



MEXICO ECONOMIC OUTLOOK

May 2006

I. World Economy

The US economy is expected to expand in line with potential during 2006 and 2007.

Real GDP expectations for 2006 and 2007
(annual variation, %)*

	2005	2006	2007
World	3.4	3.5	3.2
Industrialized countries			
USA	3.2	3.4	2.9
Japan	2.7	3.0	2.3
Euro Zone	1.4	2.1	1.8
France	1.4	2.0	2.0
Germany	0.9	1.8	1.1
UK	1.8	2.3	2.5
Asia	4.9	5.0	4.5
China	9.9	9.6	8.8
Latin America	4.2	4.4	3.9
Brazil	2.3	3.5	3.7
Mexico	3.0	3.8	3.4

* Consensus Forecasts, May 2006.

II. Mexican Economy: US-Mexico

The recovery of the manufacturing sector of Mexico is related to the evolution of traditional manufacturing in the US.

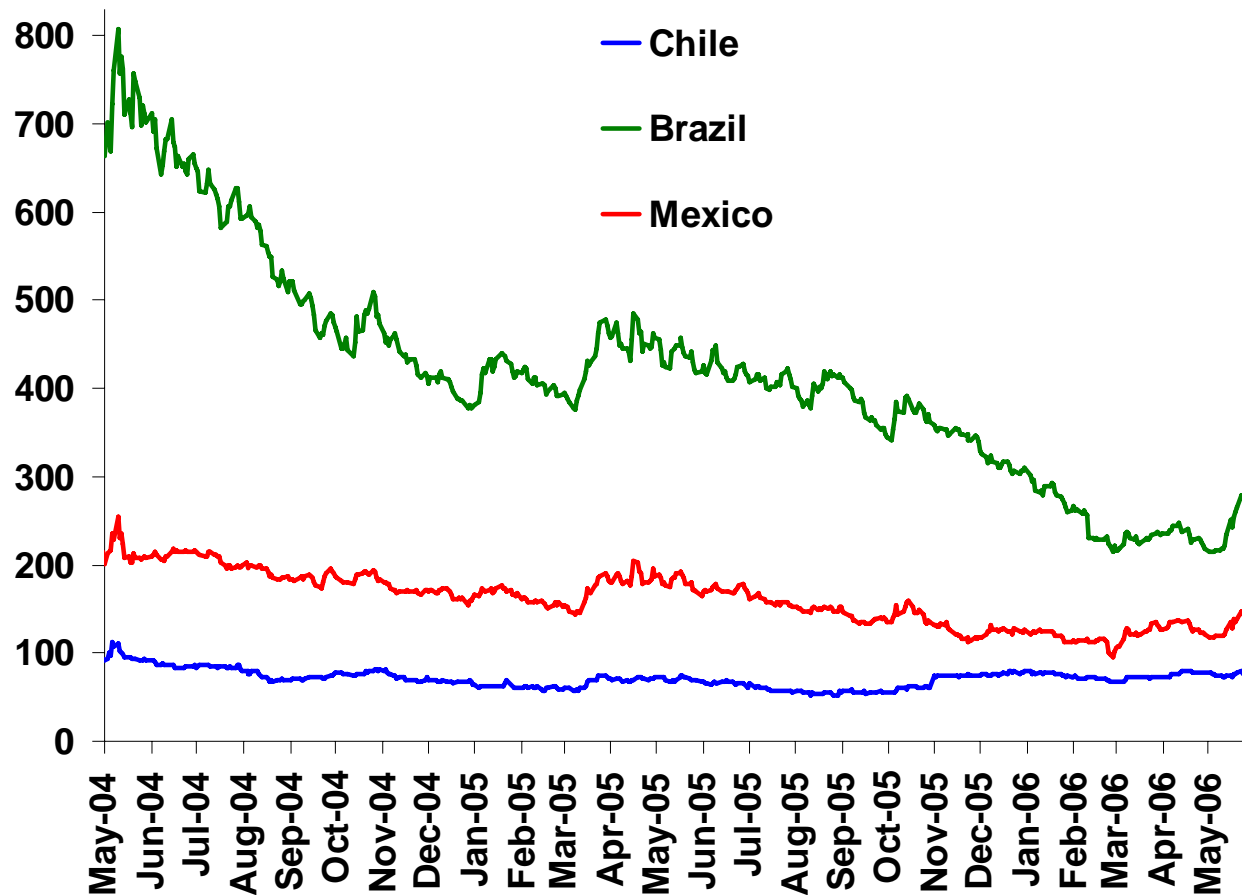


* US Manufacturing excluding computers, communications equipment and semiconductors.

II. Mexican Economy: Country risk

Despite recent market volatility, sentiment towards Mexico continues to be positive.

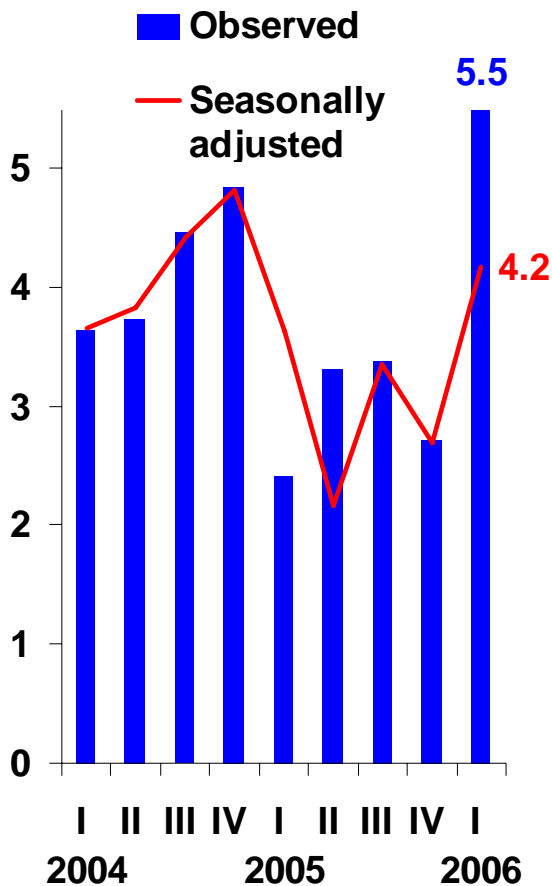
***Country-Risk Indicators: Brazil, Chile and Mexico
(EMBI+, Basis Points)***



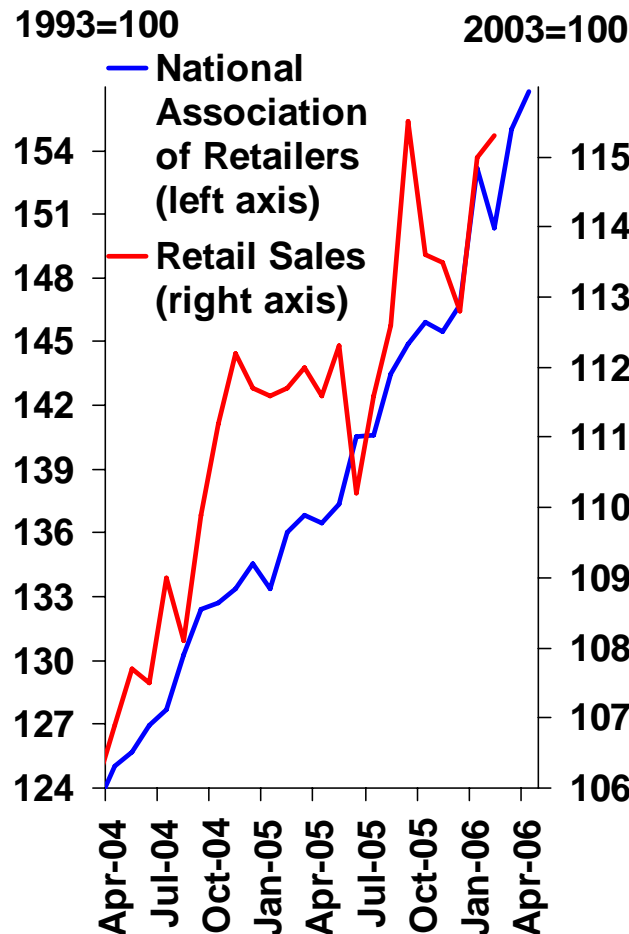
II. Mexican Economy: Growth

During the first quarter of 2006, both aggregate demand and GDP have strengthened.

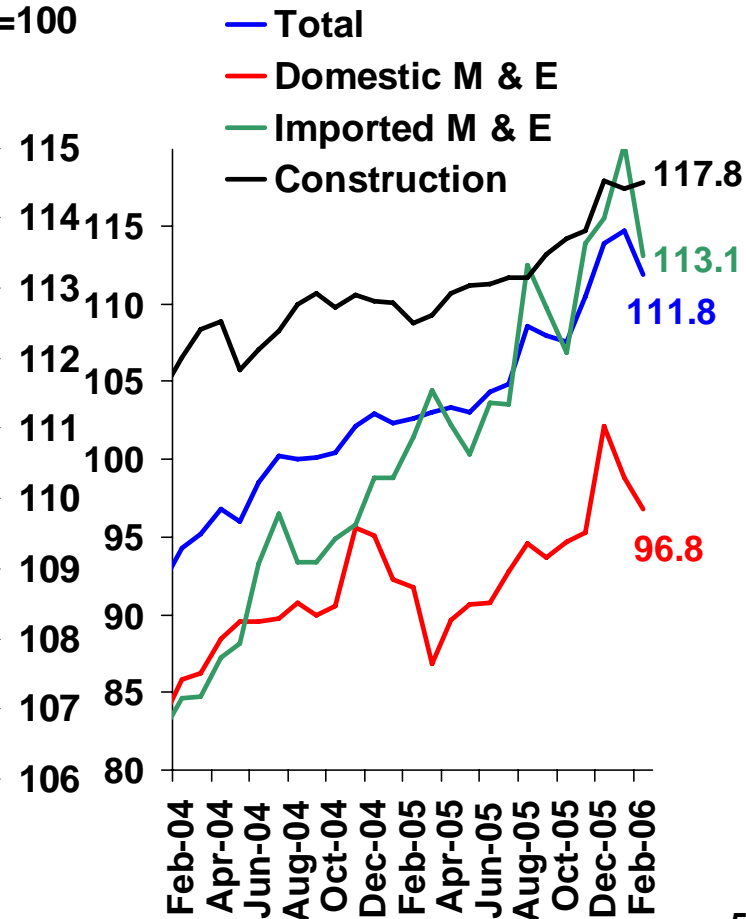
Real GDP
(Annual variation, %)



Retail Sales
(Seasonally Adjusted)



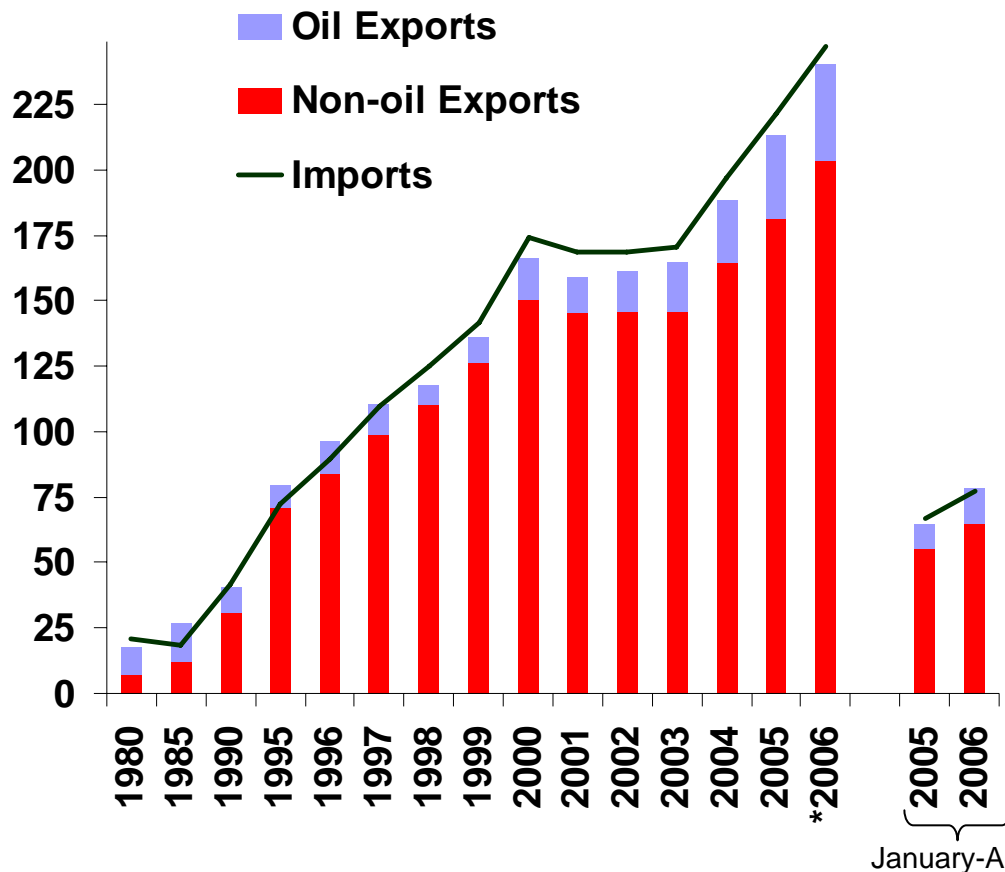
Investment
(November 2000=100, Seasonally Adjusted)



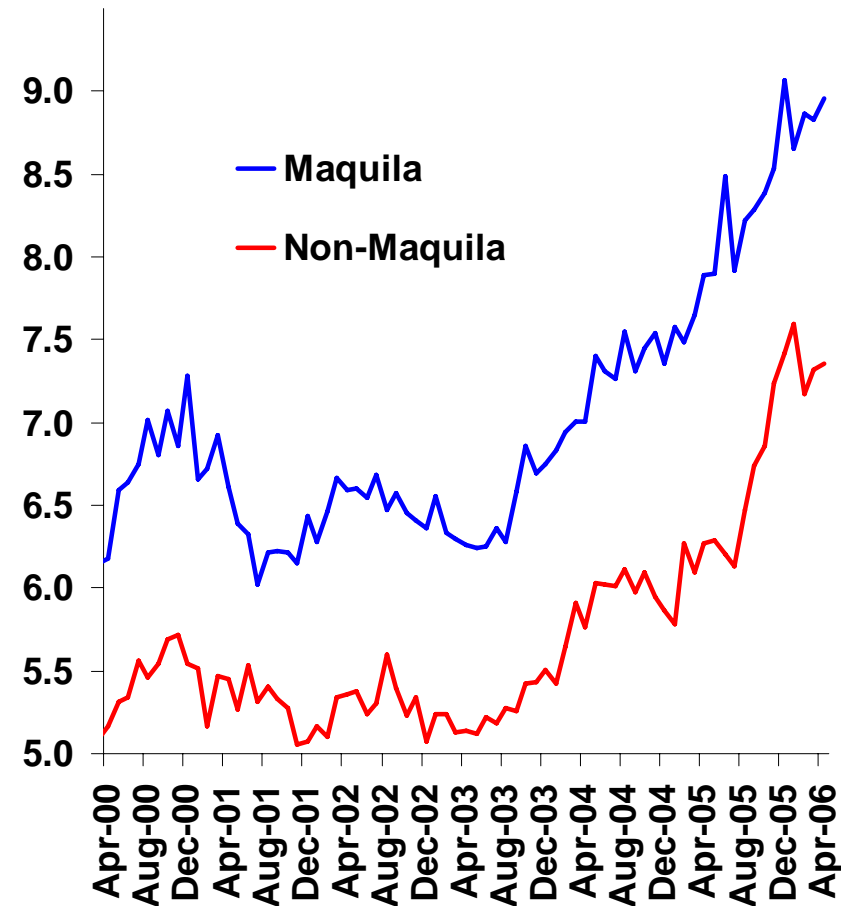
II. Mexican Economy: External Sector

During January-April 2006 exports grew at an annual rate of 22.4% as a result of increases of both oil and non-oil exports.

Non-oil and oil exports and total imports (Billion dollars)



Manufacturing exports (Billion dollars)

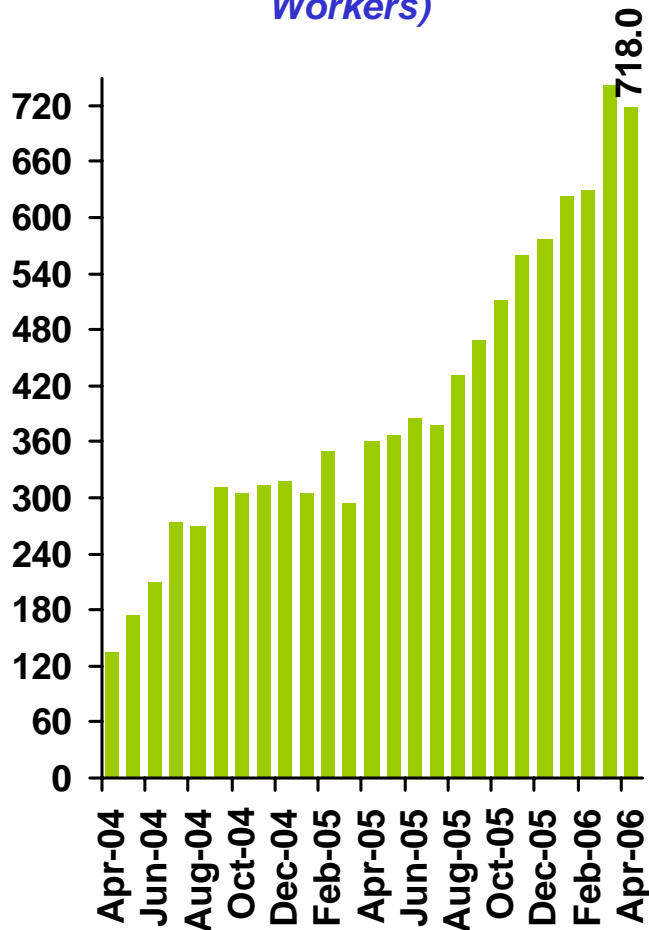


* Banco de México. Survey of Private Sector Economic Analysts' Forecasts, April 2006.

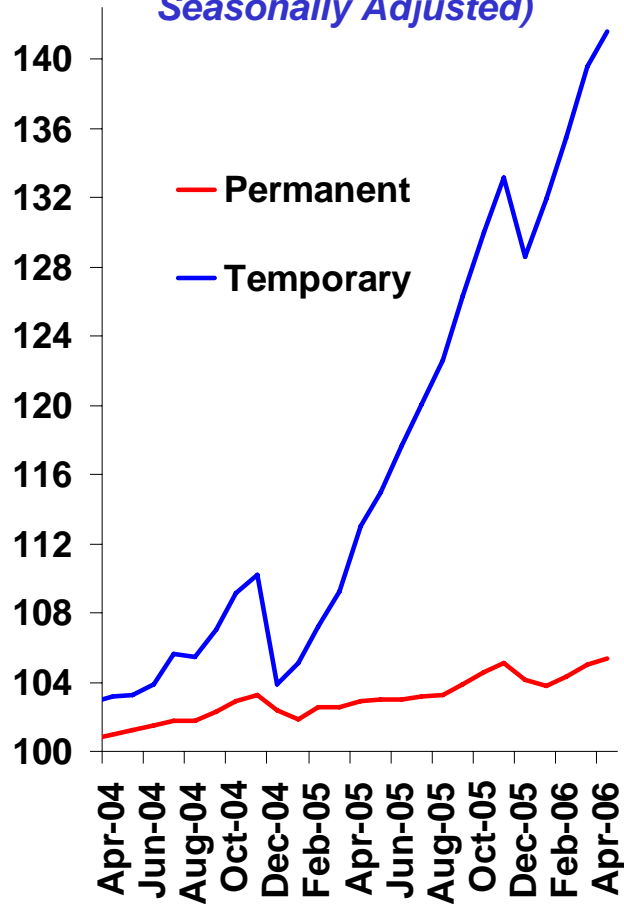
II. Mexican Economy: Employment

There has been a strong rebound of job creation since 2005. However, it has been concentrated in temporary occupations in large firms.

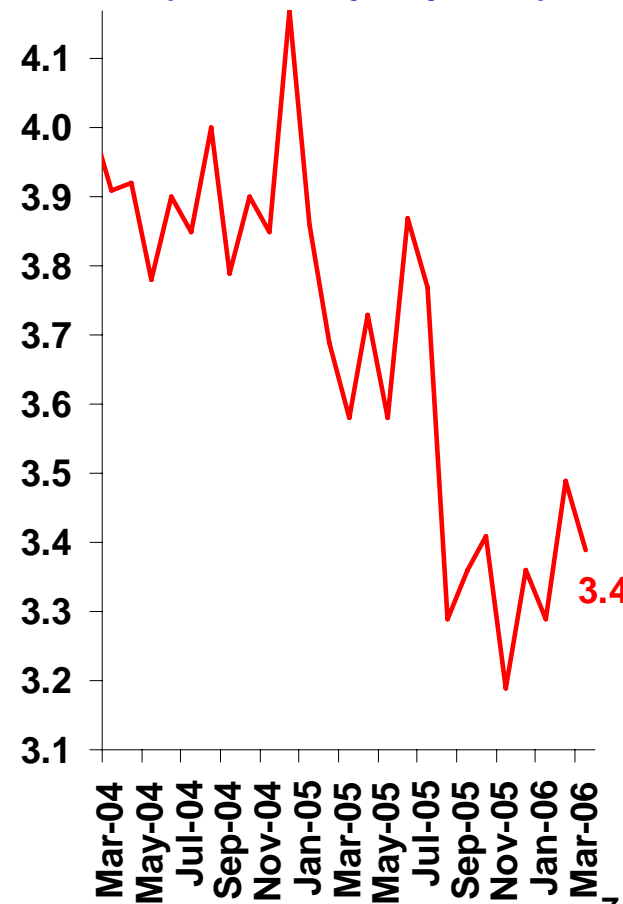
Workers Insured in IMSS
(Annual Change in Thousands of Workers)



Permanent and Temporary Workers
(July 2003=100; Seasonally Adjusted)



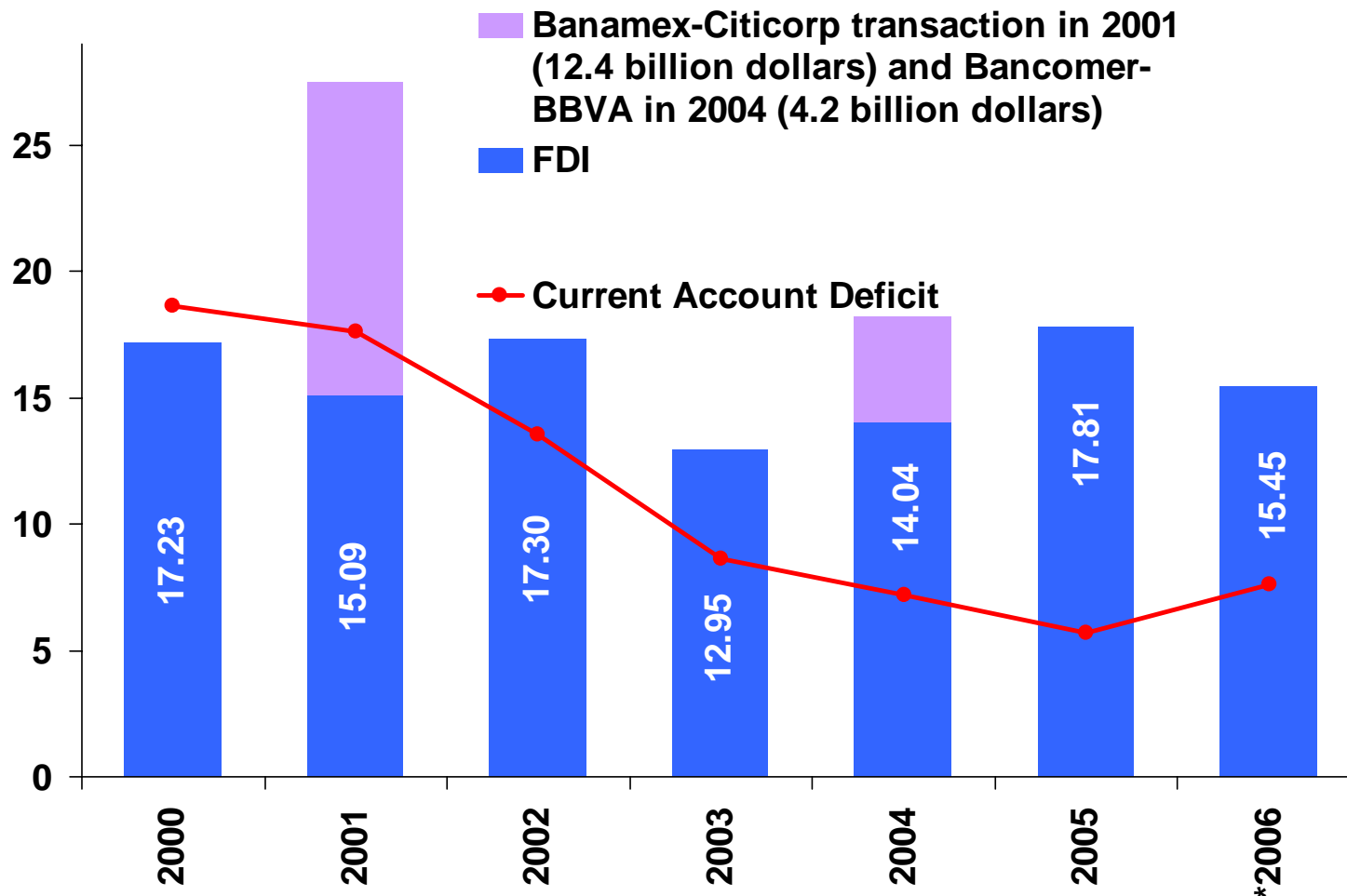
National Unemployment Rate
(Seasonally Adjusted)



II. Mexican Economy: External Sector

Moderate to small current account deficits, mostly financed with long-term capital inflows (foreign direct investment).

*Foreign Direct Investment and Current Account Deficit
(Billion dollars)*

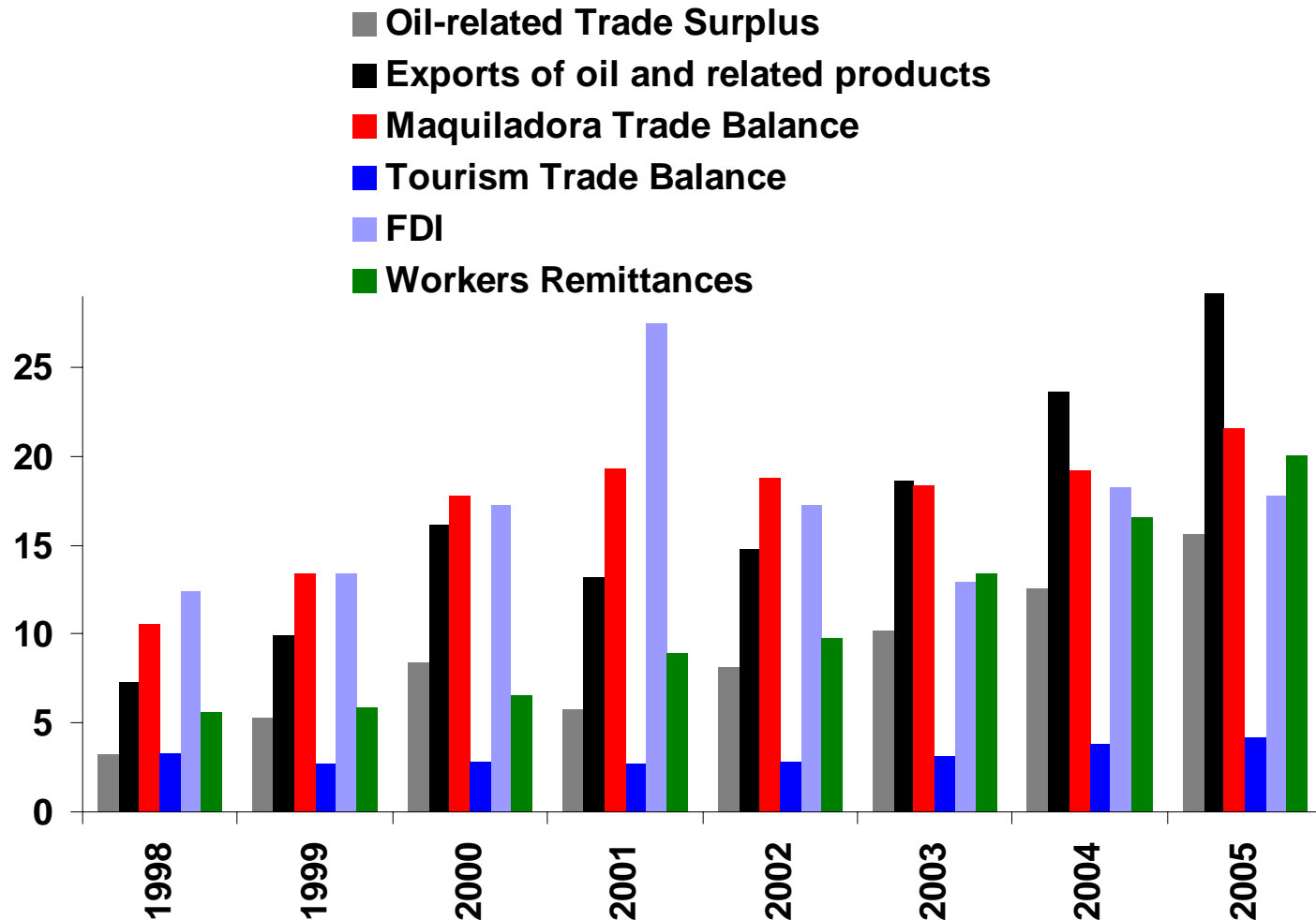


* Banco de México. Survey of Private Sector Economic Analysts' Forecasts, April 2006.

II. Mexican Economy: External Sector

Stable sources of foreign exchange.

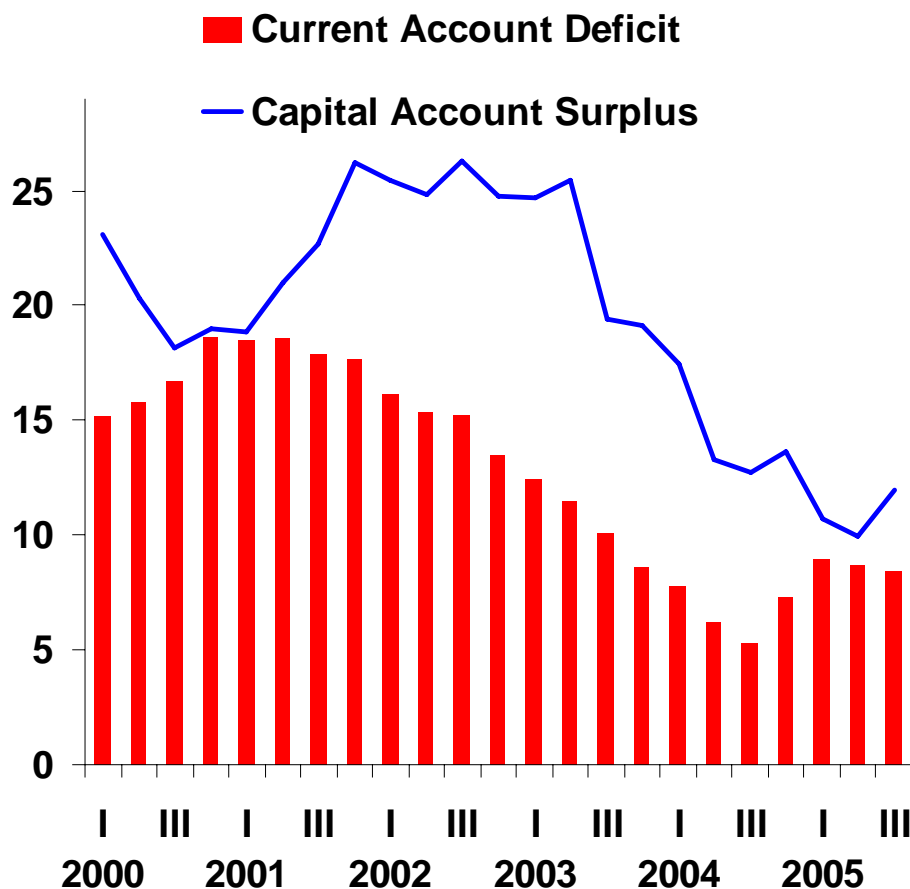
*Sources of Foreign Exchange
(billion dollars)*



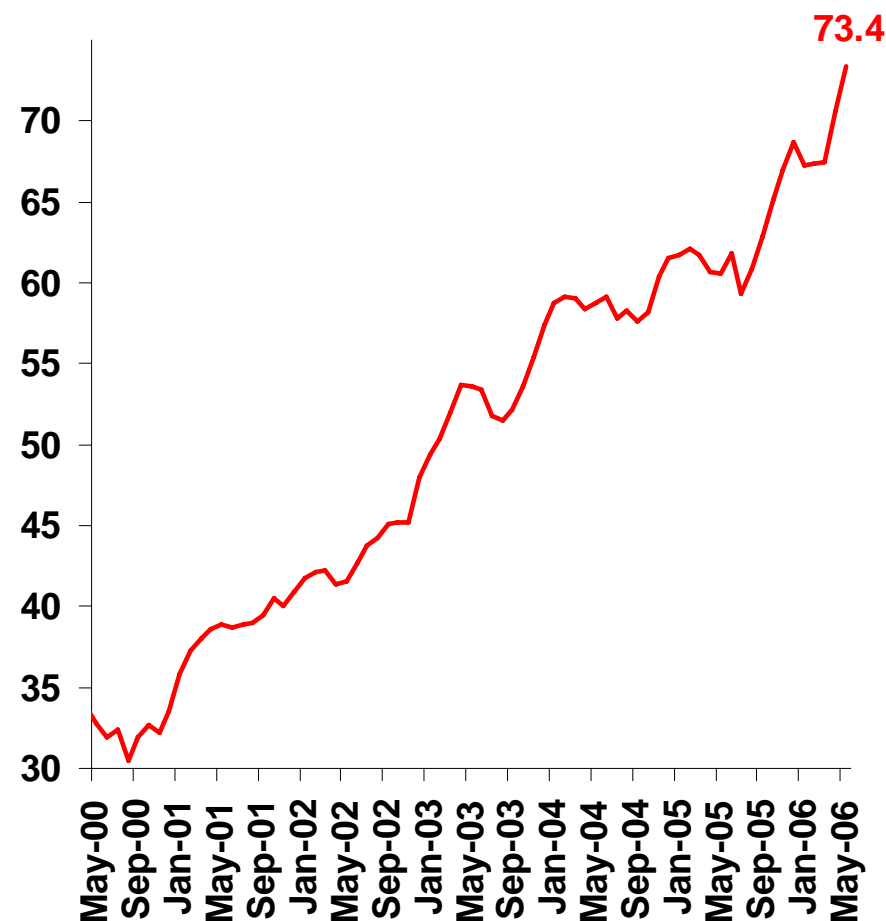
II. Mexican Economy: External Sector

- **The capital account surplus has exceeded the current account deficit.**
- **Net international reserves stand at historically high levels.**

Balance of Payments
(billion dollars, yearly accumulated)



Net International Reserves
(Stock in billion dollars)



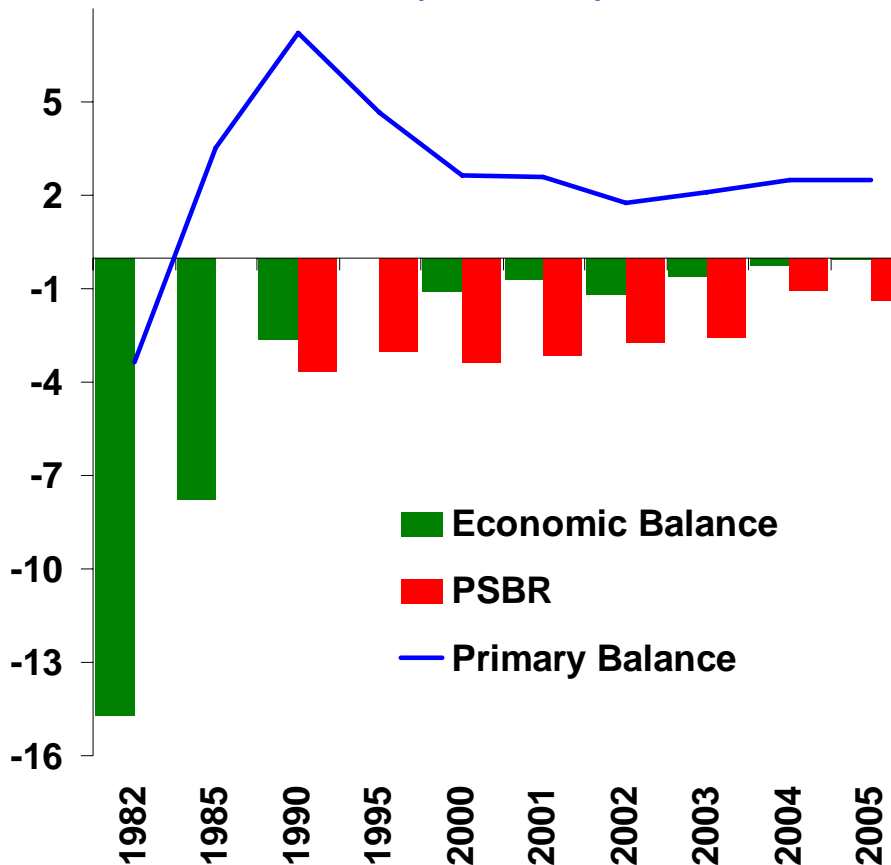
* Until May 19th.

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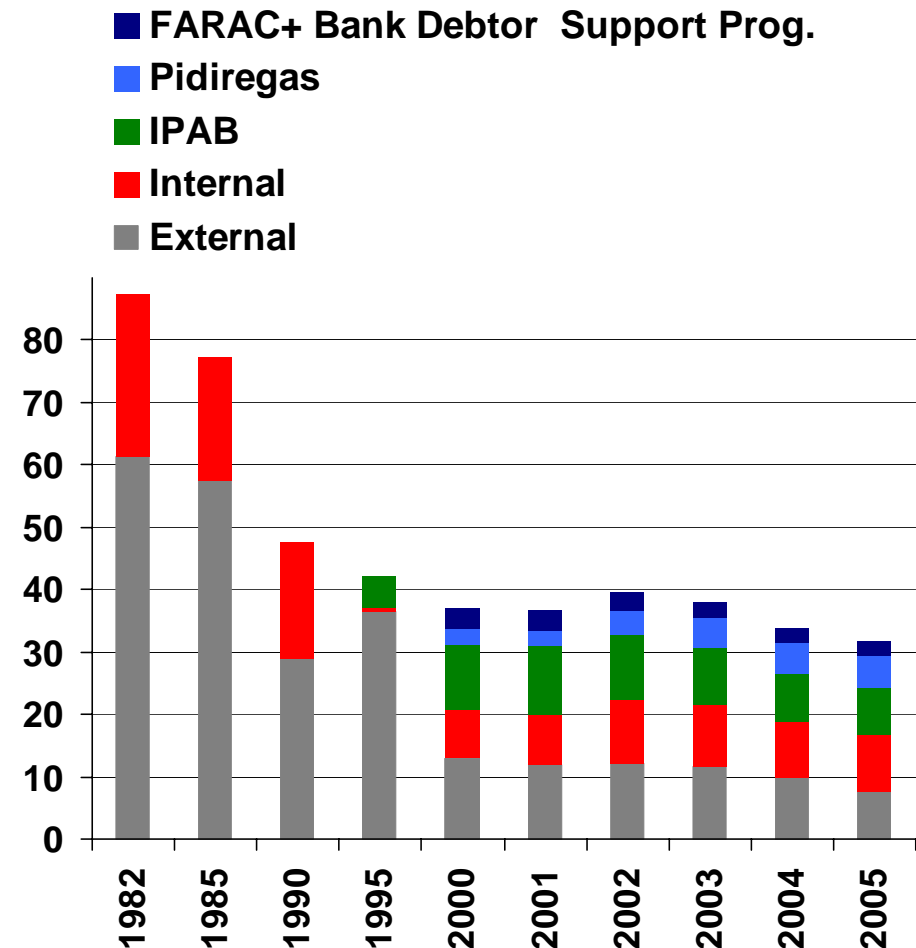
II. Mexican Economy: Public Finances

- *The fiscal balance remains in check.*
- *The ratio of public sector debt to GDP is low by international standards and there is a comfortable amortization schedule.*

*Public Sector Deficit and Primary Surplus:
1990-2005
(% of GDP)*



*Net Public Sector Debt
(% GDP)*



II. Mexican Economy: Inflation

First half May 2006 headline annual inflation was 2.95%, 0.39 percentage points lower than the level recorded during December 2005.

CPI and CPI components (annual % change)

	Weigth	Dec-04	Dec-05	Mar-06	Apr-06	May-06**
CPI	1.0000	5.19	3.33	3.41	3.20	2.95
Core	0.6956	3.80	3.12	3.04	3.20	3.12
Merchandise	0.3703	3.87	2.82	2.70	2.70	2.58
Services	0.3254	3.72	3.46	3.40	3.75	3.73
Non-Core	0.3044	8.20	3.76	4.20	3.19	2.58
Agriculture	0.0807	10.11	-0.18	1.47	-2.63	-4.07
Administered and Regulated*	0.1717	7.51	4.76	4.76	4.97	4.71

* Administered prices are: electricity, domestic gas and gasoline.

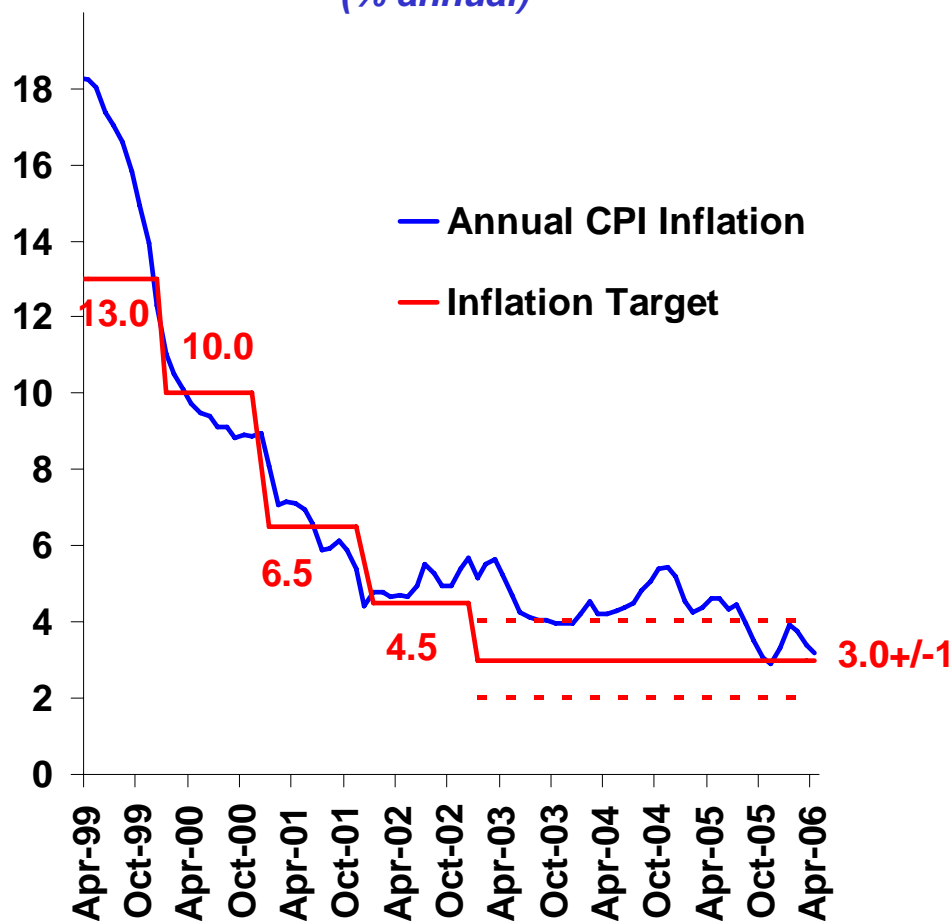
Regulated prices include items such as public transportation, telephone

** First half

II. Mexican Economy: Inflation Expectations

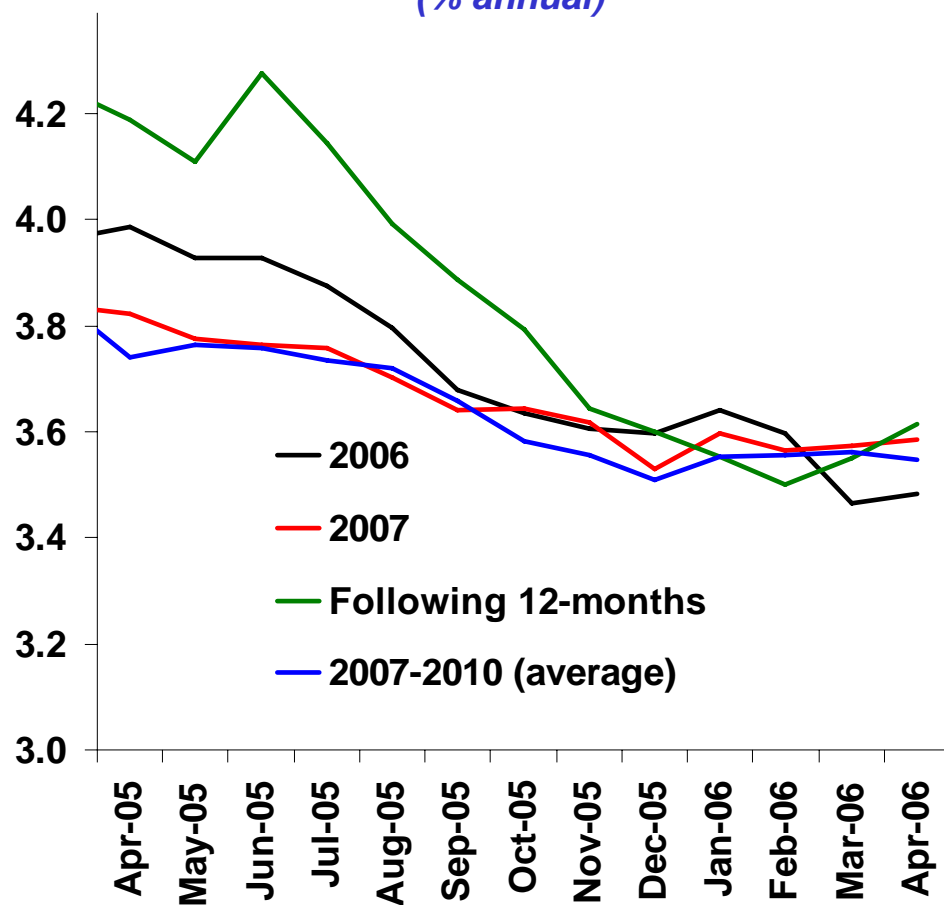
Long-run inflation expectations are now anchored at low levels. However, they still remain above the 3% target.

Observed and Targeted Inflation
(% annual)



Source: Banco de México.

Inflation Expectations for 2006, 2007, following 12-months and 2007-2010 average
(% annual)



III. Outlook for 2006 and Challenges

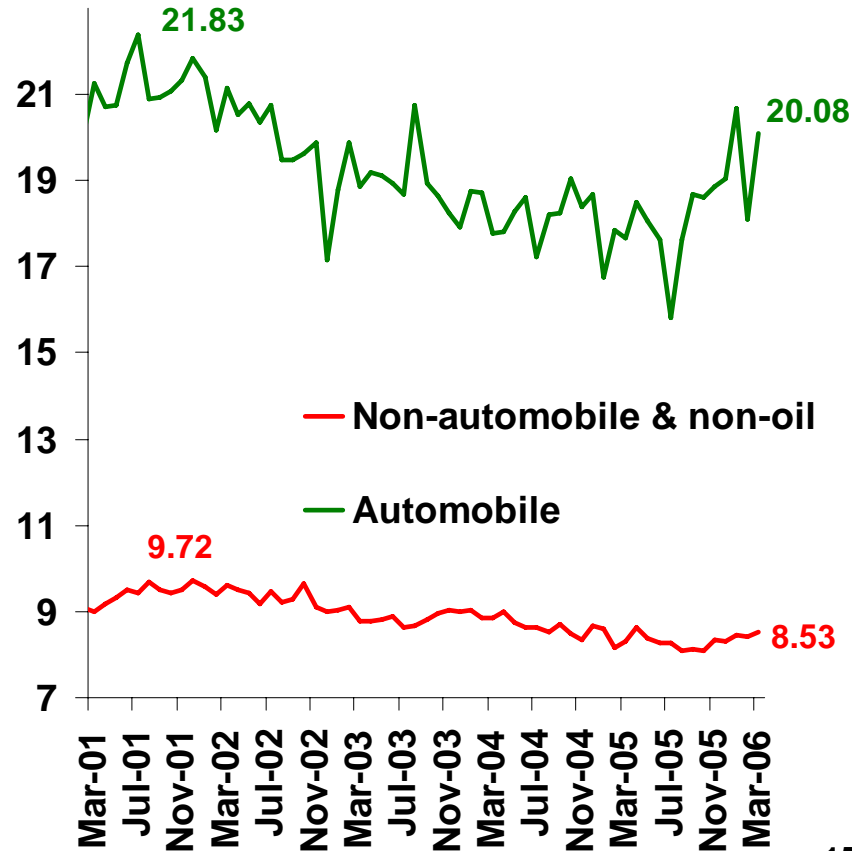
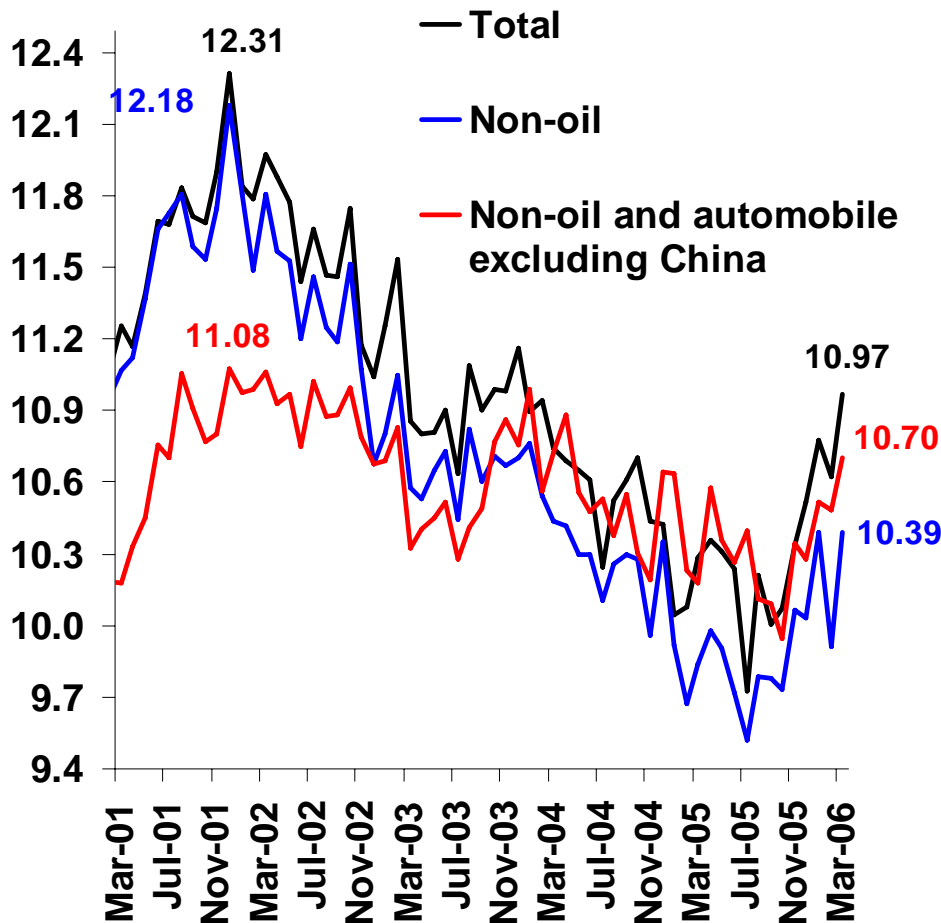
	2005	2006	
		Banco de Mexico's Survey	Economic Policy Guidelines
GDP			
Real growth (%)	3.0	3.9	3.6
Inflation			
Dec./dec. (%)	3.3	3.5	3.0
Nominal Exchange Rate			
Average (pesos/dollar)	10.9	11.0	11.4
Interest Rate (Cetes 28 days)			
Nominal average (%)	9.2	7.3	8.9
Real (%)	5.7	3.7	6.1
Current Account Deficit			
Billion dollars	5,708	7,607	16,612
% of GDP	0.7	1.0	2.2
Foreign Direct Investment			
Billion dollars	17,805	15,453	n.a.
Public Balance			
% of GDP	-0.1	-0.1	0.2
Memo items:			
USA GDP			
Real Growth (%)	3.5	3.5	3.5
Oil (Mexican mix)			
Average price (dls./barril)	42.8	48.6	31.5

Source: Banco de México and Secretaría de Hacienda y Crédito Público.

III. Outlook for 2006 and Challenges

Despite there has been a recent increase of the share of Mexican exports in the US market, it still remains well below the levels recorded on December 2001.

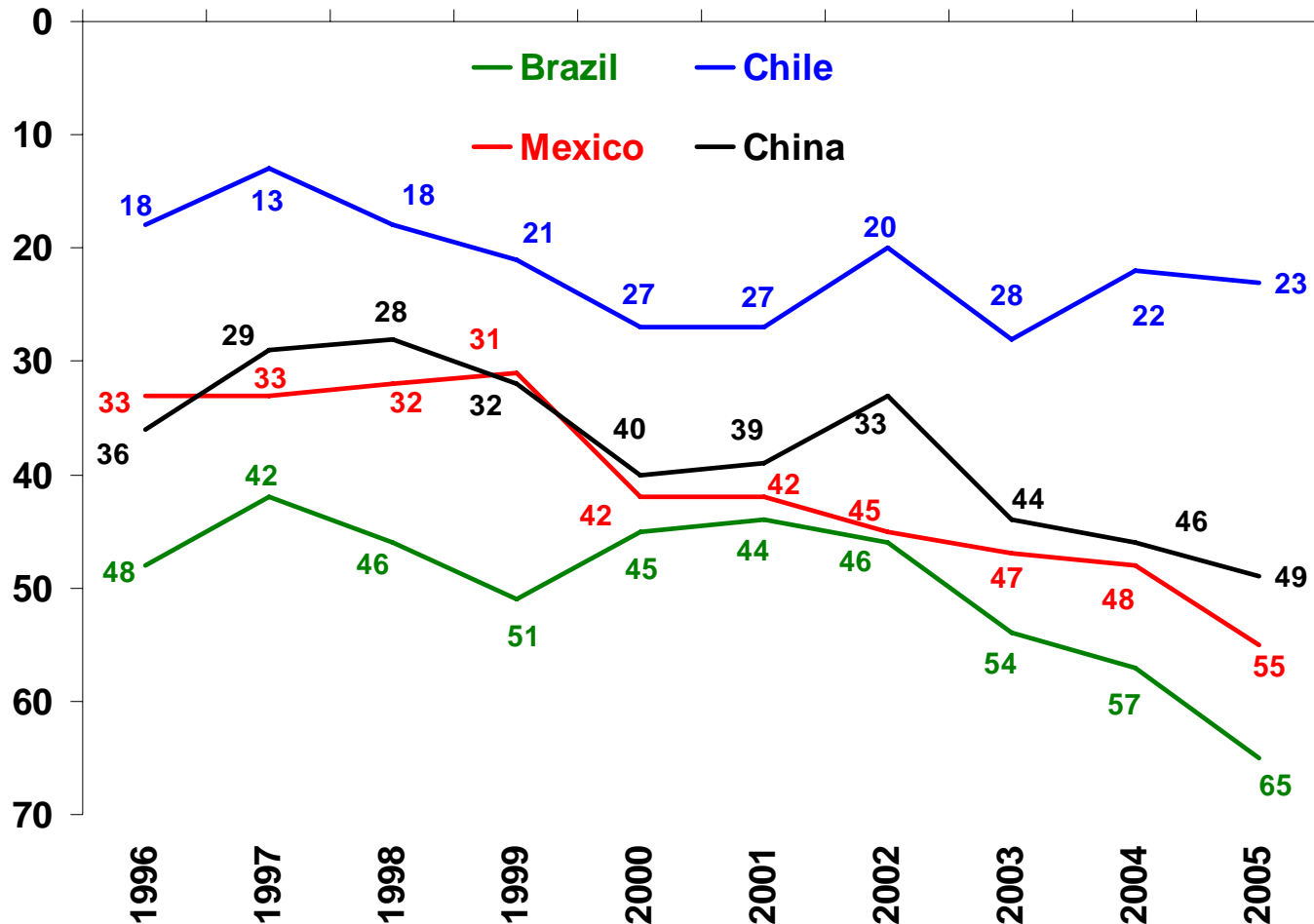
**Mexican Share in US Imports
(Seasonally Adjusted)**



III. Outlook for 2006 and Challenges

Mexico has descended in world rankings of international competitiveness.

*Growth Competitiveness Index: 1996-2005
(World Position)*



Source: World Economic Forum.

III. Outlook for 2006 and Challenges

- **Main challenge for the medium term:**
 - **Establishing conditions for high, sustainable growth**

 - **Improve efficiency and increase productivity:**
 - **Comparative and competitive advantages in the future**
 - **Pending structural reforms (labor, fiscal, energy, telecoms, better regulation, etc.)**

III. Outlook for 2006 and Challenges

Need for a “second generation of reforms” that involve strengthening the institutional infrastructure of the economy.

The state plays a key role in:

- **Efficiently providing genuine public goods:**
 - **Research & Development**
 - **Dissemination of technological knowledge**
 - **Investment in human capital**
 - **A friendly business environment**
 - **Protection of physical and intellectual property rights**
 - **Enforcement and procurement of the legal framework**
 - **Public safety**
 - **Sustainable environmental policy**

These policies require broad-based political support.

IV. Final Remarks

- ***The international environment remains favorable.***
- ***Headline inflation is low and likely to remain close to target during 2006.***
- ***Real GDP growth is expected to be above 3.5% in 2006, probably in line with potential but still insufficient.***
- ***Mexico's public and external sector deficit ratios to GDP are low.***
- ***Macroeconomic and financial stability, as a result of sound monetary and fiscal policies.***
- ***Potential volatility due to electoral process.***

IV. Final Remarks

- ***Mexico is less vulnerable to shocks due to sound macroeconomic policies and a floating exchange-rate regime.***
- ***A positive external environment and the current situation of the Mexican economy point in the direction of continued economic growth and stability in the short-run.***
- ***However, the main challenge for the medium term is to establish conditions for vigorous and sustained growth. Thus, major progress must be made in enhancing the competitiveness of Mexican economy.***