



# Weekly Observatory

June 15, 2009

## Banxico close to ending monetary easing cycle

We think that Banxico will cut its lending rate by 50 bps at its next meeting. The heavy economic recession continues to push the balance of risks towards flatter activity, which is helping medium-term inflation convergence. The bank lending rate will therefore be 4.75%, and the real rate will continue to record negative results. Given that due to the outbreak of the virus A(H1N1) epidemic growth in the second quarter of the year will be hit hard, and there will be no recovery in accordance with records in the US, Banxico has room to continue to ease the monetary policy. We therefore think that the lending rate could end the year at 4.5%. However, the uncertainty that domestic financial markets are facing for the future could be reason to bring forward the monetary policy pause, which we expect to continue throughout this year and over into 2010.

## Industrial Output Indicator in April and Aggregate Demand in 1Q09

This week sees the publication of relevant data on Mexico's economic activity. April industrial output will continue to record a decline in yoy growth, heavily influenced by external motor vehicle demand, which is still falling dramatically. It is worth noting that following the 50% collapse in domestic motor vehicle production in January, annual falls from February to May fluctuated around 40% in annual terms. In fact, the average change for the two published months of the second quarter is lower than the annual change in the first quarter (-3 vs -40%, respectively), which suggests that a quick recovery is unlikely. The rest of the manufacturing sector branches have also been hit hard by lower foreign demand and the decline in domestic demand. As regards motor vehicle output in April, we predict a -10.7% fall, although we are not ruling out an even greater drop.

Aggregate demand in the first quarter will provide important information in addition to the announced fall in GDP for the aforementioned period (-8.6% yoy and -5.9 qoq). We think that the decline in components such as private consumption will be particularly affected by the weak wage bill in recent months. Gross fixed investment could be just as weak, especially in the private sector. It should be pointed out that public investment could have injected an extra positive boost in 1Q09, but was overshadowed by the extent of the downturn. We estimate that total aggregate demand will fall 9.7%.

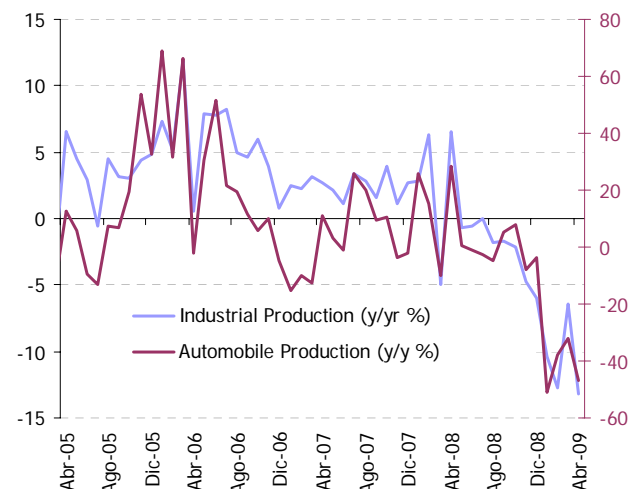
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Industrial Production and Automobile Industry  
(y/y % real & units)



## Economic Calendar

June 15 to 19

|               | Monday | Tuesday | Wednesday  | Thursday | Friday  |
|---------------|--------|---------|--|----------|---|
|               | 15     | 16      | 17   | 18       | 19  |
| <b>Mexico</b> |        |         | Industrial Activity Indicator<br>(April)<br>-10.7 (previous -6.7.) |          | Final Goods and Services<br>Supply and Demand (1Q09)<br>-9.7 (previous -3.2.) |
|               |        |         |  |          | Monetary Policy Decision<br>Announcement<br>4.75 (5.25 prev.)                 |
|               |        |         |  |          |   |

## Macroeconomic Forecasts

|                                | Mexico |       |              | U.S.   |               |               |
|--------------------------------|--------|-------|--------------|--------|---------------|---------------|
|                                | 2007   | 2008  | 2009         | 2007   | 2008          | 2009          |
| Inflation (% , end of period)* | 3.8    | 6.5   | <b>3.8</b>   | 2.9    | 4.2           | <b>0.8</b>    |
| Core (% , end of period)*      | 4.1    | 5.7   | <b>4.0</b>   | 2.3    | 2.3           | <b>1.2</b>    |
| GDP (real annual % change)     | 3.3    | 1.4   | <b>-4.5</b>  | 2.0    | 1.4           | <b>-2.0</b>   |
| Trade balance (US bn)          | -10.1  | -17.3 | <b>-16.2</b> | -700.0 | -680.0        | <b>-429.0</b> |
| Current account (US bn)        | -8.3   | -15.7 | <b>-16.3</b> | -730.0 | <b>-688.3</b> | <b>-600.0</b> |
| (% of GDP)                     | -0.8   | -1.4  | <b>-1.9</b>  | -5.3   | <b>-4.8</b>   | <b>-3.0</b>   |
| Public balance (% of GDP)      | 0.0    | -0.1  | <b>-1.8</b>  | -1.2   | -4.2          | <b>-12.7</b>  |

bn : billion

\* Average for U.S.

|               | Inflation in Mexico (%) |             |             |
|---------------|-------------------------|-------------|-------------|
|               | Month                   | Acumm.      | Annual      |
| Jan-09        | 0.23                    | 0.23        | 6.28        |
| Feb-09        | 0.22                    | 0.45        | 6.20        |
| Mar-09        | 0.58                    | 1.03        | 6.04        |
| Apr-09        | 0.35                    | 1.38        | 6.17        |
| <b>May-09</b> | <b>-0.29</b>            | <b>1.09</b> | <b>5.98</b> |
| <b>Jun-09</b> | <b>0.19</b>             | <b>1.28</b> | <b>5.74</b> |
| <b>Jul-09</b> | <b>0.26</b>             | <b>1.54</b> | <b>5.43</b> |
| <b>Aug-09</b> | <b>0.31</b>             | <b>1.86</b> | <b>5.15</b> |
| <b>Sep-09</b> | <b>0.53</b>             | <b>2.40</b> | <b>4.99</b> |
| <b>Oct-09</b> | <b>0.47</b>             | <b>2.88</b> | <b>4.77</b> |
| <b>Nov-09</b> | <b>0.59</b>             | <b>3.48</b> | <b>4.20</b> |
| <b>Dec-09</b> | <b>0.35</b>             | <b>3.84</b> | <b>3.84</b> |

\* Forecast in bold

## Financial Forecasts (% , end of period)

|                   | Mexico |       |              |       |              |              |
|-------------------|--------|-------|--------------|-------|--------------|--------------|
|                   | 2007   | 2008  | 2009         | 1Q09  | 2Q09         | 3Q09         |
| Bank funding      | 7.50   | 8.25  | <b>4.50</b>  | 6.75  | <b>4.75</b>  | <b>4.50</b>  |
| 28-day Cetes      | 7.44   | 7.94  | <b>4.47</b>  | 6.75  | <b>4.60</b>  | <b>4.47</b>  |
| 28-day TIE        | 7.93   | 8.68  | <b>4.83</b>  | 7.57  | <b>5.40</b>  | <b>4.83</b>  |
| M 10 years (avg)  | 8.04   | 8.28  | <b>6.40</b>  | 8.30  | <b>7.60</b>  | <b>6.80</b>  |
| Peso/dollar (avg) | 10.86  | 13.67 | <b>13.00</b> | 14.00 | <b>13.18</b> | <b>13.20</b> |

|               | U.S. |          |             |      |             |             |
|---------------|------|----------|-------------|------|-------------|-------------|
|               | 2007 | 2008     | 2009        | 1Q09 | 2Q09        | 3Q09        |
| Fed Funds     | 4.25 | 0 - 0.25 | <b>0.00</b> | 0.00 | <b>0.00</b> | <b>0.00</b> |
| 10-year bond  | 4.26 | 3.25     | <b>2.23</b> | 2.70 | <b>2.27</b> | <b>1.98</b> |
| Dollar / euro | 1.46 | 1.40     | <b>1.15</b> | 1.35 | <b>1.25</b> | <b>1.18</b> |

## Financial Markets Evolution

June 4 to 11

| U.S. Debt  |                |              | UMS            |             |              |                     | Cetes & Bonds (M's) with taxes |         |              |              |
|------------|----------------|--------------|----------------|-------------|--------------|---------------------|--------------------------------|---------|--------------|--------------|
| Term       | Previous close | Week chng bp | Term (days)    | Prev. Close | Week chng bp | Spread vs. Treasury | Term (days)                    | Primary | Prev. close* | Week chng bp |
| Fed Funds  | 0.25           | 0            |                |             |              |                     | Bank funding*                  |         | 5.25         | 0            |
|            |                |              |                |             |              |                     | Govnmt. funding*               |         | 5.19         | 0            |
|            |                |              |                |             |              |                     | TIE (28d)                      |         | 5.32         | -7           |
| T.Bill 91d | 0.17           | 3            |                |             |              |                     | Cetes (28d)                    | 5.10    | 5.07         | 0            |
|            |                |              |                |             |              |                     | Cetes (91d)                    | 5.15    | 5.13         | 3            |
|            |                |              |                |             |              |                     | Cetes (182d)                   | 5.22    | 5.16         | 2            |
| Libor 3m   | 0.63           | 0            |                |             |              |                     | Cetes (364d)                   |         | 5.24         | 4            |
|            |                |              |                |             |              |                     |                                |         |              |              |
|            |                |              |                |             |              |                     |                                |         |              |              |
|            |                |              |                |             |              |                     |                                |         |              |              |
|            |                |              |                |             |              |                     |                                |         |              |              |
| T-Notes    | 0.39           | 3            |                |             |              |                     |                                |         |              |              |
| 5 years    |                |              |                |             |              |                     |                                |         |              |              |
|            |                |              |                |             |              |                     |                                |         |              |              |
|            |                |              | UMS 10 (234d)  | 1.18        | -24.00       | -180                | M 7 i (195d)                   | 5.17    | 5.32         | 15           |
|            |                |              | UMS 11 (581d)  | 2.00        | 6.50         | -97                 | M 7 i (559d)                   | 5.24    | 5.36         | 12           |
| T-Notes    | 2.97           | 27           | UMS 12 (946d)  | 3.29        | 21.90        | 32                  |                                |         |              |              |
| 10 years   |                |              | UMS 13 (1314d) | 4.25        | 12.40        | 127                 | M 10 i (1287d)                 | 6.29    | 6.77         | 48           |
|            |                |              | UMS 14 (1678d) | 4.76        | 8.60         | 178                 | M 10 i (1651d)                 | 6.82    | 7.41         | 59           |
|            |                |              |                |             |              |                     |                                |         |              |              |
|            |                |              | UMS 15 (2090d) | 5.13        | 8.00         | 44                  | M 10 iL (2015d)                | 7.06    | 7.69         | 63           |
|            |                |              | UMS 16 (2652d) | 5.39        | 1.10         | 71                  |                                |         |              |              |
|            |                |              | UMS 19 (3853d) | 5.93        | -12.20       | 124                 |                                |         |              |              |
| T-Bond     | 4.69           | 10           | UMS 22 (4852d) | 6.23        | -9.30        | 154                 | M 20 i (5291d)                 | 8.09    | 8.61         | 52           |
| 30 years   |                |              | UMS 26 (6181d) | 6.43        | -6.20        | 174                 |                                |         |              |              |
|            |                |              | UMS 31 (8099d) | 6.69        | -2.20        | 200                 |                                |         |              |              |
|            |                |              | UMS 33 (8701d) | 6.70        | 0.10         | 201                 |                                |         |              |              |
|            |                |              | UMS 34 (9238d) | 6.72        | 2.10         | 203                 |                                |         |              |              |

\* Weighted rates

| Spreads              | Previous close | Week chng bp | Currencies           | Previous close | Week % chng | Bolsas    | Previous close | Week % chng |
|----------------------|----------------|--------------|----------------------|----------------|-------------|-----------|----------------|-------------|
| U.S. corporate (BAA) | 478            | -29          | Peso / dollar        | 13.36          | 0.98        | IPC       | 25,183.7       | 176         |
| EMBI+Mexico          | 236            | 10           | Real Brazil / dollar | 192            | -0.71       | Dow Jones | 8,739.0        | -0.13       |
| EMBI+Brazil          | 263            | -16          | Dollar / euro        | 141            | -0.53       | S&P       | 939.2          | -0.35       |
| EMBI+LatAm           | 463            | -30          | Yen / dollar         | 97.63          | 1.09        | Bovespa   | 53,410.9       | -0.10       |