 9.2% in December 2009 to 8.5% in December 2010 and to 7.2% in February 2011. The implicit interest rate of consumer credit is also showing a trend downward, while that of mortgage loans remains stable. In addition, supply conditions are also showing a positive performance. As was mentioned in the previous edition of this publication (Mexico Economic Outlook first quarter 2011), the Survey of Situational Evaluation of the Credit Market applied by Banco de Mexico to a sample of companies, allows knowing the conditions of credit supply for want of a financial survey of family households. In this survey, the percentage of companies, which responded that the conditions of access and the cost of the bank credit market represent "no limiting factors" for the operation of their company, which improved in the last quarter of the year by rising from 39.5% of the total of the companies surveyed in 3Q2010 to 48.2% in 4Q2010. Also, the percentage of companies that received new bank credit increased from 3Q2010 to 4Q2010 from 21.6% of the total of those surveyed to 25.6%. And the companies that hope to request financing from the commercial banks in the coming quarter rose from 28.5% of the total to 30.4% in the same period of time.

In the previous issue of this publication, a supply index was calculated based on the aforementioned survey. As of the fourth quarter of 2010, new variables were incorporated in this survey and others were modified, such as the detail of limiting factors in requesting or receiving new credit. Thus, for example, the limiting factors went from being "greater restrictions in access conditions" and "deterioration of the economic situation of the country" to the "conditions of access to bank credit" and the "general economic situation", respectively. Among the variables that were incorporated are the "credit history of your company" and the "willingness of the banks to grant credit". Including this last variable in the supply index calculated by BBVA Research would allow enriching it. All of these changes in the survey, even though they increase the available information, impede the comparability of their results over time. For example, the updating of our bank credit supply index according to the new survey indicates results that are not consistent with the other variables of the survey itself or the performance of the cost and of the balance of credit to companies.

Graph 22

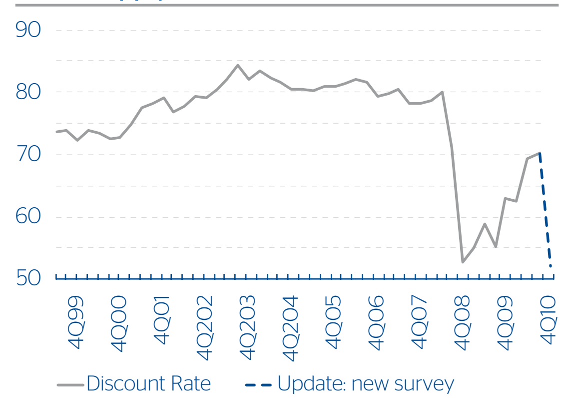
Companies that responded that the conditions of access and cost of the bank credit market are not a limiting factor for their operation (%)



Source: Survey of the situational evaluation of the credit market-Banxico

Graph 23

Credit supply index



Source: BBVA Research based on the situational evaluation of the credit market-Banxico

A review upward of growth perspectives in Mexico in 2011

The best data received on the performance of the Mexican economy in the three months that have passed since the previous issue of this publication and a global environment where Mexico will benefit from higher oil prices, lead us to review the GDP forecast for 2011 from 4.3% previously, to 4.7% currently. In its interior, we believe that the components of demand will enter a stabilization phase, where even though the expansion could be somewhat lower than in 2010 (in consumption, exports and imports, although not so in investment), the growth rates would come close to expansions consistent with more sustainable growth.

As regards Inflation, of note since the end of last year is its downward trend, mainly boosted by moderation in the non-core area, where the key element was downward in the more volatile price group such as agricultural and livestock products and government-regulated prices. Core Inflation also registered a moderation trend in the first quarter, where the group of non-food merchandise and the group of services had an influence. Let us recall at this point that the recent rise in international grain prices had a significant, although foreseeably temporary, effect on some processed foods like the tortilla. In this sense, the rise in oil prices observed in recent months and as a result of the conflicts in the countries of North Africa and the Middle East, it had a limited effect on the prices of gasoline and transportation derived from the policy of subsidies to these goods.

Based on available information up to now and considering the possibility of a coming reversion in inflation influenced by the comparison base in May and June, we think that inflation will stand at around 3.8% on average this year, in the high end of the range foreseen by Banco de Mexico (Banxico for its Spanish initials).

Higher oil revenues will increase public resources and government expenditures and will prevent transferring to household income the additional negative impact of higher gasoline prices

The rise in oil prices at an international level began in August 2010 and has intensified as a result of the revolts in Middle East countries and in northern Africa. This has led to a review upward of our forecasts compared to those some months ago. In particular, the price of Brent type oil,, now considered to be close to US$14 higher per barrel, over the price a couple of months ago, for an average in 2011 of US$106.3 dpb. The outlook that there will not be any further effects to production capacity because the tensions in these geographic areas will be decreasing and the available margin for the stock of oil products in the importing countries lead us to believe that the price rebound will be temporary, we consider that toward 2012 the price will have returned to the path previously foreseen and more in line with supply and demand expectations.

Higher oil prices at a global level have an impact on Mexico in two ways: higher foreign revenues, which has an effect on the balance of payments, and higher tax revenues. These would be the relevant channels, quite positive for Mexico, provided that this rise in oil prices will not be sufficiently intensive or lasting to threaten global growth and, with it, the lower external demand that our economy is facing.

Mexico is a net oil exporting country. Thus in 2010, the oil balance rose to US$11.471 billion, equivalent to 1.1% of GDP. In this period, 86% of the country's oil exports consisted of crude oil and the rest were derivatives such as oil from petroleum and fuel oil. In turn, Mexico's imports are fundamentally of vehicle gasoline (40% of the total) and petrochemical inputs (27%).[1]

In order to try to quantify the effect that higher oil prices would have on external accounts, we consider, in the first place, a lineal relationship between international oil prices (Brent) compared to the Mexican export oil mix, based on the historical relationship of both. This ratio has a certain volatility although we assume 90% to be reasonable, consistent with a ratio of the Mexican mix/ average Brent price since 2008. Thus obtained, the price of the Mexican mix consistent with the

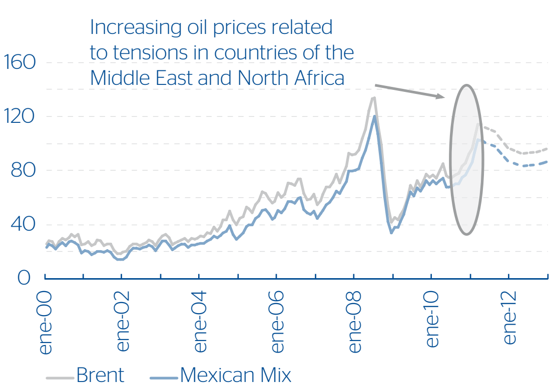
[1] Even though the proportion of crude oil exports has tended to remain relatively stable over time, this is not the case in the breakdown of imports, where, as of 2004, the proportion of gasoline imports rose from an average 20% to the current 40%.l

Brent scenario, the stability of the Mexican oil production platform and the direct relationship between oil prices and the cost of gasoline and imported inputs, allows us to estimate a direct relationship between oil prices and revenues and oil payments in the current account. With all this, it turns out that the change made in the outlook for oil prices in 2011 would imply, as a % of GDP, **1.6 additional points in oil exports and 1.3% more in imports.**[2]

Thus, the additional effect of an increase close to US$12 per barrel for the Mexican mix would be 0.3 points of GDP in 2011, which would tend to dissipate by 2012.

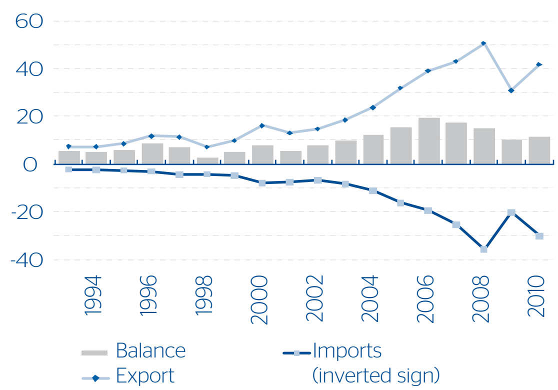
As for public income, oil revenues represent close to 30% of the total budget revenues and are obtained from taxes and the rights derived from oil extraction, exploitation, production and marketing and its derivatives. These higher oil revenues are then consistent with a scenario of increased public spending, both current and capital, as is itemized in the following section. It is estimated that the increase in oil prices will mean (everything else constant) higher public revenues, approximately of **1.4 points of GDP in 2011 and 0.1 points in 2012.**

Graph 24
Oil prices (dollars per barrel)



Source: BBVA Research

Graph 25
Oil balance (billions of dollars)



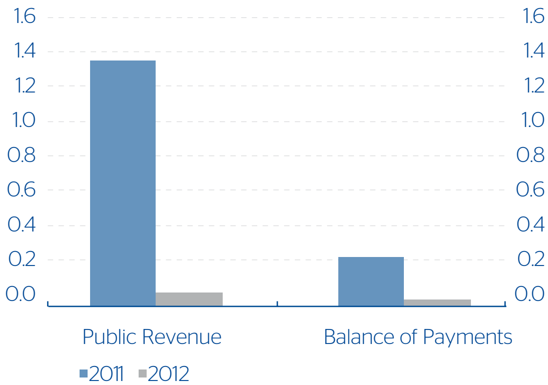
Source: BBVA Research

For Its part, the classification of the price of gasoline and diesel as government-regulated goods implies that the international price adjustments come gradually, which implies a subsidy equivalent to the differences in the prices of internal and external gasoline. Let us recall that as of December 2009, the monthly price increases on gasolines were reinitiated with the aim of reducing the amount of the subsidy and, by this, the burden on public finances. This subsidy implies not collecting income through the IEPS, thereby, it is an implicit transference in favor of consumers.

This transference, as will be discussed further on, has contributed to reducing the inflationary impact of international oil price rises. .As a percentage of GDP, the gasoline subsidy has implied a loss in tax collection of 1.8% in 2008, close to zero in 2009, and equivalent to 0.4% in 2010. The quantification of the change in the amount of this subsidy or transference due to the new outlook for prices is being done over several fiscal years3, from which it is estimated that it will imply 0.8% of GDP in 2011 and 0.3% in 2012, that is, 0.3 and 0.1 points less than with the previous oil scenario (US$12 per barrel less). Since this subsidy represents an implicit transference to consumers, it should be quantified in terms of available income of households. We estimate that this subsidy will stand at around 0.4 additional points of available income of households in 2011 and 0.1% in 2012[4], **until it totals 1 pp and 0.5pp, respectively.**

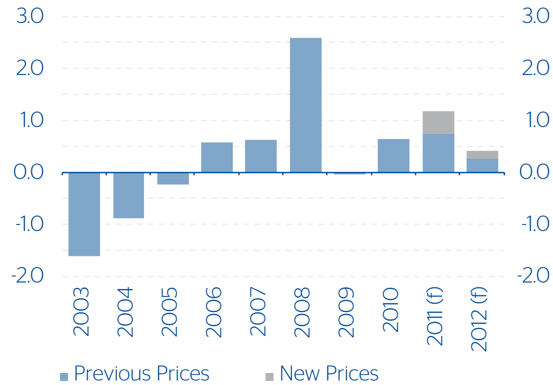
[2] For this fiscal year, it is assumed "everything else constant", that is, that the differentiated effects are not considered on other components of the current account of the balance of payments.
[3] Estimates are made where the amount of the subsidy is considered a function of the price and the amount (domestic gasoline sales, mainly Magna). In turn, it is considered that the domestic consumption of gasoline is in terms of economic activity, assuming for this, the base scenario. Other estimates considered are producer prices, consumer prices, as well as transaction costs (trade margin and transportation costs)
[4] For these estimates, a measure of disposable household income is estimated, considering data of National Accounting (Disposable Household Income) as well as the relationship of total labor income of the economy with assumed total employment wages and evolution of labor income.

Graph 26
Direct effect of a positive temporary shock on oil prices



Source: BBVA Research

Graph 27
Gasoline subsidy as % of Disposable Household Income



Source: BBVA Research

Public finances are benefiting from the recovery of tax revenues with growth and increase of government-regulated tariffs

After dropping a real annual 6.5% in 2009, consolidated budget revenues of the federal government recovered 0.9% in real terms in 2010, even though the figure seems to be modest given that in the 2010 budget, increases were approved in some taxes such as the VAT and income tax, the lower non-recurrent revenues (i.e. operating residual of Banxico) were the brake to a more intense recovery. In fact, when excluding said income from the comparison base, budget revenues rose 10%, a result that reflects both the support of the economic cycle to tax collection, some higher than estimated oil prices in the budget, and changes in the tax structure. With all of this, the budgetary revenues turned out to be almost 6% higher than projected in the Revenue Law for 2010, approximately 1.3% of GDP.

In 2010, the fiscal position continued to show a deficit to provide a stimulus in face of the crisis which was higher than that registered in 2009, such as was established when approving the budget. Thus, the deficit, excluding the Pemex investment, went from 0.2% of GDP in 2009 to 0.8% of GDP in 2010. It is expected that this will be corrected in 2012 and 2013 until reaching the new equilibrium in this measure of pubic balance.

In the detail of tax revenues, the recovery experienced by the added value tax (VAT) can be seen, by which the VAT collection rose 18.8% yr/yr supported in an increase of both its tax rate (from 15% to 16%), and the taxable base from the increase in economic activity. This improvement in activity was also perceived in the revenues of non-oil organizations and companies, with a rise in real terms of 9.2% yr/yr linked to the increase in workers affiliated in the Mexican Social Security Institute (IMSS for its Spanish initials) and higher sales of the Federal Electricity Commission (CFE for its Spanish initials). For its part, the conglomerate of taxes on income, which includes income tax (ISR for its Spanish initials), the single rate business tax (IETU for its Spanish initials) and the tax on cash deposits (IDE for its Spanish initials) rose 9-7% in real terms yr/yr.

As refers to the first quarter of 2011, the recovery in budget revenues has remained. However, the real growth rate of the quarter is of only 1.6% in real terms yr/yr due to the fact that, in February 2010, US$20 billion were recovered from the Stabilization Fund for Investment in Infrastructure of Petroleos Mexicanos (FEIPEMEX for its Spanish initials). Although when excluding these resources, public sector revenues grew a real 4.5% yr/yr. As regards expenditures, these maintained their growth trend by increasing a real 2.7% yr/yr. In their interior, programmable expenses (current and investment expenses) rose a real 4.3% yr/yr. In turn, non-programmable expenses (financial cost plus contributions to states)) was decreased by -2% thanks to a reduction of the financial cost of the public sector of -17.2%. This reduction is mainly due to a lower interest rate on the debt and to the appreciation of the peso versus the dollar.

Chart 1

Budget Revenues and Expenditures, Budgetary Balance and Public Sector Financial Requirements (% of GDP)

	2006	2007	2008	2009	2010
Budget Revenue	21.8	22.0	23.5	23.6	22.5
Oil Revenues	8.3	7.8	8.6	7.3	7.4
Tax Income	9.0	9.3	9.9	9.5	10.0
VAT	3.7	3.6	3.7	3.4	3.8
Income Tax	4.3	4.7	4.6	4.5	4.8
Other Taxes	1.0	1.0	1.5	1.5	1.4
Non-Oil Non-Tax	0.8	1.4	1.2	3.2	1.3
Organizations and Companies 1/	3.7	3.5	3.7	3.6	3.8
Budgetary Expenditures	21.7	21.8	23.6	25.9	25.3
Current Expenditures	4.0	4.3	4.2	4.4	4.4
Investment Expenditures	3.2	3.5	4.4	5.1	4.9
Hydrocarbon Investment Expenditures	0.5	0.6	0.8	2.4	2.3
Contributions	3.2	2.9	3.5	3.2	3.3
Public Sector Financial Cost	2.4	2.1	1.9	2.2	1.9
Budgetary Balance	0.1	0.1	-0.1	-2.3	-2.8
RFSP 2/	-1.2	-1.0	-1.6	-2.6	-3.4

1/ Includes CFE, IMSS, ISSSTE y LyFC during the years prior to its extinction. .2/ Includes the traditional balance (budgetary plus extra-budgetary) plus the financing needs from Pidiriegas, IPAB, FARAC, review of registries, Development Bank and promotion funds and Debtor Support Programs

The boost from the cycle and from higher oil prices would allow greater ambition in the fiscal consolidation effort, which would allow for a greater margin for action in times of adjustment

So as to be able to evaluate in the best possible way the nature of the fiscal position and to what extent the decisions taken in the budget presume a boost or a brake for growth, it is necessary to eliminate the various concepts of public revenue and expenditures that economic activity has on these, arriving at the measure of structural budgetary balance. There are various procedures for extracting the impact of the economic cycle in the budgetary magnitudes, either through the selection of items affected by the cycle or through the aggregate balance. In order to contrast the results and assure that the results are robust, we have used different approximations[5] based on both focuses. The results of the different procedures do not present large differences as to the decomposition of the budgetary balance in its component linked to the cycle and the remainder, which is then considered as structural, and therefore a reflection of the policies of budget policy. The adjoining graph presents the breakdown finally considered.

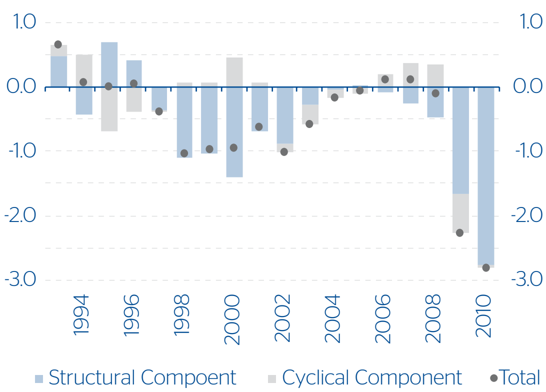
From a comparative perspective, the role of the cycle of the Mexican budgetary balance must consider the specific characteristics of its economy. In the first place, a reduced level in the percentage of GDP of revenue and expenditures, which, a priori, leads one to presume a lesser role for the public sector. But in addition, there are important differences in its composition. Thus, the cyclical component incorporates a part associated with the economic cycle of the country and another with the impact of oil prices, which would tend to increase the demand coming from the public sector. Finally, the lack of counter-cyclical stabilizers from the side of public spending such as, for example, the unemployment subsidy, an element that minimizes the counter-cyclical nature of Mexican fiscal policy.

Beyond the concrete magnitude of the breakdown, a first conclusion is that in 2009, in contract to 1995, Mexican budgetary policy had a margin for mitigating the impact of the recession.

[5] For details regarding these, see: Situación México BBVA Third Quarter 2010 and Situación España October 2006, both available at www.bbvaresearch.com

Graph 28

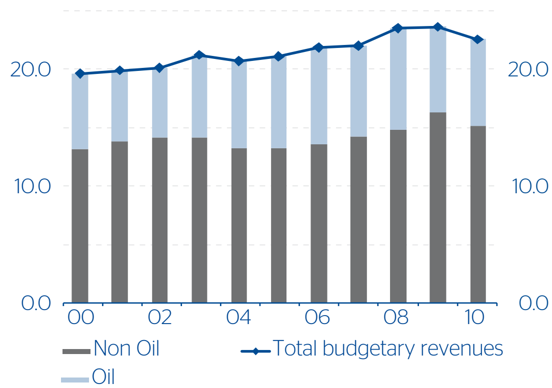
Budgetary Balance, impact from the economic cycle (GDP %)



Source: BBVA Research and SHCP. Estimate through Method proposed by Burside and Meshchyakova (2005).

Graph 29

Budget Revenues, Oil and Non-Oil (GDP %)



Source; SHCP and BBVA Research

The results also show that the estimated cyclical component, that is, the effect of economic growth on the balance after having been negative in 2009, is close to zero in accordance with any of the estimation methods considered. This implies that the effects of the crisis have stopped being a factor that will increase the budget deficit. Alternatively, the various estimates show that the structural balance is approximately the same size as the budget balance observed and approved by Congress. This leads us to infer that the budgetary decisions do not favor undesired increases of the deficit financed only thanks to a temporary increase of revenues associated with the cycle. Mexico only needs to approve balanced budgets (excluding the Pemex investment) under the current structure, so as not to accumulate deficits, given that the Treasury Stability Law guarantees annual budgetary equilibrium. There are no institutional faults that would lead to undesirable deficits.

Maintaining a balanced budget year to year supposes a structural balance that expands in moments of cyclical expansion and even more if oil revenues help, that is, an additional boost for growth from the public sector in periods when the economy grows by itself and when the limit can presume, for example, a rise in inflationary tensions. In contrast, in moments of low growth or even of recession, the cyclical balance becomes less positive or more negative and forces the taking of contractual structural measures in order to maintain the equilibrium. The continued commitment of the Mexican institutions with fiscal consolidation allowed taking counter-cyclical steps through an increase in public investment in 2009 and 2010. However, there is room for being more ambitious in order to improve the role of fiscal policy as the stabilizer of the cycle and to make more efficient use of the resources obtained. One way to be explored for continuing the counter-cyclical role of budgetary policy could be the expansion of the objectives and the granting of funds from oil stabilization.

References

Burside, Craig and Meshcheryakova, Yuliya (2005a), "Cyclical Adjustment of the Budget Surplus: Concepts and Measurement Issues", en Burnside, Craig (Editor), Fiscal Sustainabiliy in Theory and Practice. A Handbook, The World Bank, Chapter 5, pp. 113 - 132..

Distribution of oil revenues and stabilization funds

Non-budgeted revenues derived from crude oil exports have three destinations: the oil revenue stabilization funds, investment in infrastructure of the Petroleos Mexicanos (PEMEX) Company, and the states which allocate the funds to expenditures and investment.

Considering a scenario for the expected average price of the Mexican oil mix for 2011 of US$95, it is estimated that the surplus oil revenues previously estimated by the government could reach around 1.4% of GDP in 2011. These resources would be distributed in the following way: 0.6pp would go to the states, 0.5pp to the stabilization fund and 0.3pp would be destined for increasing the PEMEX infrastructure.

In order to accumulate public resources to meet various long-term objectives, different countries have created sovereign wealth funds. Most of these funds are created by countries that have important amounts of natural resources, in particula energy, seeking that the non-renewable resources contribute to stability and development in the long term. Particularly noteworthy among their specific objectives are the stability of public finances in view of movements in the prices of natural resources, the transfer of resources among generations and the investment of part of the reserves seeking a better relationship between risk and yield. The Stabilization Fund of Mexico's Oil Revenues is one of these sovereign funds, directed toward minimizing the impact of possible decreases in the oil revenues of the federal government, compared to those initially estimated in the fiscal year, thereby allowing that the expenditures foreseen in the budget of the year be covered. The stabilizing fund is financed by the sale of crude oil through two items: the first is the right over hydrocarbons, which applies a rate between 1% and 10% on the annual value of total crude oil extraction in the year, depending on the price of the oil exported. The second is 40% of the oil revenue in excess over what was initially budgeted, although the resources of this item are credited against the former.

Chart 2

Distribution of the additional revenue of the Government derived from crude oil exports (GDP % save for contrary indication)

		Extraordinary Right	Surplus Revenues			
Price of the Mexican crude oil mix, 2011 (dollars)	Revenues in excess of the government	Revenues of the States	Revenues of the States 25%	Infrastructure of the States, 10%	Stabilization Fund, 40%	PEMEX Infrastructure, 25%
95	**1.4**	**0.18**	**0.30**	**0.12**	**0.49**	**0.30**
Memorandum:						
States			0.6			
Stabilization Fund			0.5			
PEMEX Infrastructure			0.3			

Notes:
Expected growth in 2011 GDP of 4.7%
Oil prices in the revenuws estimate: 65.4 dollars.
Extraordinary right: 13.1% is applied to the difference between the oil sale prices and budgeted prices.
Assuming that there are no additional expenses relative to the budget or from natural disasters
Source: BBVA Research with data from the Finance Ministry.

Oil being a non-renewable resource, it would be quite positive that said fund be used as a tool of fiscal policy oriented toward the long term, to generate the conditions that will permit maintaining the capacity for economic growth, once oil resources have been depleted. A fund with this characteristic and that is frequently cited as an example is the Global Fund of the Norwegian Government (GPF for Its English initials). This fund obtains its capital through oil exports and, even though it supports public spending, it does so in a moderate way, so that the capital is preserved. According to Velculescu (2008), as of 2001, Norway has a fiscal rule stipulating that the non-oil structural public deficit must maintain a limit of 4% of the assets of the Fund. This is due to the fact that 4% is the estimated long-term rate of real return for investing the resources of the Fund. This rule allows maintaining the real capital of the Fund and spending only its return. Among the sovereign funds, it is common to seek to preserve and even to make the capital grow in real terms through long-term investment This is so, given the future exhaustion of the natural resources of their countries and their objectives of assuring and maintaining the future well-being of the country (i.e. Abu Dhabi and Kuwait), covering workers' pensions (i.e. Russia) or saving for future generations (i.e. Alberta, Canada) which contrasts with the objective of covering the expenses foreseen only in the fiscal year.

So as to maintain a sufficient savings level for meeting the long-term objectives of sustainability of the public finances and the capacity to grow, different countries have managed to accumulate important amounts in their sovereign funds, which, in the case of the oil exporting countries, they also back themselves by important amounts of exports. Compared with other oil-exporting countries and given its level of crude oil exports, the amount of assets of the stabilization fund in Mexico is low.

Chart 3

Some sovereign wealth funds of which the capital comes from revenues from oil activities

Country	Name of the Fund	Asset (Billions of dollars)	Asset (% of GDP)	Oil exports of the country (thousands of barrels a day)
Oriental Timor	Timor-Leste Petroleum Fund	6	1,003.2	101
UAE	Abu Dhabi Investment Authority	627	207.7	2,700
Kuwait	Kuwait Investment Authority	260	198.0	2,349
Norway	Government Pension Fund – Global	557	134.4	2,150
Saudi Arabia	SAMA Foreign Holdings	439	98.9	8,728
Libya	Libyan Investment Authority	70	94.3	1,542
Qatar	Qatar Investment Authority	85	65.6	753
Bahrein	Mumtalakat Holding Company	9	40.2	238
Algeria	Revenue Regulation Fund	57	35.4	1,891
Kazakhstan	Kazakhstan National Fund	39	27.9	1,345
Oman	State General Reserve Fund	8	14.7	594
Trinidad and Tobago	Heritage and Stabilization Fund	3	14.1	248
Russia	National Welfare Fund	143	9.7	5,430
Iran	Oil Stabilization Fund	23	6.4	2,400
Canada	Alberta's Heritage Fund	14	0.9	2,001
USA	Alaska Permanent Fund	40	0.3	1,704
Mexico	Fondo de Estabilización de Ingre. Petroleros	3	0.3	1,360
Venezuela	Fondo de Estabilización Macroeconómica	1	0.3	2,182
Nigeria	Excess Crude Account	1	0.2	2,327

Latest figures available
Source: Sovereign Wealth Fund Institute, The World Factbook-Central Intelligence Agency, IMF and BBVA Research

4. Banxico, new monetary cycle that will not reach the previous peak

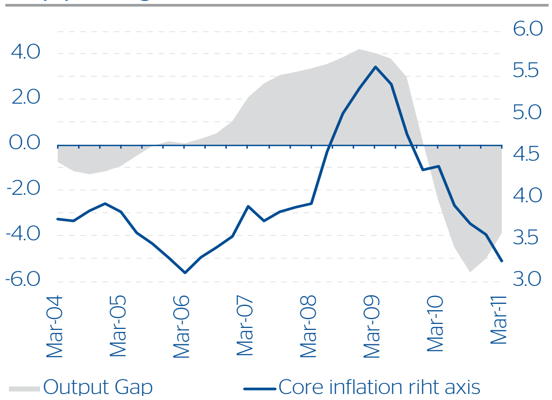
Inflation: medium-term anchoring, but uncertainty in the short term in a scenario of supply shocks

During the first three months of the year, average annual inflation was 3.5%, within the range estimated by the central bank for the first quarter of between 3% and 4%. Specifically, in March, inflation posted what will be its minimum annual rate for 2011, 3.0%. Despite this favorable behavior, some factors in addition to an unfavorable base effect, lead to expectations of an inflationary rebound in the next few months. First of all, the increase in prices of oil and other energy resources such as natural gas, in response to the political tensions in some Middle Eastern and North African countries. In addition, prices of food inputs continued to increase due to supply problems amid strong demand. Among these food inputs, corn and wheat have a relatively high weight in the domestic consumption basket. Both factors are expected to be transitory, although their anticipated intensity during the current year implies upward revisions of our inflationary projections for 2011. It is important to clarify that the elements that undercut the rise in inflation, mentioned in previous editions of this publication, remain in effect.

In this sense, **domestic demand does not appear to be generating upward pressures on prices.** Thus, the output gap between the registered level of production and its potential, which we estimate will close in the second half of the year, will not be sufficiently high to represent an additional risk in and of itself for inflation. Furthermore, the projected growth in real wages in the near future will support this scenario.[1] Furthermore, the exchange rate will also not be a factor pressuring prices upward, thanks to the appreciation experienced by the peso in the course of the past few quarters, consistent with the scenario of domestic growth and the quest for financial profitability on a global level. This scenario could continue in the projection horizon, sustaining the peso's strength. An abrupt adjustment in response to the increase in the global risk premium is not very probable and its effect on prices would be limited, as the experience at the end of 2008 would seem to justify.

Graph 30

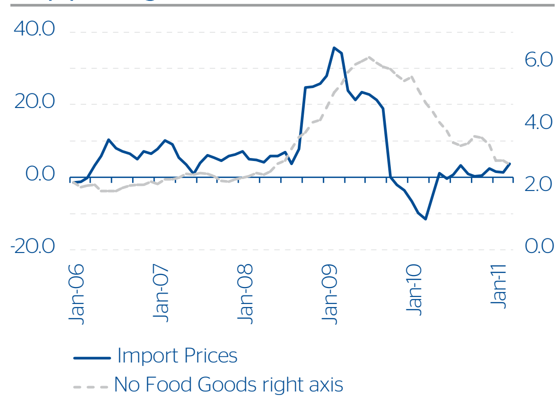
4Q Delay in output gap (%) and core inflation (% y/y change)



Source: BBVA Research and Banxico

Graph 31

Import prices * and core inflation (% y/y change)



* The sum of the annual variation in the index of import prices in US$ and the variation in the nominal exchange rate of the peso in relation to the US$

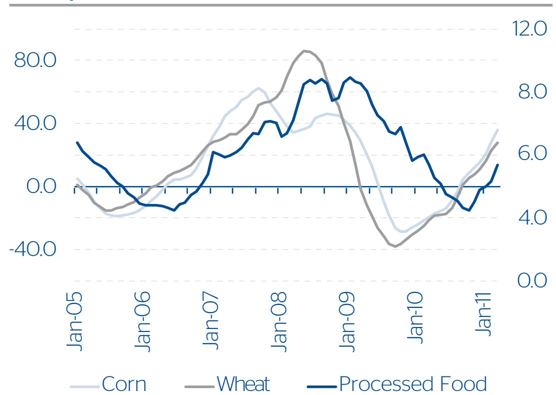
Source; Banxico and BBVA Research

[1] The behavior of the unemployment rate at levels higher than those prior to the crisis is consistent with the lack of tensions in the labor market.

Finally, we believe that the prices of agricultural products (fruits and vegetables), even though they experienced a transitory shock as a result of freezing temperatures in northern Mexico in February, will remain in line with our expectations made at the beginning of the year. A positive factor to consider is the good performance of the prices set by local governments at the beginning of the year, which in addition to benefitting from a base effect in relation to 2010 levels, have posted very limited monthly increases in the first quarter of the year, due to a large extent to discounts and even the cancellation of motor vehicle ownership taxes in different cities and states. If this performance is maintained over the rest of the year, it will be a factor that contains inflation.

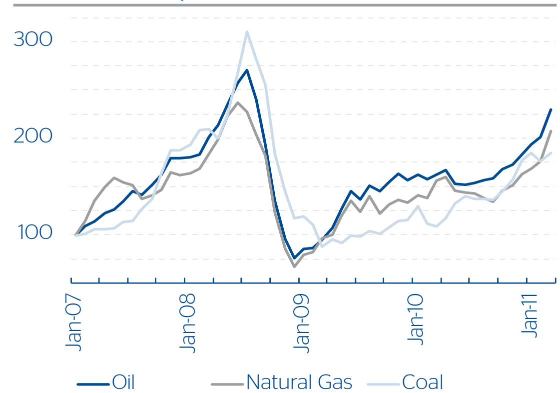
The most important of the exogenous factors that lead to an upward bias in our projections is the price of crude oil, which has recovered its uptrend since January 2009, after having drastically fallen with the beginning of the crisis. This trend incorporates both the economic recovery of the developing countries as well as the greater demand on the part of emerging economies. With the consolidation of the world economic recovery and more recently with the political tensions that have arisen in some oil producing countries, the increase in oil prices has accelerated in the past few months. Our previous scenario for oil prices did not incorporate the political tensions, and therefore the projected trend in prices for the year pointed to lower prices. Our new scenario incorporates these tensions into oil prices, leading them to affect the cost structure of different sectors and spur increases in consumer prices. **Thus, the oil shock will have an estimated 0.2pp effect on annual inflation at the close of 2011, a limited impact since the market structure in Mexico allows for avoiding a major transfer of global supply shocks to final domestic prices.** Gasoline prices have inched upward in accordance with a rule previously established by Mexico's Finance Ministry (SHCP) (eight centavos per liter a month in the case of Magna gasoline). It does not appear that this trend will be modified at least this year, but the increases could be less pronounced in 2012, with the decline in oil prices and the spread between gasoline prices in Mexico and the United States. Meanwhile, electricity rates will also have an impact; however in this case, gas and coal prices have a greater effect, even though we feel that more pronounced adjustments in electricity rates and the diversity in energy production in Mexico –which range from hydroelectric generation to nuclear power – will limit the contagion of the shock. Finally, domestic gas will also have an important impact; however, once again, the structure of the market is highly regulated, and this will prevent its complete transmission to final prices.

Graph 32
Wheat and corn prices in international markets (% y/y change) and the growth of processed food prices



Source: BBVA Research, Banxico and Bloomberg

Graph 33
Energy price indexes in international markets (index, January 2007=100)



Source; BBVA Research and Bloomberg

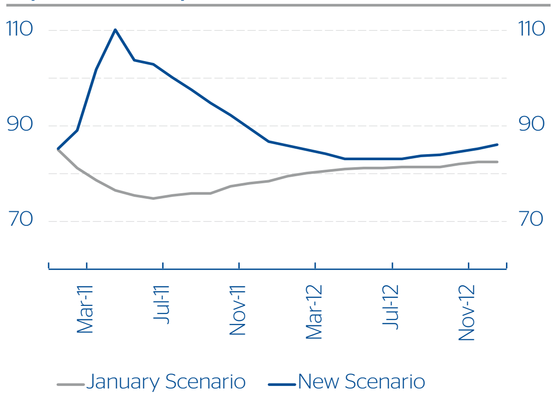
The recent trend in international grain markets involves constant price increases, which for wheat and corn is extremely important in Mexico, given that their direct consumption[2] accounts for around 22% of the consumption of processed foods and close to 3.2% of the total consumption basket. These increases can be attributed to both key factors --smaller harvests and greater demand-- and to a lesser extent to the appeal of food inputs as financial investment instruments. However these grains are commonly used as intermediate inputs in other processed foods, and therefore the effects of increases in their respective prices are felt in the entire subindex, which has risen from a rate of 3.4% y/y in October to 5.6% y/y in March. In addition, grain prices affect meat prices (pork, beef, and chicken) due to their being intermediate inputs. **Our scenario incorporates a slow gradual decrease in wheat and corn prices in the next few months thanks to their harvests very probably being higher this year.** However, given the growing demand for food in the developing countries, prices will remain high. These elements will have an additional 0.1pp effect on inflation compared with our previous scenario. All in all, on average, the adjustments introduced to our scenario represent a 0.1% increase in average inflation for 2011, which will rise from 3.7% to 3.8%; however in terms of the close of the year, inflation will grow from the previous estimate of 3.8% to 4.1% in the new scenario. In addition, inflation could be above 4% as of August.

The most important factors in the medium term behavior of inflation, such as demand pressures, the evolution of the peso/dollar exchange rate, and the anchoring of agents' inflationary projections, continue to be favorable for price stability. At the same time, pressures from the energy and food input markets transitorily shift prices in 2011 from their convergence trend.

Finally, we must emphasize **the existence of risks –both upside and downside- on the panorama described,** which reflect the existing uncertainty in the economic scenarios. Among those that would benefit from the convergence of prices are the continuity in the favorable performance of prices set by the local governments and, above all, **the possibility that competition will intensify in some sectors, favoring consumers.** Among the factors that would provide an upward bias to prices **are the possibility that oil prices will continue to increase due to the infection of political tensions to Middle Eastern countries with a greater weight in global crude oil production,** a new cycle of small harvests due to weather conditions, and finally, an abrupt reversal of capital inflows that could be caused by an episode of sharp international financial volatility. The materialization of the previous developments would bias our projections upward or downward, respectively.

Graph 34

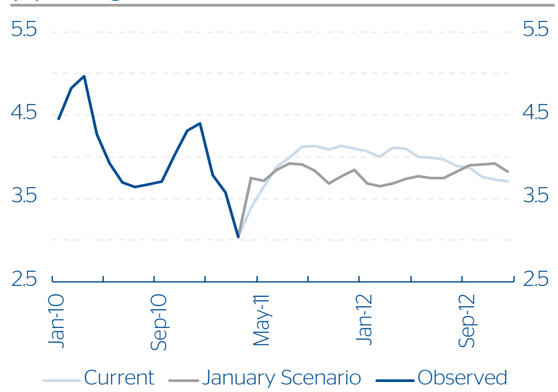
Scenarios for the price of the Mexican oil mix (dpb) new and previous



Source Banxico and BBVA Research

Graph 35

Inflationary scenarios: current and previous (% y/y change



Source Banxico and BBVA Research

[2] The direct consumption of wheat and corn involves products such as tortillas, bread, and corn flake type cereals.

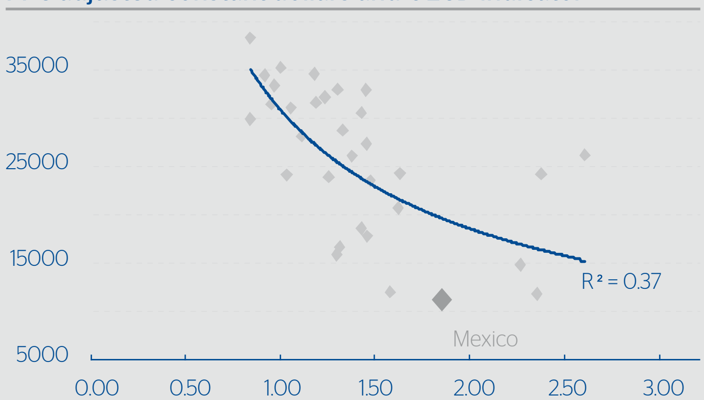
Inset 1: Reform of the Federal Competition Law: a necessary reform pending regulation

The recent reform of the Federal Competition Law aligns Mexican regulation with that which, according to literature on the matter, is considered the most advanced. In short, the reforms[1] approved reinforce the capabilities of investigation and sanctions by the Federal Competition Commission (CFC for its Spanish initials) through: i) higher fines, and even penalties due to monopolistic practices, ii) the possibility of verification visits without prior notice and with the help of public forces, as well as the establishment of precautionary measures while the investigation is in progress, iii) the simplification of proceedings and control of the legality of the decisions made that prevent the possibility of undue delays. Regardless, to consider this reform an accomplished fact, approval and publication of the regulation pertaining to the Law is still pending, which should occur within the next six months, as well as setting the procedural laws and the establishment by the Judicial Power of the Federation of the courts specialized in the matter of economic competition. The regulation must establish the technical criteria to allow for preventive measures for the termination of practices considered to be monopolistic and the procedural rules and specialized courts shall determine the actual effectiveness of the approved reform. Special attention should be lent to this, given the importance of this regulatory change.

Regulation aimed at strengthening competition between the economic agents has positive effects on productivity and the economy's capacity for growth, at the same time that the provision of amounts and the setting of the prices of goods and services allows consumers to maximize the usefulness obtained from their disposable income.[2] As shown in the adjoining graph, there is a direct relationship between the degree of restriction to competition given by the regulation of a country and its standard of living measured through per capita GDP adjusted by purchasing power. Mexico is among the OECD countries in which the margin for improvement as regards reducing the restrictions to competition and increasing per capita GDP is greater. The indicator on restrictions to competition prepared by the OECD is greater in Israel, Greece, Poland and Turkey, all of these countries with higher per capita income than Mexico[3]

Graph 36

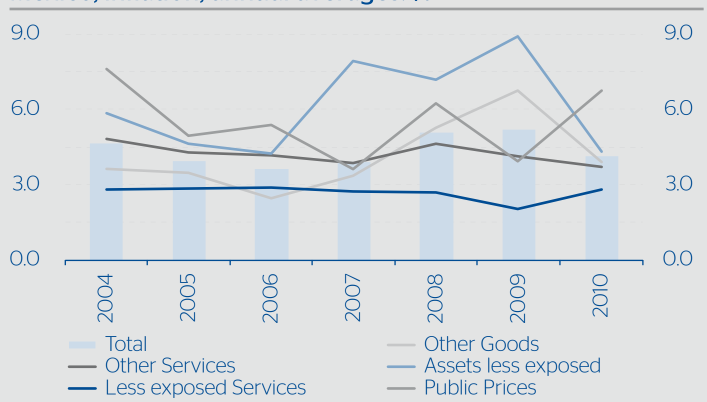
OECD. Per capita GDP and restrictions to competition. 2008. PPC adjusted constant dollars and OECD indicator[4]



The sample includes: Brazil, Canada, Chile, China, Hong Kong, France, Germany, Italy, the Netherlands, Norway, Korea, Spain, England, the United States and Venezuela.
Source: BBVA Research with data from the UN National Accounts Main Aggregates

Graph 37

Mexico, inflation, annual averages. %



Source: BBVA Research with data from the UN National Accounts Main Aggregates and WEO Database, Oct. 2010

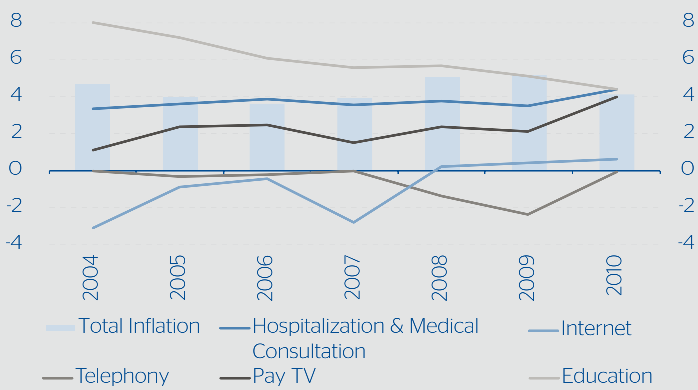
[1] Text on the reform in the Senate Gazette, available on the internet: http://www.cfc.gob.mx//images/stories/Noticias/Comunicados2011/dictamenreformalfce2011.pdf
[2] In the CFC web site there is diverse material on this thesis. Some good synthesis are:
http://www.cfc.gob.mx/images/stories/Noticias/Presentaciones/11.competenciaycompetitividadsep2010.pdf
http://www.cfc.gob.mx/images/stories/Noticias/Presentaciones/consumidores-mar2010.ppt
[3] Of the four most developed economies with greater measures of restrictions to competition than Mexico (Poland, Turkey, Greece and Israel), two of these, Greece and Israel, have per capita GDP levels that more than double that of Mexico in terms of real income per person.
[4] Indicator prepared by the OECD for the countries in the area, with a scale from 0 to 6, from lower to greater restrictions to competition. For greater details on its preparation: http://www.oecd.org/document/36/0,3746,en_2649_37463_35790244_1_1_1_37463,00.html

As regards the improvement in consumers' real income as a consequence of a price formation process in which competition hinders the extraction process of consumer income, the evidence is also favorable.[5] In this sense, we have classified the basket of goods and services of the NCPI into five large groups. In the first place, we have added to the Public Prices group all those items in the NCPI in which the prices of goods or services are provided or determined by the public sector. These are, basically, prices and rates on energy and water, in addition to rates for services, such as the issue of documents, parking lots or highway tolls. In the second place, for the items of goods and services, we have separated those that, according to existing literature on the matter in Mexico, include the possibility of corporate market power.[6] Specifically, among those goods that presumably indicate a greater market power by companies we have included medicines and some food items.[7] In terms of services, this group includes: air transportation, telecommunications, hospital and doctors' services, education and automobile insurance.[8]

As shown in the adjoining graph, while the group of services items shows lower price increases than those of the basket items of NCPI,[9] the price growth level of goods is higher, and among the goods, is even greater for those products in which a greater market power by companies is presumed. Of course, this is not the only factor that underlies the relative differences of inflation figures. The impact of the exchange rate on imported inflation is very important in goods and particularly in the case of Other Goods, manufactured goods basically. Moreover, the sign of these variations coincides with depreciations and appreciaitons of the peso versus the dollar. As for the impact of the pressures of demand on inflation, using the output gap as reference, we could consider a priori a more important impact on services than on goods, but information presented by the central bank (Banxico)[10] on the greater frequency of promotions in the supermarket chains in 2010 would be consistent with the important role of demand in the price formation of goods, at least in 2010 in an environment of moderate recovery of consumer demand.

Graph 38

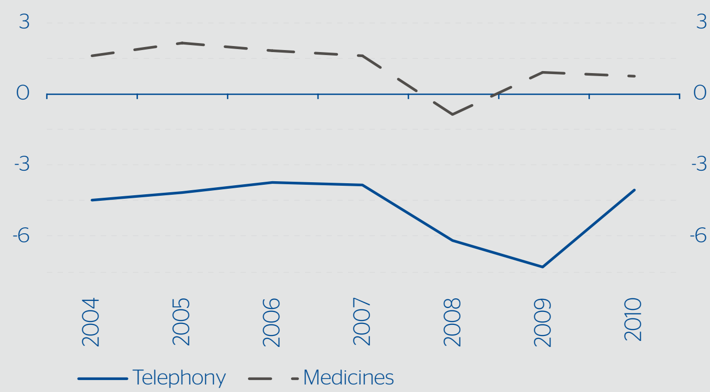
Mexico, inflation in some branches of services where there is greater market power by companies. Annual averages, %



Source: BBVA Research with Banxico (central bank) data

Graph 39

Mexico, real variation in prices, with total inflation of the economy discounted, %



Source: BBVA Research with Banxico (central bank) data

[5] In the case of Mexico and for an approach by deciles in income and regional detail, consult as reference: Urzúa, C. (2008). "Evaluación de los efectos distributivos y espaciales de las empresas con poder de mercado en México", ("Evaluation of the distributive and spacial effects of companies with market power in Mexico") ITESM, CCM and INEGI, Encuesta Nacional de Ingresos y Gastos de los Hogares 2006 (National Survey of Household Income and Expenses, 2006). Available at: www.oecd.org/dataoecd/43/20/45047597.pdf

[6] Urzúa, (2008) and Urzúa C. (2009). "Efectos sobre el bienestar social de las empresas con poder de mercado en México" ("Effects on social well-being of companies with market power in Mexico"). EGAP ITESM. Available at: http://alejandria.ccm.itesm.mx/egap/documentos/EGAP-2009-05.pdf

[7] Specifically: soft-drinks, processed meats, chicken, milk, eggs, corn, sugar, coffee, cigarettes and beer.

[8] This last item is the only one that with the information available is reported with a weighting factor of its importance in the NCPI and which could be considered as corresponding to financial services.

[9] Except in the case of those denominated as Other Services between 2004 and 2006.

[10] See Banxico, Annual Report 2010, pp 36 to 41, available at: http://www.banxico.org.mx/publicaciones-y-discursos/publicaciones/informes-periodicos/anual/index.html

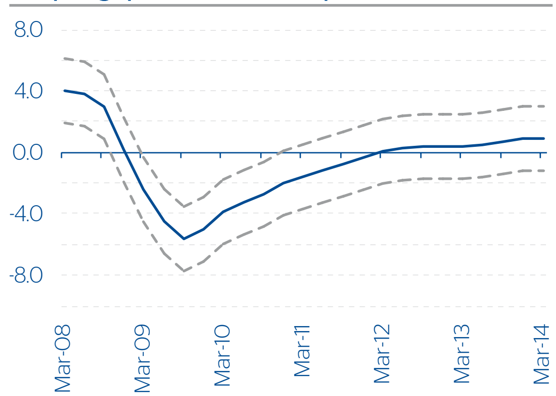
All in all, it could be an *a priori* call that the group of products in the consumption basket of the NCPI that registers the lowest increases in their prices in the last four years, is the group that includes those services in which a greater market power by companies is presumed when prices are set and which supposedly accounts for 10% of the NCPI.

As shown in the adjoining graph, the prices of hospital services and paid television show stable growth between 2% and 4%, while education maintains a declining trend in its price growth rate, converging toward average levels of the consumption basket. On the other hand, telephone services show inflation declines in 2008 and 2009 and no growth in 2010 after years of stability. That is, telephone service, with a weight of 3.3% in the NCPI basket, is contributing toward reducing inflation in recent years, precisely the period in which competition in the sector has intensified with the entry of new service offerers in the market and with a regulation aimed at increasing competition among participants. The changes in the regulation could also be starting to be seen in consumer prices of medicines, which are slightly reducing the positive growth gap between its prices and those of the overall NCPI basket.

Monetary policy: wait and see in relation to the possible materialization of upward inflation risks

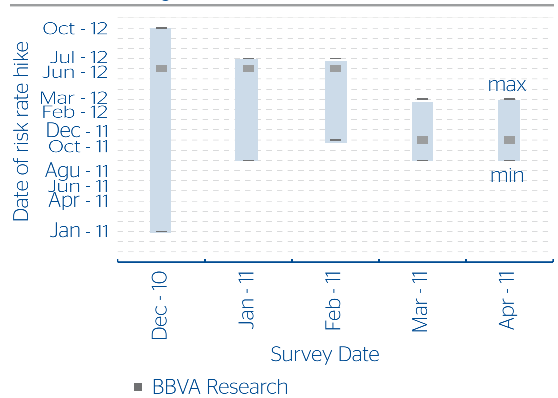
During the first four months of the year the tone of the government's official communications regarding monetary policy has become more tempered, given that a more favorable scenario for domestic inflation has been emerging, albeit with inflationary risks that, in our opinion, have not decreased and with a high degree of uncertainty in the short term, as has been described previously. For example, the monetary policy statement for March emphasized inflation risks that on previous occasions had been considered as being of a lesser impact, and a "weakening of the inflation risk balance" was recognized, as a result of two factors. First, the high degree of uncertainty in relation to future prices of grains and other inputs and, secondly, the possibility that the geopolitical conflicts might generate reallocations of portfolio investment and capital flows that could pressure the exchange rate. In addition, it was emphasized that the output gap could become positive toward mid-year and not during the second half of 2011 as was stated in previous communications, although this was softened by affirming that "different indicators of the markets for the factors of production are still encouraging." Furthermore, in the minutes of the March meeting it can be noted that both the weakening of the inflation balance as well as the closing of the output gap have been subject to debate among the members of the Board of Governors of the central bank. On the one hand, the possible inflationary effect that the rise in energy prices could have was discussed at the meeting, and as in the minutes of the January meeting, it was emphasized that only to the extent that the change in the relative prices of inputs could contaminate expectations can a scenario of generalized inflation be contemplated. On the other hand, there were also different opinions in relation to the capacity of the output gap to adequately approximate price pressures. Indeed, some members of the Board reiterated that it should be used in a complementary fashion with other indicators measuring the greater or lesser strength of demand. Thus, regarding this point, the minutes of the March and April meetings emphasized that it is possible that the evolution of the output gap has not been accompanied by price pressures due to the "comfortable conditions" that still exist in the labor market, in the credit market, and in the use of installed capacity, in addition to the reduced current account deficit. It was also felt that non-marketable goods and services will continue growing slightly below their potential.

Graph 40
Output gap estimate, (% of potential GDP)



Source: BBVA Research

Graph 41
Outlook for the first movement of the funding rate



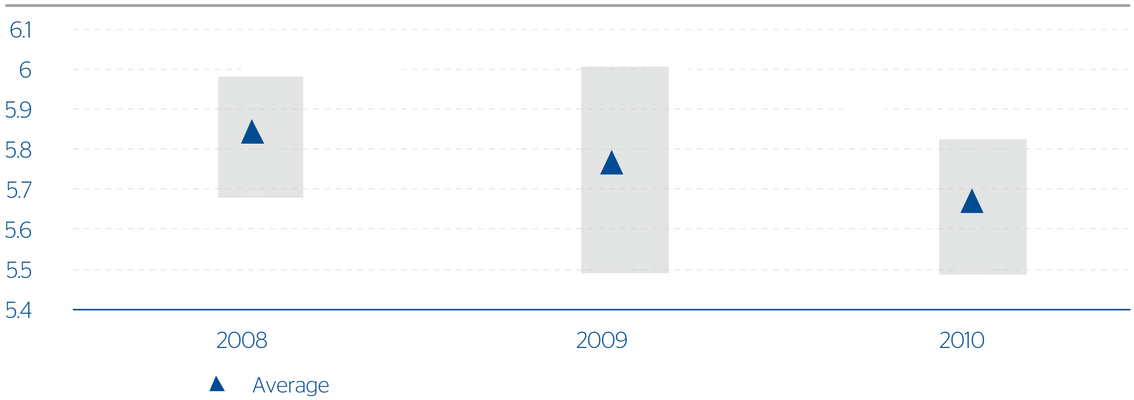
Source: BBVA Research and Banamex survey

The rise in the funding rate, aimed at maintaining the anchoring of the inflation outlook, will be less intense than in previous tension cycles

Thus, it is confirmed that a key factor to determine the position of monetary policy is the inflation expectation, which currently appears anchored but is exposed to important risks. To begin with, it is necessary to point out its nature as a variable that is not directly observable, but whose evolution and outlook must be followed based on other indicators and diagnosed in terms of a broad array of information. Therefore, the tone of the Banxico communication is moderate and, with inflation at levels below 3.5%, in the short term there does not appear to be a change toward a more restrictive position. However, it is felt that **monetary policy could be hardened and the monetary pause could conclude during the last quarter of the year** for the following reasons. In the first place, it is believed that the increase in prices of raw materials, coupled with an adverse base effect, will lead to inflation being above the upper limit of the variability interval for target inflation for a few months as of the summer. Secondly, it is projected that economic activity in both the United States and Mexico will continue growing, which will be reflected sooner or later in the markets of the factors of production, which could generate pressure on prices. These elements, in the final analysis, could have an effect on the rise of inflationary expectations, and as a result, **there would be growing possibilities of seeing an increase in the monetary policy rate in order to avoid a generalized increase in prices**. Specifically, we estimate that the monetary policy rate will increase by 50 basis points during the fourth quarter of 2011 and will continue rising in 2012 toward levels of 5.5 percent, which is close to our more recent estimates of what can be considered Mexico's natural interest rate.[1] It should be recalled that the natural rate is the equilibrium interest rate consistent with price stability in a context in which production grows in accordance with its potential. This rate is not a benchmark for what the funding rate should be at a given moment, but what the estimate of the funding rate is at each point in time consistent with price stability and zero demand pressures. Given its nature as a variable that is non-observable and representative of equilibriums from period to period **and with a central long-term trend,** it can be expected that it will not fluctuate very much and that its decline would be consistent, for example, with a drop in inflation expectations in the economy tied to an increase in the credibility of Banxico's monetary policy. **During the past few years, it appears that the natural interest rate in Mexico has decreased, slowly but constantly,** which is consistent with, everything else being equal, the upcoming monetary cycle being able to achieve funding rates lower than have been previously registered. This is even more the case if, as expected, it does not appear that the cyclical dynamism of economic activity will reach the levels registered during the first half of the previous decade.

Graph 42

Natural interest rate, alternative estimates. %



Source: BBVA Research

[1] For details on the methodology of the estimate, see Hernández and Amador (2008), "La Tasa Natural en México: un Parámetro Importante para la Estrategia de Política Monetaria" ("The Natural Rate in Mexico: an Important Parameter for the Strategy of Monetary Policy"), Observatorio Económico, November 28, 2008. Available on the Internet.

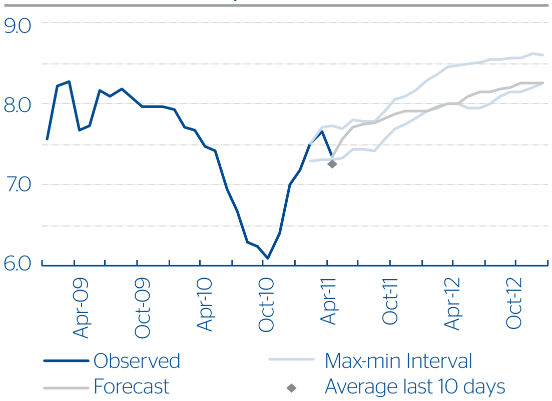
Moderate rise in long-term rates and the strength of the peso, assuming a global financial environment favorable to capital inflows to Mexico

The interest rates in the developed economies have moved in the past few months as a result of counterposed factors. They have risen due to the impact of higher inflation expectations on monetary policies as a result of the increase in input prices, especially, oil prices. They have declined as a result of the perception that cyclical growth is somewhat less intense in these past few months than in regard to the end of 2010 and, therefore, the expectation that the abandonment of the lax monetary policies in prices and quantities will continue to be very cautious, particularly in the United States. In that country, the market has been incorporating an increase in inflation expectations in its long-term interest rates, in accordance with the spread between the bond rates that offer nominal yields and those that pay in real terms (breakeven). In a context of monetary relaxation, investors demand a higher yield in response to hints of a rise in prices and the opportunity of obtaining greater yields in other financial assets as a result of the expectation of an economic recovery. In addition, as the month of June approaches, and with it, the end of the second monetary relaxation program (QE2), the scope of the turnaround in rates derived from the withdrawal of Federal Reserve (FED) interventions in the government bond market is beginning to be considered. On this point, two ways in which Treasury bond purchases by the FED affect interest rates can be distinguished. First, the "flow effect", defined as the response of prices to the buy transactions, and; second, the "stock effect", defined as the persistent changes in price that result from movements along the curve and include the reaction of the market derived from changes in expectations on the quantity of available assets.[1] It should be pointed out that this latter effect acts on interest rates through the reduction in the quantity of instruments held by the market and along with it, the reduction, in aggregate terms, in the premium that investors demand to maintain a long-term asset. As partisans of the predominance of the "flow effect", PIMCO managers have recently emphasized that the FED's withdrawal from the bond market will bring about a strong rise in interest rates, given the high percentage of the total that these buybacks represent.[2] On the other side of the spectrum, there are those who are in favor of the prevalence of the "stock effect", among them the chairman of the FED who affirmed before Congress in February that he does not expect to see a great impact on bond yields when the FED concludes the asset purchases. Furthermore, the assets held by the FED will continue to be reinvested as they mature, without there existing at this moment a calendar for the reduction of the size of their balance. All in all, whatever view prevails, **the final result of the elimination of the policy of abundant and cheap liquidity in a scenario of cyclical recovery will be increases in the profitability of the public debt in the United States. The uncertainty is, above all, in line with the rhythm of the increases.**

From the domestic standpoint, in Mexico it is projected that the highest inflation, which will increase in the middle months of 2011, and the expectation of a rise in the funding rate during the last quarter of the year, will, in the next few months, add a certain upside pressure on local long-term rates to the pressures already coming from the increase in global market yields. Thus, it is expected that the yield on the 10-year Mexican bond will approach levels of 7.9 per cent at the end of 2011. All in all, if the strong increase in capital flows to Mexico continues, a certain downward bias will be imposed on the growth of long-term yields in the next few months. In this sense, in accordance with Banxico (the central bank) data, in 2010 net holdings of Mexican public debt at the nominal yield increased by around 23 billion U.S. dollars, with growing rates throughout the year, a trend that has continued in the first quarter of 2011 with the figure rising by an additional 10 billion dollars. Part of these flows are linked to the very relaxed tone of U.S. monetary policy, which will gradually dissipate, but another part should be more permanent, tied to the entry of the local public debt in benchmark indexes such as Citigroup's World Government Bond Index (WGBI), which has allowed for the participation of large institutional investors in the Mexican market.

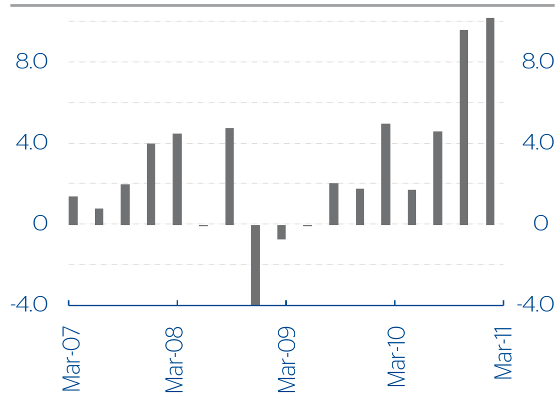
[1] It is calculated that the purchase of Treasury bonds by the FED in the period from March 17, 2009 to October 29, 2009 reduced interest rates, on average, by around 30 basis points along the curve (stock effect) and led to a four basis points fall in the yields in the sectors subject to demand on the days on which the purchases were made. D'Amico, S. et al. "Flow and Stock Effects of Large-Scale Treasury Purchases." Board of Governors of the Federal Reserve System Finance and Economics Discussion Series, no. 2010-52, September. pp 3
[2] The Economist. "Buttonwood | The old Bill". Volumen 398 Número 8725. Pp 82

Graph 43
Interest rates on 10-year Mexican bonds,%



Source: BBVA Research with Banxico data

Graph 44
Capital flows from abroad to Mexican public debt, millions of dollars

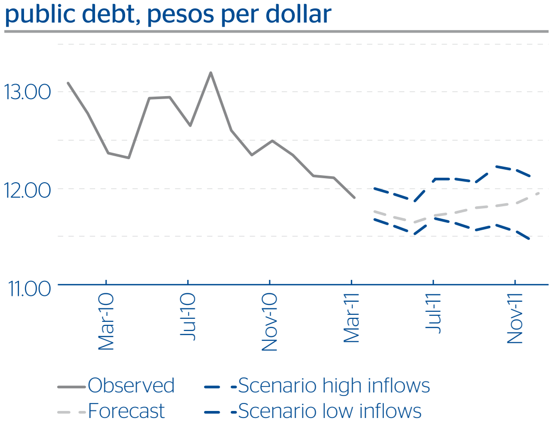


Source; Banxico and BBVA Research

The downside bias on yield forecasts becomes an appreciation bias in projections on the peso-dollar exchange rate for the next few quarters. Indeed, the peso has further appreciated compared to three months ago, when commented in the previous edition of this publication. To limit the impact of foreign capital inflows to debt, a simple model has been applied in which two scenarios for such flows, high and low, are contemplated, based on a hypothesis for the behavior of the Mexican stock market. The scenario of high flows is based on Mexico having greater weight in the WGBI in 2011 due to the withdrawal of Greece, while the low -flow scenario is associated with minimum levels of the past few years in the months following June, at the end of the QE2. It is also considered that toward the close of 2011, the monetary stimuli will have decreased (e.g. the end of the QE2) and with this, capital inflows will decline, especially on the shortest end of the Mexican yield curve.

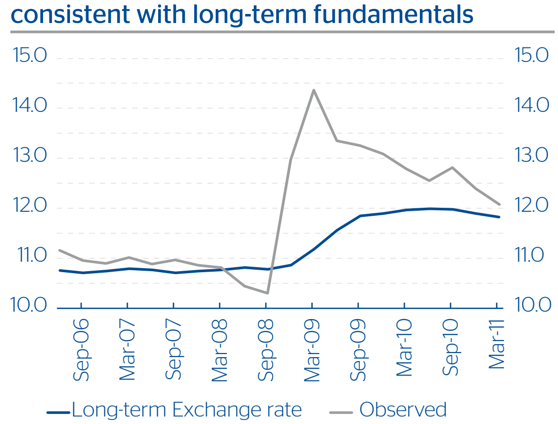
With all these factors, we feel that appreciations of the peso cannot be ruled out in the short term, below the levels posed as central, which in any event would be somewhat higher in the second part of 2011, with the previously mentioned reduction in capital inflows, albeit without reaching 12.0 pesos per dollar. Finally, it should be pointed out that these levels are not far from those that are considered consistent with the evolution of prices and apparent relative productivity of Mexico and the United States.

Graph 45
Peso-dollar exchange rate, alternative scenarios according to foreign capital flows to public debt, pesos per dollar



Source: BBVA Research with Banxico (central bank) data

Graph 46
Peso-dollar exchange rate, level registered and consistent with long-term fundamentals



Source: BBVA Research with Banxico (central bank) data

5. Indicators and Forecasts

Cuadro 4

United States Indicators and Forecasts

	2009	2010	2011	2012	1T10	2T10	3T10	4T10	1T11	2T11	3T11	4T11
Macroeconomic Indicators												
GDP (real % change)	-2.6	2.9	**3.0**	**2.7**	2.4	3.0	3.2	2.8	2.3	**2.9**	**3.3**	**3.3**
Personal consumption (real % change)	-1.2	1.7	**2.8**	**2.4**	0.8	1.7	1.8	2.6	2.8	**2.9**	**3.0**	**2.6**
Government consumption (real % change)	1.6	1.0	**0.9**	**1.8**	1.1	0.6	1.2	1.1	0.2	**0.9**	**0.9**	**1.6**
Gross fixed investment (real % change)	-18.3	3.9	**7.3**	**7.8**	-2.0	5.1	5.3	7.4	6.7	**5.9**	**8.0**	**8.7**
Construction[1]	-22.9	-3.0	**-1.9**	**4.5**	-6.2	4.9	-5.6	-4.6	-2.5	**-7.4**	**1.3**	**1.6**
Industrial production (real annual % change)	-11.0	5.3	**5.2**	**3.9**	1.6	6.5	6.9	6.3	5.7	**5.3**	**4.7**	**5.0**
Current account balance (% of GDP)	-2.7	-3.3	**-3.6**	**-3.7**	-3.1	-3.4	-3.5	-3.2	**-4.1**	**-3.6**	**-3.1**	**-3.6**
Final annual inflation	2.7	1.5	**3.0**	**2.0**	2.3	1.1	1.1	1.5	2.7	**3.3**	**3.2**	**3.0**
Average annual inflation	-0.4	1.6	**2.8**	**2.2**	2.4	1.8	1.2	1.3	2.1	**2.9**	**3.2**	**3.1**
Primary fiscal balance[2] (% of GDP)	-10.0	-8.8	**-9.6**	**-7.6**	-	-	-	-8.8				**-9.6**

Cuadro 5

Mexico Indicators and Forecasts

	2009	2010	2011	2012	1T10	2T10	3T10	4T10	1T11	2T11	3T11	4T11
Economic Activity												
GDP (seasonally-adjusted series)												
Real annual % change	-6.1	5.5	**4.7**	**3.8**	**5.0**	**7.4**	**5.3**	**3.1**	**5.7**	**4.3**	4.4	4.2
Per inhabitant (US dollars)	8,170	9,691	**10,537**	**10,602**	**9,055**	**9,552**	**9,856**	**10,302**	**10,242**	**10,395**	**10,534**	**10,979**
US$ billions	884	1,044	**1,211**	**1,265**	**997**	**1,034**	**1,031**	**1,114**	**1,153**	**1,213**	**1,220**	**1,256**
Inflation (average, %)												
Headline	5.3	4.2	**3.8**	**3.9**	4.8	4.0	3.7	4.2	**3.5**	**3.6**	**4.0**	**4.1**
Core	5.0	3.9	**3.6**	**3.7**	4.4	3.9	3.7	3.6	**3.2**	**3.3**	**3.7**	**4.0**
Financial Markets (eop, %)												
Interest rates												
Bank funding	4.5	**4.5**	**5.0**	**5.5**	4.5	4.5	4.5	4.5	**4.5**	**4.5**	**4.5**	**5.0**
28-day Cetes	4.5	4.1	**5.2**	**5.6**	4.5	4.5	4.5	4.1	**4.1**	**4.3**	**4.8**	**5.2**
28-day TIIE	4.9	4.9	5.3	5.9	4.9	4.9	4.9	4.9	**4.9**	**4.8**	**5.0**	**5.3**
10-year Bond (%, average)	8.1	6.6	**7.5**	**8.1**	7.7	6.9	6.0	5.8	**7.5**	**7.3**	**7.5**	**7.8**
Exchange rate (average)												
Pesos per dollar	13.5	12.6	**11.8**	**12.2**	12.8	12.6	12.8	12.4	**12.0**	**11.6**	**11.6**	**11.8**
Public Finances												
*FRPS (% of GDP)	-2.7	**-3.2**	**-2.9**	**-2.7**	--	--	--	-3.2	**--**	**--**	**--**	**-2.9**
External Sector[3]												
Trade balance (US$ billions)	-4.6	-3.1	**-13.5**	**-21.8**	0.4	-0.1	-2.3	-1.1	0.6	**-1.8**	**-6.3**	**-6.1**
Current account (US$ billions)	-6.2	-5.7	**-13.4**	**-19.0**	0.5	-0.7	-1.9	-3.6	**-2.6**	**-2.0**	**-4.8**	**-4.0**
Current account (% of GDP)	-0.7	-0.5	**-1.0**	**-1.6**	0.2	-0.3	-0.7	-1.3	**-0.2**	**-0.7**	**-1.6**	**-1.4**
Oil (Mexican mix, dpb, eop)	70.3	77.6	**90.0**	**85.7**	71.5	69.9	69.5	77.6	**93.4**	**102.9**	**98.1**	**90.0**
Employment												
Formal Private (annual % change)	-3.1	3.7	**5.0**	**3.7**	1.0	3.7	4.9	5.4	**4.9**	**5.2**	**5.0**	**4.8**
Open Unemployment Rate (% active pop.)	5.5	5.4	**4.5**	**4.0**	5.3	5.3	5.6	5.3	**5.0**	**4.7**	**4.4**	**4.2**

Cuadro 6

Mexico Indicators and Forecasts

	2009	2010	2011	2012	1Q10	2Q10	3Q10	4Q10	1Q11	2Q11	3Q11	4Q11
Aggregate Demand (ann. % chge., seasonally-adjusted)												
Total	-9.4	9.3	**6.2**	**5.6**	8.5	12.8	9.1	7.0	**6.7**	**4.9**	**6.1**	**7.2**
Domestic Demand	-6.9	4.2	**4.2**	**3.8**	2.4	5.7	4.0	4.6	**4.4**	**4.6**	**4.1**	**3.8**
Consumption	-5.7	4.7	**3.5**	**3.5**	3.7	6.8	4.1	4.1	**4.3**	**4.1**	**3.1**	**2.5**
Private	-7.1	5.0	**3.6**	**3.4**	4.2	7.0	4.4	4.5	**4.9**	**4.7**	**3.0**	**2.1**
Public	3.5	2.8	**2.5**	**3.6**	1.2	5.3	2.6	2.1	**0.5**	**0.5**	**3.6**	**5.3**
Investment	-10.9	2.4	**7.0**	**5.0**	-2.2	2.0	3.4	6.6	**4.9**	**6.6**	**7.9**	**8.7**
Private	-16.8	2.8	**8.5**	**6.1**	-3.8	1.8	6.3	7.7	**5.1**	**8.0**	**8.9**	**12.1**
Public	9.4	1.2	**3.1**	**2.1**	2.2	2.5	-3.7	3.9	**4.4**	**2.7**	**5.1**	**0.0**
External Demand	-13.1	24.8	**12.2**	**10.7**	23.4	33.8	27.0	15.1	**11.7**	**8.3**	**11.0**	**17.8**
Imports	-18.3	22.6	**10.8**	**10.5**	20.4	32.3	22.2	15.3	**9.6**	**6.5**	**10.8**	**16.1**
GDP by sectors (ann. % chge., seasonally-adjusted)												
Primary	-1.9	5.7	**3.8**	**2.9**	-0.1	4.2	8.9	9.8	**7.7**	**2.2**	**2.7**	**2.9**
Secondary	-7.4	6.1	**4.8**	**4.4**	6.2	7.2	6.3	4.6	**5.7**	**4.6**	**4.2**	**4.8**
Mining	-2.5	2.4	**1.2**	**2.7**	1.8	3.3	3.0	1.4	**-0.1**	**1.4**	**1.6**	**2.1**
Electricity	2.2	2.3	**4.4**	**3.6**	0.9	2.1	3.3	2.8	**7.1**	**3.4**	**3.6**	**3.7**
Construction	-6.4	0.0	**5.4**	**6.7**	-3.2	-1.6	0.8	4.2	**5.8**	**5.3**	**5.1**	**5.3**
Manufacturing	-9.8	10.0	**5.7**	**4.2**	12.0	13.4	9.4	5.9	**7.4**	**5.4**	**4.6**	**5.4**
Tertiary	-5.3	5.0	**5.1**	**4.1**	4.7	7.3	3.9	4.1	**6.0**	**4.8**	**5.0**	**4.8**
Retail	-14.2	13.4	**7.7**	**6.2**	14.8	17.7	12.0	9.5	**9.8**	**7.2**	**7.6**	**6.1**
Transportation, mail and warehouse	-6.5	6.5	**3.9**	**3.1**	7.3	10.9	5.1	2.9	**5.2**	**3.4**	**3.8**	**3.4**
Massive media information	0.8	5.6	**6.4**	**8.1**	5.2	4.4	6.1	6.6	**7.5**	**7.0**	**5.1**	**6.0**
Financial and insurance	-6.6	2.7	**6.4**	**7.8**	-1.2	5.4	-2.1	9.5	**4.7**	**5.4**	**8.2**	**7.3**
Real-estate and rent	-0.6	1.8	**3.7**	**3.0**	3.5	1.6	0.9	1.4	**3.6**	**3.6**	**3.7**	**3.9**
Prof., scientific and technical servs.	-4.7	-3.0	**2.8**	**2.3**	-3.6	-3.6	-2.5	-2.2	**3.0**	**2.9**	**2.6**	**2.5**
Company and corporate management	-7.6	1.4	**5.3**	**2.0**	-6.0	-2.4	9.0	6.2	**8.3**	**9.0**	**2.1**	**2.1**
Business support services	-4.7	1.3	**2.7**	**2.3**	-0.5	2.0	1.0	2.9	**2.5**	**3.2**	**2.5**	**2.6**
Education	0.5	3.0	**2.6**	**2.4**	2.2	13.5	-0.8	-1.1	**2.3**	**2.6**	**2.7**	**2.7**
Health and social security	0.8	-1.7	**0.8**	**0.7**	1.4	-9.9	0.7	1.3	**1.6**	**0.6**	**0.5**	**0.4**
Cultural and sport	-4.6	1.7	**1.0**	**2.2**	-1.7	2.0	2.2	4.5	**3.8**	**2.1**	**0.3**	**-2.0**
Temporary stay	-7.7	3.9	**2.3**	**2.1**	-0.9	11.9	2.7	2.6	**2.0**	**2.5**	**2.3**	**2.4**
Other services, except government activities	-0.7	0.6	**2.9**	**2.7**	-0.7	-0.8	1.4	2.6	**2.5**	**3.1**	**3.0**	**3.1**
Government activities	4.6	4.4	**2.3**	**1.3**	0.9	8.5	5.0	3.3	**6.8**	**-1.1**	**0.9**	**3.0**

1: Residential investment
2: Fiscal balance (% GDP)
3: Accumulated, last 12 months
dpb: dollars per barrel
*RFSP: Financial Requirements of the Public Sector
Note: **Bold** figures are forecast
Source: BBVA Research with Federal Reserve, Bureau of Labor Statistics, Banco de Mexico, INEGI and SHCP data

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