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MEXICO: INDICATIONS OF GRADUAL GROWTH RECOVERY

November 26th 2013

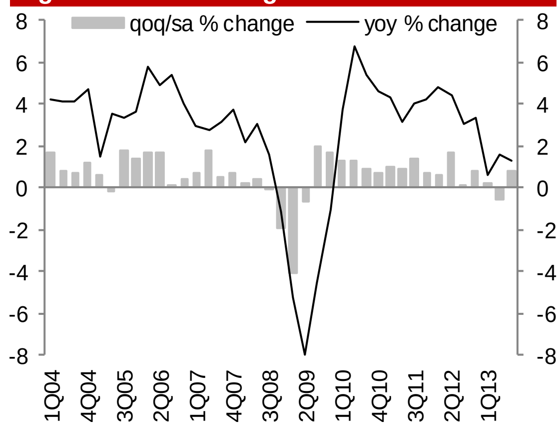
3Q13 GDP result: Economic activity rebounds

Mexico's 3Q13 GDP result indicates a gradual recovery from the deceleration during 1H13 that was owed to weakness of external and domestic factors. The rebound of growth in 3Q was led by the external sector, especially manufacturing, while domestic demand remains sluggish.

Real GDP expanded 0.8% quarter-on-quarter (qoq/sa) in 3Q after having contracted by a revised 0.6% qoq/sa in 2Q, according to results released last week. (Figure 1.) In annualized seasonally-adjusted terms, growth accelerated to 3.4% from a decline of 2.2% in 2Q. Despite this improvement, the growth pace remains moderated; GDP expanded 1.3% yoy and 1.2% year-to-date as this year's deceleration has been owed to a combination of weakness in manufacturing and exports, slowed construction activity, and low government spending.

Data for 2Q was revised upwards to -0.6% qoq/sa (from -0.7%) and to 1.6% yoy (from 1.5%).

Figure 1: Real GDP growth



Source: INEGI; BTMU Economic Research.

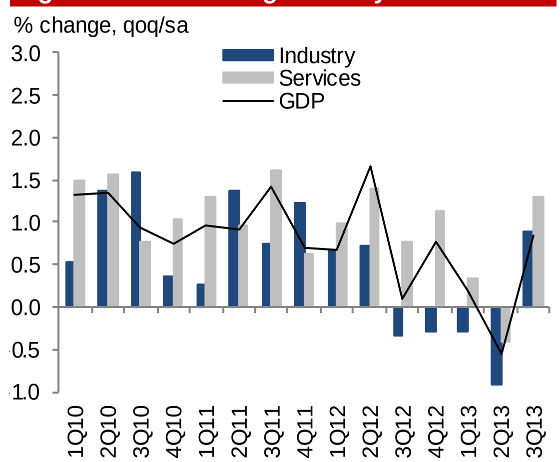
Externally-driven sectors are underpinning modest growth recovery

Growth in 3Q was driven by the industry and services sectors, both which recovered from quarterly contractions in 2Q. (Figure 2.)

Industry grew 0.9% qoq/sa, halting four consecutive quarters decline, as the externally-driven manufacturing sector accelerated. However, the slowdown of the construction sector weighed on industry's growth in annual terms. Industry contracted -0.6% yoy (vs -0.3% yoy in 2Q). Construction fell 6.9% yoy (vs -3.6% yoy in 2Q), and the pick-up of construction activity is likely to continue to be slow while the largest homebuilders restructure and the government redefines its housing program. On the other hand, the export-oriented manufacturing segment accelerated 2.9% yoy in 3Q from 1.9% yoy in 2Q upon broad-based improvement. It is noteworthy that both automobile production and non-automobile production have picked up. Indeed, the computer, electronic appliance, and other machinery and equipment export segments are on an upward growth trend since April. (Figure 3.)

The services sector posted the strongest performance—despite still-sluggish domestic demand—on account of segments tied to external demand. Services grew 1.3% qoq/sa, improving from -0.4% qoq/sa in 2Q. In annual terms, however, its expansion of 2.3% yoy is below 2.6% yoy in 2Q and unchanged from the year-to-date figure posted in 1H. Reflecting weak private consumption, retail sales growth has contracted for two consecutive months. It fell 4% yoy in September, compared to a drop of 2.2% yoy in August, during a month in which the result was impacted by two hurricanes and heavy rainfall. Employment growth in commercial sales has held up, however, with a 2.5% yoy expansion. Domestic demand should strengthen by 1Q14 as economic activity accelerates. Meanwhile, the government has begun to deliver higher public expenditures to sustain the recovery of growth.

Figure 2: Real GDP growth by main sectors



Source: INEGI; BTMU Economic Research.

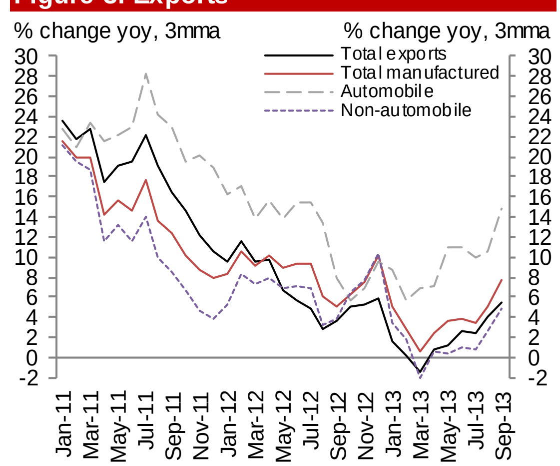
Gradual cyclical growth acceleration in 2014

Mexico's 3Q GDP result is in line with the expected, gradual acceleration of economic growth in 2014. While the consensus expects this year's growth to come in at 1.3%, next year's forecast is a higher 3.5%. The cyclical growth acceleration should be supported by a gradually improving external environment, larger fiscal impulse, and the Central Bank's rate cuts in 2013.

Manufacturing should continue to underpin the recovery as the external environment becomes more supportive of higher demand for Mexican auto and non-auto exports. Also, the government's 2014 budget will widen the fiscal deficit to 1.5% of GDP, from an estimated -0.4% this year. This will support higher consumption and investment expenditures as the government retakes its public spending, though the expansionary impulse seems too large in our view. Moreover, following Banxico's two 25bp cuts in September and October, the negative real rate should support economic activity. Banxico has indicated its intent to keep the policy rate on hold, and we expect it to remain at 4% for the rest of 2013 and all of 2014.

The reform agenda presents opportunities to elevate structural growth. The energy reform—which would open the oil, gas, and electricity sectors to some degree of private investment—could receive votes before the end of Congress' ordinary session on December 15th if the political reform is reviewed by end-November, a condition set by the opposition PAN party.

Figure 3: Exports



Source: INEGI; BTMU Economic Research.

For historical data and commentary following BTMU's Economic News Releases, see our website at: http://www.bk.mufg.jp/report/ecolatin2013/index.htm