The North Wind Doth Blow: 
U.S. Recession Brings Turbulence to the Mexican Economy

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Presented by: 
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Latin America: not immune but in better shape than in the previous crisis
Interest rates trending downward

Tasas de interés, porcentaje

Jun-99 | Jul-00 | Aug-01 | Sep-02 | Oct-03 | Nov-04 | Dec-05 | Jan-07 | Feb-08
---|---|---|---|---|---|---|---|---
Embí+ | Embí+ Latin America | US 10- year Treasury Bonds | Embí+ México
## In better shape

<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Real Domestic Consumption (%)</td>
<td>64.84</td>
<td>65.0</td>
<td>65.3</td>
<td>65.1</td>
<td>66.2</td>
<td>67.0</td>
</tr>
<tr>
<td>Real Gross Fixed Investment (%)</td>
<td>16.44</td>
<td>16.5</td>
<td>16.0</td>
<td>15.0</td>
<td>17.4</td>
<td>18.5</td>
</tr>
<tr>
<td>Real Exports (%)</td>
<td>22.88</td>
<td>24.5</td>
<td>25.0</td>
<td>25.3</td>
<td>28.4</td>
<td>28.2</td>
</tr>
<tr>
<td>Short-Term Interest Rate (%)</td>
<td>21.2</td>
<td>15.6</td>
<td>15.1</td>
<td>16.9</td>
<td>11.3</td>
<td>10.1</td>
</tr>
<tr>
<td>Policy Rate (%)</td>
<td>21.7</td>
<td>17.5</td>
<td>17.5</td>
<td>18.2</td>
<td>14.0</td>
<td>12.3</td>
</tr>
<tr>
<td>Overall Fiscal Balance (%)</td>
<td>-0.7</td>
<td>-0.6</td>
<td>-0.7</td>
<td>-0.6</td>
<td>0.3</td>
<td>0.3</td>
</tr>
<tr>
<td>Current Account Balance (%)</td>
<td>-3.2</td>
<td>-2.5</td>
<td>-2.7</td>
<td>-1.1</td>
<td>1.4</td>
<td>0.2</td>
</tr>
<tr>
<td>Total External Debt (%)</td>
<td>34.1*</td>
<td>29.7*</td>
<td>31.6*</td>
<td>36.0*</td>
<td>25.4</td>
<td>23.1</td>
</tr>
<tr>
<td>Inflation Rate (%)</td>
<td>7.7</td>
<td>7.1</td>
<td>5.9</td>
<td>8.5</td>
<td>5.2</td>
<td>5.3</td>
</tr>
</tbody>
</table>
The dark side of high commodities prices

High Agriculture Commodities Prices and Inflation Rate in LA

- cpi (left axis)
- Wheat
- Corn
- Soybeans
- Rice

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Wide variations in regional economic growth

(Real GDP, percent change)

- NAFTA
- Western Europe
- Japan
- Other Asia-Pacific
- Emerging Europe
- Mideast-N. Africa
- Other Americas

- 2006
- 2007
- 2008
- 2009
Contagion from the U.S. recession

- **Major risks**
  - Demand for Mexican exports, mostly manufactures; exports of light vehicles show a different trend
  - Remittances: housing crisis in the U.S. compounds the risk
  - Interest rates: low interest rates in the U.S. is actually good news
  - Stock markets, consumer confidence and business sentiment

- **Other variables**
  - Exchange rate: shock absorbing variable
  - Inflation: not direct contagion
  - Prices of commodities and food products
  - Oil prices and energy reform
  - Tourism
Close Commercial Ties

Exports to USA
(As Percent of Total)
Not Decoupling, but Mexico now moves at a faster pace

Mexico is far from decoupling
(Percent change from a year earlier)

Mexico and US GDP Growth
(Percent change from a year earlier)
U.S. Auto sales are down while...
...Mexico’s output is increasing
Oil prices: the wild card

North Sea Dated Price Outlook Scenarios
(Dollars per barrel)

Firm demand growth, particularly in Asia, while non-OPEC increases build up only slowly. OPEC adopt an aggressive stance on supporting prices. Weak dollar drives financial sector support for oil futures. Geo-political tensions resurface with problems for supply in Nigeria and Iraq.

Prices weaken with slowing global economy and dollar strengthens. Demand slows but OPEC does not reduce output fast enough to keep prices in the upper part of their apparently preferred $80-90/barrel range.
Remittances grew 1% in 2007, down 3% in Q1 2008

Remittances

- Total $million - left scale
- Number (000's) - right scale
Remittances totaled 23.98 billion US$ in 2007

- Represent almost 4% of total private consumption
  - Grew at an average rate of 21% per year for over five years up until 2006, but only 1% in 2007, thus growth in consumption derived from growth in remittances will be definitely hurt, now that transfers are going down
  - Multiplier of remittances spending in the 1.4–2.0 range
  - If remittances drop 10%, private consumption declines half a percentage point
  - Some specific sectors suffer more than other
  - A 10% drop in remittances is compensated by a $4 increase in the price of oil
Macroeconomic Fundamentals

- Monetary Policy
  - Inflation: in and out of bounds, but relatively low
  - Interest rates: stable
  - Credit: still growing with ample room for further expansion

- Exchange rate not seriously misaligned

- Fiscal Accounts: in equilibrium supported by oil

- External accounts: relatively small deficit, financed mostly by FDI, does not impose constraints

- Enhanced external debt profile, longer maturities, lower interest rates; “pesification” of debt
# Inflationary objectives vs. registered inflation

<table>
<thead>
<tr>
<th>Year</th>
<th>Objective</th>
<th>Registered Inflation</th>
<th>Target</th>
</tr>
</thead>
<tbody>
<tr>
<td>2000</td>
<td>10.0%</td>
<td>9.0%</td>
<td>Met</td>
</tr>
<tr>
<td>2001</td>
<td>6.5%</td>
<td>4.4%</td>
<td>Met</td>
</tr>
<tr>
<td>2002</td>
<td>4.5%</td>
<td>5.7%</td>
<td>Not Met</td>
</tr>
<tr>
<td>2003</td>
<td>3.0% +/- 1</td>
<td>4.0%</td>
<td>Met</td>
</tr>
<tr>
<td>2004</td>
<td>3.0% +/- 1</td>
<td>5.2%</td>
<td>Not Met</td>
</tr>
<tr>
<td>2005</td>
<td>3.0% +/- 1</td>
<td>3.3%</td>
<td>Met</td>
</tr>
<tr>
<td>2006</td>
<td>3.0% +/- 1</td>
<td>4.05%</td>
<td>Not Met</td>
</tr>
<tr>
<td>2007</td>
<td>3.0% +/- 1</td>
<td>3.74%</td>
<td>Met</td>
</tr>
</tbody>
</table>
Inflation is going out of the targeted band, but still under control

Inflation
(Percent change from a year earlier)
External shocks will be difficult to handle

**Corn Prices**

<table>
<thead>
<tr>
<th>Month</th>
<th>Price ($/Bushel)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apr-06</td>
<td>2.00</td>
</tr>
<tr>
<td>Oct-06</td>
<td>2.50</td>
</tr>
<tr>
<td>Apr-07</td>
<td>3.00</td>
</tr>
<tr>
<td>Oct-07</td>
<td>3.50</td>
</tr>
<tr>
<td>Apr-08</td>
<td>4.00</td>
</tr>
</tbody>
</table>

**Soybean Prices**

<table>
<thead>
<tr>
<th>Month</th>
<th>Price ($/Bushel)</th>
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<tbody>
<tr>
<td>Apr-06</td>
<td>2.00</td>
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<tr>
<td>Oct-06</td>
<td>2.50</td>
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<tr>
<td>Apr-07</td>
<td>3.00</td>
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<tr>
<td>Oct-07</td>
<td>3.50</td>
</tr>
<tr>
<td>Apr-08</td>
<td>4.00</td>
</tr>
</tbody>
</table>

**Wheat Prices**

<table>
<thead>
<tr>
<th>Month</th>
<th>Price ($/Bushel)</th>
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<tbody>
<tr>
<td>Apr-06</td>
<td>10.00</td>
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<tr>
<td>Oct-06</td>
<td>10.50</td>
</tr>
<tr>
<td>Apr-07</td>
<td>11.00</td>
</tr>
<tr>
<td>Oct-07</td>
<td>11.50</td>
</tr>
<tr>
<td>Apr-08</td>
<td>12.00</td>
</tr>
</tbody>
</table>
Relative prices

Relative Prices
(June 2002=100)
The strength of the Mexican peso or the weakness of the U.S. dollar?

Exchange Rate

Mexican Pesos per U.S. Dollar
Mexican Pesos per Euro
Short-term capital inflows will put downward pressure on the exchange rate

Interest Rates: Mexico vs. U.S.A.
(Percent)

Apr-03 Apr-04 Apr-05 Apr-06 Apr-07 Apr-08
US 4-week T Bills
Mexico Cetes28

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…and foreign exchange reserves pile up

Net International Reserves
(Millions of U.S. dollars)

55,000 60,000 65,000 70,000 75,000 80,000 85,000

Jan-04 Nov-04 Sep-05 Jul-06 May-07 Mar-08
Strong export growth

Exports
(Percent change from a year earlier)

[Bar chart showing export growth over time with categories for oil exports and non-oil exports]
External deficit is manageable

External Accounts
(Billions of U.S. dollars)
Foreign direct investment more than offsets the current account deficit

External Financing
(Billions of U.S. dollars)

- Current account deficit
- FDI
Balanced fiscal accounts

Fiscal Balance
(As percent of GDP)
# Milking the Cow of PEMEX

## PEMEX: Financial Results (US$ millions)

<table>
<thead>
<tr>
<th></th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total Sales</strong></td>
<td>55,726</td>
<td>69,119</td>
<td>86,146</td>
<td>97,244</td>
<td>104,451</td>
</tr>
<tr>
<td>-- Domestic</td>
<td>34,465</td>
<td>39,861</td>
<td>46,844</td>
<td>50,248</td>
<td>54,485</td>
</tr>
<tr>
<td>-- Exports</td>
<td>21,261</td>
<td>29,258</td>
<td>39,302</td>
<td>46,996</td>
<td>49,855</td>
</tr>
<tr>
<td><strong>Net Income before taxes and contributions to the government</strong></td>
<td>30,309</td>
<td>40,736</td>
<td>49,669</td>
<td>57,619</td>
<td>60,753</td>
</tr>
<tr>
<td><strong>Taxes and contributions to the government</strong></td>
<td>34,028</td>
<td>41,991</td>
<td>53,653</td>
<td>53,714</td>
<td>62,234</td>
</tr>
<tr>
<td><strong>Net Income (loss)</strong></td>
<td>(3,719)</td>
<td>(1,255)</td>
<td>(3,984)</td>
<td>3,906</td>
<td>(1,484)</td>
</tr>
</tbody>
</table>
Border States Performance and Contagion
Mexico: border states economic growth

Regional GSP Growth
(Percent change from a year earlier)
Texas border Mexican states

Regional GSP Growth
(Percent change from a year earlier)
# Growth scenarios

(Percent change from a year earlier)

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Real GDP</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Baseline scenario</td>
<td>2.6</td>
<td>3.4</td>
<td>4.1</td>
</tr>
<tr>
<td>With fiscal stimulus</td>
<td>3.0</td>
<td>3.9</td>
<td>4.5</td>
</tr>
<tr>
<td><strong>Total Consumption</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Baseline scenario</td>
<td>4.4</td>
<td>3.7</td>
<td>3.9</td>
</tr>
<tr>
<td>With fiscal stimulus</td>
<td>4.8</td>
<td>4.5</td>
<td>4.3</td>
</tr>
<tr>
<td><strong>Investment</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Baseline scenario</td>
<td>6.7</td>
<td>6.4</td>
<td>6.3</td>
</tr>
<tr>
<td>With fiscal stimulus</td>
<td>7.1</td>
<td>7.4</td>
<td>7.2</td>
</tr>
</tbody>
</table>
Mexico: Crunch time for President Calderon
Energy reform: Calderon’s toughest test

- Mid-terms scheduled for 2009 make this congressional session crucial.
- President Calderon is more dependent than ever on the opposition Institutional Revolutionary Party (PRI).
- Dominant elements of leftist Democratic Revolution Party (PRD) are hardening anti-government stance.
- 70th anniversary of oil expropriation is fuelling nationalist sentiment.
- Corruption scandal scorching Government Secretary Juan Camilo Mouriño.
- Other reforms on the back burner.
Social tensions and security risks

- Periodic protests against NAFTA anticipated.
- Enhanced economic risk increases threat of social unrest and crime.
- Suspected links between the illegal drug trade and acts of terrorism.
- Backlash against police continues.
- Public perceptions of security crackdown linked to President Calderon’s approval ratings.
Final remarks

- Contagion from US economic slowdown will hurt Mexico’s economy but will not go into recession.
- Slow to moderate growth is the most likely outcome in the near future.
- Oil prices: the wild card, but will keep the Mexican economy rolling; medium term outlook for energy sector is uncertain.
- China’s hard landing is not yet in the baseline scenario
- Macroeconomic fundamentals in place
- Mexican economy is better prepared for external shocks, with an enhanced debt profile and higher FX reserves
- Long-term growth will be just moderate unless deeper and additional reforms are approved and implemented
Thank You!

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