BTMU Focus Latin America

Mexico: macroeconomic performance

(3Q GDP and Current Monthly Indicators)

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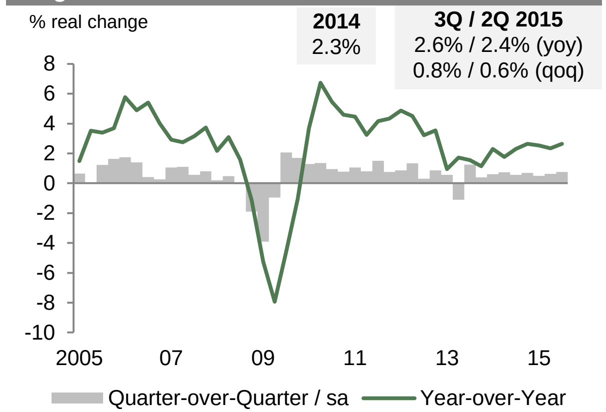
Contents

I) Mexico: Growth Momentum (1)

▪ Third-quarter results were better than expected, but caution is still warranted.

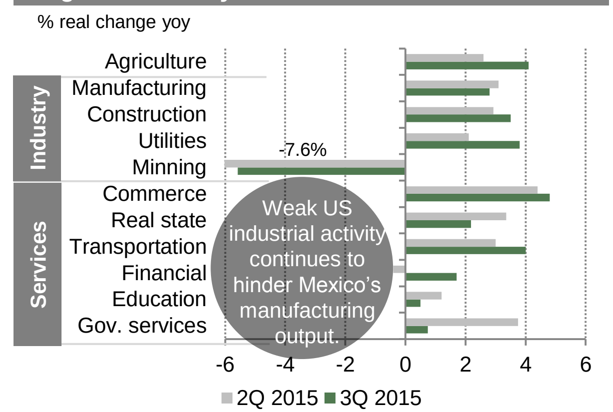
- Just when analysts thought the Mexican economy was going to lose more momentum in the second half of 2015, it surprisingly posted a growth rate of 0.8% qoq in 3Q, the fastest pace since 2013. On a yoy basis, the economy grew at a 2.6% rate, which was as well higher than the market consensus of 2.2%. Interestingly, this renewed momentum chiefly stemmed from a moderate recovery in the industry sector that, throughout 1H 2015, had been showing signs of slowing down. Yet caution is still warranted down the road as the recovery was primarily fueled by increased construction activity and utility output, rather than by better results in manufacturing and oil production. That is also truth from a demand-side perspective. For instance, consumer spending remained robust in 3Q, but there is no clear signs it would accelerate soon. Export volume expanded at a solid 10% rate but it is particularly dependent on the US demand. Also, growth in gross fixed capital formation (GFCF), though still very positive, slowed to 4.1% in 3Q from 5.5% in 2Q, as a result of fiscal consolidation efforts (i.e., fall in public investments).

Figure 1: GDP Growth



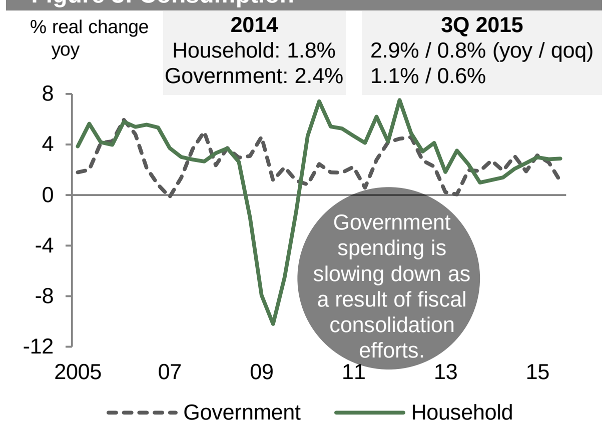
Source: Instituto Nacional de Estadística y Geografía (INEGI); BTMU

Figure 2: GDP by Sector



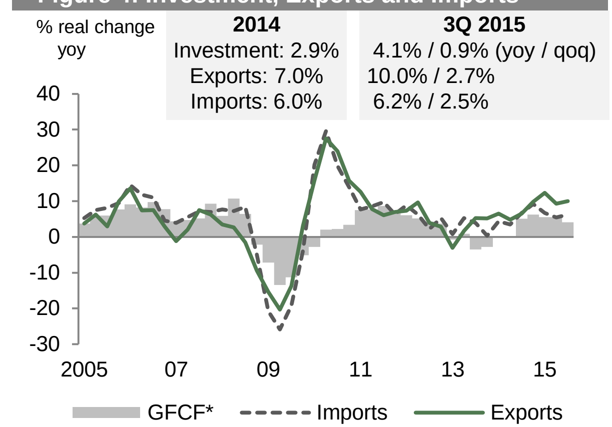
Source: INEGI; BTMU

Figure 3: Consumption



Source: INEGI; BTMU

Figure 4: Investment, Exports and Imports



* Gross Fixed Capital Formation
Source: INEGI; BTMU

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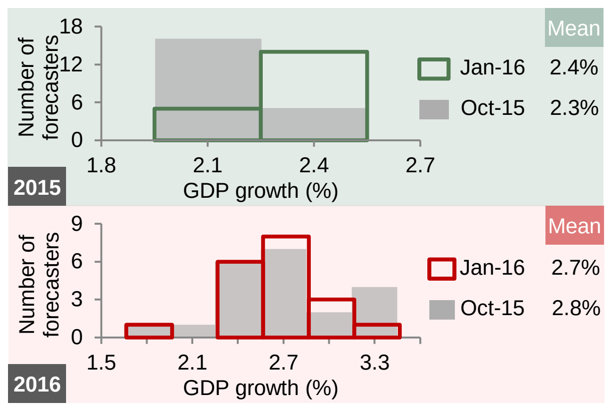
I) Mexico: Growth Momentum (2)

▪ **A bittersweet year in 2015: GDP growth remained stable but is expected to fall short of expectations again.**

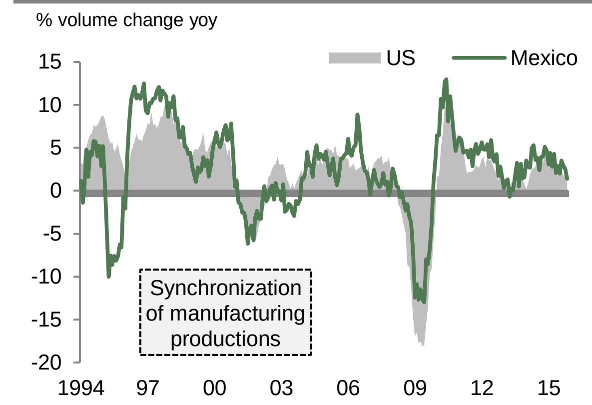
- 2015 was a bittersweet year for the second largest economy of Latin America. The Mexican peso, one of the most-traded currencies globally (by *BIS Triennial Central Bank Survey*), was harshly hit by the slump in oil prices, increased financial volatility, and the strength of the US dollar. Still, the weaker peso has so far showed little sign that it has fueled inflationary pressures or hurt firms and consumers by raising import costs. Other important headwind for the economy was the sharp decline in fiscal revenues from oil, which arguably forced the Peña Nieto administration to shift toward a tight (or less loose) policy stance, cutting off the possibility of boosting growth with short-term stimulus. Again, it is fair to say the government has done so far a fine job in balancing its budget, especially considering its hefty reliance on oil-related revenues (~30% of total fiscal income in 2014). To add to the unease, GDP growth in 2015 is expected to fall short of initial expectations, limited by a declining domestic oil production, and to a greater extent, a feeble US manufacturing sector (continued on next slide).

Figure 5: GDP Growth (private forecasts)



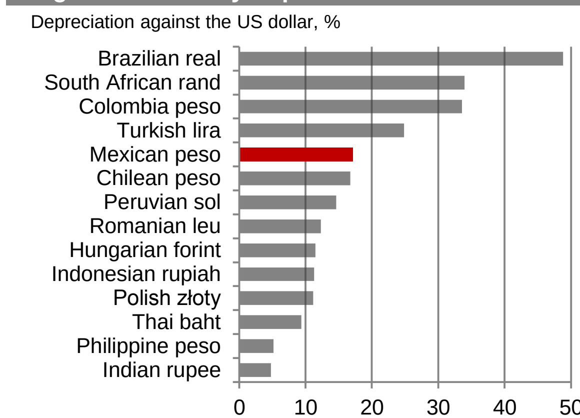
Source: Consensus Economics; BTMU

Figure 6: Manufacturing Productions



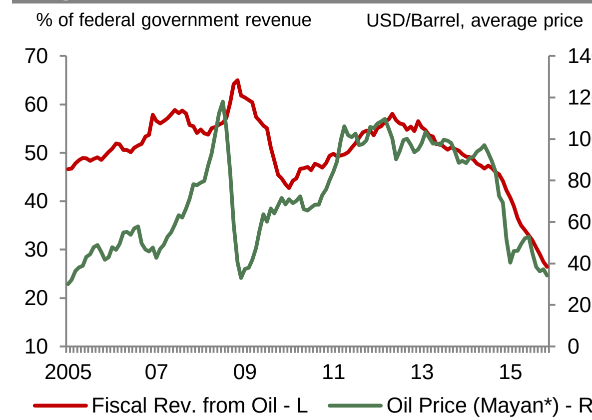
Source: INEGI; Federal Reserve; BTMU

Figure 7: Currency Depreciation in 2015



Source: Thomson Reuters; BTMU

Figure 8: Fiscal Revenues and Oil Prices



* Mexican Mayan crude oil

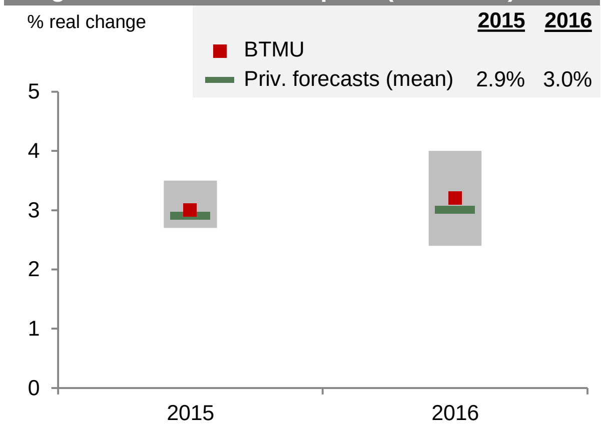
Source: Ministry of Finance and Public Credit (SHCP); PEMEX; BTMU

I) Mexico: Growth Momentum (3)

▪ Mexico is in a promising position to raise its growth rate to the range of 3% to 4% in the short-to-medium term.

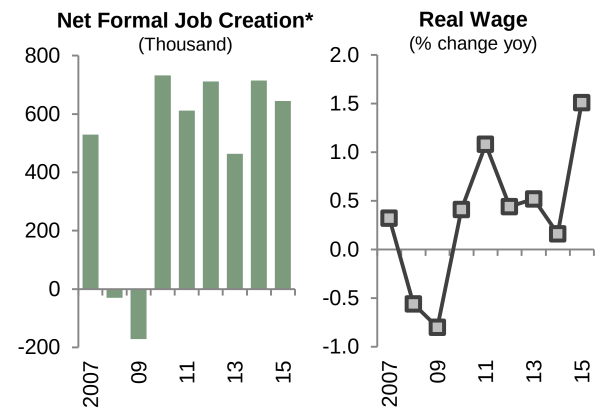
- The implication is that the Mexican economy has stayed below its potential rate of growth for at least two consecutive years, in spite of the wide-ranging structural reforms the current administration has put in place (announced in late 2012). Still, Mexico is probably in a more promising position than other major Latin American countries to lift up its growth rate to the range of 3% to 4% in the short-to-medium term. First, because Mexico's economy is closely tied to the US economy. The positive momentum of the latter could potentially provide a boost to Mexican manufacturing exports, with spillovers to private investment and consumption. Second, Mexico's degree of commodity reliance is relatively low, meaning that low commodity prices should not hurt investment or consumption, at least not as much as in Chile or Colombia. Finally, the anticipated benefits of some reforms are starting to kick in: telecom prices have went down; total fiscal income has went up by about 10% in 2015; and the success in the last two oil auctions hints investors are still keen to invest in Mexico's energy market.

Figure 9: Private Consumption (Forecasts)



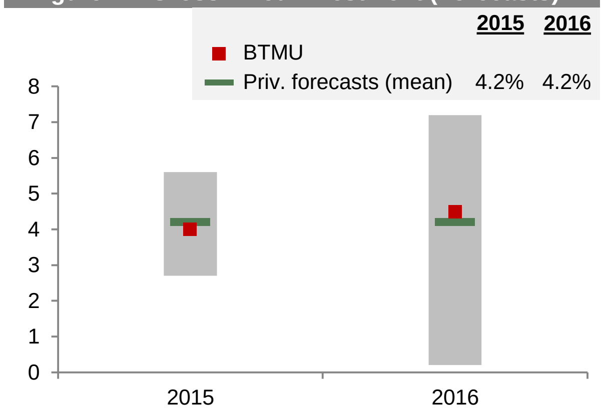
Source: Consensus Economics; BTMU

Figure 10: Job Creation and Real Wages



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

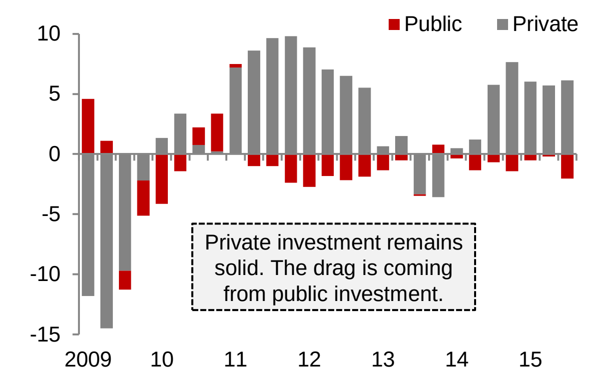
Figure 11: Gross Fixed Investment (Forecasts)



Source: Consensus Economics; BTMU

Figure 12: Private and Public Investment

Contribution to % real change yoy, percentage point



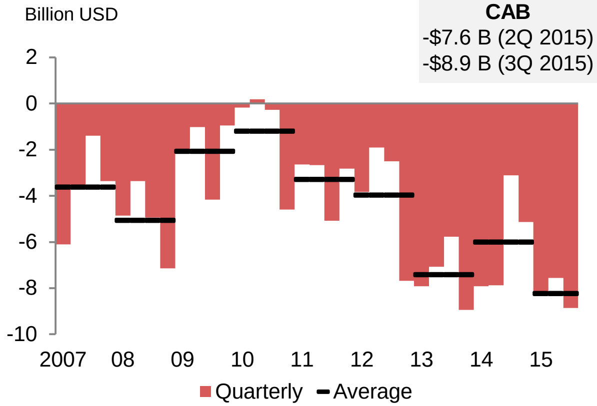
Source: INEGI; BTMU

II) Mexico: External Sector

▪ Current account deficit widened significantly in 2015, though it is still relatively small.

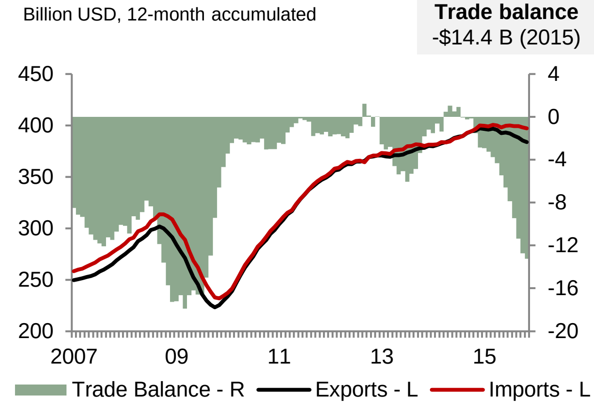
- Mexico's current-account deficit is believed to have widened markedly in 2015. So far, the accumulated deficit (the first three quarters) has reached $24.7 billion, which is about 31% larger than in the same period of 2014. And because the fourth-quarter's results are expected to follow a similar trend, it is likely the annual deficit has widened to around $33 billion in 2015, in spite of a large improvement in its service balance (underpinned by a rise in tourism). Clearly, much of the fault lies with the gaping trade deficit that, in turn, is largely explained by the fall in exports, and is more than four times as much as it was in 2014. This downward trend in exports was partly fueled by low oil prices and the steady fall in local oil production, and partly driven by lackluster manufacturing exports, which barely grew despite positive growth in vehicle exports. Overall imports as well dropped in 2015, mainly caused by cheaper oil and weak demand for intermediate goods. Now, in fairness, the country's current-account deficit is still small (possibly below 3% of GDP in 2015) and largely financed by foreign direct investments.

Figure 13: Current Account Balance



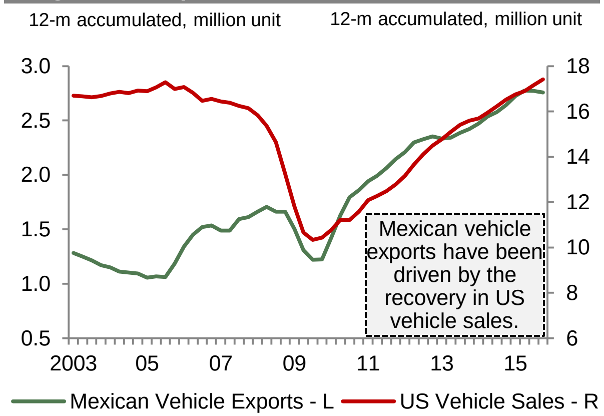
Source: Banco de Mexico; BTMU

Figure 14: Trade Balance, Exports and Imports



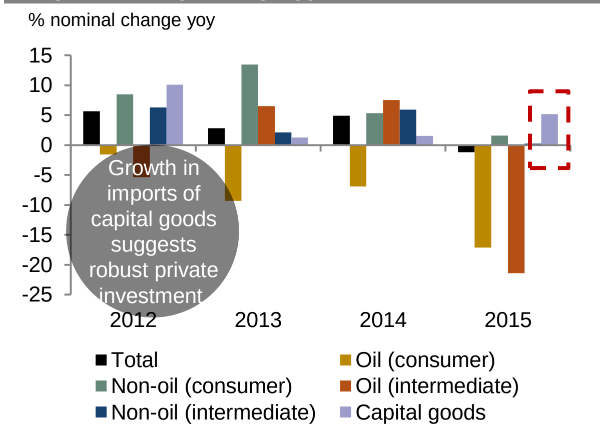
Source: Banco de Mexico; BTMU

Figure 15: Exports and Sales of Vehicles



Source: AMIA; Autodata Corporation; Thomson Reuters; BTMU

Figure 16: Imports by Types of Goods



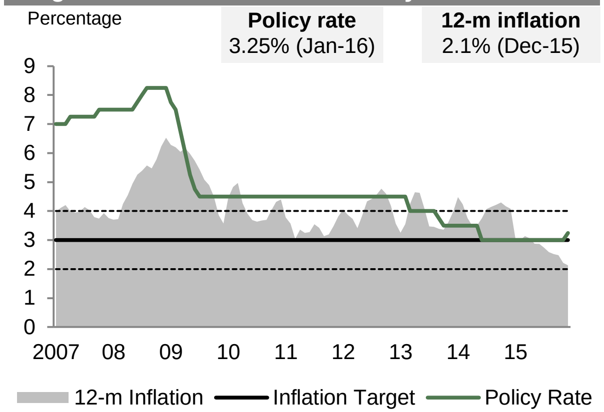
Source: INEGI; BTMU

III) Mexico: Prices and Monetary Policy

▪ This low-inflation environment will probably be short-lived.

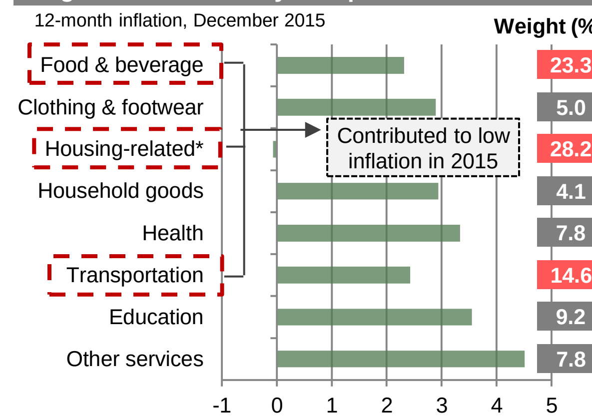
- Mexico's 12-month inflation ended 2015 with a rate of 2.1%, its lowest level since data on CPI became available in 1969. The rate is also within the central bank's (known as Banxico) official target range of 2%-4%. Notwithstanding, as we underscored in the prior report, this low-inflation environment will likely to be short-lived. In fact, barring major surprises in this year's GDP growth, inflation will likely pick up in 2016, possibly above 3%. The first reason is the stabilization of telecom prices, which fell greatly last year as a result of the sweeping telecom reforms in 2014. Second, the marginal effects of low oil prices on electricity fares and transportation prices should be more moderate this year. Third, food prices will probably rise at a faster pace as the favorable base effects, triggered by tax hikes in food items in 2014, are expected to reverse this year. Fourth, so far the inflationary pressures coming from a weaker peso have been limited, but it does not imply the risk of higher prices of tradable goods cannot materialize this year. Lastly, rising wages and robust domestic demand will continue to exert pressures on prices.

Figure 17: CPI Inflation and Policy Rate



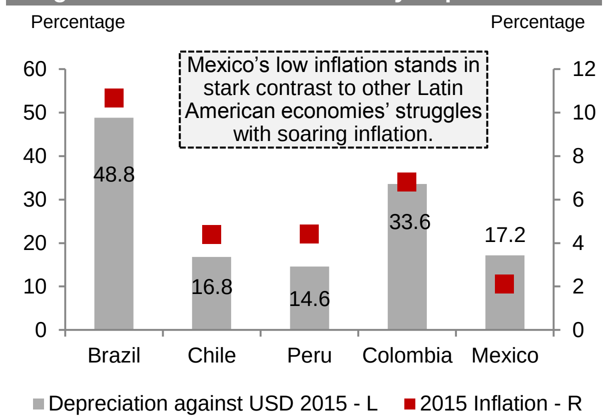
Source: INEGI; Banco de Mexico; BTMU

Figure 18: Inflation by Components



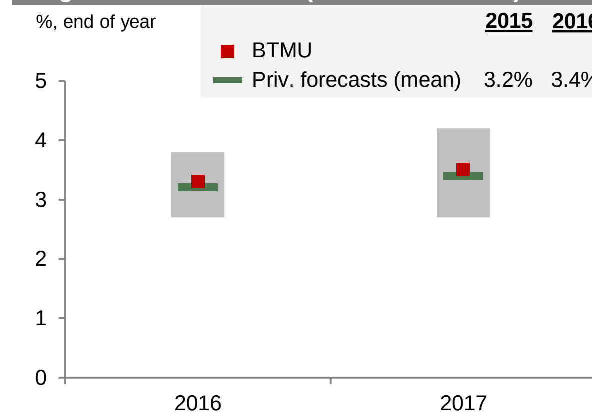
*Includes housing costs, electricity fares and telecom services
Source: INEGI; BTMU

Figure 19: Inflation and Currency Depreciation



Source: Thomson Reuters; BTMU

Figure 20: CPI Inflation (Private Forecasts)



Source: Consensus Economics; BTMU

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- **This report is based on information believed to be reliable, but we do not guarantee its accuracy. The contents of this report may be revised without notice.**