# BTMU Focus Latin America

## Mexico: macroeconomic performance (1Q 2015)

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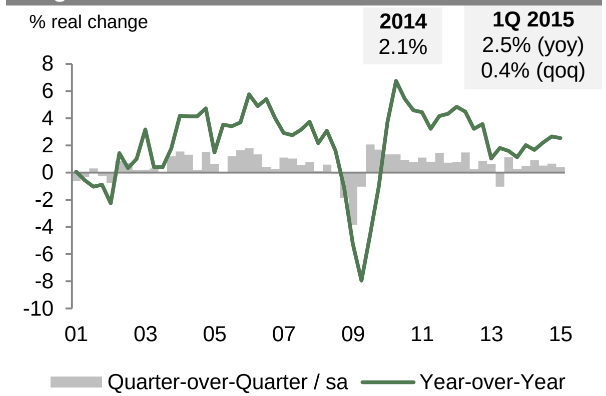
# I) Mexico: Growth Momentum (1)

## ▪ A weak start for Latin America’s second-largest economy.

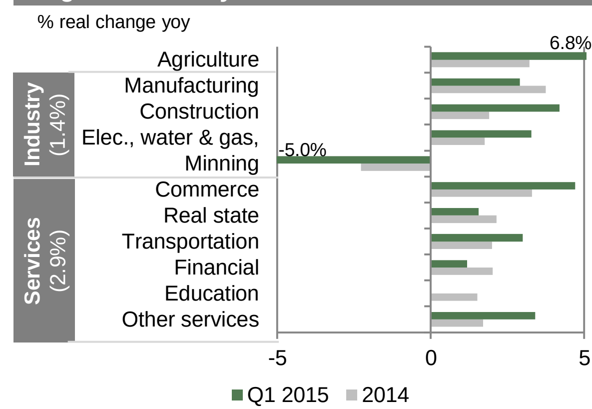
- Mexico’s economic growth slowed to 0.4% qoq in 1Q 2015 from 0.7% in the previous quarter, a disappointing start for the country that, over the last two years, has set in motion a wave of bold structural reforms in several key sectors (e.g. energy, telecom and financial), aimed at boosting its sluggish economy in the short term, and lifting its potential growth in the medium to long term. However, the economy lost momentum in 1Q, as a weak US economy put a dent in Mexico’s manufacturing sector, an export-led industry that is fairly reliant on US demand. Thus, industry production rose by a mild 1.4% yoy in 1Q, following a 2.4% in the previous quarter. To be fair, low oil prices and falling oil production were also factors that contributed to this discouraging start. Still, not all is bad news, household consumption and gross fixed capital formation (GFCF) has begun to show some signs of gaining momentum. Finally, export growth slowed to 1.8% qoq in 1Q from 3.4% in the prior quarter; while exports posted a 12.1% yoy gain.

**Figure 1: GDP Growth**



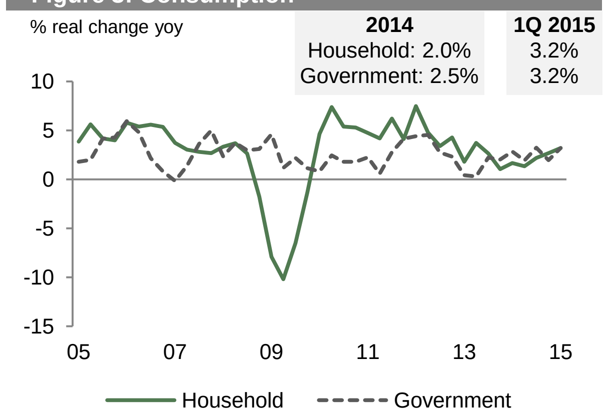

Source: Instituto Nacional de Estadística y Geografía (INEGI); BTMU

**Figure 2: GDP by Sector**



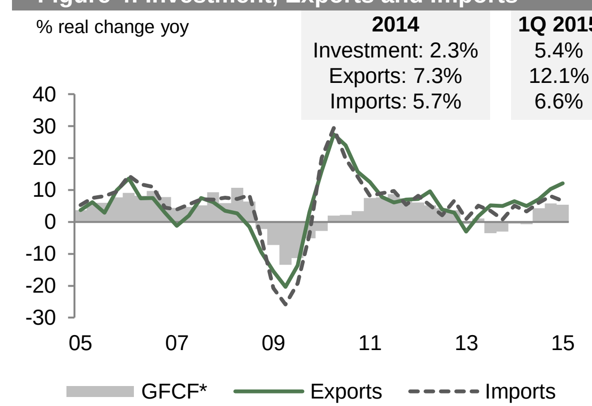

Source: INEGI; BTMU

**Figure 3: Consumption**




Source: INEGI; BTMU

**Figure 4: Investment, Exports and Imports**




* Gross Fixed Capital Formation
Source: INEGI; BTMU



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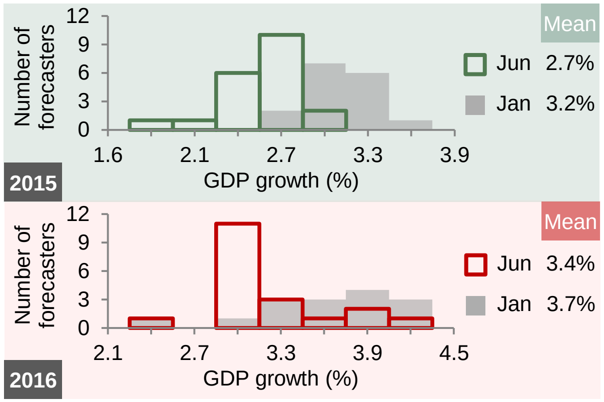
# I) Mexico: Growth Momentum (2)

- **Economic activity should pick up in the next quarters, on the back of stronger US demand.**

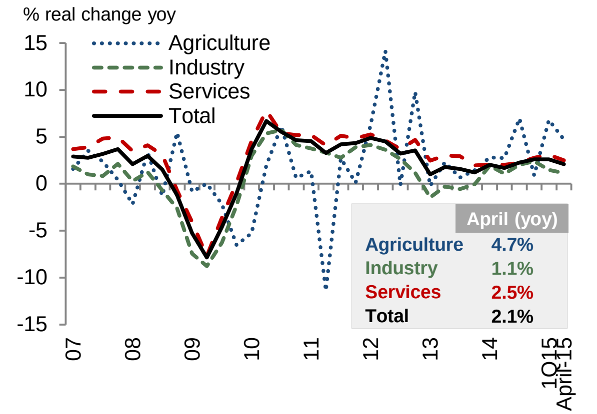
- **Overall Outlook:** Market expectations for this year's GDP growth have moderated after a feeble economic performance in 1Q 2015 (*Figure 5*). We expect economic activity to gradually pick up over the next quarters, supported by stronger demand from the US; but judging by the soft economic readings until April (particularly in the industry and service sectors), it is hard to see the economy growing above 3% without the help of unexpected tailwinds (e.g., a sudden rise in oil prices). Next year's prospects are better, but higher growth will hinge on the extent to which the reforms, especially in the energy sector, start to deliver the benefits.
- **Outlook for Consumption:** Household spending has been building momentum over the last four months as reflected in retail sales, which surged 4.4% yoy in real terms in April. Yet some drivers of consumer spending seem to suggest that, in the short term, consumption might not return to growth rates of above 4% as in 2010-12: consumer confidence has not yet fully recovered since its peak in early 2013; and real wage remains low.

**Figure 5: GDP Growth (private forecasts)**



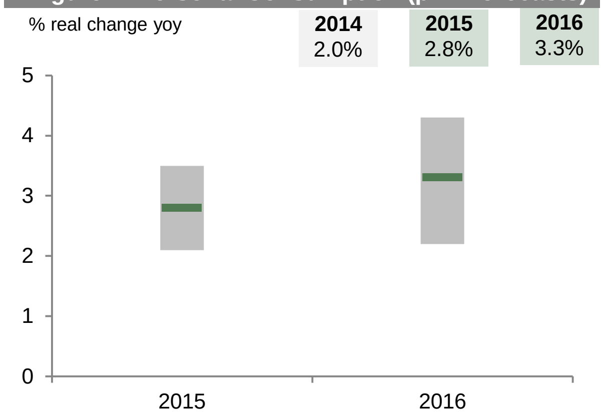

Source: Consensus Economics; BTMU

**Figure 6: Index of Economic Activity (IGAE)**



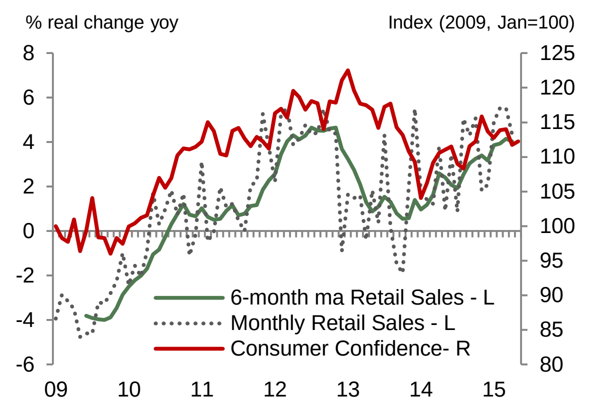

Source: INEGI; BTMU

**Figure 7: Personal Consumption (priv. forecasts)**




Source: Consensus Economics; BTMU

**Figure 8: Retail Sales and Consumer Confidence**



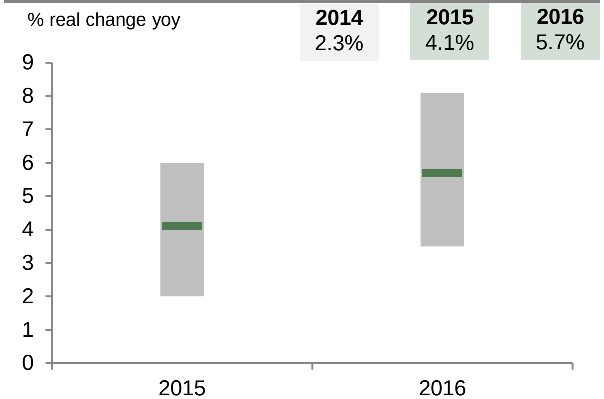

Source: INEGI; BTMU

# I) Mexico: Growth Momentum (3)

## ▪ Business investment will probably pick up this year.

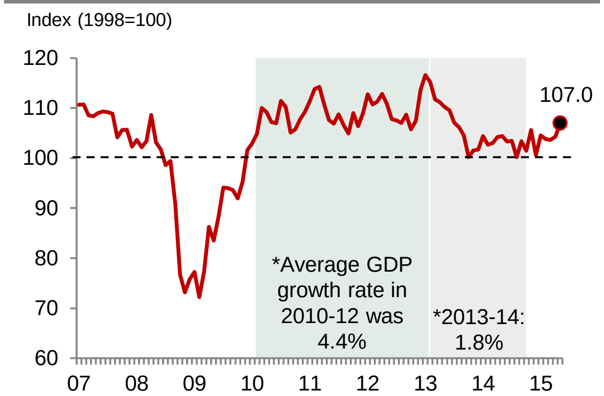
- **Outlook for Investment:** GFCF will probably pick up this year as companies start to invest in key industries (e.g., automobile production) that are closely connected to the US market. Also, recent structural reforms could possibly attract more foreign investors in 2016, further boosting capital expenditures. But bear in mind that this outlook will not become so strong and is subject to several downside risks. To begin with, construction output and imports of capital goods, two main components of GFCF according to the Central Bank, appear to have lost momentum so far this year, which would explain why business confidence still remain low. Second, the recent budget cuts announced by the government (around 0.7% of GDP this year and a similar amount in 2016) to offset the sharp drop in oil revenue will probably act as a drag on GFCF. Third, the implementation of the energy reform has been moving quickly (the disclosure of bids for the first oil contracts is expected to be in mid-July), but it is still too early to celebrate given the institutional and regulatory challenges ahead.

**Figure 9: Gross Fixed Investment (priv. forecasts)**



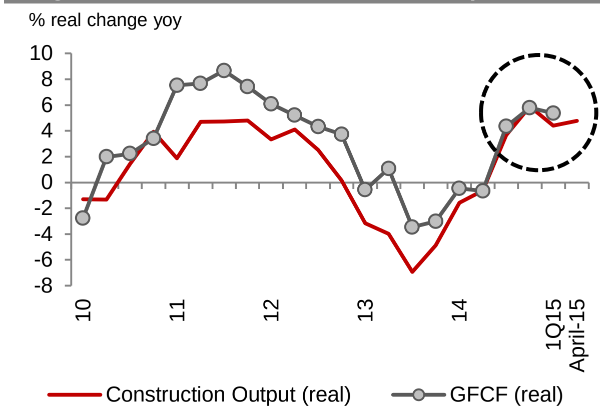

Source: Consensus Economics; BTMU

**Figure 10: Business Confidence**



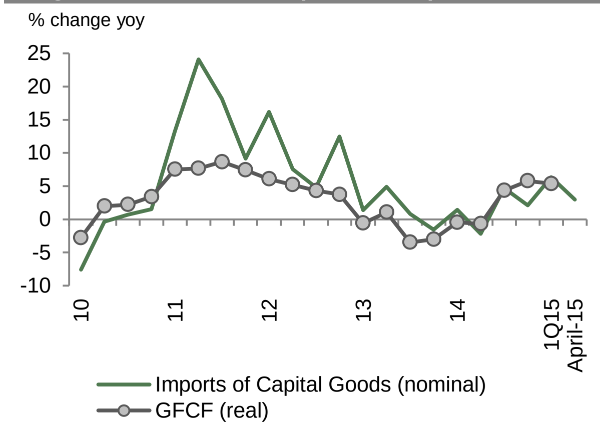

Source: Banco de Mexico; BTMU

**Figure 11: GFCF and Construction Output**




Source: INEGI; BTMU

**Figure 12: GFCF and Imports of Capital Goods**



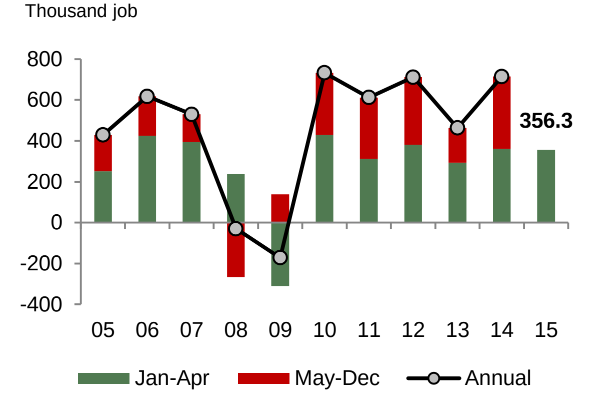

Source: Banco de Mexico; BTMU

# II) Mexico: Labor Market and Prices

- **Annual inflation hit record low level in May, and Banxico left its policy rate unchanged.**

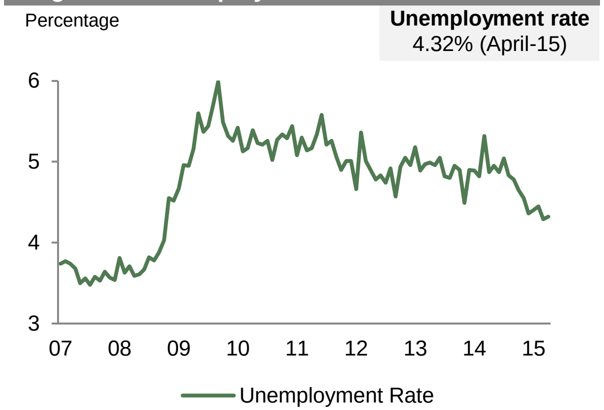
- **Labor Market:** Labor conditions in Mexico continue to improve gradually. Around 715,000 jobs were added in the private sector last year, which were more than twice as much as the 2013 numbers. Likewise, unemployment rate dropped sharply to 4.3% in April from its peak of 6% in late 2009, but it is still above pre-recession levels. The informal labor market also remains large (employs 58% of Mexico's workforce according to INEGI), and is one of the main hurdles for raising productivity.
- **Inflation:** Annual inflation slowed to a record low level of 2.88% in May, partly due to lower food, transportation and telecommunications prices, and partly because the pass-through effect of the recent sharp currency depreciation has been low. Banxico, Mexico's central bank, expects inflation to stay close to the target of 3%. But it also acknowledges the possibility that inflation could fall further should the economy loses dynamism in 2H 2015. The policy rate has been held at 3% since mid-2014, but a possible interest rate hike by the Fed would probably force Banxico to do the same.

**Figure 13: Net Formal Jobs* Creation**



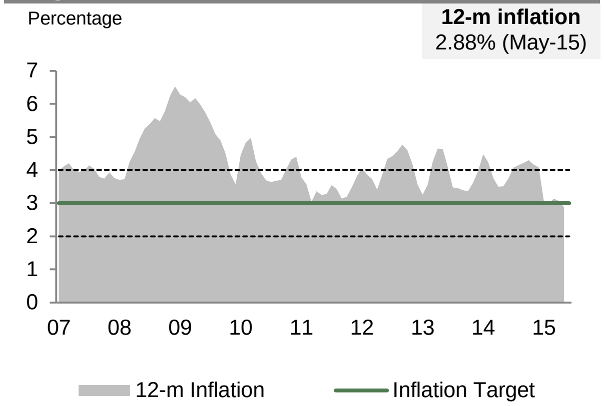

*Mexican Social Security (IMSS)-insured workers
Source: Secretariat of Labor and Social Welfare; BTMU

**Figure 14: Unemployment Rate**



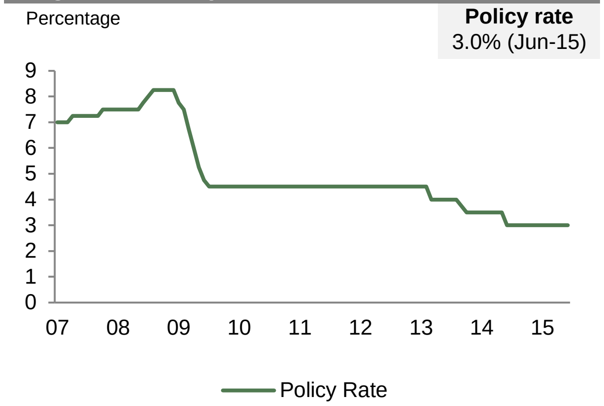

Source: INEGI; BTMU

**Figure 15: Inflation**




Source: INEGI; BTMU

**Figure 16: Policy Rate**




Source: Banco de Mexico; BTMU

# III) Mexico: Exchange Rate and Current Account

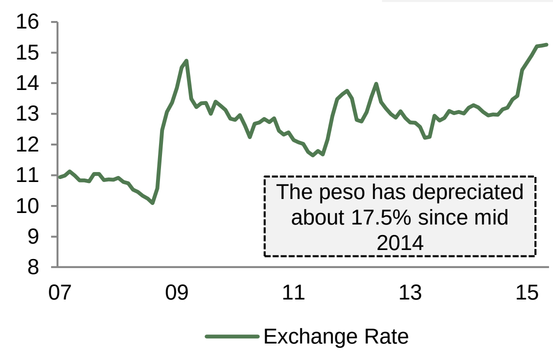
## ▪ Mexico's current account worsened sharply in Q1 2015, owing to weak demand from the US.

- **Exchange rate:** The Mexican peso has come under intense downward pressure from several fronts since mid-2014: the strength of the US economy, coupled with a highly expected interest rate hike by the Fed; low oil prices, and by extension, lower oil tax revenue to stabilized the government's large fiscal deficit; and the recent political turmoil caused by the country's ongoing drug violence. Although the peso has stabilized lately, it could face more downward pressure when the Fed decides to normalize its stance on monetary policy.
- **Current Account:** Mexico's current account deficit widened considerably to $9.4 billion in 1Q 2015 from $5.1 billion in the prior quarter. The reasons are twofold. First, trade deficit jumped more than 150% due to weaker demand from the US. Second, income account deficit also expanded sharply from $6.7 billion in 4Q 2014 to $10.4 billion. Banxico expects to see improvements in the coming quarters, fueled by stronger demand for Mexico's exports.

**Figure 17: Exchange Rate**

MXN per USD

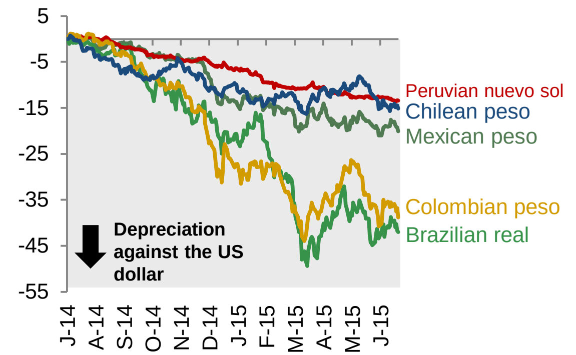
**Exchange rate**
15.26 (May-15)




Source: Banco de Mexico; BTMU

**Figure 18: Exchange rates**

Movement of Latin American currencies against the US dollar, %



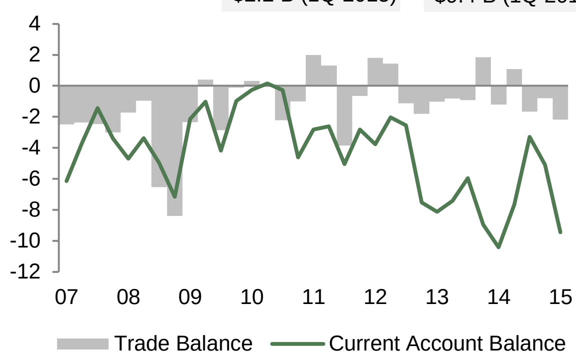

Source: Thomson Reuters; BTMU

**Figure 19: Current Account Balance**

Billion USD

**Trade balance**
-$2.2 B (1Q 2015)

**CAB**
-$9.4 B (1Q 2015)

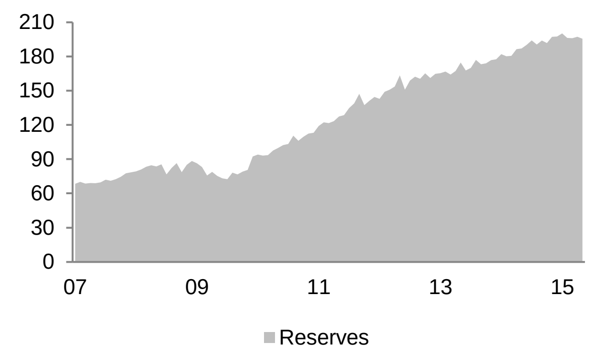



Source: Banco de Mexico; BTMU

**Figure 20: International Reserves**

Billion USD

**Reserves**
$196 B (May-15)




Source: Banco de Mexico; BTMU

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