Mexico's Macroeconomic Performance: Q4 2017 GDP and Current Economic Indicators

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Overview

Mexico's GDP grew by 1.5% YoY in Q4 2017, the slowest pace since the fourth quarter of 2013. On a quarter-over-quarter basis (compared to Q3 2017), Mexico's GDP increased by 0.8%.

Consumption grew 2.1% YoY in Q4 2017, a deceleration from the previous quarter. The deceleration in household consumption could be explained in part by the high inflation that hit real wages in 2017.

Investment in Mexico continued on its negative trajectory. During Q4 2017, Gross Fixed Capital Formation (GFCF) contracted 2.5% YoY. This could have been driven in part by higher interest rates and the continued high uncertainties related to the renegotiation of NAFTA.

During 2017, inflation in Mexico was affected by internal and external factors that caused it to reach high levels. Recent data show that inflation has begun to subside. In March, CPI decelerated to 5.0% YoY, demonstrating that the price shock from the lifting of fuel subsidies has begun to ebb.

The Central Bank decided to keep the interest rate unchanged (7.5%) at its last meeting in April. The Central Bank highlighted the decrease in inflation in comparison to December and the anchoring of inflation expectations for 2018 as some of the reasons behind the decision.

It is expected that Mexican GDP growth could accelerate slightly in 2018. A contributing factor to this could be the continued strong US demand that will impact exports positively. Additionally, investment in the energy sector is expected to increase as a result of the recently implemented energy reform. A tighter monetary policy could cause inflation to continue to subside throughout 2018.

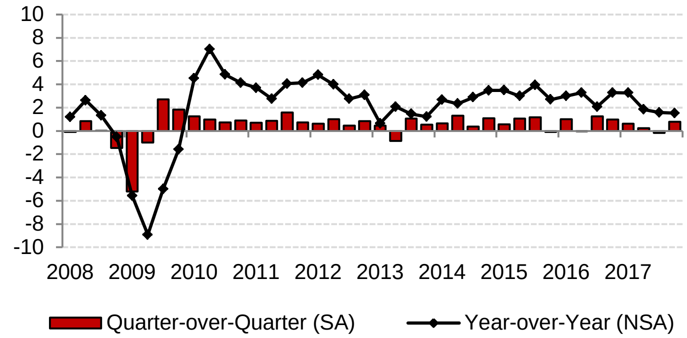
1. GDP

Mexico's GDP grew by 1.5% YoY in Q4 2017, the slowest pace since the fourth quarter of 2013 (Figure 1). On a quarter-over-quarter basis (compared to Q3 2017), Mexico's GDP increased by 0.8%.

The slowest pace of Mexico's GDP growth was driven by a slowdown of household consumption and a lackluster investment (Figure 2).

Figure 1: GDP Growth

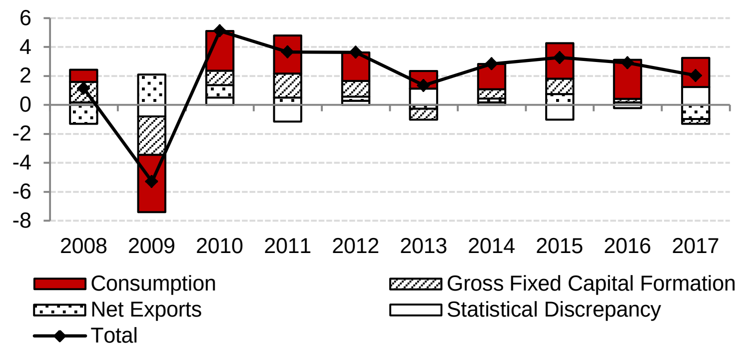
%, real change



Source: INEGI (National Institute of Statistics and Geography), MFG

Figure 2: GDP by Demand Components

%, real change, YoY



Source: INEGI, MUFG

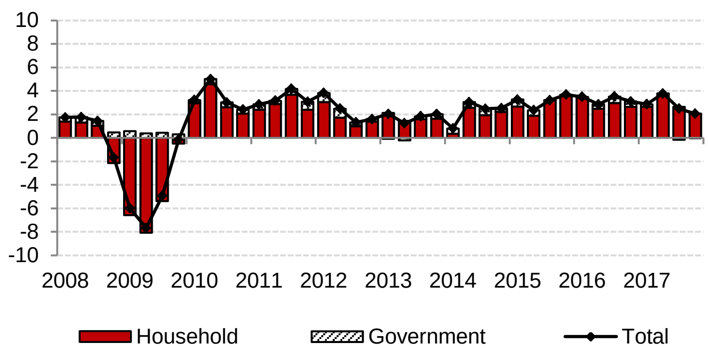
Consumption

Consumption grew 2.1% YoY in Q4 2017, a deceleration from the previous quarter (Figure 3).

The deceleration in household consumption could be explained in part by the high inflation that hit real wages in 2017. However, the streghtening of the labor market provided a positive countereffect; unemployment was at its lowest level since 2008 (Figure 4).

Figure 3: Consumption

%, real change, YoY (SA)



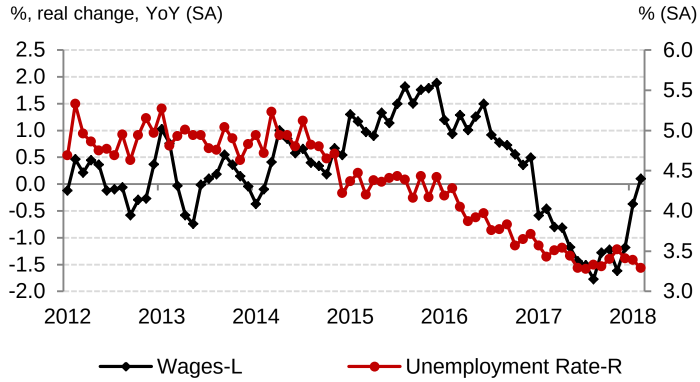
Source: INEGI, MUFG

Investment

Investment in Mexico continued on its negative trajectory. During Q4 2017, Gross Fixed Capital Formation (GFCF) contracted 2.5% YoY (Figure 5). Investment in construction continues to decrease, and investment in machinery and equipment reported a contraction in Q4 2017 for the first time since Q4 2013. This could have been driven in part by higher interest rates and the continued high uncertainties related to the renegotiation of NAFTA.

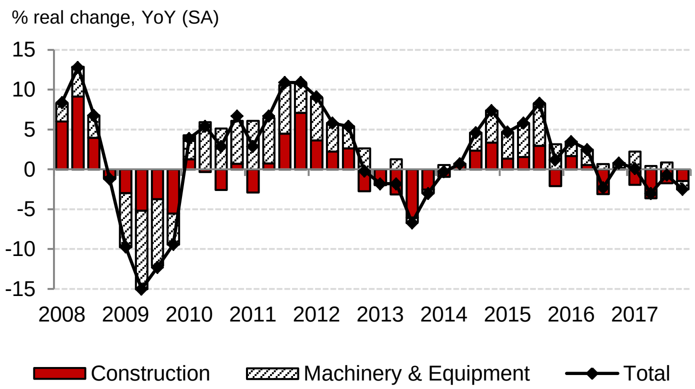
Foreign direct investment (FDI) inflows decreased marginally in 2017 (-0.2% YoY) (Figure 6). Although the rest of the world FDI decreased 16.1% YoY, the FDI from the US increased 27.3%. The manufacturing sector attracted 45.3% of total FDI in 2017, but total FDI to this sector decreased 22.3% in comparison to 2016.

Figure 4: Wages and Unemployment Rate



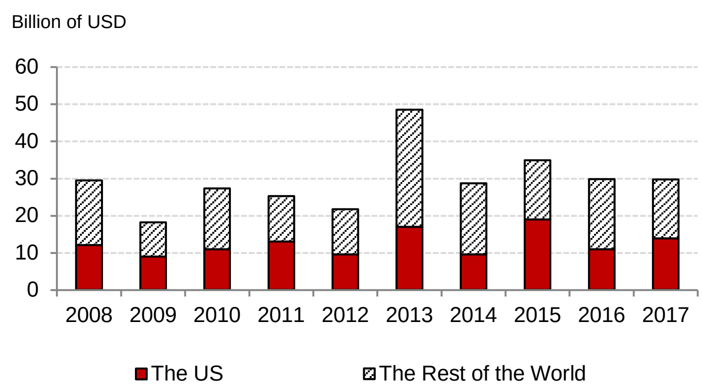
Source: INEGI, MUFG

Figure 5: Gross Fixed Capital Formation



Source: INEGI, DataStream, MUFG

Figure 6: Foreign Direct Investment by Region (Inflow)



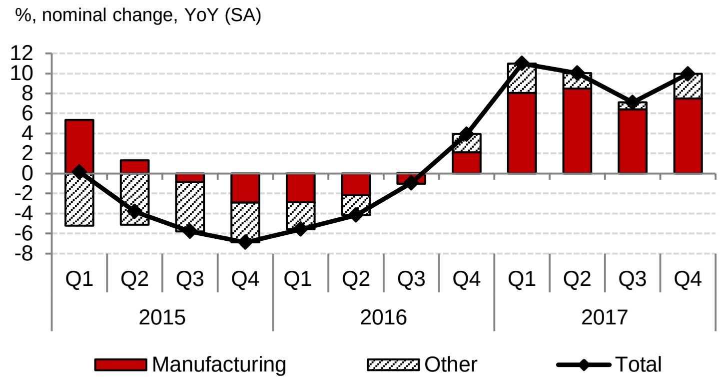
Source: Secretariat of Economy, MUFG

Exports and Imports

Exports experienced a favorable performance throughout 2017. During Q4 2017, exports increased 10.0% YoY (Figure 7). This expansion was mainly driven by manufacturing exports that have experienced steady growth throughout 2017. This is in line with the improvement of global economic activity and a weaker Mexican peso.

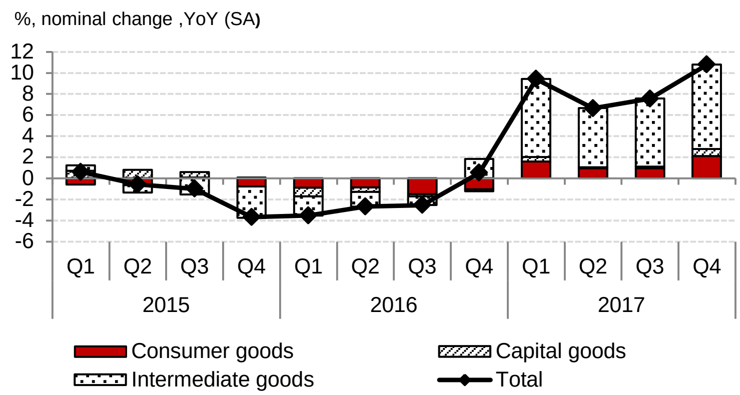
Imports also increased throughout 2017. During Q4 2017, imports registered a 10.8% YoY increase (Figure 8). The increase in imports of intermediate goods is consistent with the increase in manufacturing exports. Imports of capital goods were lackluster throughout 2017, being in line with the weak investment performance in 2017.

Figure 7: Exports of Goods



Source: Bank of Mexico (Central Bank of Mexico), DataStream, MUFG

Figure 8: Import of Goods



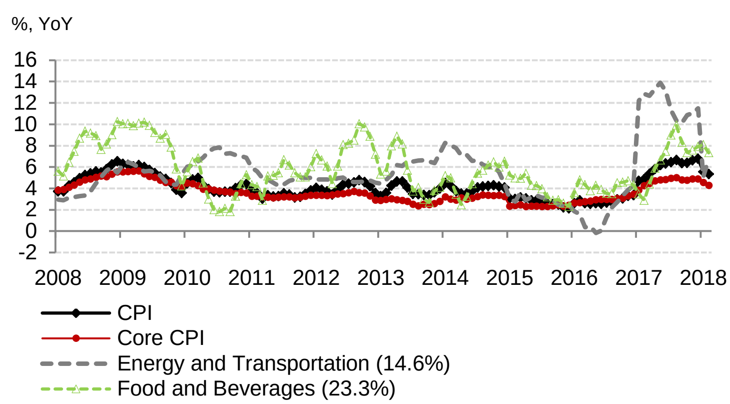
Source: Bank of Mexico, DataStream, MUFG

2. Inflation and Monetary Policy

During 2017, inflation in Mexico was affected by internal and external factors that caused it to reach high levels. In December 2017, Consumer Price Index (CPI) reached 6.8% YoY, the highest rate since May 2001 (Figure 9).

There are three main factors that affected inflation during 2017: 1) the increase in fuel prices due to the process of liberalization as part of the energy reform implemented by the government, 2) the depreciation of the Mexican Peso, and 3) the increase in the minimun wage that

Figure 9: Inflation



Note: The number in the bracket is the weight on overall inflation (2010).
Source: INEGI, MUFG

entered into effect in December 2017 instead of January 2018 put more pressure on inflation during the last month of 2017.

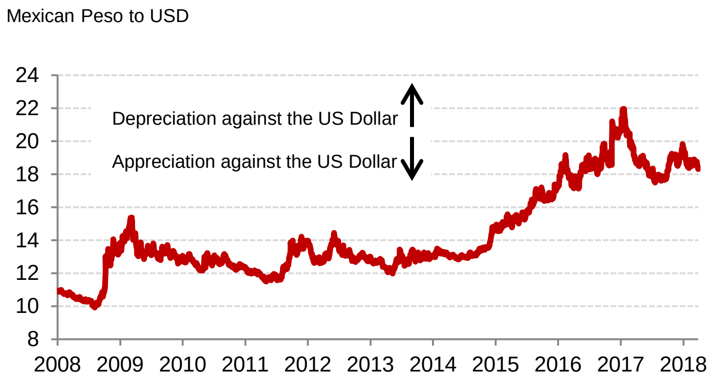
Recent data show that inflation has begun to subside. In March, CPI decelerated to 5.0% YoY, demonstrating that the price shock from the lifting of fuel subsidies has begun to ebb.

The Central Bank decided to keep the interest rate unchanged (7.5%) at its last meeting in April. The Central Bank highlighted the decrease in inflation in comparison to December and the anchoring of inflation expectations for 2018 as some of the reasons behind the decision.

3. Exchange rate

The Mexican peso has been volatile. After regaining some of its lost value at the end of 2017, the Mexican peso experienced depreciation and has maintained its value since then (18.9 Mexican Peso per USD[1]) (Figure 10). This depreciation could have been caused by the normalization process of the interest rate in the US, the uncertainty coming from the NAFTA renegotiation, and, to a certain extent, the electoral process.

Figure 10: Exchange Rate



Source: Bank of Mexico, MUFG

4. Outlook

It is expected that Mexican GDP growth could accelerate slightly in 2018. A contributing factor to this could be the continued strong US demand that will impact exports positively. Additionally, investment in the energy sector is expected to increase as a result of the recently implemented energy reform. A tighter monetary policy could cause inflation to continue to subside throughout 2018.

[1] As of the average of March 2018