

Mexican Outlook: How did it face the crisis, the way out and challenges ahead

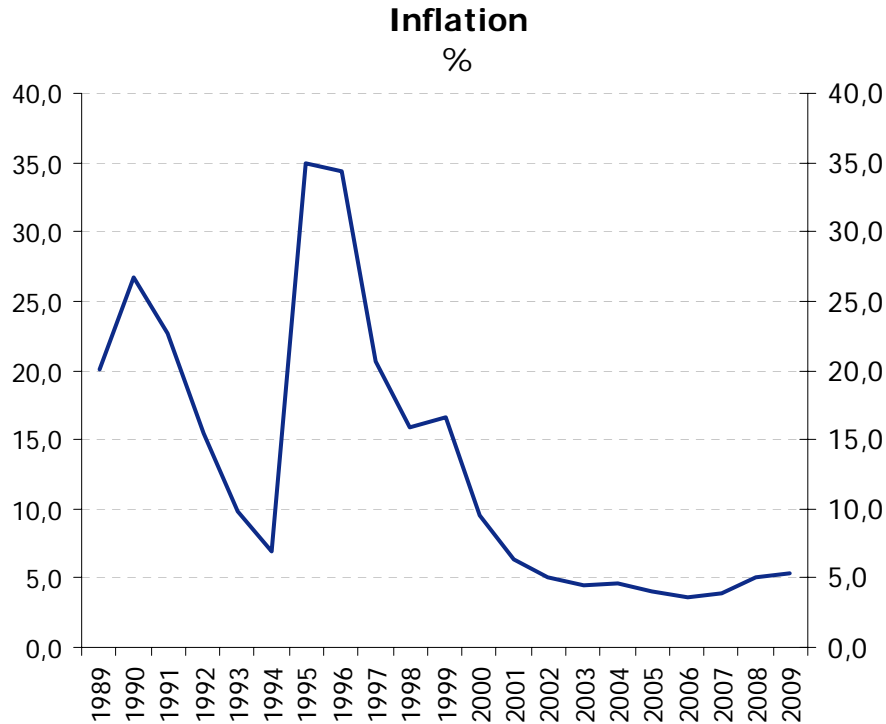
BBVA Economic Research Department
December, 2009

1. ¿How has Mexico faced the crisis?

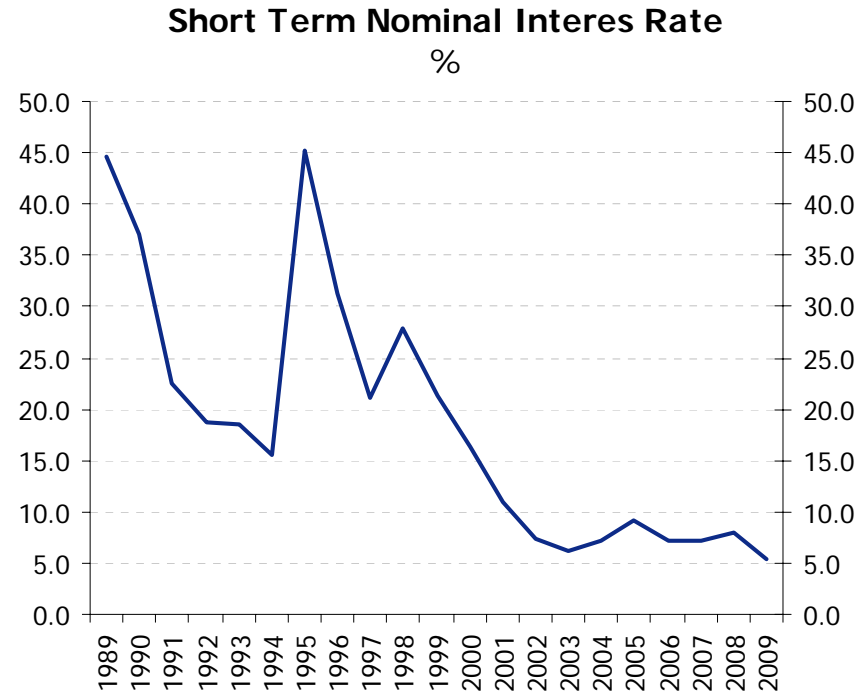
2. Short- Term Outlook

3. Medium-Term Outlook

Nominal Stability: there were not adverse effects on purchasing power



Dashed, recession periods
Fuente: SEE BBVA Bancomer

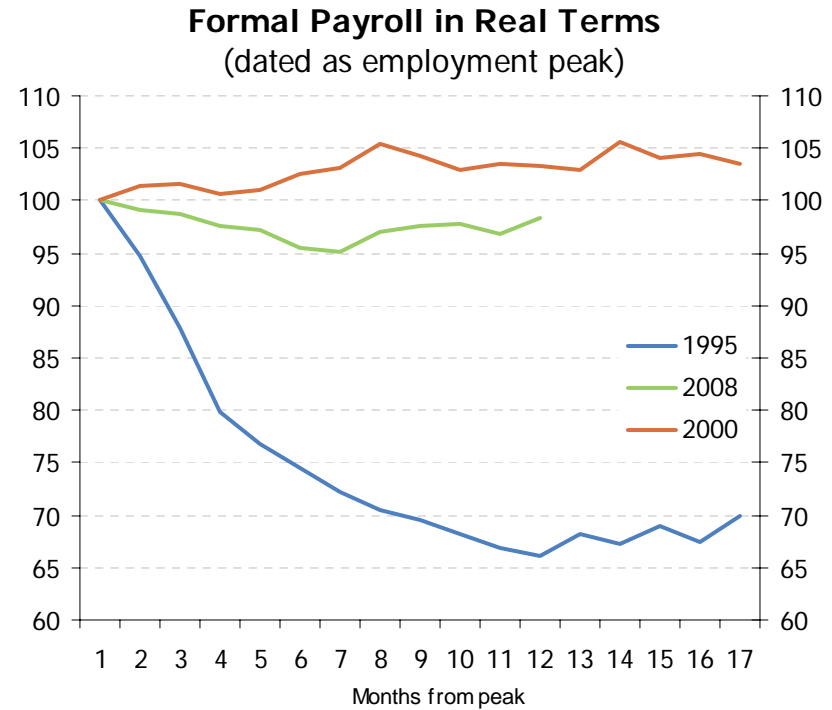
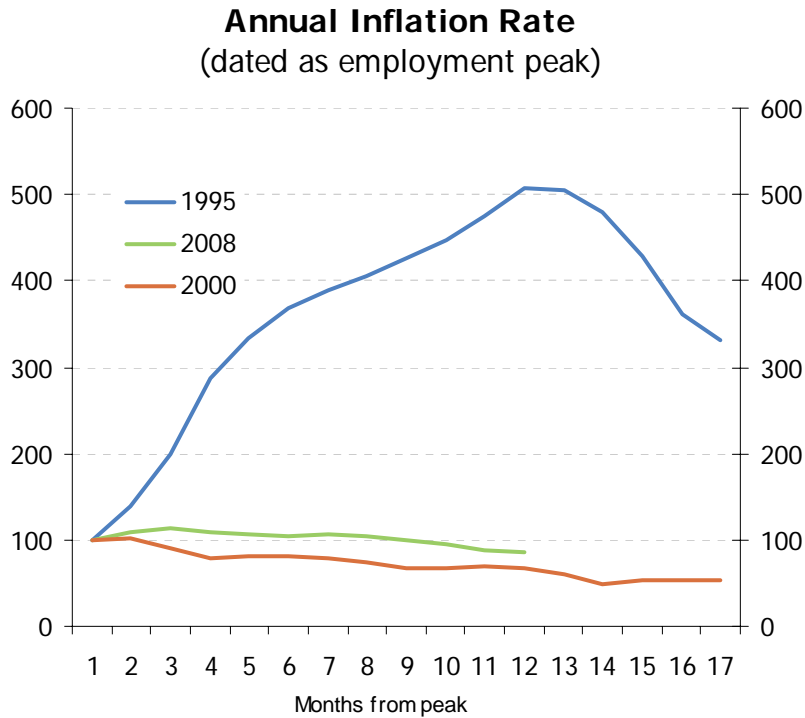


GDP contraction period signaled. Before 1995: CPP
Source: BBVA Bancomer ERD

Inflation has been contained at low levels

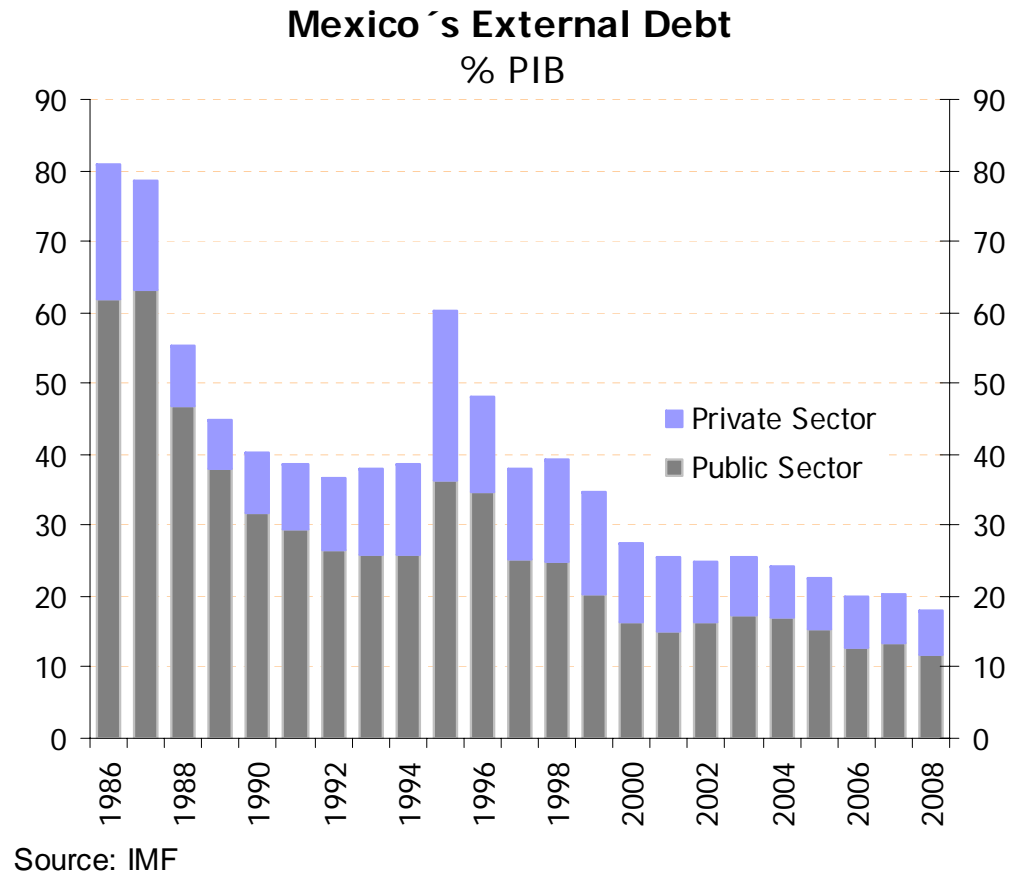
Low & stable interest rates helped to improve households & firms' expenditure capacity

Nominal Stability: there were not adverse effects on purchasing power



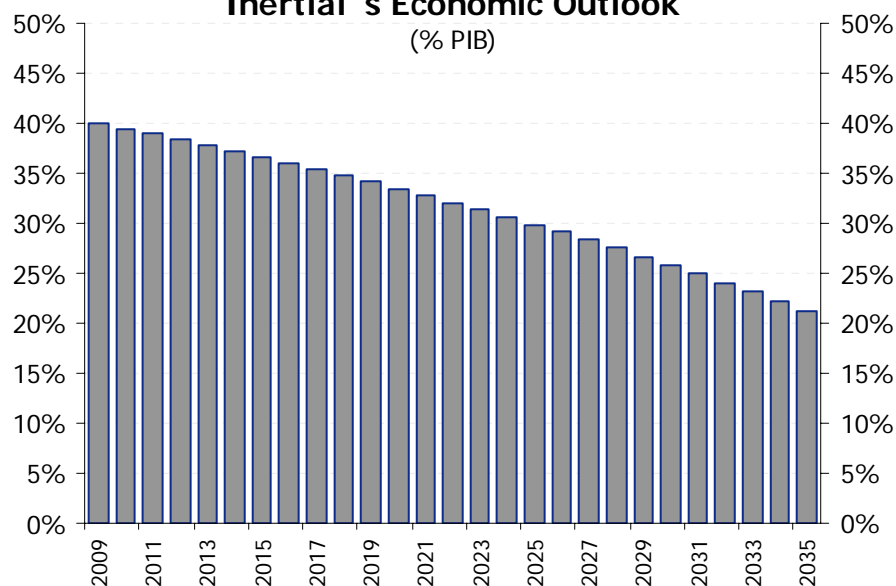
Contained inflation expectations have avoided additional loosening of households' purchasing power, which has helped somewhat the labor market

Less dependence on external funding in both public and private sectors



Public Sector: Public debt is sustainable in the mid term.

**Mexico's Public Debt
Inertial's Economic Outlook**
(% PIB)



Source: BBVA Bancomer ERD

Table 1: Debt's sustainability under several scenarios
Assumptions: growth=2.5% & initial debt =40% PIB

Primary balance (public balance without interest payments)					
r	2.0%	1.5%	1.0%	0.5%	0.0%
4.0%	S	S	S		
4.5%	S	S	S		
5.0%	S	S	S		
6.0%	S	S	I		
7.0%	S	I	I		

Fuente: SEE BBVA; S=Sustentable, I=Insostenible

Table 2: Debt's sustainability under several scenarios
Assumptions: growth=3.5% & initial debt =40% PIB

Primary balance (public balance without interest payments)					
r	2.0%	1.5%	1.0%	0.5%	0.0%
4.0%	S	S	S	S	
4.5%	S	S	S	S	
5.0%	S	S	S		
6.0%	S	S	S		
7.0%	S	S	I		

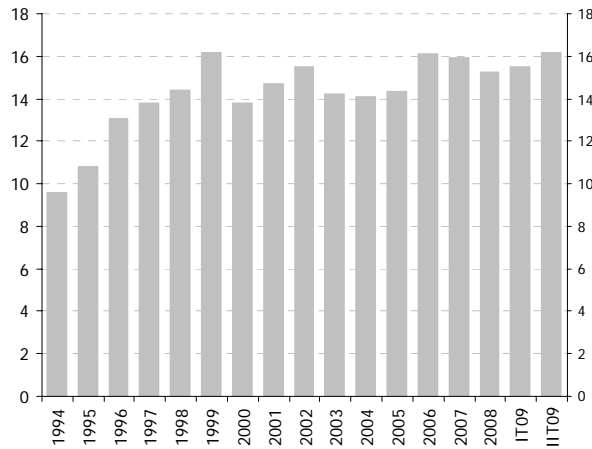
Source: SEE BBVA

Under reasonable assumptions about growth, interest rates and primary surplus round 1.5% of GDP, the downward pattern of public debt would hold in the future.

Higher growth capability will imply more room for public sector to improve capital stock through investment and infrastructure and education

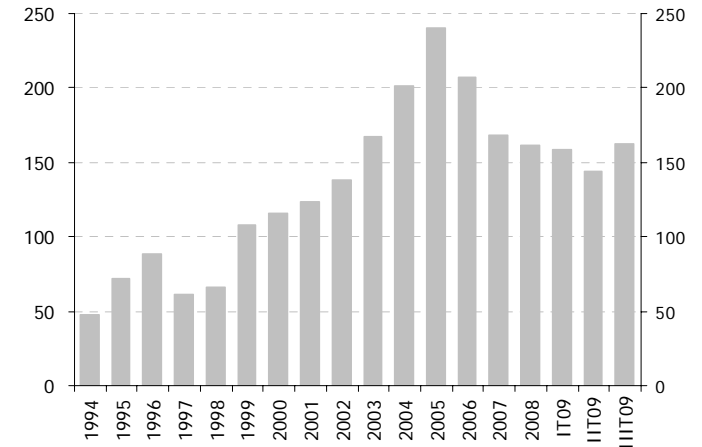
Financial Sector: Strength built through better regulation

Capitalization Index, Commercial Banks (%)



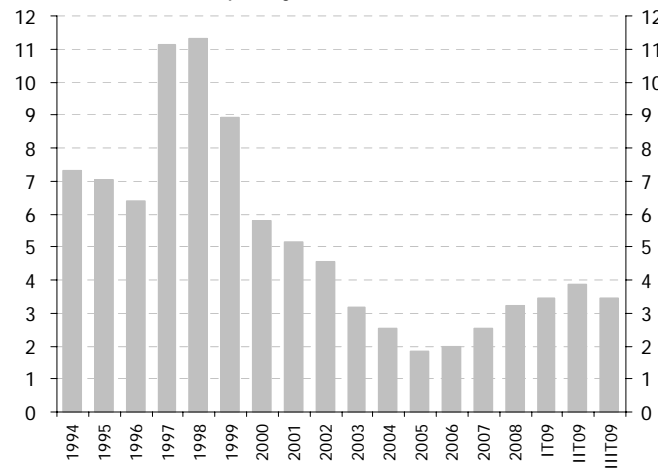
Source: CNBV

Hedge Index, Commercial Banks
Reserves / Default Portfolio %



Source: CNBV

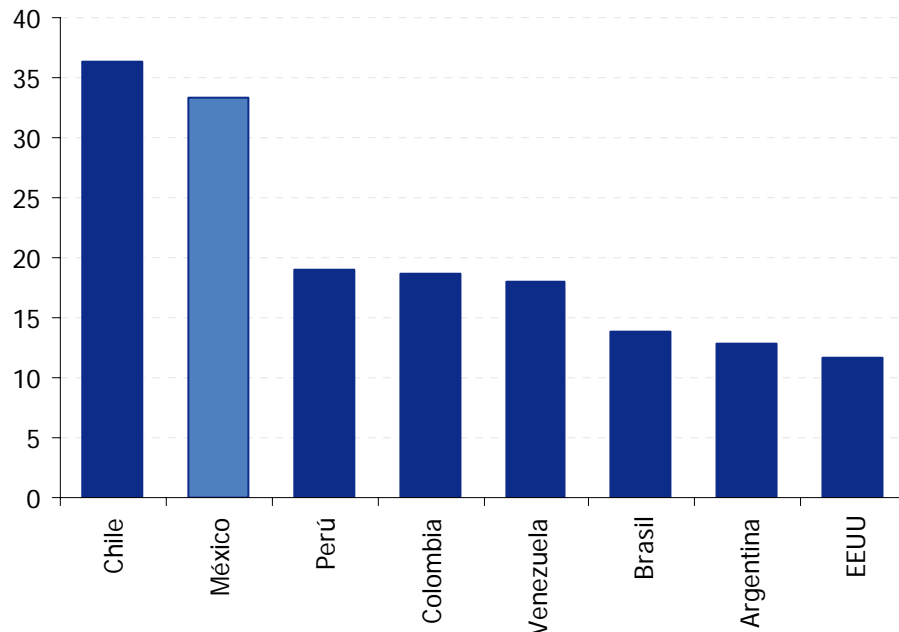
Delinquency Rate, Commercial Banks
Delinquency loans / Portfolio, %



Source: CNBV

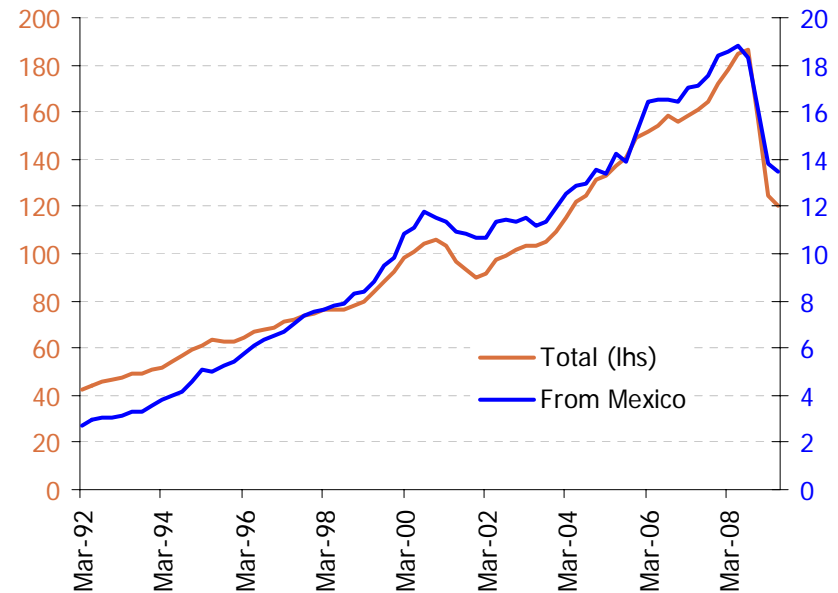
Demand Shock: Collapse in global trade & high exposure to US

Exports in 2008 (% of GDP)



Source: ECLAC/UN & SEE BBVA Bancomer

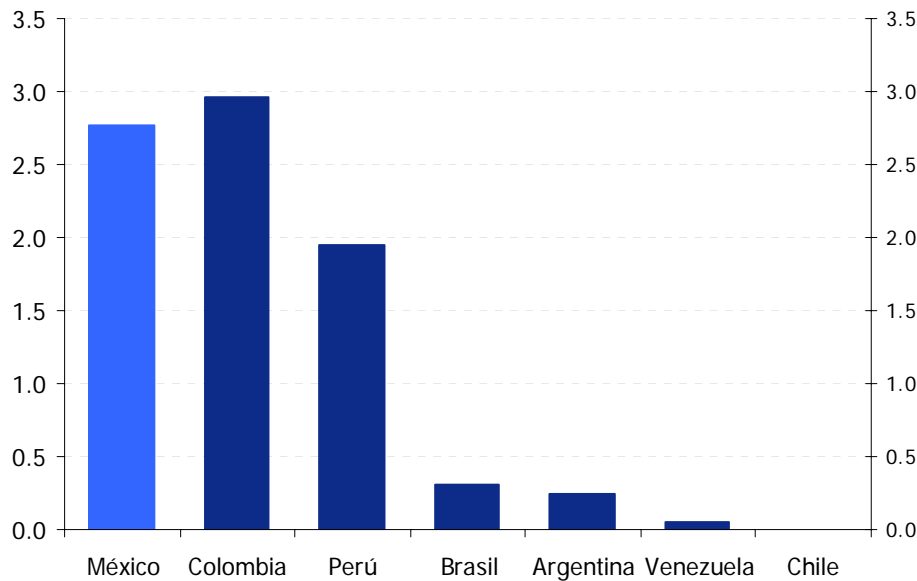
USA Imports
(Total and from Mexico, bill US\$)



Mexico exports 1/3 of its GDP and its main partner is US, where the recent economic downturn has been severe

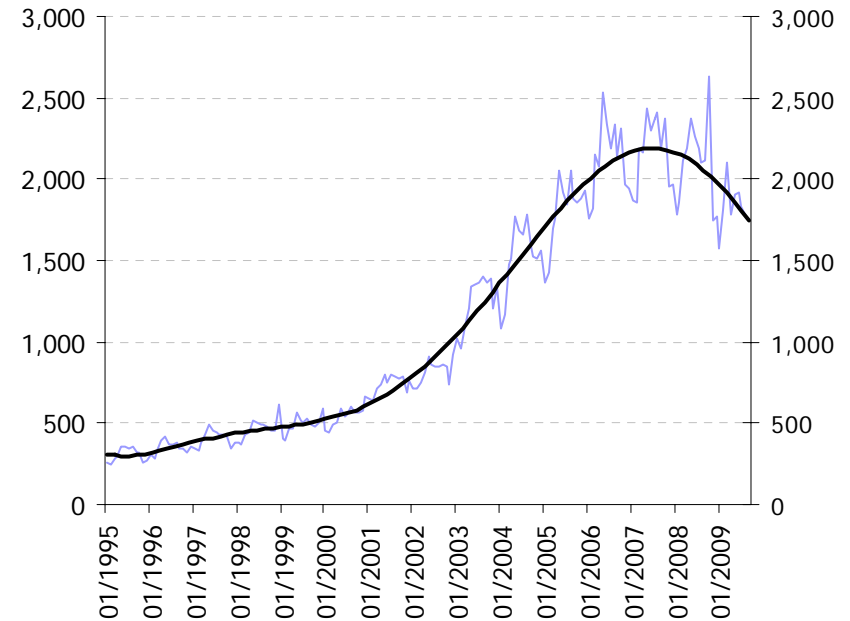
Demand Shock: Collapse in global trade & high exposure to US

Remittances in 2007 (% of GDP)



Source: World Bank

**Remittances to Mexico
mill \$USD**

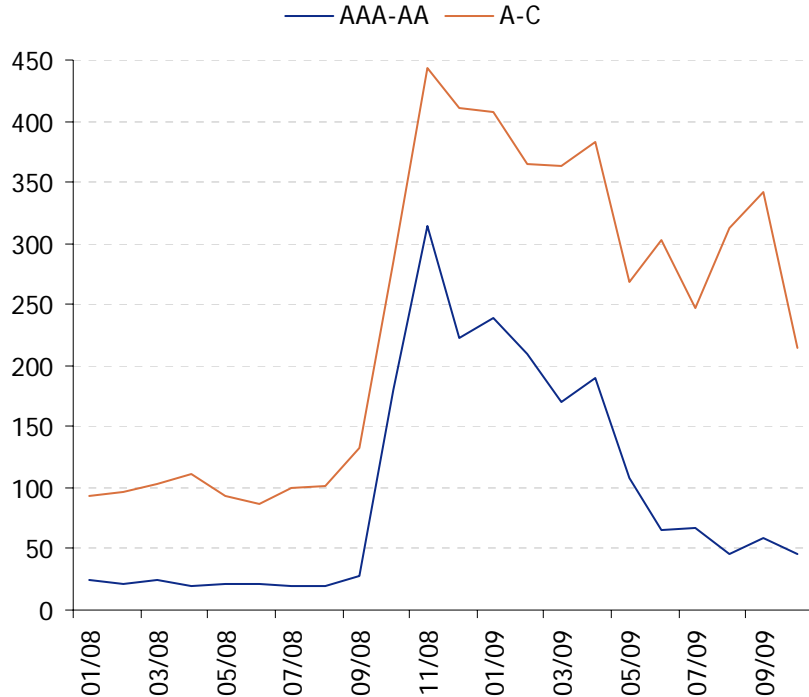


Source: Banxico

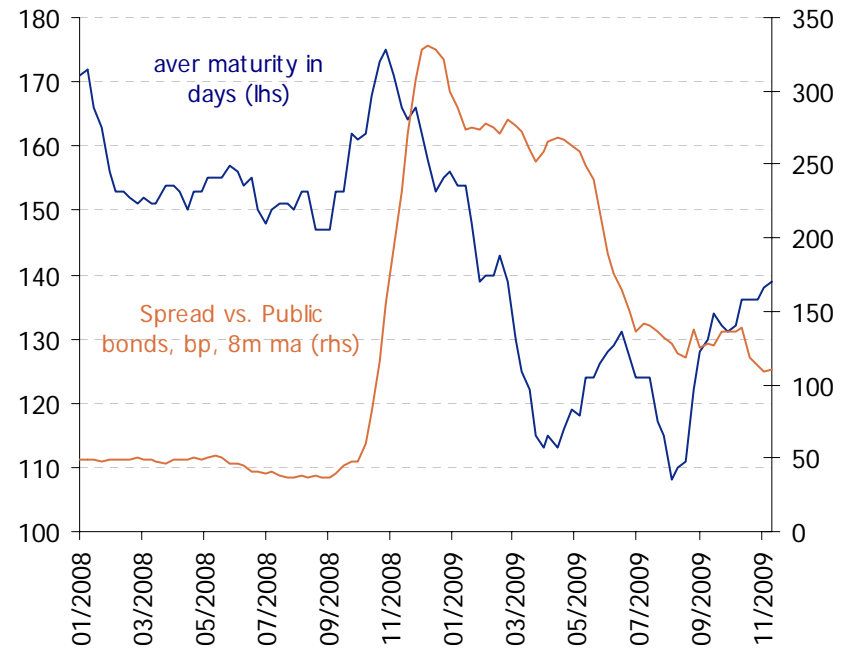
Vulnerability to external shocks through remittances is higher in Mexico than other countries. A high proportion of these flows come from US.

Financial Shock: Higher financing costs for corporations

Corporate Debt Spread (bp)



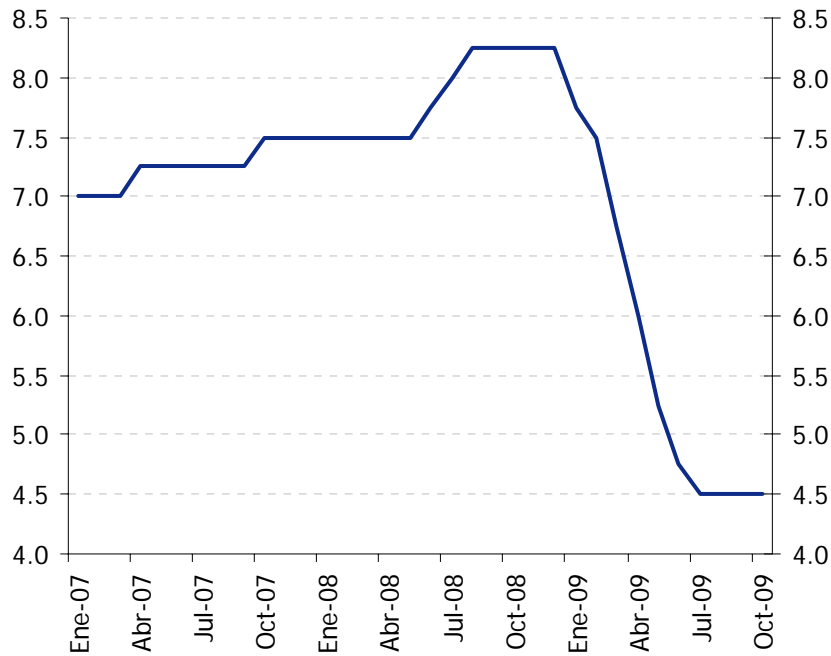
Short-Term Corporate Bonds



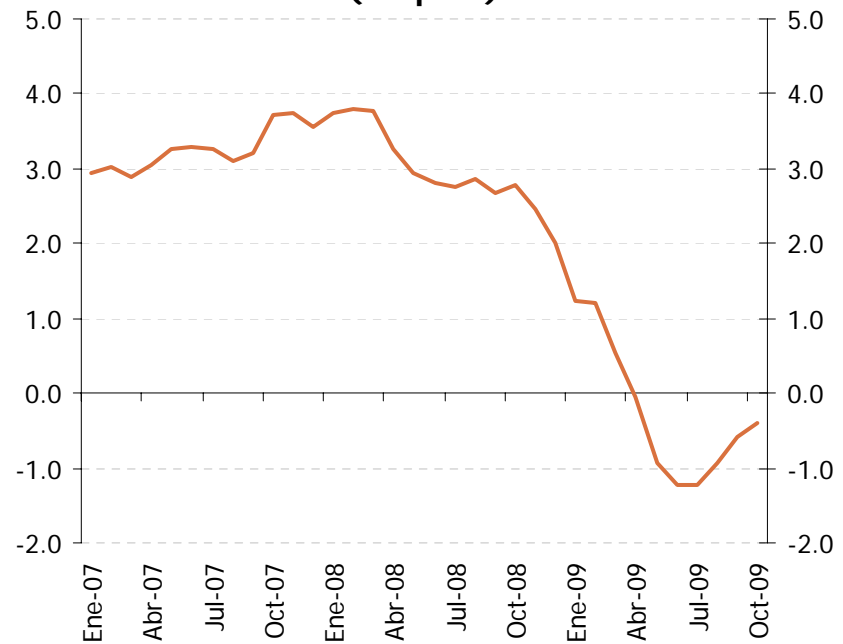
Mexican corporate bonds paying higher yields within shorter maturities, hand in hand with a fall in external demand, have both contributed to slowdown economic activity and employment.

Monetary Policy, liquidity provision & financing support

Nominal FONDEO Rate, %

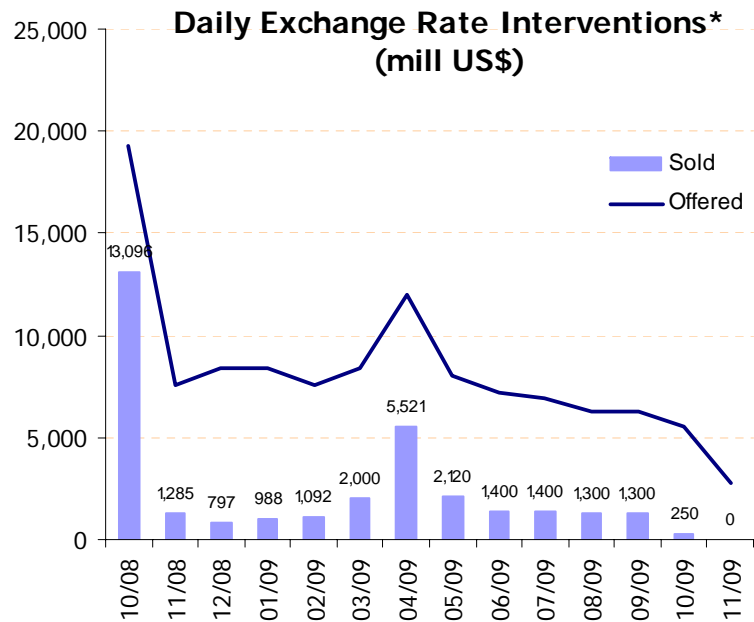


Real FONDEO Rate, % (ex-post)

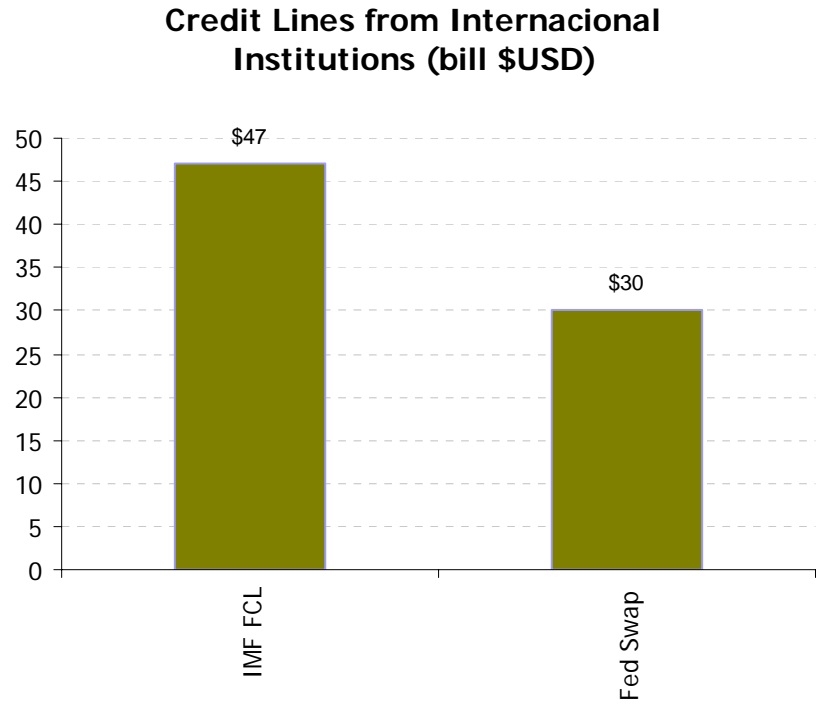


Real fondeo rates (ex post) have been negative since 2Q09

Monetary Policy, liquidity provision & financing support



* Includes minimum & no n-minimum price.
 Note: to 18/Nov/2009. In April 2009, it includes \$3221dls from Fed's Swap Line.
 Source: Banxico



Banxico's daily exchange rate interventions have secured enough USD supply

Moreover, the assured availability of abundant and low-cost USD funding have contribute to reduce liquidity tensions

Monetary Policy, liquidity provision & financing support

At the end of 2008, the Mexican government implemented a program to support financing of productive activities mainly through guarantees and other financial instruments

Financial Program: Additional resources managed by NDB

	billion pesos	% GDP
Total Program	180	1.4%
Corporate Credit Support (NAFIN & BANCOMEXT)	85	0.7%
Housing Sector (SHF & NAFIN)	40	0.3%
Infrastructure Sector (BANOBRAS)	30	0.2%
Farm Sector (FINANCIERA RURAL)	25	0.2%
Infrastructure National Fund	35	0.3%

Monetary Policy, liquidity provision & financing support

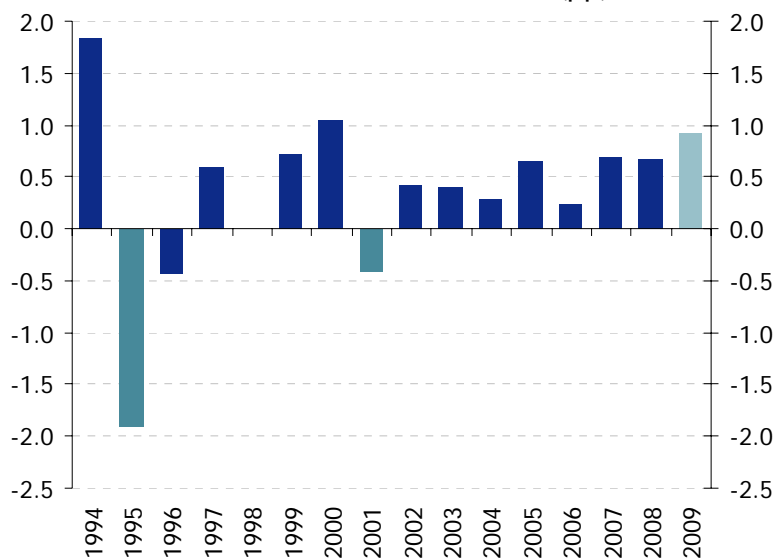
Main characteristics (amounts in billion pesos, bn)

	Corporate Credit	Corporate Credit	Housing Sector	Infrastructure Sector	Farm Sector
NDB	NAFIN & BANCOMEXT	NAFIN	SHF & NAFIN	BANOBRAS	FINRURAL
Target	Small & Medium firms (non-financial sector) (PYME)	Non-financial sector & non-bank banks (excludes mortgage)	Mortgage non-bank banks (Sofoles) & developers	Corporate	Farms producers
Instrument	<ul style="list-style-type: none"> Revolving loans (23bn) channeled by commercial banks Guarantee Loans (12bn) 	<ul style="list-style-type: none"> Guaranties for commercial paper refinancing up to 50% of the face value (50bn) 	<ul style="list-style-type: none"> Guaranties for corporate bonds emissions (20bn) Medium term revolving loans and securitization program (20bn) 	<ul style="list-style-type: none"> Revolving Loans (30bn) 	<ul style="list-style-type: none"> Guarantee Fund (20bn) Credit subsidies and loans (5bn)
Total Amount	35bn	50bn	42bn	30bn	25bn
Addendum		<ul style="list-style-type: none"> The program is positive, however the bulk of short term debt could be 2/3 higher 	<ul style="list-style-type: none"> Mortgage non-bank banks have short term maturity loans around 22bn 	<ul style="list-style-type: none"> Investment rules for Pension funds (SIEFORES) could be changed in order to increase infrastructure funds 	

Fiscal Policy

For the very first time, a countercyclical policy was implemented to boost economic growth during recession

**Public Consumption & Investment
Contribution to Growth (pp)**



Signaled periods of GDP contraction
Source:BBVA Bancomer ERD

Fiscal Measures in 2009 (% of GDP)

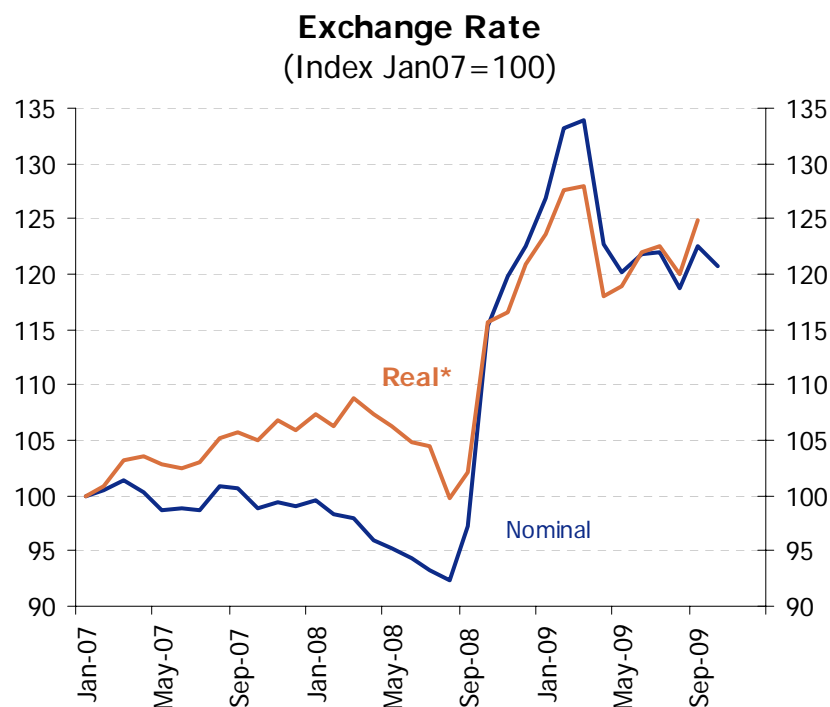
Fiscal Stimulus		Taxes*	Current Spending	Capital Spending	Total
a) Contracicycal programme	8 & 20 Oct 08			0.50%	0.50%
b) Contracicycal programme	07 jan 09		0.30%	0.20%	0.50%
c) Contracicycal programme	05-May-09	0.12%	0.002%		0.13%
d) Saving measures			-0.50%	-0.20%	-0.70%
	28-May-09		-0.30%		-0.30%
	23-Jul-09		-0.20%	-0.20%	-0.40%
Total (a+b+c+d)		0.12%	-0.20%	-0.50%	0.43%

* Implies lower expected tax revenues

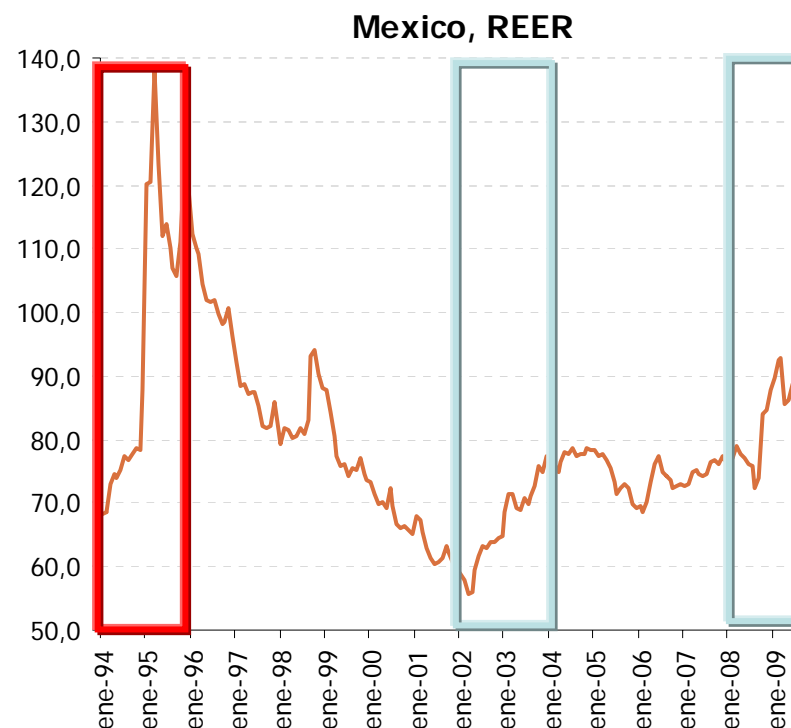
Sources: Own estimations using SHCP information. Figures might differ from official numbers.

Additionally, to fix gasoline prices in 2009 correspond to an income transfer round 0.9% of GDP.

Exchange-Rate Flexibility



* Banxico's REER, with consumer prices and with respect to 111 countries



Inflation pass-through has been limited by both demand weakness and Banxico's credibility

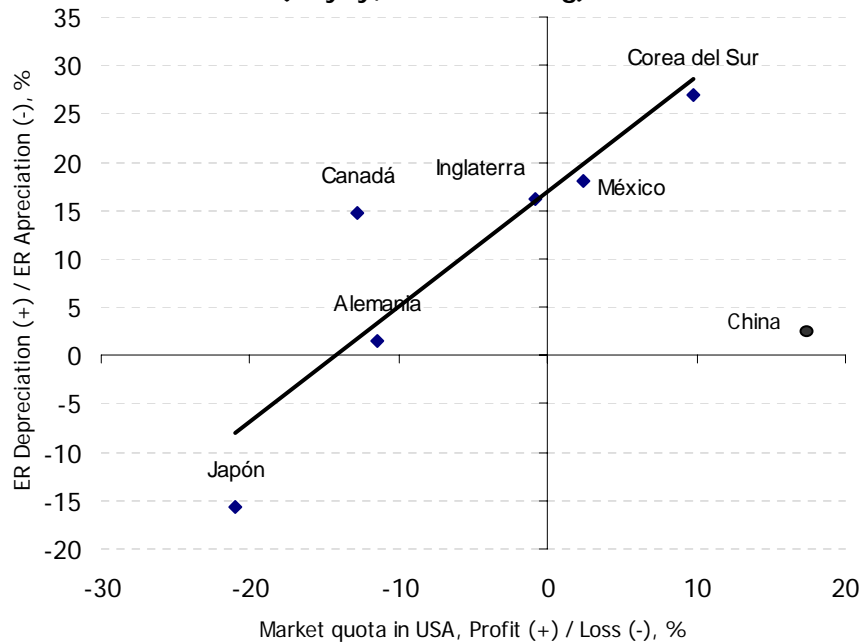
Mexico, Real Efective Exchange Rate (□%)

	1995/94	2003/02	2007/2002	2009/2008	1H09/1H08
REER	54,4	17,6	23,2	13,6	15,2
ER (E/E*)	97,1	19,7	31,5	17,7	20,2
Prices (P/P*)	28,1	1,8	6,8	3,8	4,3

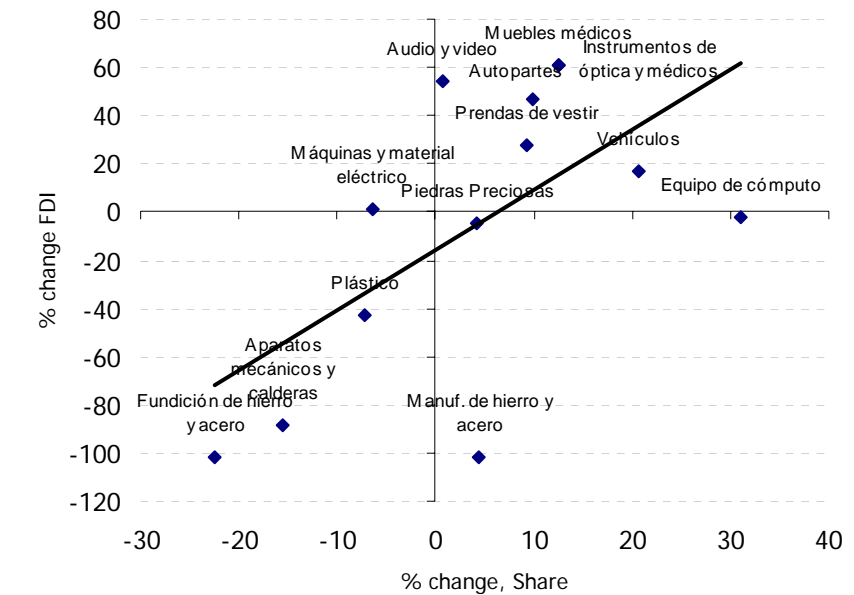
Source: BBVA ERD with Banxico data

Exchange-Rate Flexibility

**US Import Market, Share and
& Real Exchange Rate
(% y/y, manufacturing)**



**US Import Market, Mexican Share by
Activity & FDI
(%, y/y)**



Source: BBVA Bnacomer ERD with data from Secretaria de Economía & US Census

Exchange rate depreciation has been a determinant factor improving manufacturing quota in the US market

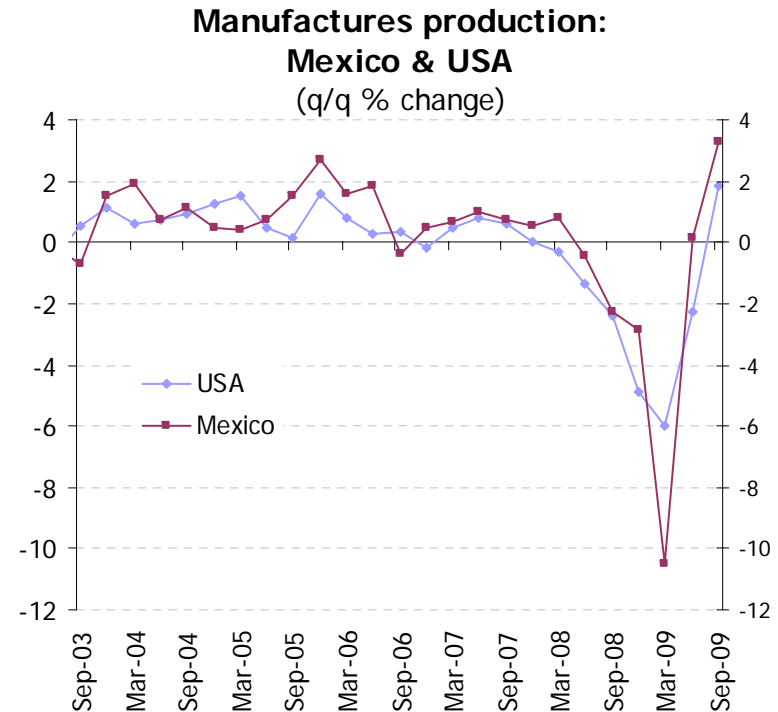
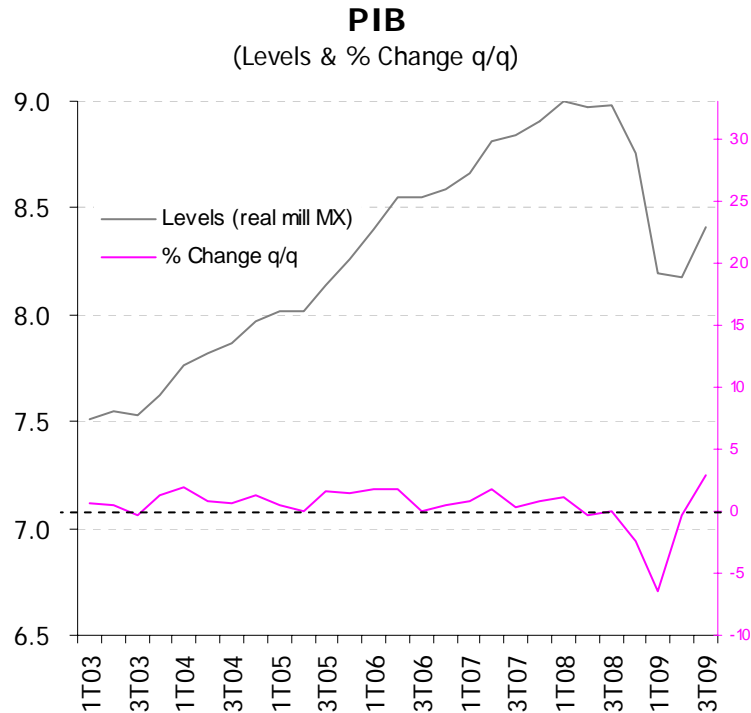
... however, those sectors capable to attract FDI usually show higher increases

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3. Medium and Long-term Outlook

GDP growth in the 3Q09

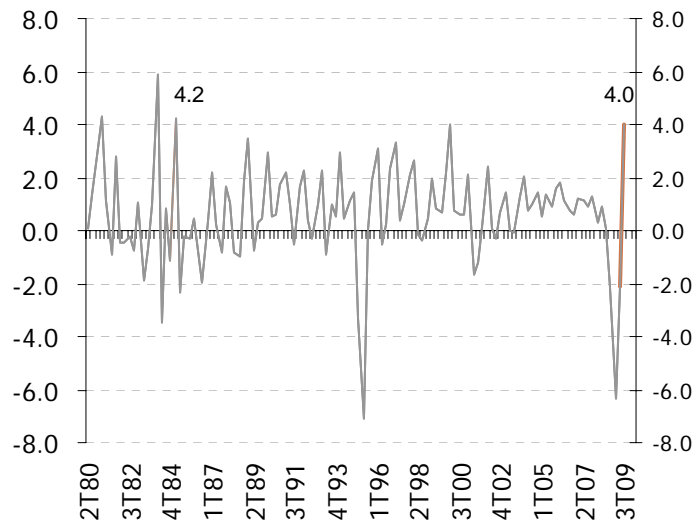


Mexican economy reached the bottom in 01Q9 (quarterly rates).

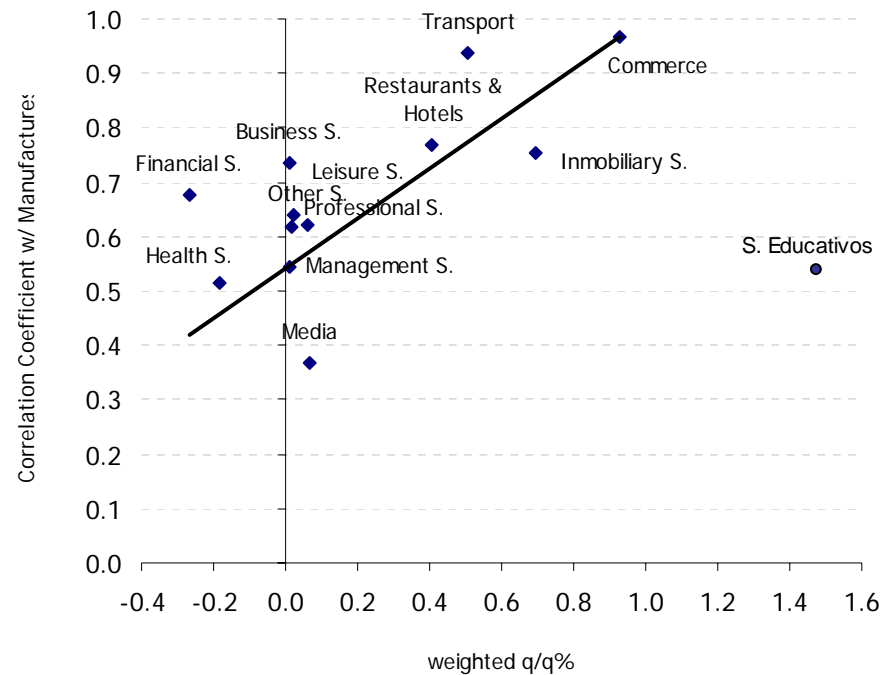
The recovery relies on US economy performance through commercial linkages, in particular manufactures exports

GDP growth in the 3Q09

GDP: Services
(q/q/ % change)

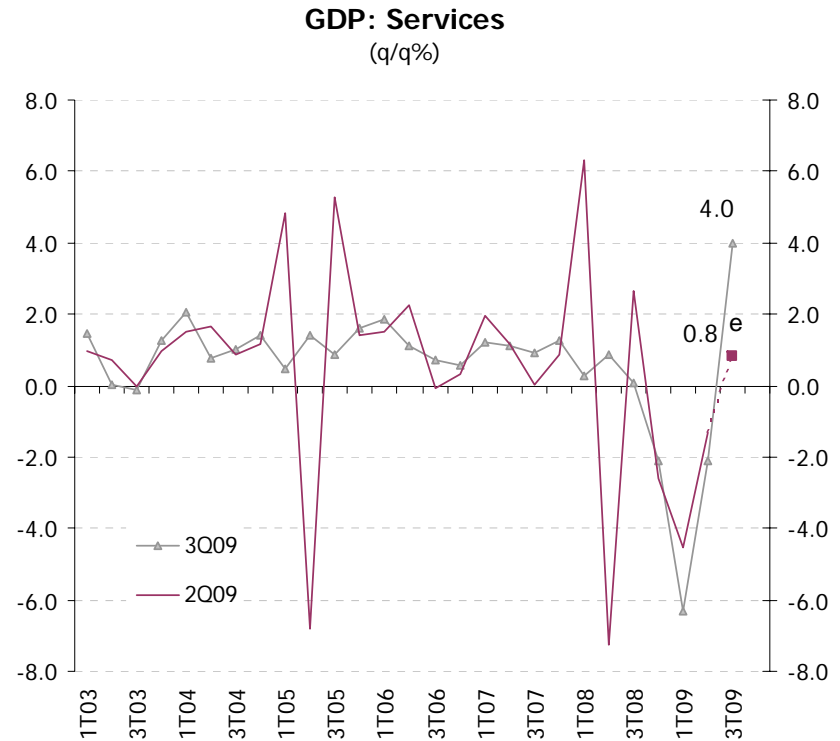
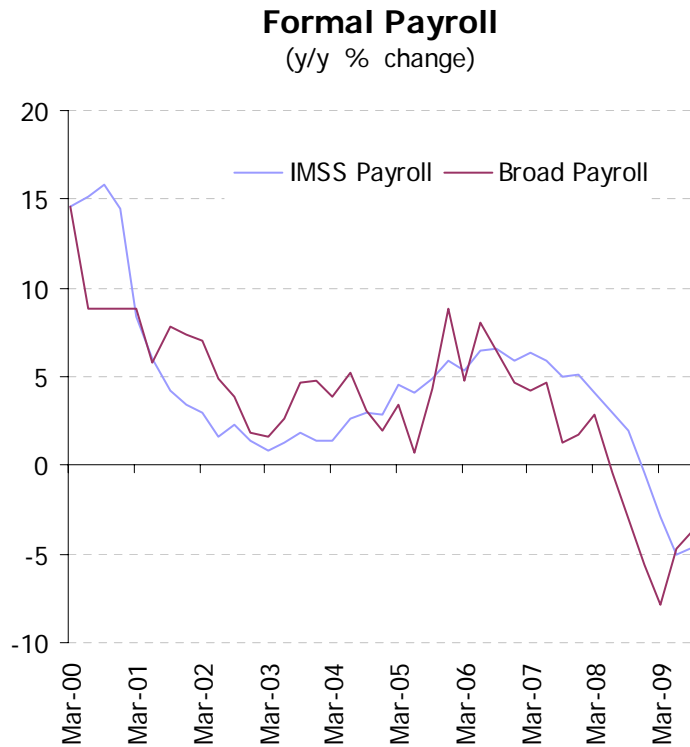


Services & Industry Correlation
(weighted q/q% & correlation coefficient)



The services sector showed the largest growth in 03Q09 ever since 1985. Worth to note are all those services linked to international trade (transport & retails) and the rebound effect on those services from the AH1N1 episode (retails, restaurants and hotels)

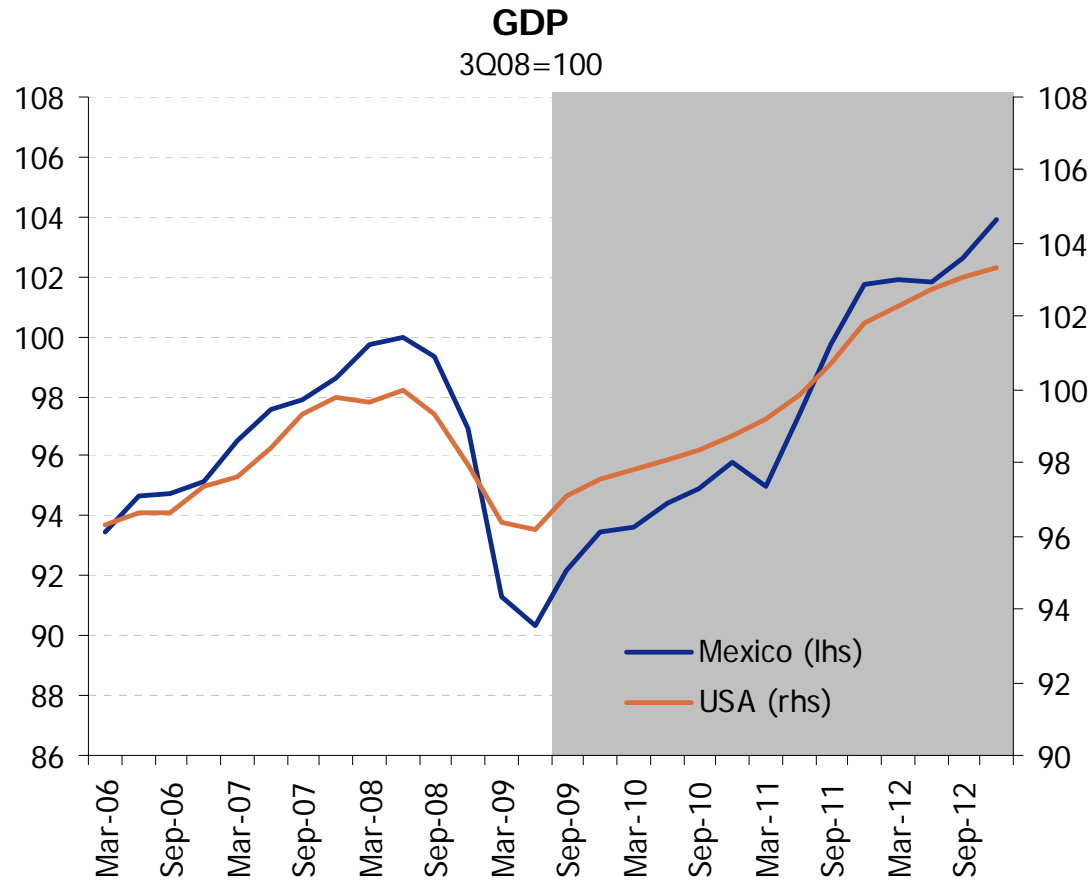
GDP growth in the 3Q09



Another factor affecting the recovery in the services sector has been the rise in payroll (broad and IMSS definition) in yearly rates during 2Q09.

With corrected INEGI figures we can conclude that the contraction was more severe while the recovery was better than expected

Economic recovery based on a better external context and employment endurance



Source: SEE BBVA

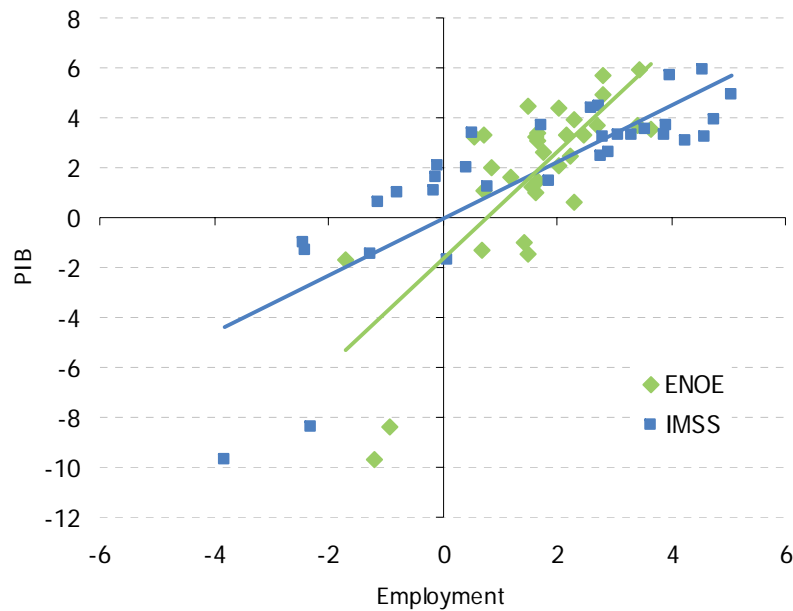
Economic recovery based on a better external context and employment resilience

IMSS's Employment & IGAE
(% change y/y)

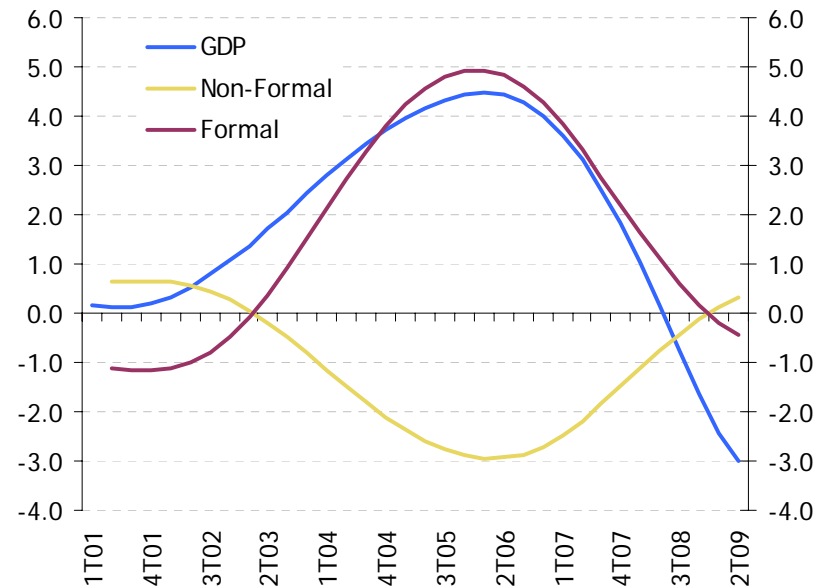


Economic recovery based on a better external context and employment resilience

Economic Activity & Employment
(% change y/y)



Growth & Employment
(y/y % and trend)



Source: BBVA ERD

Comparing both data sources, it is evident a less cyclical character in total employment ...

... this suggest that informal employment acts as a buffer.

The 2010 budget: Things to do yet to achieve comprehensive fiscal reform

The fiscal gap in 2010 will be covered by more debt, lower taxes increment and a higher dependence on oil industry than in the original proposal

Fiscal Measures for 2010

Income minus Disbursements (before adjustment)	(before adjustment)		Fiscal Measures (SHCP)		Fiscal Measures (Congress)		
	billion pesos	% GDP	billion pesos	% GDP	billion pesos	% GDP	
TOTAL FISCAL GAP	374.0	3.2%	374.0	3.2%	374.0	3.2%	
<i>Cyclical Component</i>	155.0	1.3%	<i>Transitory measures</i>	155.0	1.3%	183.9	1.6%
			Additional Debt / Additional deficit	60.0	0.5%	88.9	0.8%
			Oil stabilization fund and other assets	45.0	0.4%	45.0	0.4%
			Non-recurrent income	50.0	0.4%	50.0	0.4%
<i>Structural Component</i>	219.0	1.8%	<i>Permanent measures</i>	219.0	1.8%	190.1	1.6%
			Fiscal savings	74.2	0.6%	110.6	0.9%
			New taxes receipts	155.3	1.3%	90.0	0.8%
			Fiscal efficiency	20.4	0.2%	20.4	0.2%
			Higher fiscal cost and States distributions	-30.9	-0.3%	-30.9	-0.3%

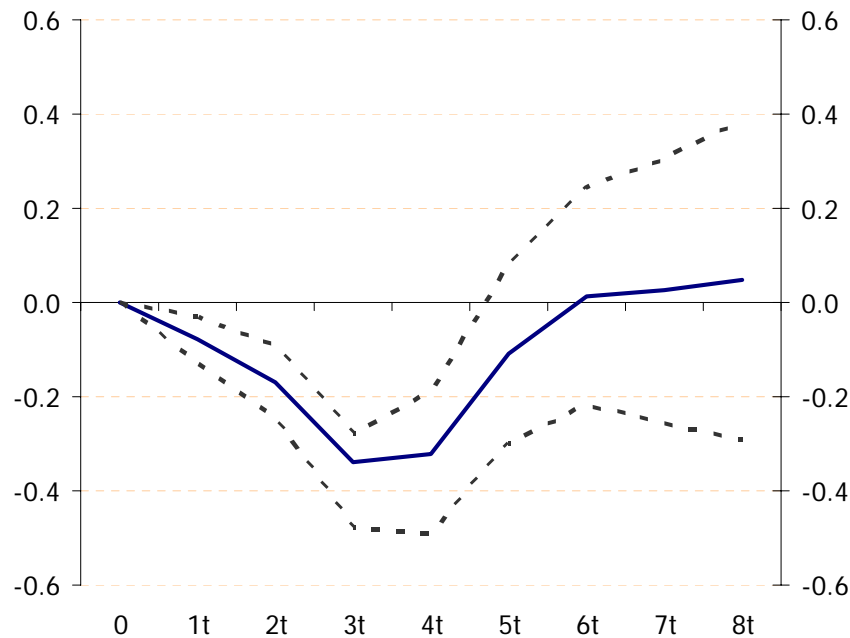
* Fiscal GAP considers a lower income in relation to budget approved for 2009

Source: BBVA with SHCP Budget for 2010

Fiscal Policy Impact: limited in intensity & duration

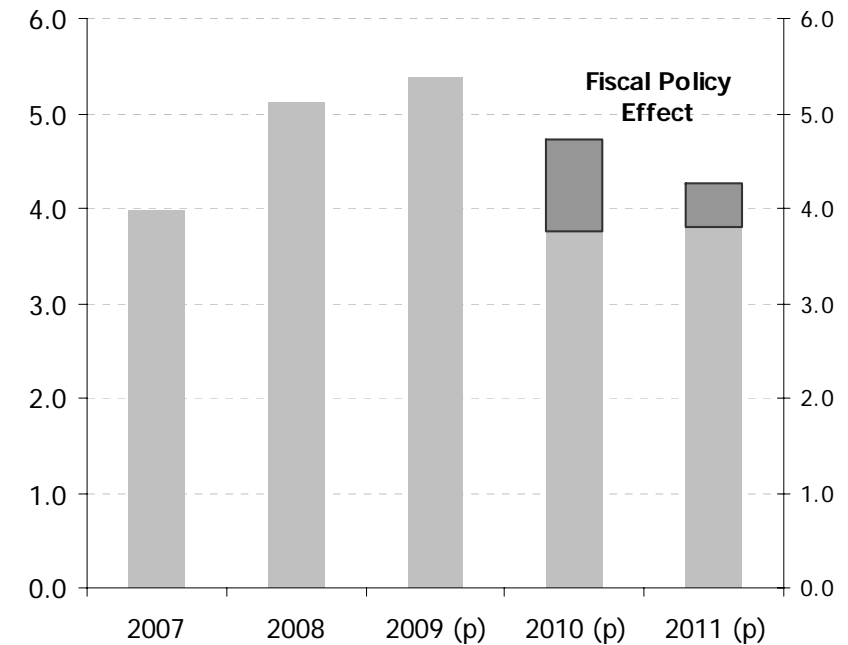
The effects on growth & inflation are limited in intensity & duration

2010 Budget, Effect of Tax Increments on GDP (pp)



Source: BBVA ERD

Mexico's Inflation Forecast INPC, y/y %

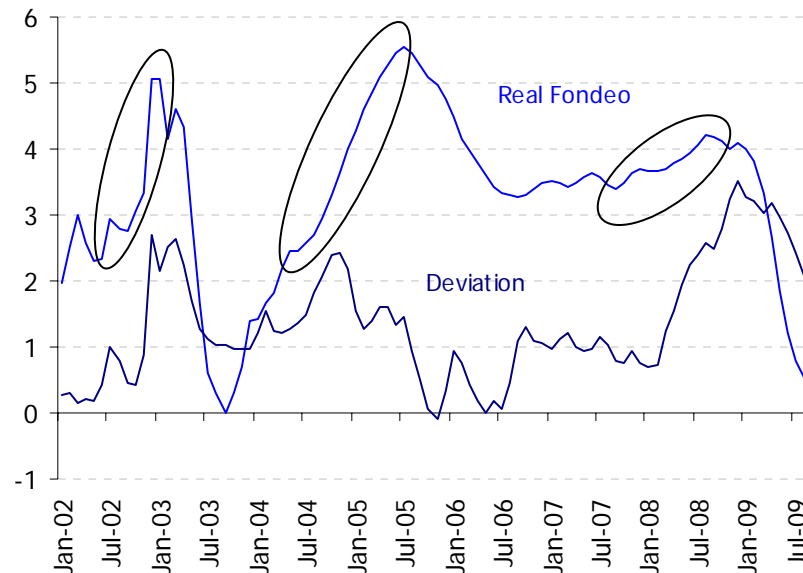


Source: BBVA ERD

Monetary Policy: Banxico uses its earned credibility

A flexible monetary policy –pre-emptive actions- has granted Banxico credibility gains

Real FONDEO & Inflation Deviation from Banxico's Target (% ex post 3mma & pp)



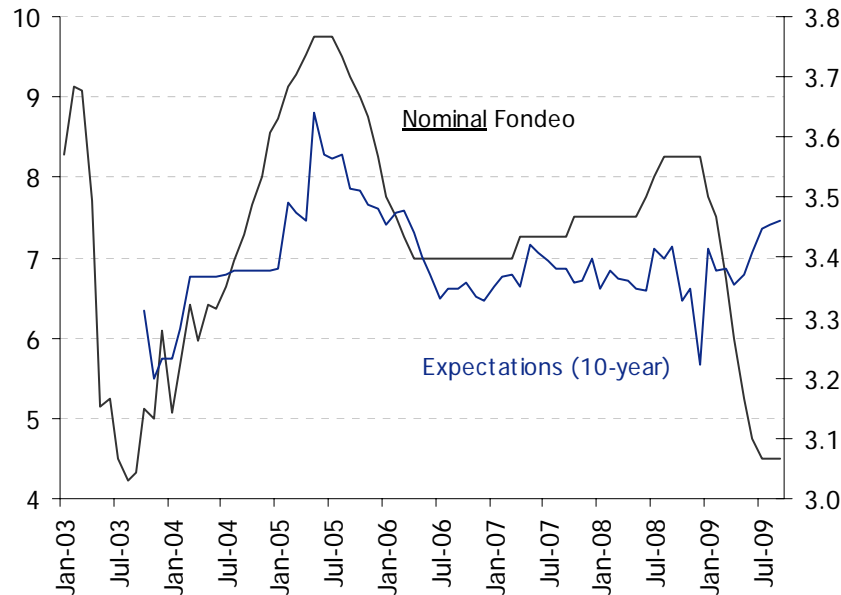
Note: Banxico's Inflation Targets: 10.0% in 2000, 6.5% in 2001, 4.5% in 2002, 3.0% +/- 1pp since 2003
 Source: BBVA Bancomer with Banxico's & Infosef's data

The monetary policy actions (ie, rate hikes) that Banxico needs to take to bring inflation closer to its target have been getting smaller

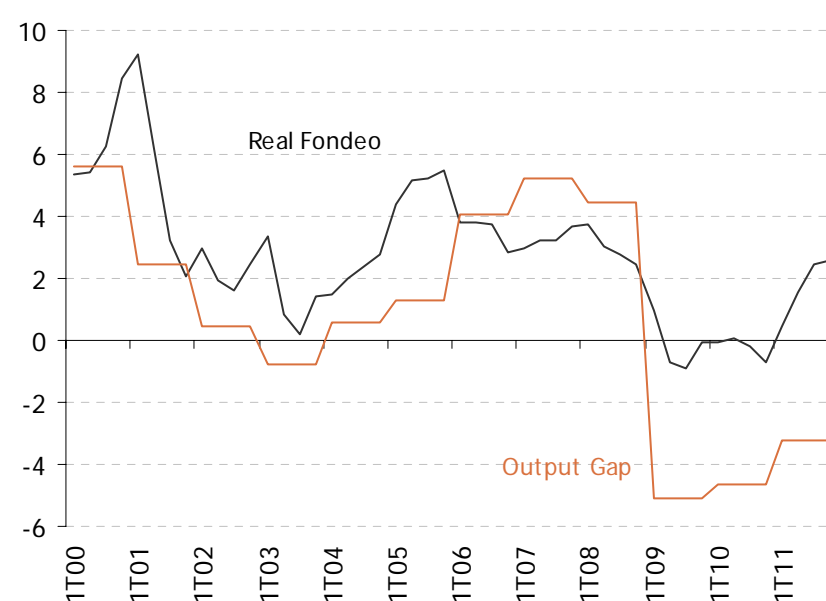
Monetary Policy: Banxico uses its earned credibility

Long-term inflation expectations will remain well-anchored. The rise in inflation in 2010 due to the fiscal shock will be limited and transitory

Banxico's Reference Rate & Long-Term Inflation Expectations (%)

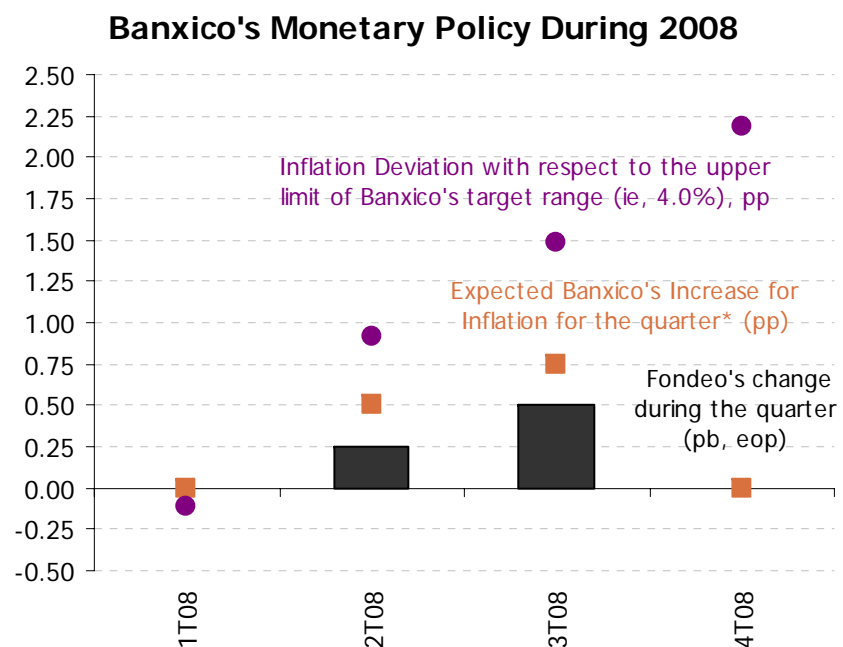


Real Fondeo Rate & Output Gap (% ex-post, quarterly average & pp)



Source: BBVA Bancomer with Banxico's data

Flexibility, Non-Linearity & Risk-Management Approach in Monetary Policy



* New estimate released in the last month of the previous quarter and compared with the previous estimate
 Source: BBVA Bancomer with Banxico's data

- During 2Q and 3Qo8, Banxico considered that inflation deviation was large enough to increase the probability of a particularly adverse scenario: an increase in long-term inflation expectations
 - Expectations remained anchored, in part probably as a result of Banxico's pre-emptive hikes. In face of non-linearity's in inflation developments, Banxico adopted a non-linear monetary policy and by acting flexibly decided to hike pre-emptive –ie, with a risk-management approach- during Q2o8 (+25pb) and 3Qo8 (+50pb, two hikes of 25pb each)
 - Banxico acted also with communication by increasing their expected inflation path and postponing the achievement of their goal, but also by increasing rates

An alternative estimate for the monetary policy rule

Two non-linear monetary policy reaction functions were estimated: hybrid Taylor Rules. The first one is a simple quadratic function. The second one, is a non-linear function. The solution to its initial values determines the functional form of the Taylor Rule (Gauss-Newton estimation)

$$i_t = c + \beta_1(\pi_t - \hat{\pi}) + \beta_2(\pi_t - \hat{\pi})^2 + \beta_3(i_{t-1}) + \beta_4(y_t - \hat{y}) + e_t \dots (1)$$

$$i_t = c + \beta_1(\pi_t - \hat{\pi}) + \beta_2(\pi_t - \hat{\pi})^\alpha + \beta_3(i_{t-1}) + \beta_4(y_t - \hat{y}) + e_t \dots (2)$$

where i is the monetary policy interest rate, π is the observed inflation rate, $\hat{\pi}$ is the target inflation rate, y is the observed GDP (in ln) and \hat{y} is the potencial GDP.

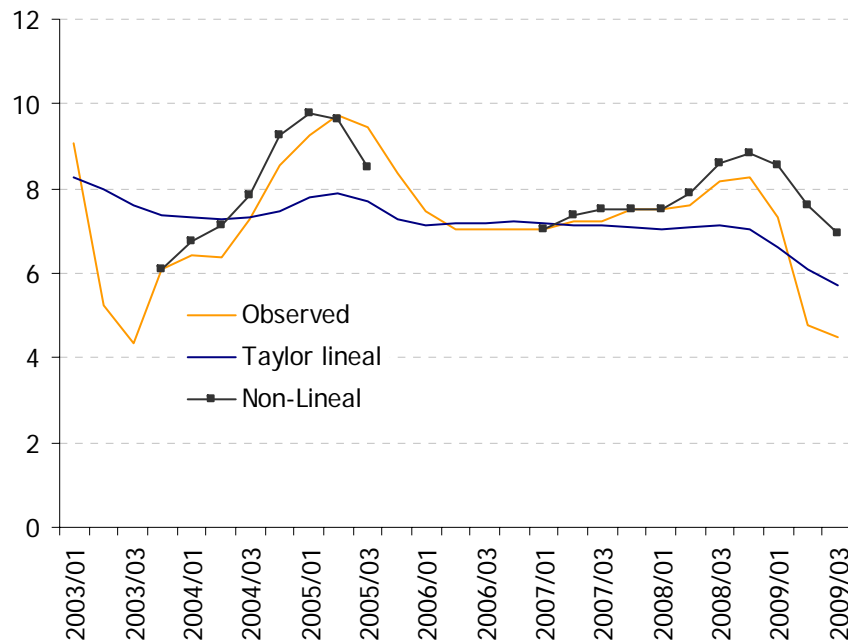
Table 1
Quarterly

	B1	B2	B3	R ²
<i>Est 1</i>	-0.020 (-.036)	0.963 (3.653)	0.690 (5.178)	0.85
<i>Est 2</i>	0.006 (2.385)	1.085 (1.761)	0.620 (8.050)	0.73
Monthly				
<i>Est1</i>	-0.102 (-1.661)	0.859 (2.439)	0.810 (4.407)	0.95
<i>Est 2</i>	-0.137 (-.528)	2.991 (1.609)	0.906 (9.931)	0.61

T-statistics in brackets

An alternative estimate for the monetary policy rule

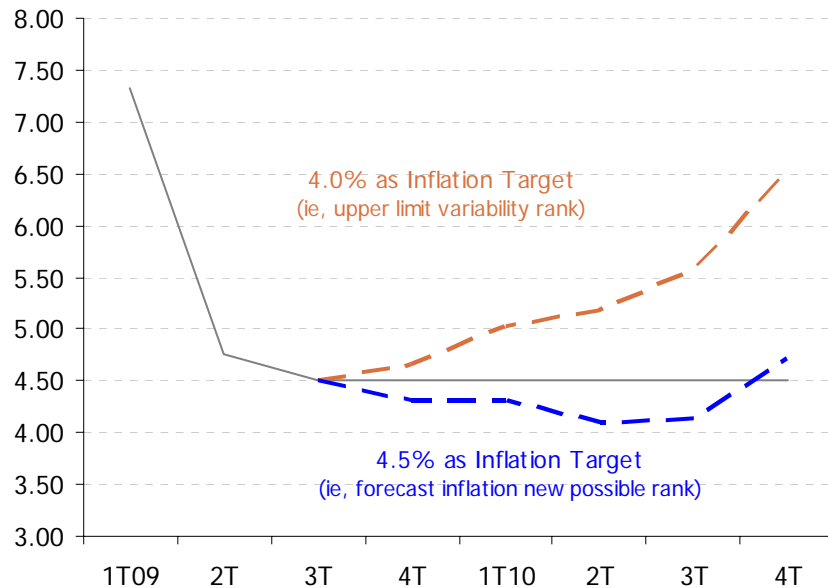
Fondeo rate: Observed & Forecast



- Banxico, like other central banks, modifies its behavior as a response of the circumstances they face, responding sometimes in a lineal fashion and in special occasions in a non-lineal one.
- The lineal Taylor Rule, with error accumulation, captures the trend in fondeo’s fluctuations, but misses the magnitude of changes when significant.
- In contrast, the non-lineal estimation, anticipates the intensity with which the fondeo’s rate adjusts in the face of pronounced deviations of inflation. However, noteworthy to mention, it tends to overestimate the strength of the adjustment.

An alternative estimate for the monetary policy rule

**Non-Linear Fondo's Forecast
(%, quarterly ave.)**



- Inflation will once again deviate from Banxico's target. Two possible scenarios:
 - 1.- Banxico through communication (eg, hawkish tone in statements) anchors long-term inflation expectations. If that is the case, we can use 4.5% as Banxico's implicit target for 2010 (which could be close to their new estimated range for inflation. In turn, they could extend their monetary policy pause
 - 2.- Expectations tend to increase. If that is the case Banxico would have to consider a 4.0% target (or even lower) in their reaction function and as a consequence would have to increase gradually its policy rate throughout the year

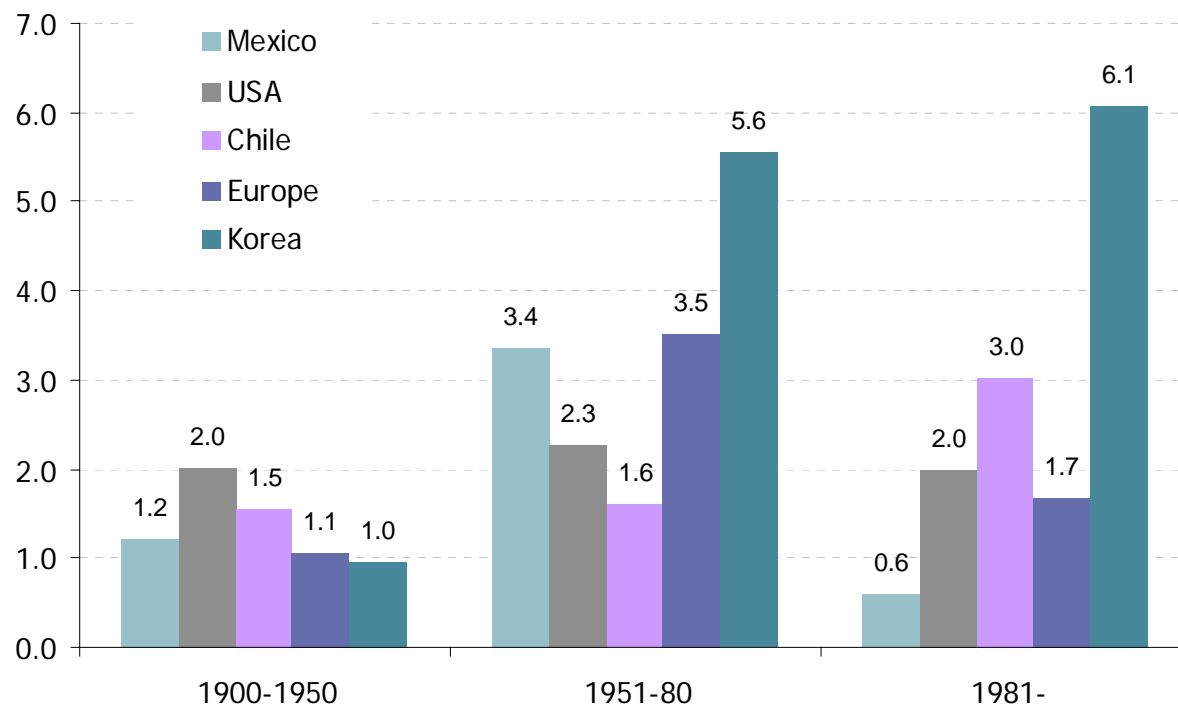
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Potential growth, dependent on efficiency

Per capita Income Growth
(ave p.a. %)



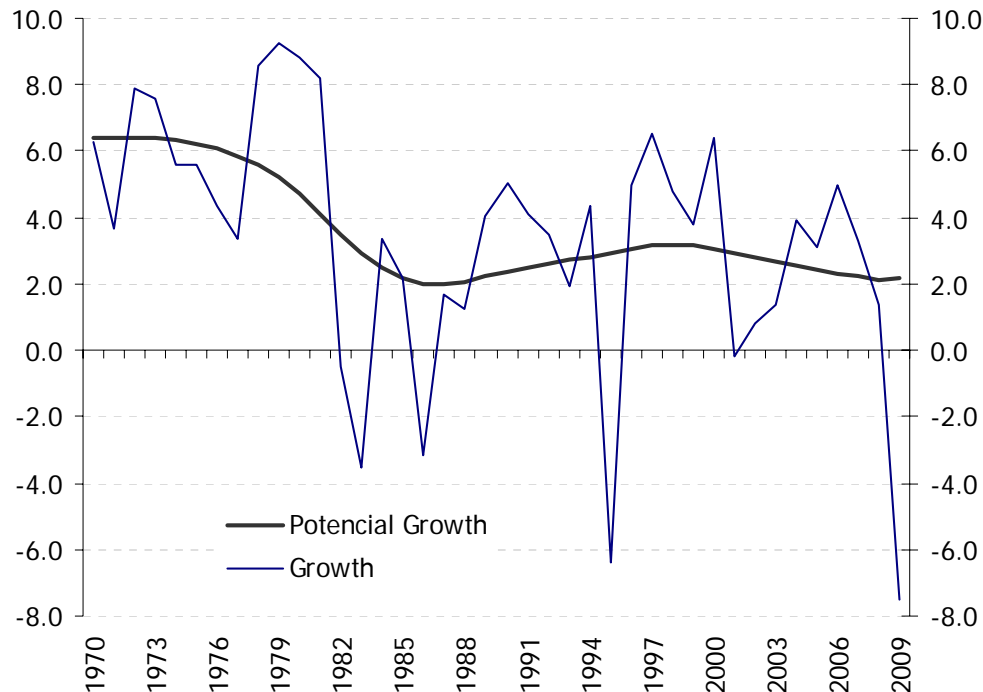
Source: BBVA Bancomer with Angus Maddison data

Mexico consistently registers a disadvantage in economic growth performance

Potential growth, dependent on efficiency

There are alternative estimates to calculate an economy potential growth

Potential and GDP Growth (%)



Source: BBVA ERD

Potencial GDP: Various Forecast

Own Est.	H-P Filter	OECD	E.Acevedo ^{II}	Faal (IMF) ^{III}	E. Loria ^{IV}
2009-2010	2009-2010	2009-2010	2006-2007	1996-2003	1996-2006
2.2	2.4	1.9	[3.7-4.3]	3.6	3.7

^I OCDE: The effect of financial crisis on potential output: new empirical evidence from OCDE countries. WP No. 699 Furceri & Mourougane

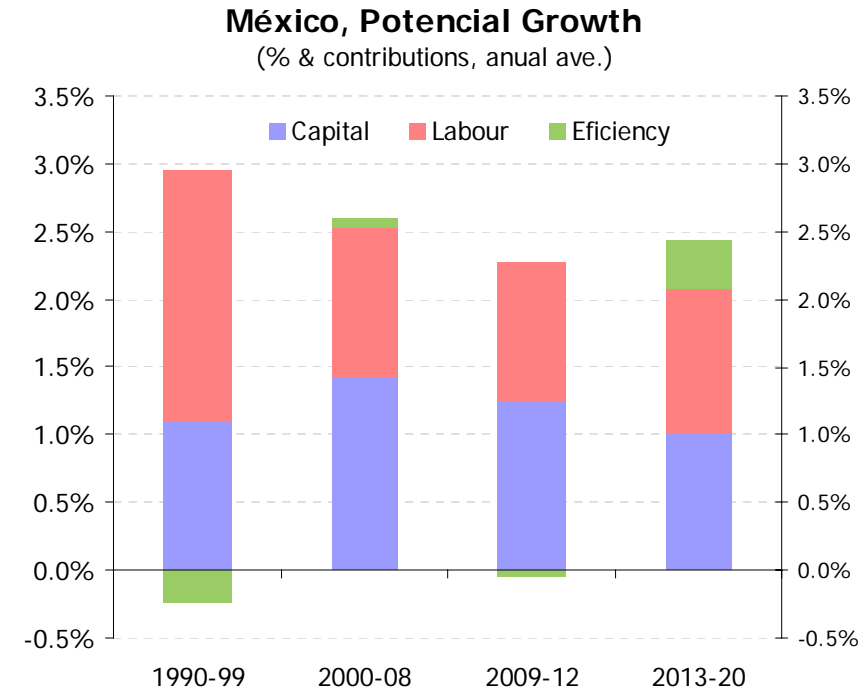
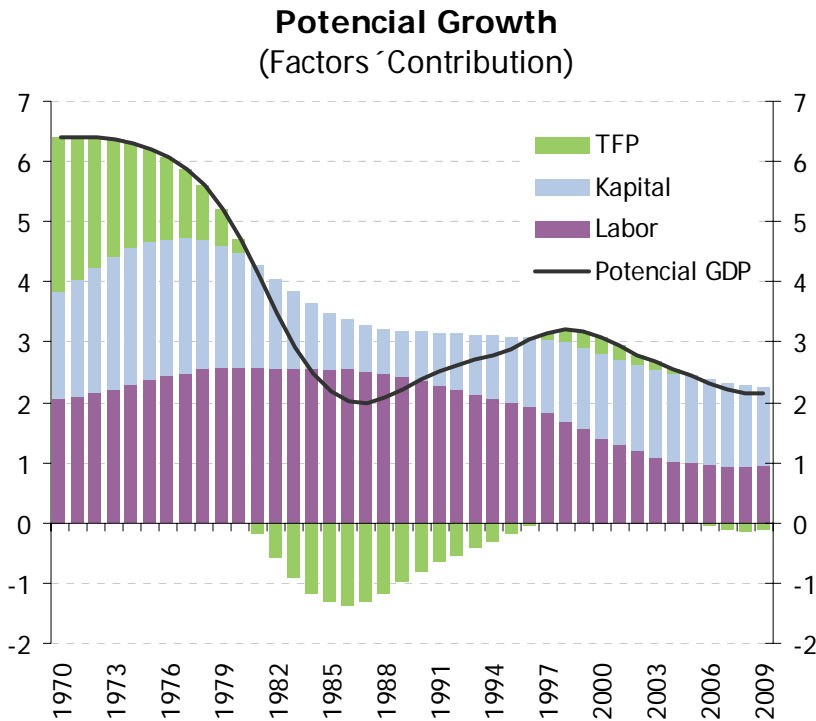
^{II} PIB potencial y productividad total de los factores. Economía Mexicana Vol. XCIII no. 2 CIDE

^{III} GDP Growth, potential output & output gaps in Mexico. Ebrima & Faal IMF WP/05/93 May 2005

^{IV} Producto Potencial y Ciclos Económicos en México, 1980.1-2006.4 UNAM2007

Potential growth, dependent on efficiency

Mexican's economy capacity to grow is limited by the drop in productivity, the efficiency in the use of productive factors, and a slower demographic dynamism

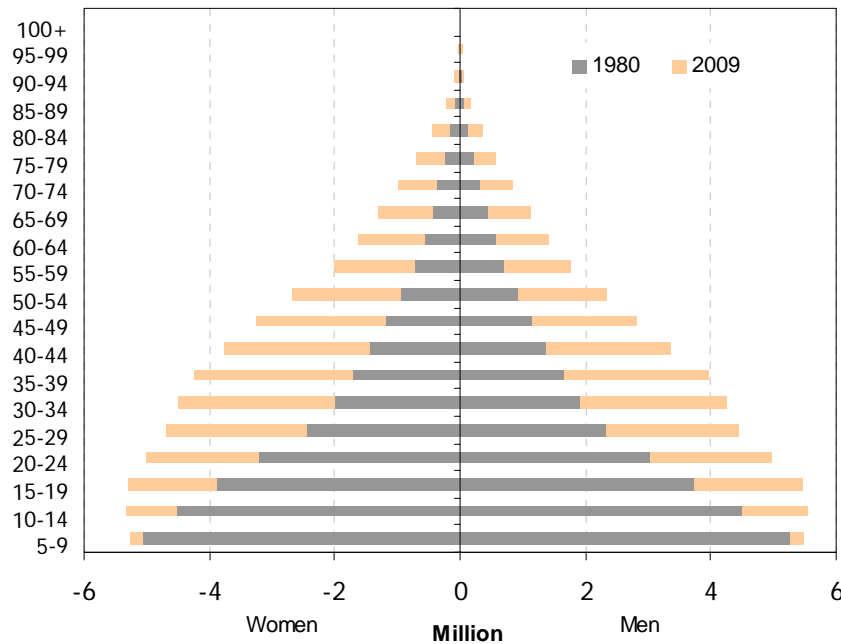


Source: BBVA ERD

Potential growth, dependent on efficiency

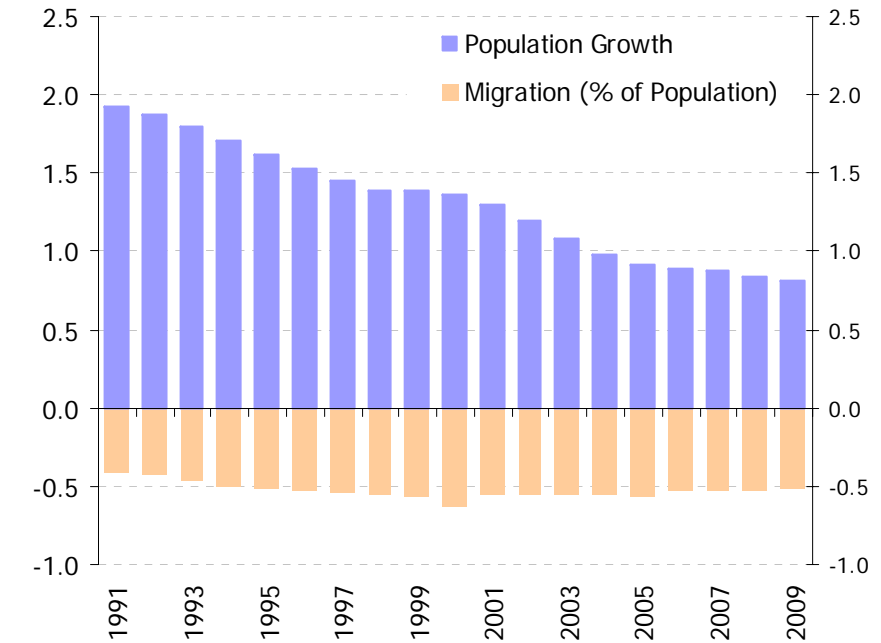
The demographic bonus is getting smaller and smaller, and this trend is worsening due to sustained negative migration flow

Mexican Population Pyramid



Source: US Census Bureau

Mexico: Population & Migration



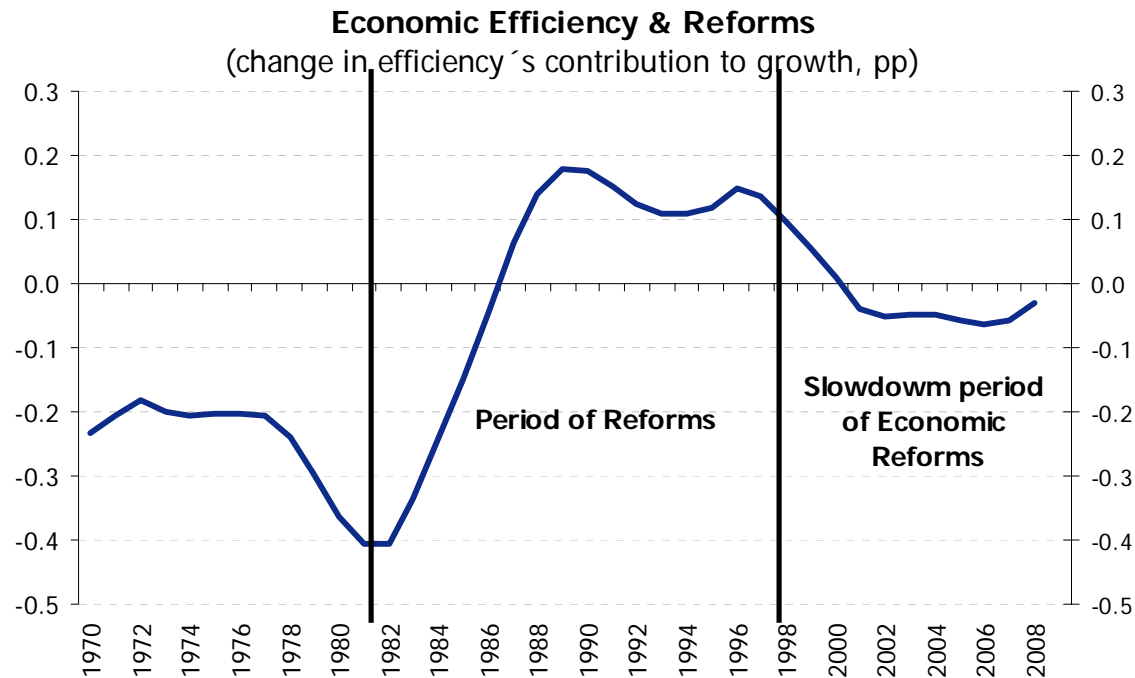
Source: Conapo

Population's growth has increased more in age ranges consistent with a larger labour market participation ...

... yet, Mexico's population level has decreased 0.5% per year consistently due to the negative migration net balance

Potential growth, dependent on efficiency

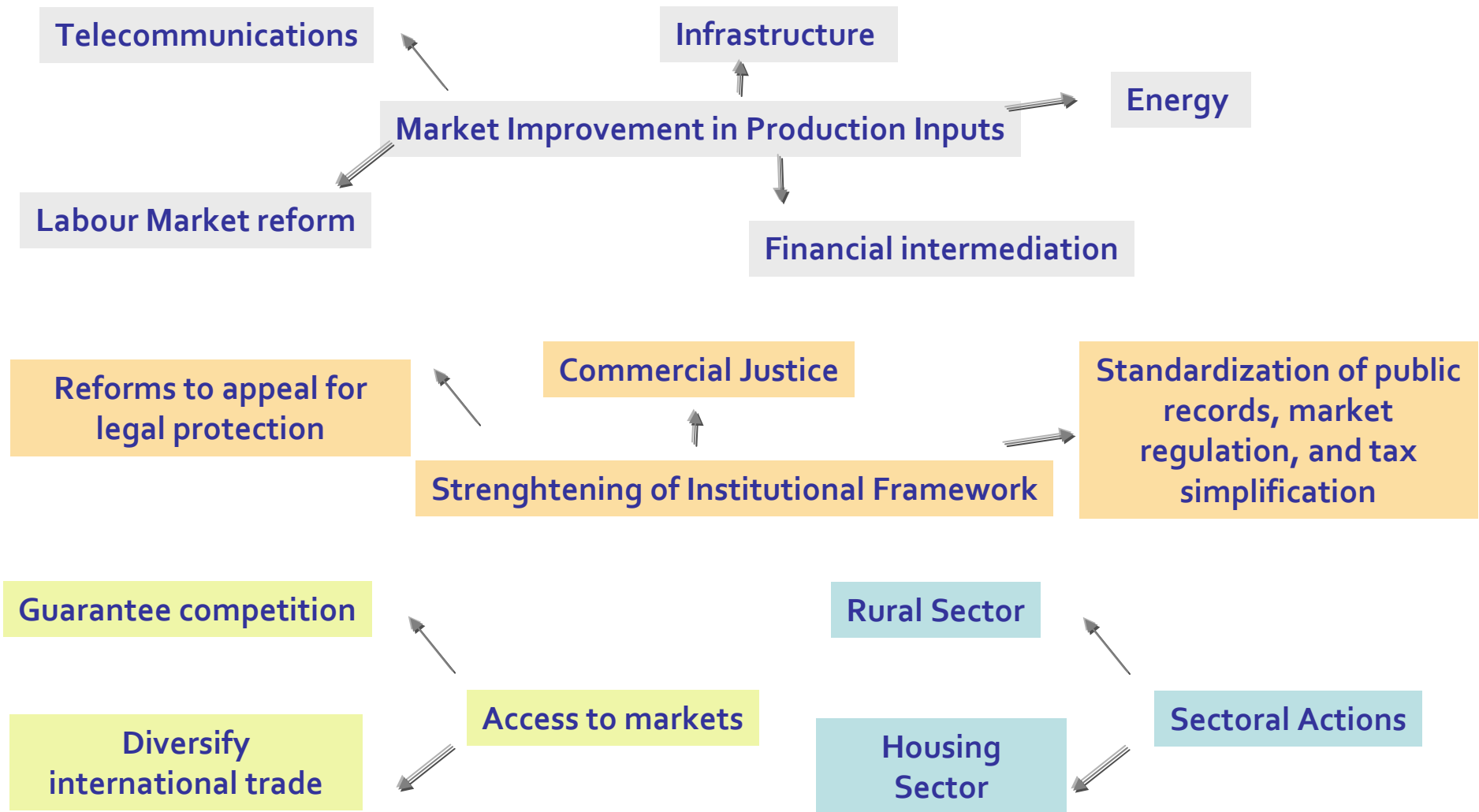
The efficiency of an economy increases with reforms oriented to achieving a more favourable business environment



Source: BBVA ERD
Efficiency: Total Factor Productivity, growth that is not explained by capital nor labour

México faces the challenge of implementing a second round of reforms which boost its capacity to grow in the mid-term

Reform agenda is broad based



Reform agenda is broad based

Reform agenda is broad based and its implementation will be complex

Market Improvement in production factor markets

Labor Market Reform

- New hiring methods

Telecommunications

- Openness to foreign investment,
- Pricing and long-distance area redefinition
- CFE's network bidding
- Triple Play
- Institutional Redesign (Cofetel-SCT)

Energy

- Improve Efficiency (LyFC)

Financial Intermediation

- New Instruments
- Bankruptcy Law
- SOFOMES regulation
- Afores: Fees, transferences and investment rules
- Development Banks role

Infrastructure

- Public-Private Partnership Law
- Dual Scheme for Bidding (direct appointment)
- Speeding of land acquisition

Reform agenda is broad based

Strengthening of Institutional Framework

Reforms to appeal for legal protection

- Appeal “to effects” (prevent delay in settlements)
 - Fiscal Appeal (prevent legal-accounting strategies for tax evasion)
 - Agricultural Appeal (guarantee certainty to land investors)
-

Commercial Justice

- Specialized federal courts in commercial justice (to standardize criteria)
-

Standardization of public records, market regulation, and tax simplification

- Public records for certainty in property rights
- Deregulate economic activity
- Simplify and automate SAT procedures

Reform agenda is broad based

Access to Markets

Guarantee economic competition

- To strengthen the Federal Competition Commission
 - Increase “its dissuasive and corrective power” through sanction faculties
-

Diversify international trade

- South-America (Brazil)
- Carbon Certificates in NAFTA

Sectoral Actions

Rural Sector

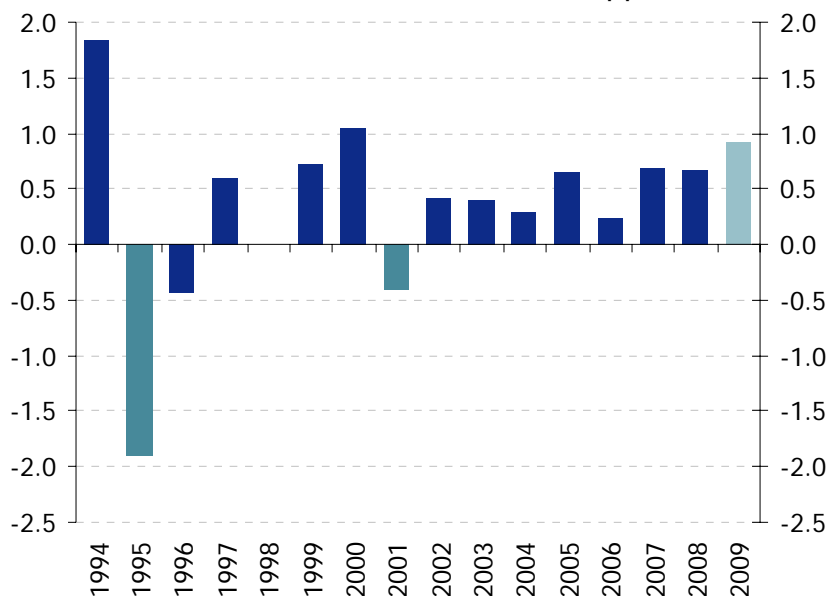
- Budget, bureaucracy and financing
-

Housing Sector

- Sustainable housing
- Loosen rules for the resources in each workers housing (ie, Infonavit) account

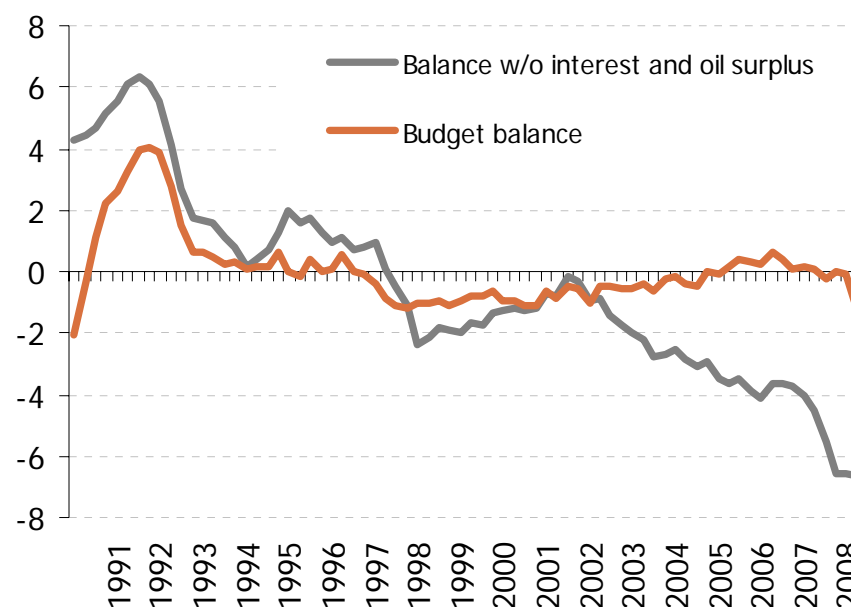
The economy benefits for orthodox macro policies ... which have limits

Public Consumption & Investment Contribution to Growth (pp)



Signaled periods of GDP contraction
Source:BBVA Bancomer ERD

Mexico: Budget balance structure
(% GDP, neg. = deficit)



For the first time in time of crisis, a counter-cyclical fiscal policy has been implemented ...

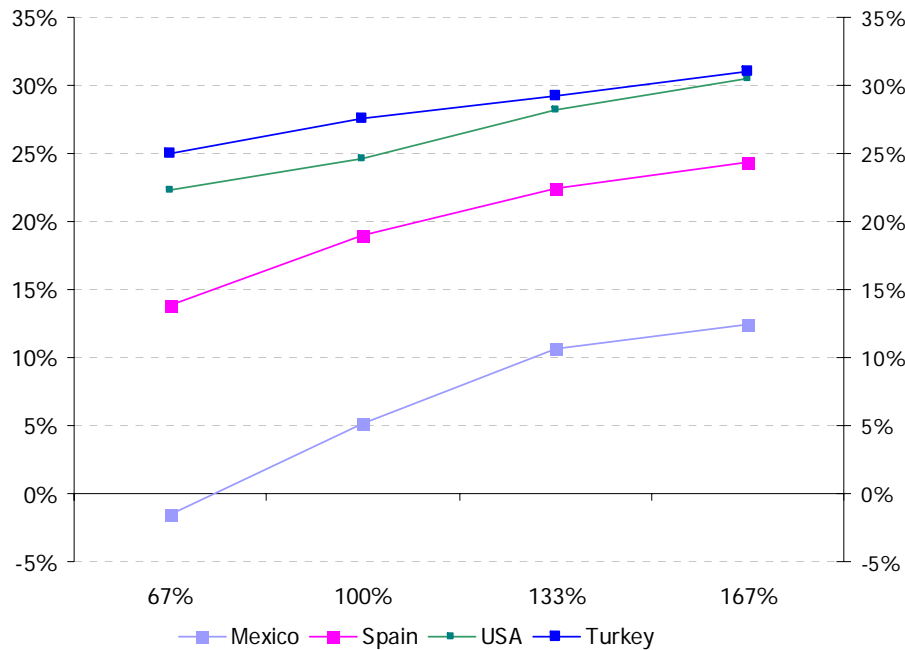
... but the margin is quite limited due to a balanced-budget law requirement (*)

(*) In May and July the government announced two public spending cuts equivalent to 0.7% of GDP, especially focused in current spending

Tax tariff in Mexico are relatively low, contributing to an insufficient tax collection to guarantee an adequate investment level

Labour Taxes(*)

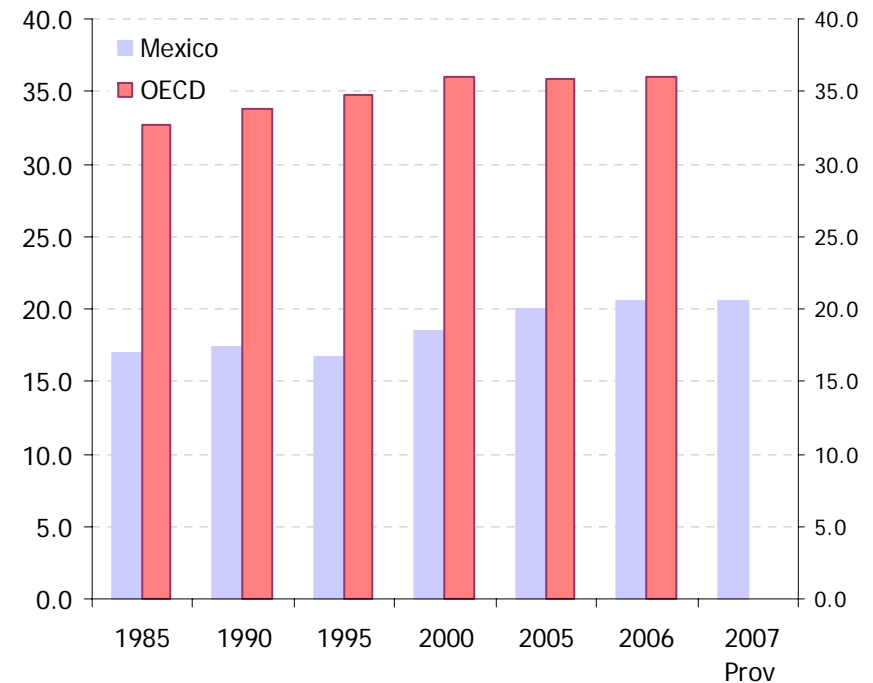
(By salary income ranks respect to average)



Source: OECD, 2008

(*) Tariffs measured by rank of income tax & social security paid by employer.

Tax Revenues (% of GDP)



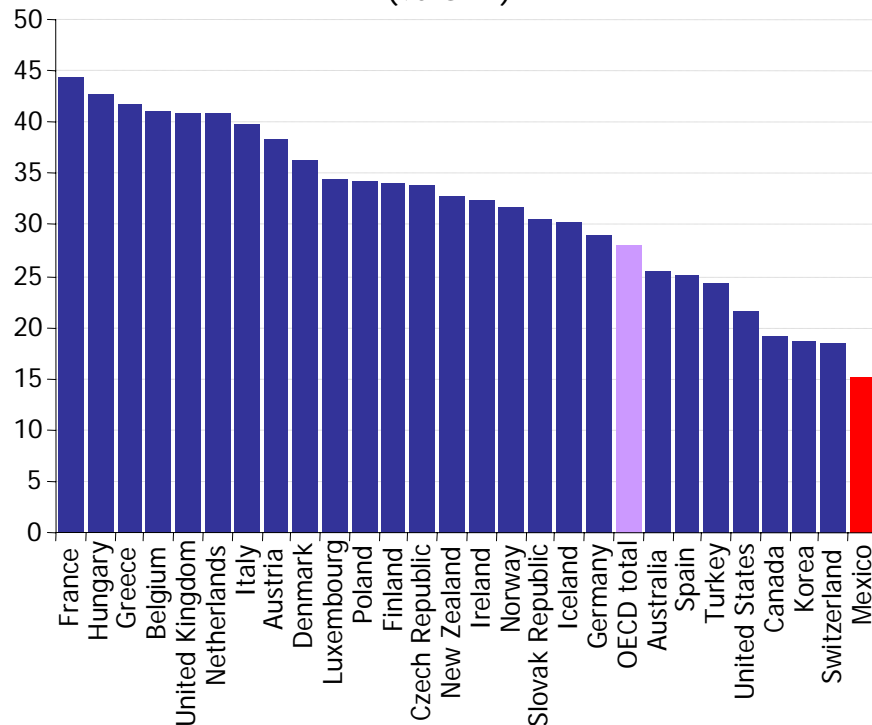
Source: OECD

Low tax collection is also related to the informal sector's relevant weight



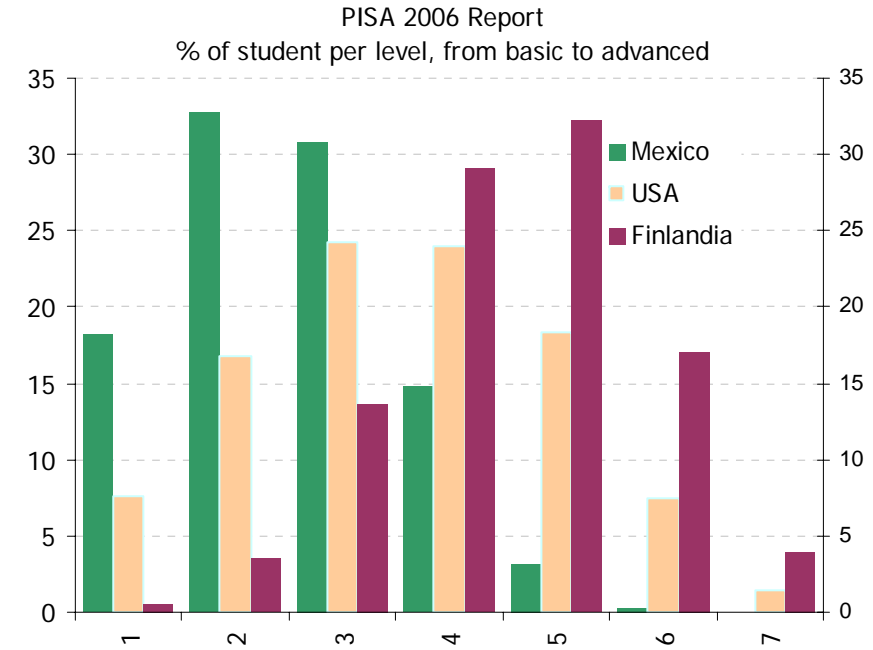
Even if the risk of debt-sustainability is negligible in the mid-term, tax collection is insufficient to guarantee an adequate investment level in infrastructure and education

Public Expenditure
(% GDP)



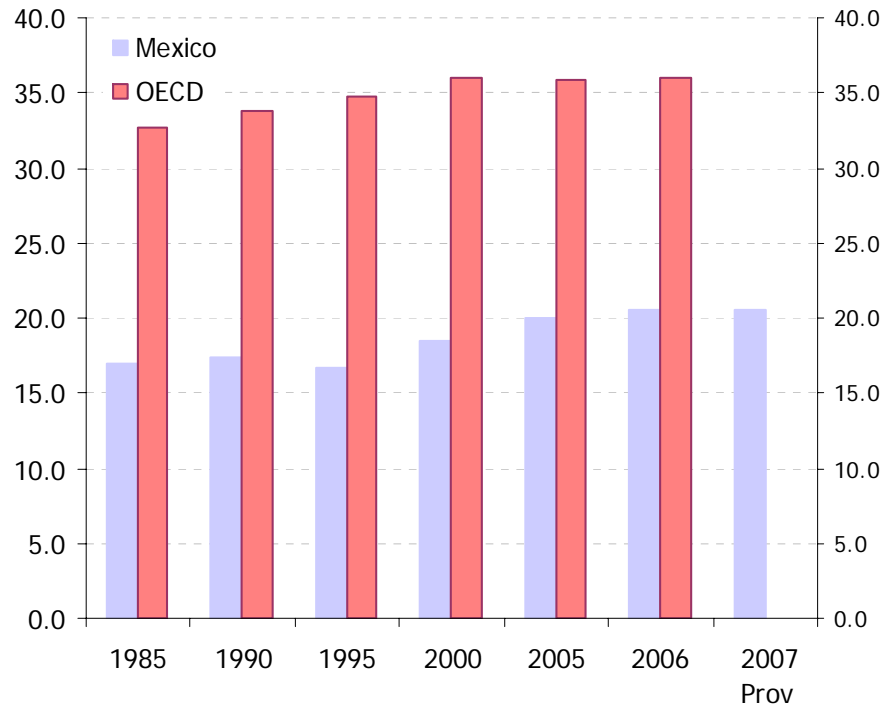
Source: World Bank

Scientific Knowledge



Source: PISA 2006 Report

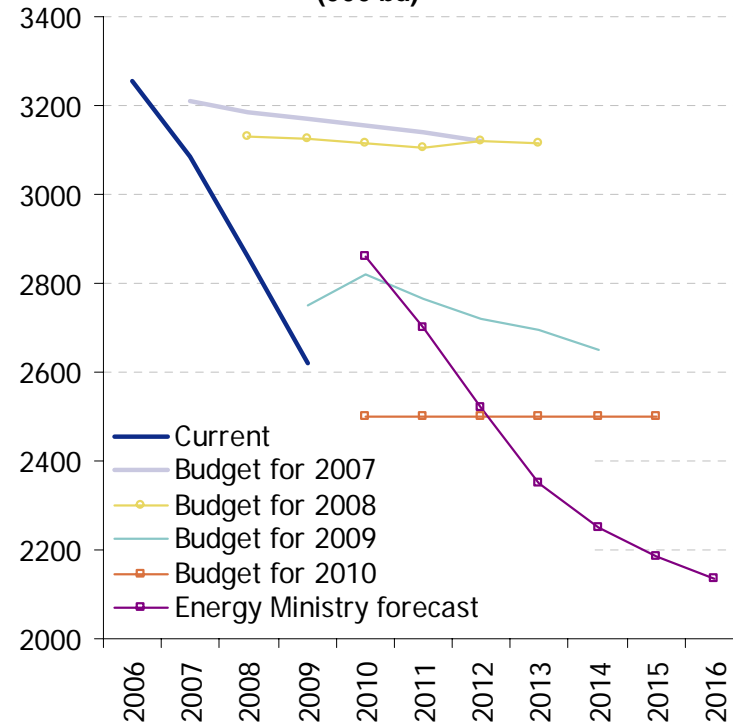
Tax Revenues (% of GDP)



Source: OECD

Mexico has comparatively low tax collection levels ...

Oil Production Official Forecast (000 bd)



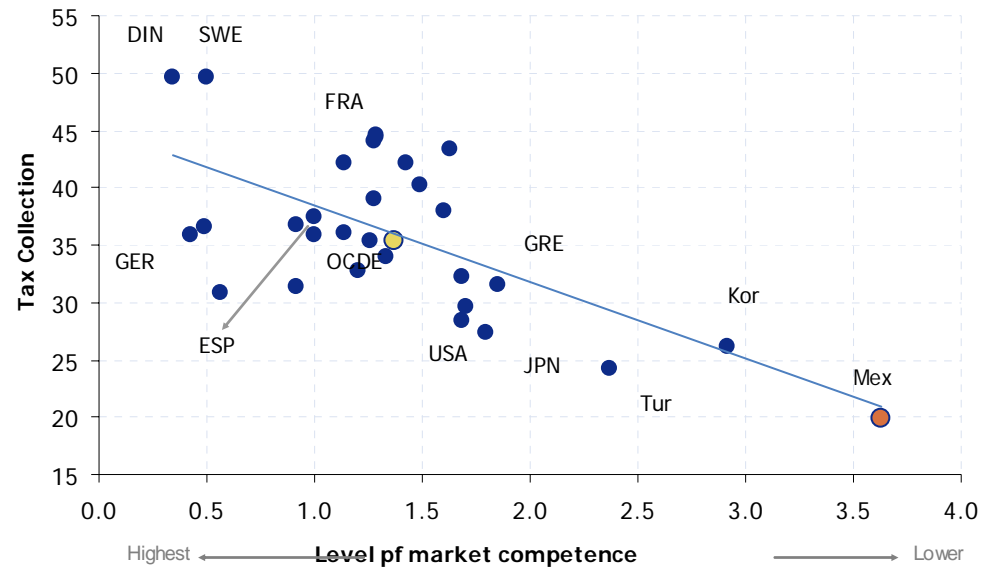
... which declining oil production (and perspectives) put in doubt

Fiscal Budget
(% of GDP)

	2008	2009
ISR	2,4	2,4
Corporations	1,5	1,5
Persons	0,9	0,9
IETU	0,9	0,8
IVA	2,0	2,0
IEPS, ISAN e ISTUV	1,9	1,2
Fiscal Stimulus	0,1	0,1
Total	9,8	9,0

Source: SHCP, 2008

Tax Collection & Monopolies in Mexico
(% of GDP; Competence Index 0= highest & 6=lowest)



Yet, not only oil limits the tax collection capacity and hence productive spending

- The open and highly linked to US **Mexican economy** has been **overly exposed to the global crisis**.
- The economy present some **strengths to face this crisis**: nominal **stability**, **sustainable foreign financing**, a **sound financial system** and room of manoeuvre of **fiscal and monetary policies**.
- **Employment resilience** and **competitiveness gains** in the most trade-integrated and FDI receptor productive activities have been positive surprises.
- **There is not a risk over public debt sustainability**, but a **redesign of fiscal policy foundations is needed** to increase tax collection efficiency (and reduce oil dependency) and **accountability** in public spending.
- The **low growth rate that has been featuring** Mexico is due low efficiency from both capital and labour rather their unavailability.
- A **continuing process, broad and decisive of structural reforms** should lead to efficiency **improvements**, and thus to higher **growth in the medium term**.

Economic Research Department

	2007	2008	2009	2010	2011	2012	
ECONOMIC ACTIVITY							
REAL GDP (yoy %)	3.3	1.4	-7.2	3.1	4.0	4.2	
Consumption	3.6	1.5	-6.5	3.1	3.1	3.2	
Private Consumption	3.9	1.6	-7.7	3.2	2.6	3.4	
Public Consumption	2.1	0.6	1.7	2.7	5.9	2.2	
Gross Capital Formation	6.7	4.2	-11.2	-0.3	6.0	9.0	
Domestic Demand (contribution to growth)	3.9	2.4	-8.9	2.9	4.3	4.8	
Exports	5.6	1.5	-20.8	2.2	8.9	14.0	
Imports	6.9	4.6	-24.0	1.5	7.5	14.5	
External Demand (contribution to growth)	-0.6	-1.1	1.6	0.2	-0.3	-0.6	
LABOUR MARKET							
Employment ¹	4.2	2.0	-3.2	1.7	2.4	3.3	
Unemployment rate (% of labour force)	3.7	4.0	5.5	5.3	4.6	4.1	
EXTERNAL SECTOR							
Current Account Balance	% GDP	-0.8	-1.4	-1.0	-1.5	-2.1	-2.5
PUBLIC FINANCES							
Government Balance ²	% GDP	-1.1	-2.1	-3.0	-3.7	-3.2	-2.9
PRICES							
CPI , %	avg	4.0	5.1	5.4	4.7	4.3	3.8
CPI , %	eop	3.8	6.5	4.0	5.2	3.8	3.8
EXCHANGE RATE							
Exchange Rate (against US\$), average	avg	10.9	11.1	13.5	13.0	13.0	13.4
Exchange Rate (against US\$), end period	eop	10.9	13.4	13.0	12.7	13.2	13.4
INTEREST RATE							
Official Interest Rate (REPO)	avg	7.5	8.3	4.5	4.5	6.5	6.5
Official Interest Rate (REPO)	eop	7.3	7.9	5.4	4.5	6.2	6.5
DTF A.	avg	7.6	8.0	7.8	7.6	7.5	7.2
DTF A.	eop	8.0	8.9	7.6	7.6	7.6	7.2

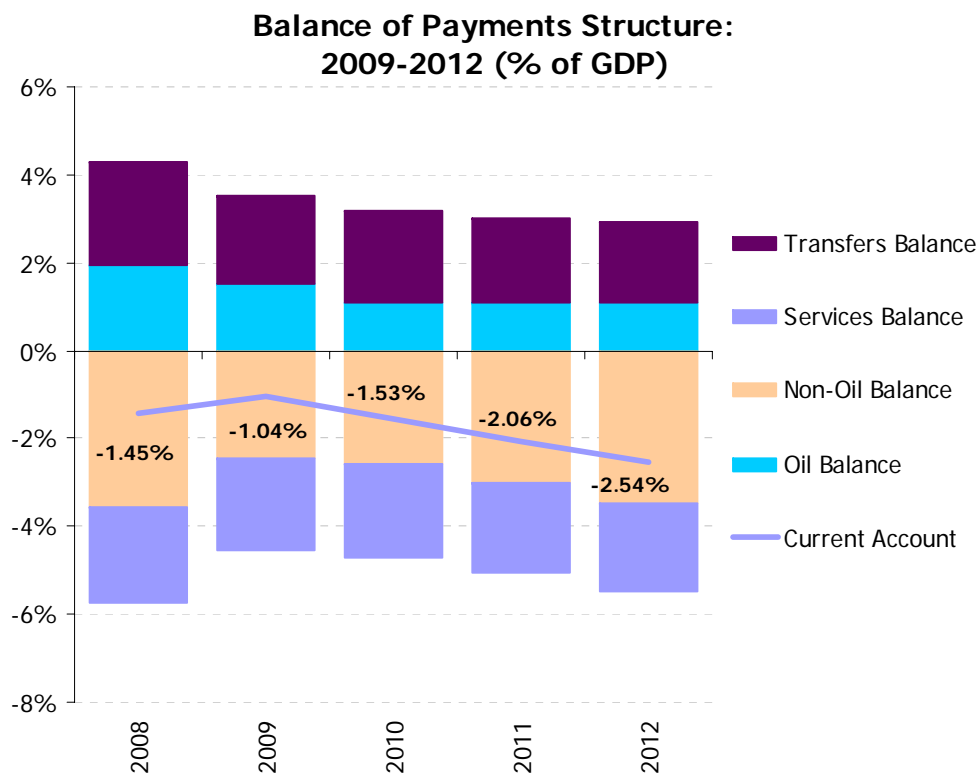
BBVA Economic Research Department

¹ Private Formal Employment

² Public Sector Borrowing Requirements (PSBR)

Balance of Payments Adjustment and its Risks

As the economy tends to its potential growth, the balance of payment deficit will increase...



Note: Negative figures imply external saving needs

Factors in favor:

- Remittances will rise only moderately, depending on US economic recovery.
- Higher oil prices will increase the value of exports, however a lower oil production will contain the surplus in the oil balance.

Factors against:

- Higher non-oil trade deficit as economy grows
- Higher deficit in net factor income (interest, dividends, etc)

Positive bias in 2009 given the effects of economic contraction

Negative bias in the mid term because structural weaknesses in productivity.

Equilibrium Exchange Rate

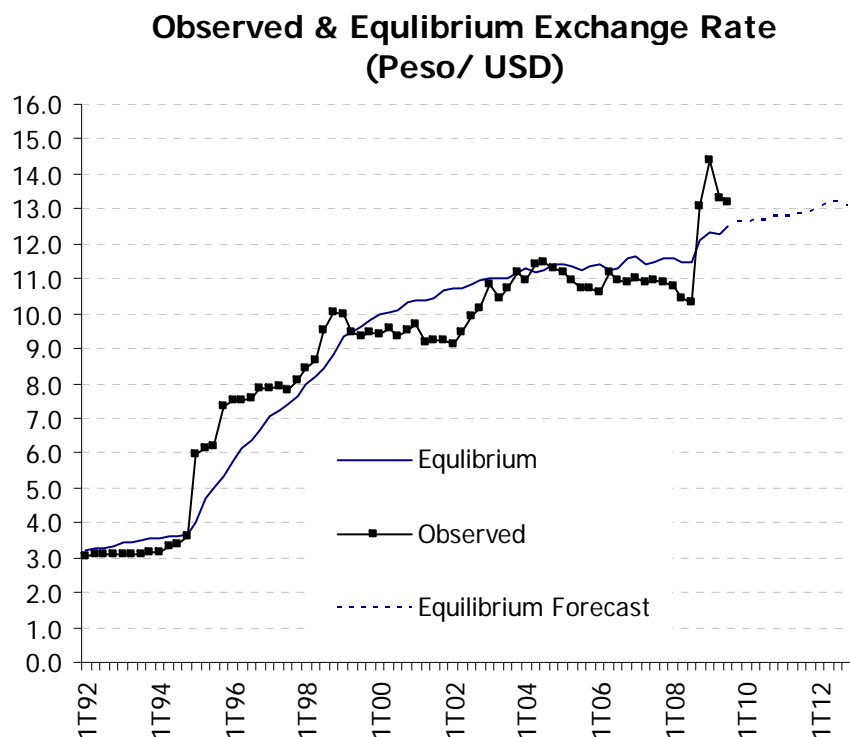
Equilibrium Exchange Rate will tend to slightly depreciate: a) higher inflation gap, b) higher deficit in current account, c) lagged productivity vs USA.

Before the crisis, the equilibrium exchange was over-valued

Up to day, the peso is sub-valued but not far away from its equilibrium level.

In fact, we estimate that in the following months the peso could fluctuate again below its equilibrium level.

Forecast based on long-term vectors estimations: 1) PPP, 2) PPP adjusted by productivity, 3) BEERS (Behavioral Exchange Rate, 4) CHEERS (Capital Enhanced Exchange Rate)



Mexican Outlook: How did it face the crisis, the way out and challenges ahead

BBVA Economic Research Department
December, 2009

Operating with goods and services not prohibited by law

According to the National Accounts System of the United Nations, those economic units differentiate because of two characteristics:

- They do not constitute an independent corporate body from neither the household owner nor its members
- They do not have complete accounting which allows to distinguish neither the production activities of the organization from others of their owners, nor the income flows and capital between the former and the latter

Irregularities

With unlawful goods

- Drug production
- stolen goods' trade
- Smuggling
- Piracy

With lawful goods

- Tax evasion: ISR, Payroll, ...
- Social security intallments' evasion: IMSS, INFONAVIT, SAR
- Non-fulfillment of labor laws, health, and others

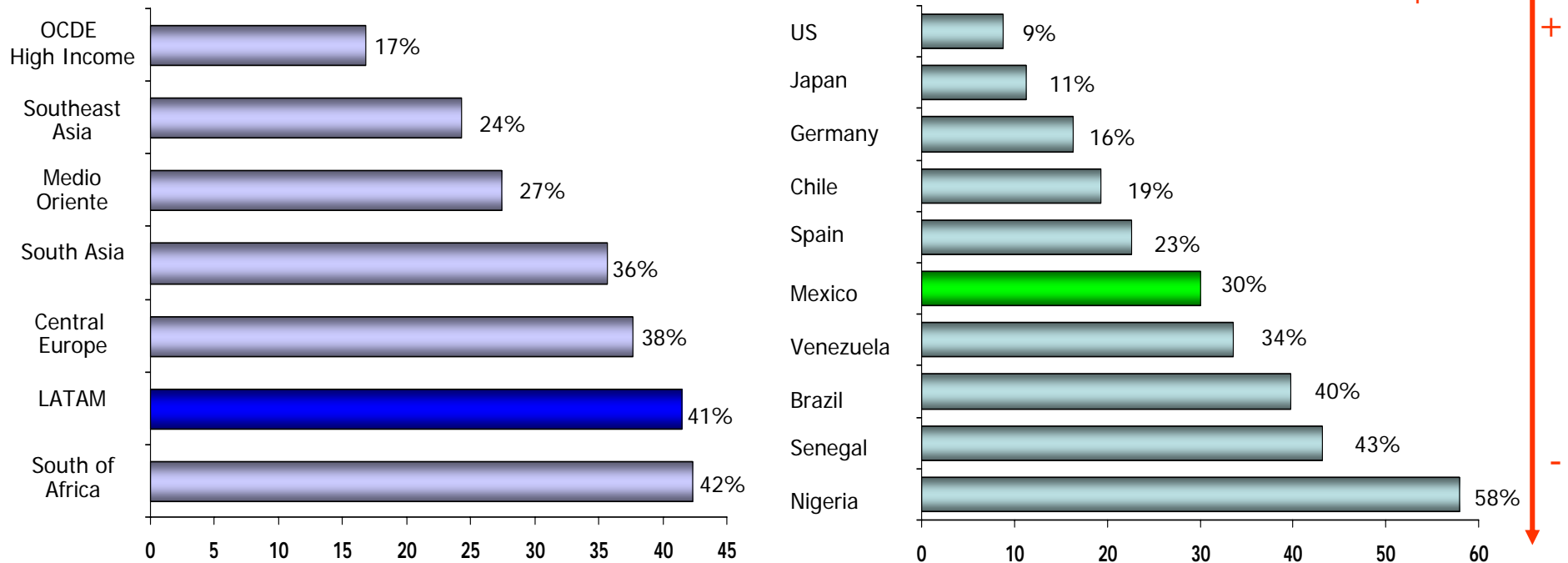
Hidden or underground economy

Informal economy

Source: BBVA Bancomer con información de INEGI

In developed countries its share is significantly lower

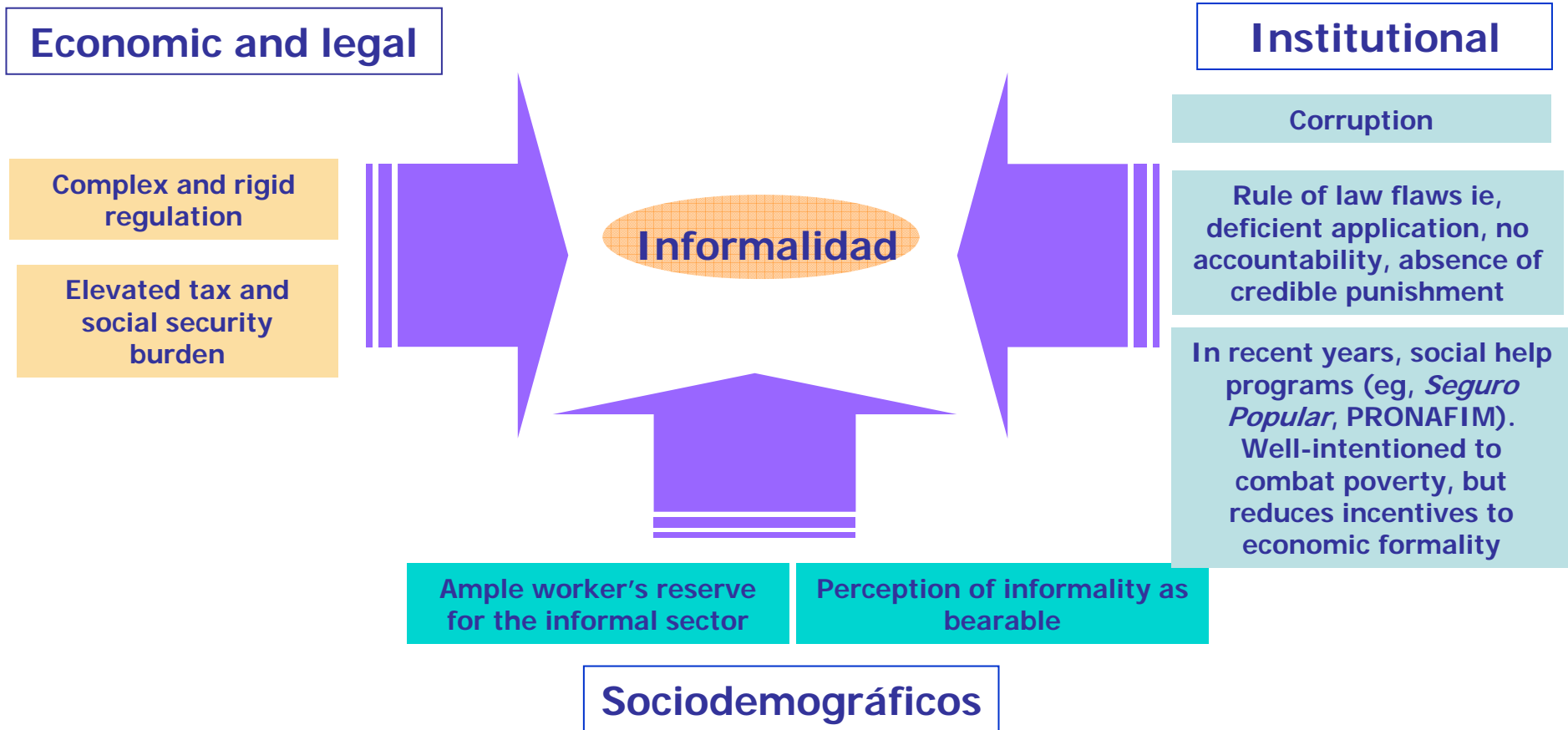
Informal Economy*
 % of Gross National Income, 2003



* In a broad sense: business activities with income not accounted for in the legal production of goods and services

Source: World Bank, Doing Business 2005

Informality originates from combining economic, institutional and socio-demographic elements



Source: BBVA Bancomer based on "The Economics of the Informal Sector", Norman Loayza, World Bank, 1996, and "Good Intentions, Bad Outcomes Socail Policy, Informality and Economic Growth in Mexico", Santigao Levy, BID, 2008.

The informal economy by being low productive, restrains growth

It is set up by economic units that typically operate in small scale

■ Low level of organization

■ Scarce division of labour and capital

- Low-skilled labour force. Employment relations, if they exist, are based on occasional employment, family, personal or social relationship.
- Fixed assets shared with household
- Undeveloped technology

■ Impossible to distinguish households' net worth from the productive unit

■ Liability acquisition only in a private capacity

Small productive scale

Examples:

- Street vendors of food and other goods
- Craftsmen
- Carriers
- Domestic servants and repair (ie, handymen)



Source: BBVA Bancomer with INEGI's information