

## CONSENSUS ECONOMIC FORECAST

## MÉXICO



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## Prices, Petroleum, P/Es, and the Peso

There are only a few things that cause more curiosity and generate more questions than the behavior over time of a major exchange rate such as that between the peso and the dollar. As many borderplex business managers have claimed over the years, the peso seemingly defies quantitative economic, financial market, political arena, and literary analysis. While that statement, born out of years of peso-watching and occasional currency market losses, may be partially accurate much of the time, it does not afford business analysts or economists the luxury of walking away from this market issue and spectator sport.

The behavior of the peso/dollar exchange rate has been particularly interesting to observe in 2006 and 2007. During that period, the monthly average nominal exchange rate has oscillated in a relatively tight band between P/\$ 10.48 and P/\$ 11.39. In fact, the monthly average nominal exchange rate has not breached either the P/\$ 10 or the P/\$ 12 from September 2002 forward. Given everything that has occurred during that period, plus an inflationary gap between the two economies that still persists, such stability is somewhat surprising.

Consumer prices are increasing at a faster clip in Mexico than in the United States. That type of pattern has, from 1976 forward, led the peso to depreciate in nominal terms against the dollar. There are at least two factors that have caused at least a temporary deviation from the historical norm. Central bank autonomy at Banco de México allows it to set interest rate targets largely without political interference. At present, 3-month certificate of deposits in Mexico offer a nearly 200 basis point premium relative to their counterpart instruments from north of the border. That difference more than compensates for the 140 basis point inflationary gap between the countries and encourages investors to hold onto peso-denominated instruments.

International reserves currently stand at \$78.2 billion, a substantial increase from less than \$60 billion as recently as 2003. A major contributor to that increase has been higher oil prices. While PEMEX has faced well-documented investment difficulties in recent years, Mexico is still a net petroleum exporter and the 2005 run-up in global oil prices has helped bolster its reserves position. Annual non-petroleum exports increased by more than \$60 billion between 2003 and 2006, also contributing to the *Aztec forex* bonanza.

Of course, the bulk of all merchandise exports from Mexico are destined for the United States. Given that, whenever the United States runs into economic trouble such as what occurred in 2001, it invariably hurts Mexico's trade balance and causes the peso to depreciate. In response, the currency market monitors north-of-the-border equity markets and any sign of corporate earnings or profitability weakness quickly translates into peso jitters. Equity market performance since mid-2003 in the United States has been enviable. The well-known Dow Jones Industrial Average grew by approximately 73 percent between February 2003 and May 2007. Surprisingly, the broader Standard & Poors 500 index increased by nearly 82 percent during the same period. The stock market strength also helped maintain nominal exchange rate stability during an era of ongoing inflationary differentials between these large trading partners.

Given the financial market volatility and economic uncertainty that has been observed in recent weeks, it is no surprise that the peso has retreated somewhat in nominal terms. Crude oil prices seem to have leveled off at less than \$75 per barrel and appear subject to more downside than upside risks. Prospects for the various stock market indices are not much different, with corporate profitability in the United States constrained by a moderately weak business cycle outlook. One factor that might cause further peso gains versus the dollar is the potential for downward movements in north-of-the-border interest yields, if their counterparts in Mexico hold steady. Another is ongoing direct foreign investment inflows. Aside from those possibilities, some nominal depreciation for the peso would not come as a surprise. Whether such a development will go far enough to erase the progressive real currency appreciation of the peso remains to be seen.

— Thomas M. Fullerton, Jr.; Angel L. Molina, Jr.; and  
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UTEP Border Region Modeling Project

# 2007 MEXICO CONSENSUS ECONOMIC FORECAST

	Annual Percent Change 2007 from 2006						Annual Average		
	GDP 1993 Peso	Private Con- sumption	Government Con- sumption	Total Invest- ment	Exports	Imports	Consumer Price Index	Exchange Rate	CETES 28 Day
AMERICAN CHAMBER MEXICO	3.5	4.2	3.1	7.6	4.0	9.3	3.7	11.110	7.0
BANAMEX	3.2	3.9	-1.0	6.6	5.8	9.3	3.9	10.878	7.2
BANCOMER	3.1	4.3	1.4	5.7	5.2	7.3	3.5	11.370	7.1
CENTER FOR ECONOMIC FORECASTING OF MEXICO	2.0	2.8	-2.5	2.5	5.0	5.5	4.0	11.150	7.2
LATIN SOURCE MEXICO/ GEA	3.4	4.7	2.5	7.1	5.2	7.6	3.6	11.040	7.2
UTEP BORDER REGION MODELING PROJECT	3.2	3.2	3.4	3.8	8.8	9.1	4.0	11.000	7.2
<b>CONSENSUS – THIS QUARTER</b>	<b>3.1</b>	<b>3.9</b>	<b>1.2</b>	<b>5.6</b>	<b>5.7</b>	<b>8.0</b>	<b>3.8</b>	<b>11.091</b>	<b>7.1</b>
<b>– LAST QUARTER</b>	<b>3.0</b>	<b>3.6</b>	<b>1.1</b>	<b>5.3</b>	<b>6.1</b>	<b>7.9</b>	<b>3.6</b>	<b>11.081</b>	<b>7.2</b>

# 2008 MEXICO CONSENSUS ECONOMIC FORECAST

	Annual Percent Change 2008 from 2007						Annual Average		
	GDP 1993 Peso	Private Con- sumption	Government Con- sumption	Total Invest- ment	Exports	Imports	Consumer Price Index	Exchange Rate	CETES 28 Day
AMERICAN CHAMBER MEXICO	3.7	4.3	2.9	8.4	10.5	12.5	3.5	11.400	6.9
BANAMEX	3.8	4.3	0.7	6.7	8.3	8.6	3.4	11.090	6.8
BANCOMER	3.8	5.7	0.4	8.4	7.3	9.5	3.5	11.210	6.2
CENTER FOR ECONOMIC FORECASTING OF MEXICO	4.0	4.2	3.4	7.5	8.5	9.5	3.5	11.650	7.2
LATIN SOURCE MEXICO/ GEA	3.8	3.7	3.8	5.4	11.5	9.1	3.3	11.500	7.0
UTEP BORDER REGION MODELING PROJECT	3.7	3.6	3.6	3.7	9.4	9.5	3.7	11.500	7.0
<b>CONSENSUS – THIS QUARTER</b>	<b>3.8</b>	<b>4.3</b>	<b>2.5</b>	<b>6.7</b>	<b>9.3</b>	<b>9.8</b>	<b>3.5</b>	<b>11.392</b>	<b>6.9</b>
<b>– LAST QUARTER</b>	<b>3.7</b>	<b>4.1</b>	<b>2.8</b>	<b>7.4</b>	<b>8.0</b>	<b>8.2</b>	<b>3.4</b>	<b>11.300</b>	<b>7.0</b>

## HISTORICAL DATA

Source: INEGI	GDP – 1993 Pesos (billions)	Private Consumption 1993 Pesos (billions)	Government Consumption 1993 Pesos (billions)	Total Investment 1993 Pesos (billions)	Exports (Trade Bal.) US Dollars (millions)	Imports (Trade Bal.) US Dollars (millions)	Consumer Price Index June 02=100 Dec./Dec.	Exchange Rate Pesos/Dollars (annual av.)	CETES 28 Day (annual av.)
2006*	1,826.5	1,350.9	159.2	389.9	242.1	249.8	120.4	12.1	9.9
Percent Change	4.0%	4.6%	2.6%	7.1%	13.0%	12.6%	3.5%	11.1%	7.6%
2005	1,756.2	1,291.5	155.2	364.1	214.2	221.8	116.3	10.9	9.2
Percent Change	3.0%	1.8%	0.5%	3.4%	14.0%	12.7%	3.3%	-4.0%	35.3%
2004	1,705.8	1,268.6	154.5	352.2	188.0	196.8	112.6	11.4	6.8
Percent Change	4.2%	5.6%	-0.4%	1.5%	14.1%	15.4%	5.2%	4.2%	9.7%
2003	1,637.4	1,200.8	155.1	346.9	164.8	170.5	107.0	10.9	6.2
Percent Change	1.4%	2.3%	0.8%	-4.2%	2.3%	1.1%	4.0%	11.1%	-12.7%
2002	1,615.6	1,173.4	153.9	362.0	161.0	168.7	102.9	9.8	7.1
Percent Change	0.8%	1.4%	-0.3%	-1.1%	1.4%	0.2%	5.6%	4.7%	-37.2%
2001	1,602.3	1,157.7	154.4	366.2	158.8	168.4	97.4	9.4	11.3
Percent Change	-0.2%	2.2%	-2.0%	-3.9%	-4.4%	-3.5%	4.5%	-1.7%	-25.7%

\* Consensus

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