Mexican Economy: Recent Performance and Outlook

Gerardo Esquivel Hernández*
Deputy Governor, Banco de Mexico

6th BBVA Latin America Conference, London, United Kingdom
January 20, 2020

Summary of Mexico's economic performance in 2019.

a) Strong macroeconomic fundamentals.

    i. <u>Fiscal responsibility</u> (primary surplus was approximately 1% of GDP).

    ii. <u>Low inflation</u> (2.83%).

b) No growth (0%).

How did Mexican financial assets performed in 2019?

Asset Performance in 2019
%, basis points

Region	Country	Currencies	Stock indices	2Y Interest rates	10Y Interest rates	CDS
Latin America	Mexico	3.68%	4.56%	-194	-204	-76
	Brazil	-4.02%	31.58%	-210	-255	-108
	Chile	-8.38%	-8.53%	-155	-114	-20
	Colombia	-1.01%	19.26%	-20	-58	-85
	Argentina	-58.95%	37.56%	5,238	809	2,497
Europe	Russia	11.08%	28.55%	-324	-224	-98
	Poland	-1.53%	0.25%	-6	-63	-9
	Turkey	-12.51%	25.37%	-852	-394	-79
	Czech Rep.	-1.16%	13.08%	24	-3	-6
	Hungary	-5.45%	17.74%	-44	-68	-19
Asia	China	-1.23%	22.30%	-13	-48	-36
	Malaysia	1.03%	-6.02%	-43	-17	-75
	India	-2.30%	14.38%	-65	-67	-45
	Philippines	3.67%	4.68%	-241	-248	-55
	Thailand	7.93%	1.02%	-64	-84	-19
	Indonesia	3.64%	1.70%	-152	-90	-70
Africa	South Africa	2.42%	8.24%	-75	-51	-60
North America	United States	2.22%	28.88%	-92	-77	-8

Note: Interest rates correspond to swap rates for a period of two and ten years, except for Indonesia and Turkey, where the government values of these terms are used as a reference. Additionally, for Argentina, the sovereign debt rates denominated in US dollars of 2- and 9-year terms are used, as they are the most liquid and those that best reflect the performance of this country's fixed income market.
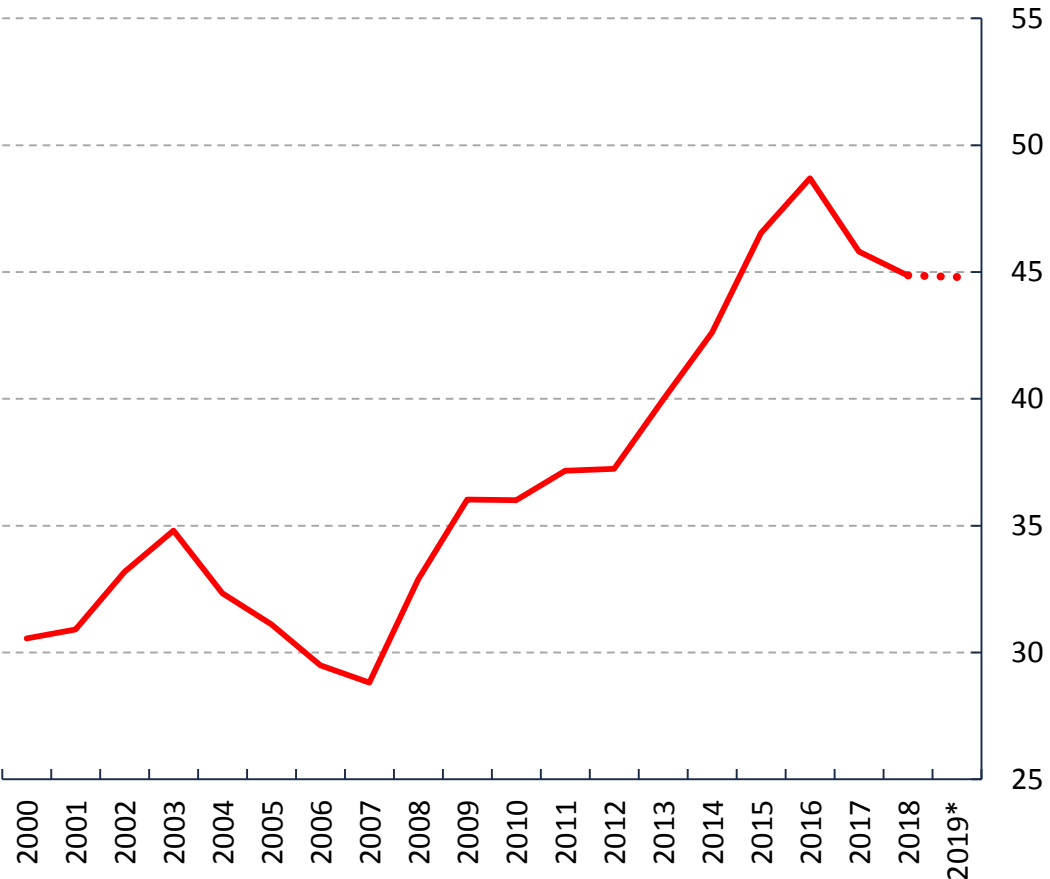Source: Banco de México using data from Bloomberg.

Summary of perspectives for 2020.

a) Strong macroeconomic fundamentals.

    i. <u>Fiscal Responsibility</u> (committed primary surplus of 0.7% of GDP).

    ii. <u>Low inflation </u>(approximately 3% by the end of the year).

b) Slight recovery (expected GDP growth of 1.3% [1]).

1/ See Quarterly Report, July-September 2019, Banco de México .

Mexico's current fiscal stance.

Debt to GDP Ratio[1]
%

Fiscal (RFSP) Primary Balance [2]
Thousands of millions of pesos of 2018

Legend:
- Central Bank operating surplus transferred to the government
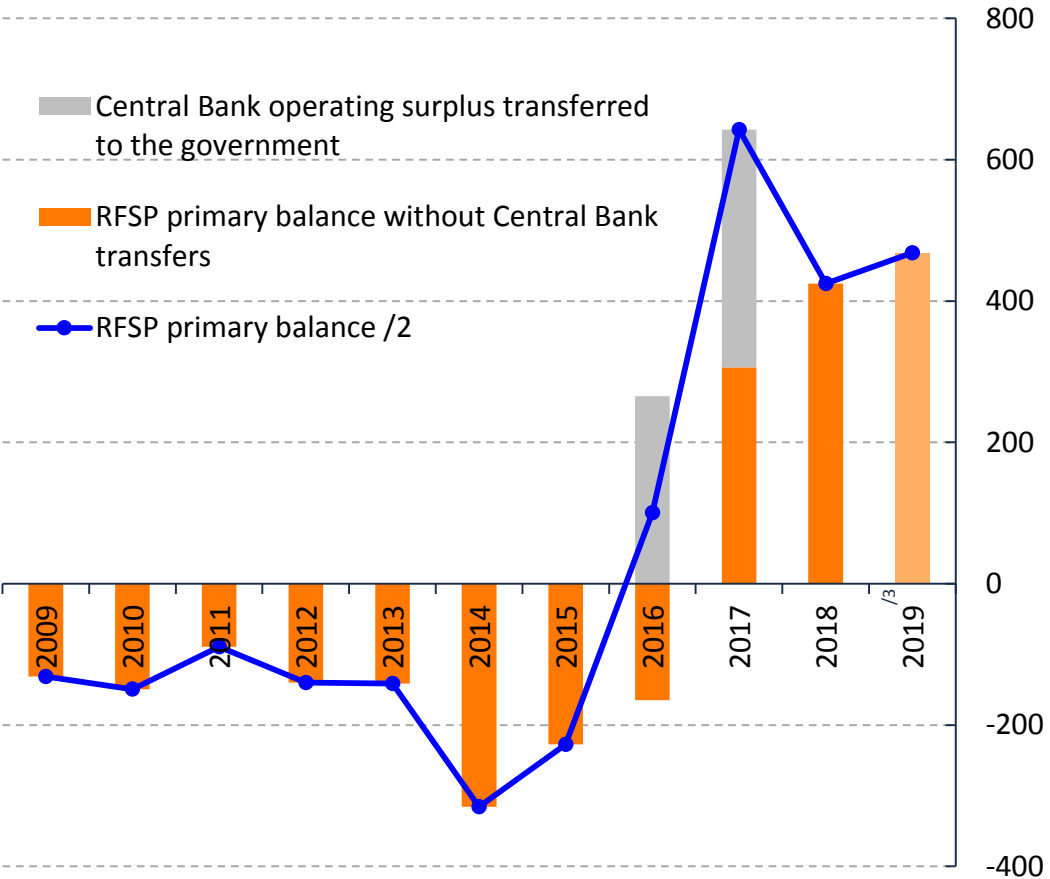- RFSP primary balance without Central Bank transfers
- RFSP primary balance /2

1/ The debt concept used to compute this ratio corresponds to the "Saldo Histórico de los Requerimientos Financieros del Sector Público" or SHRFSP which is the widest concept of public debt in Mexico.
*/ For the year 2019, the ratio is estimated by the author based on the latest figures.
Source: Author's own calculations using data from SHCP.

2/ The fiscal RFSP primary balance corresponds to the primary result of the "Requerimientos Financieros del Sector Público" or RFSP, which is the widest concept of fiscal deficit in Mexico.
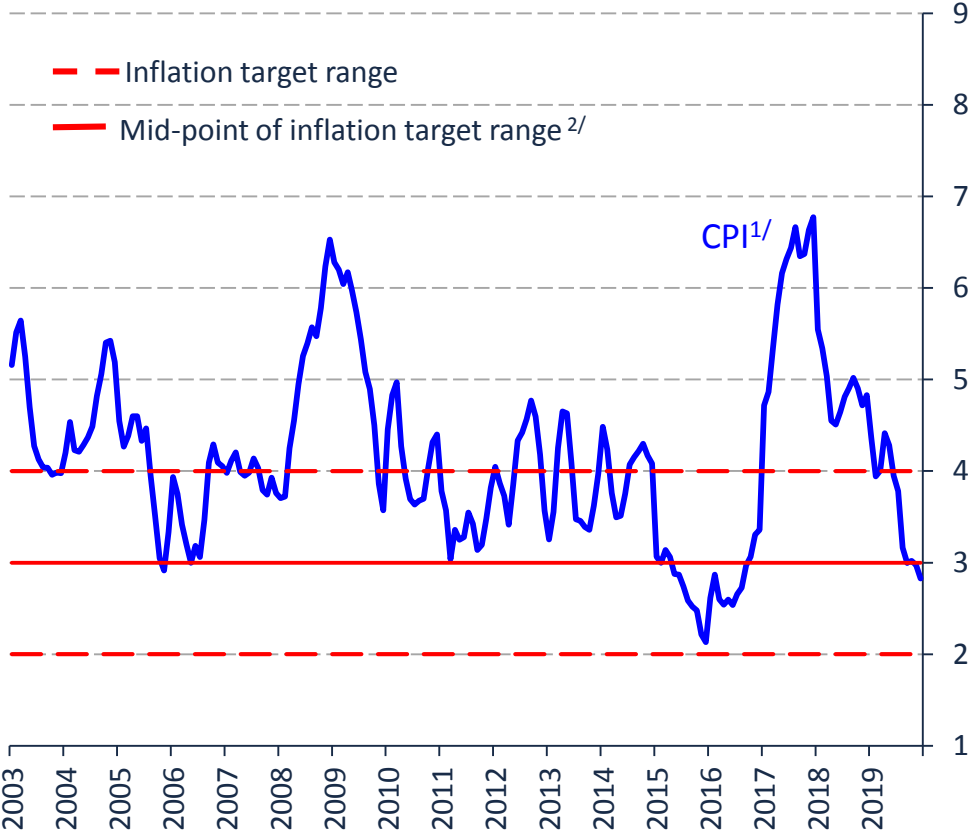3/ Cumulated balance January-November, 2019.
Source: Author's own calculations, using data from SHCP.
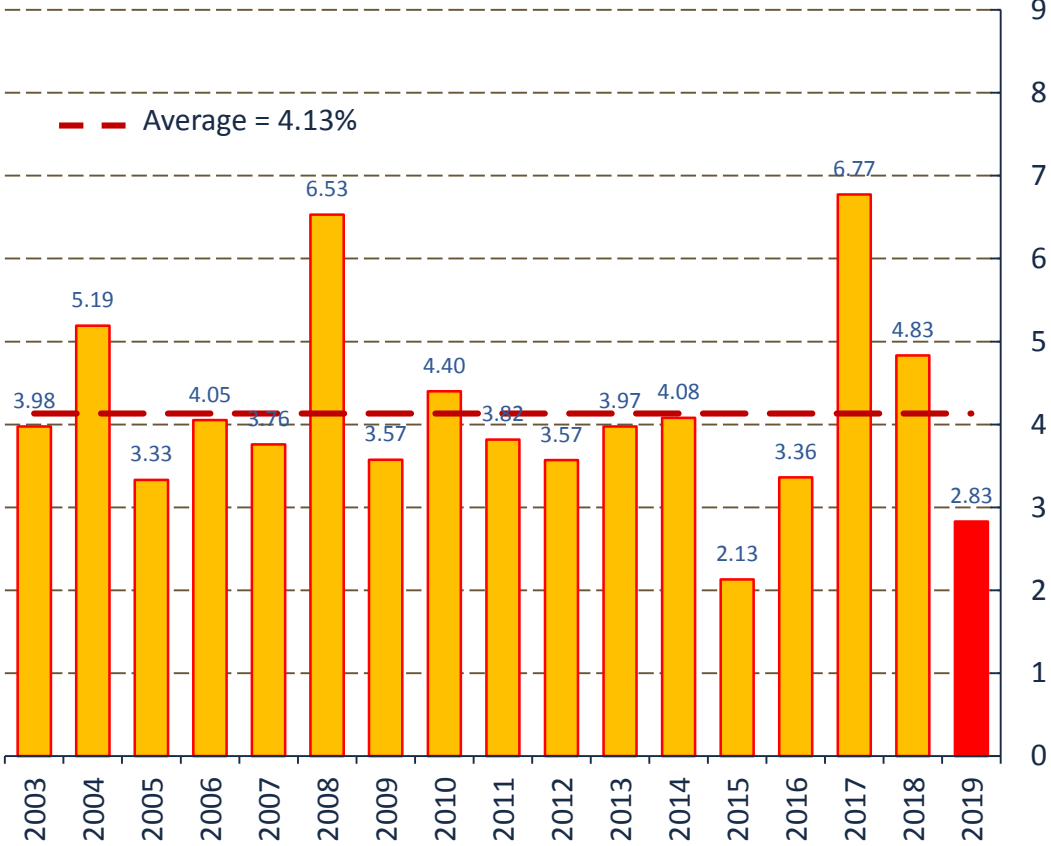
Mexico's current inflation.

Inflation Rate (Monthly Frequency)
%

- - - Inflation target range
— Mid-point of inflation target range [2]

CPI[1]

2003 2004 2005 2006 2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019
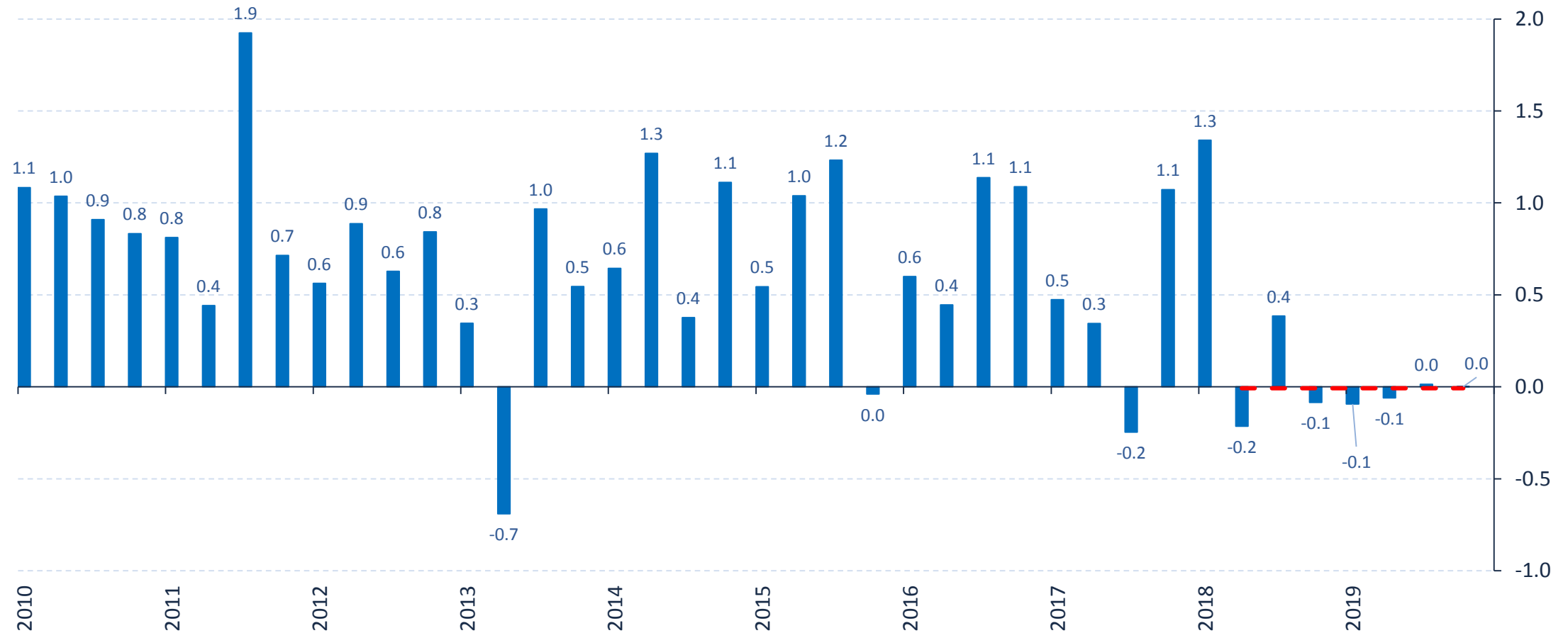
Source: Author's own calculations, using data from INEGI and Banco de México.
1/ CPI = Consumer Price Index
2/ Since 2003, a permanent inflation target of 3%, with a variability interval of +/-1%, was established.

Inflation Rate (Annual Frequency)
%

- - - Average = 4.13%

Year	Value
2003	3.98
2004	5.19
2005	3.33
2006	4.05
2007	3.76
2008	6.53
2009	3.57
2010	4.40
2011	3.82
2012	3.57
2013	3.97
2014	4.08
2015	2.13
2016	3.36
2017	6.77
2018	4.83
2019	2.83

Note: The red line represents the average inflation in the 2003-2019 period (4.13%).
Source: Author's own calculations, using data from INEGI.

Absence of growth occurred since the second quarter of 2018.

Gross Domestic Product
Quarterly growth rate, %, s.a.

s.a. Seasonally adjusted data.
Notes: The dotted red line corresponds to the average in the 2018Q2 – 2019Q4 period. For the fourth quarter of 2019 the growth rate is estimated by the author.
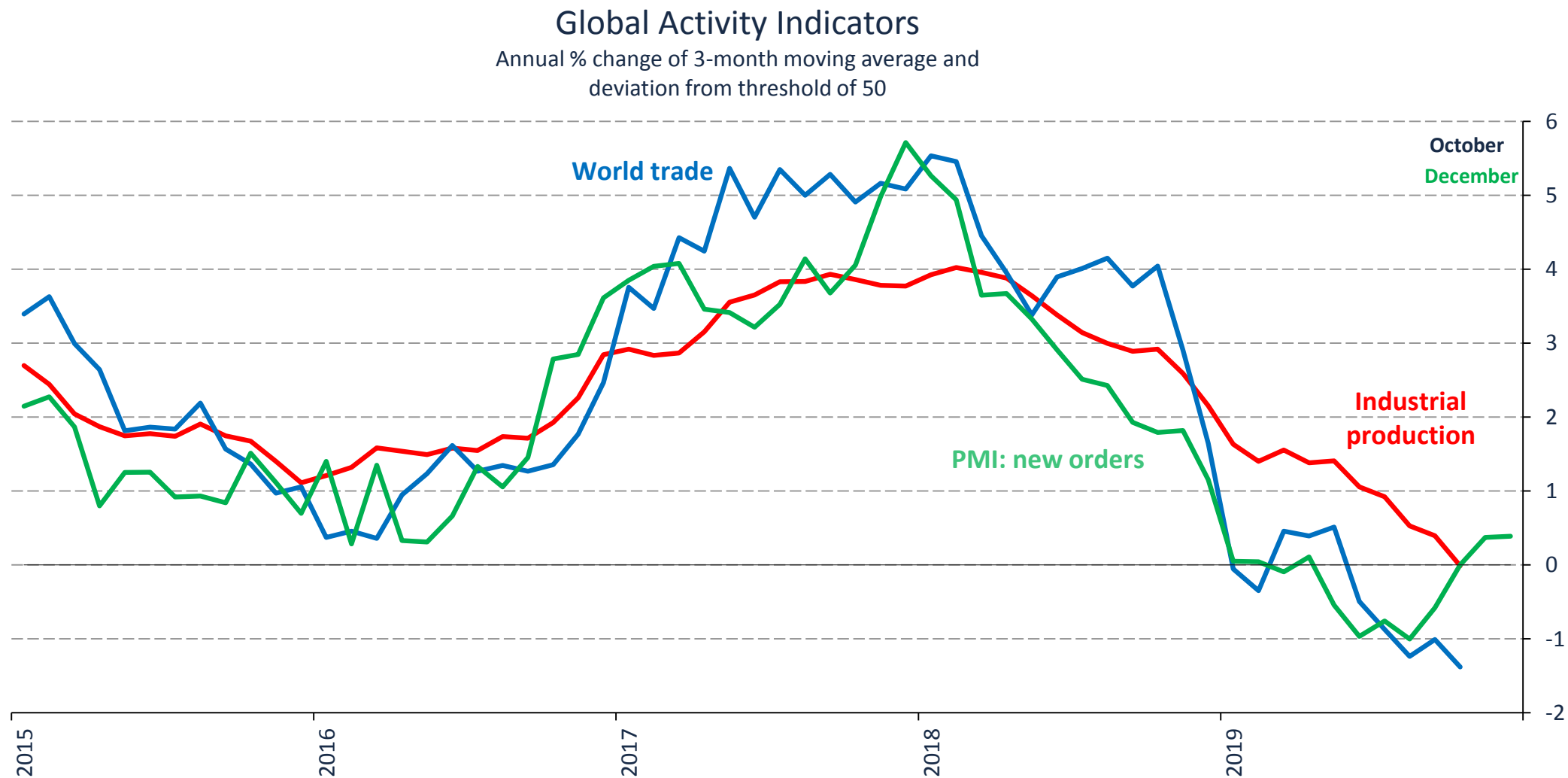Source: Author's own calculations using data from INEGI.

Why was there 0% growth in 2019?

a) Global context of weak economic activity.

b) Beginning of a new administration.

c) Some controversial public policy decisions.

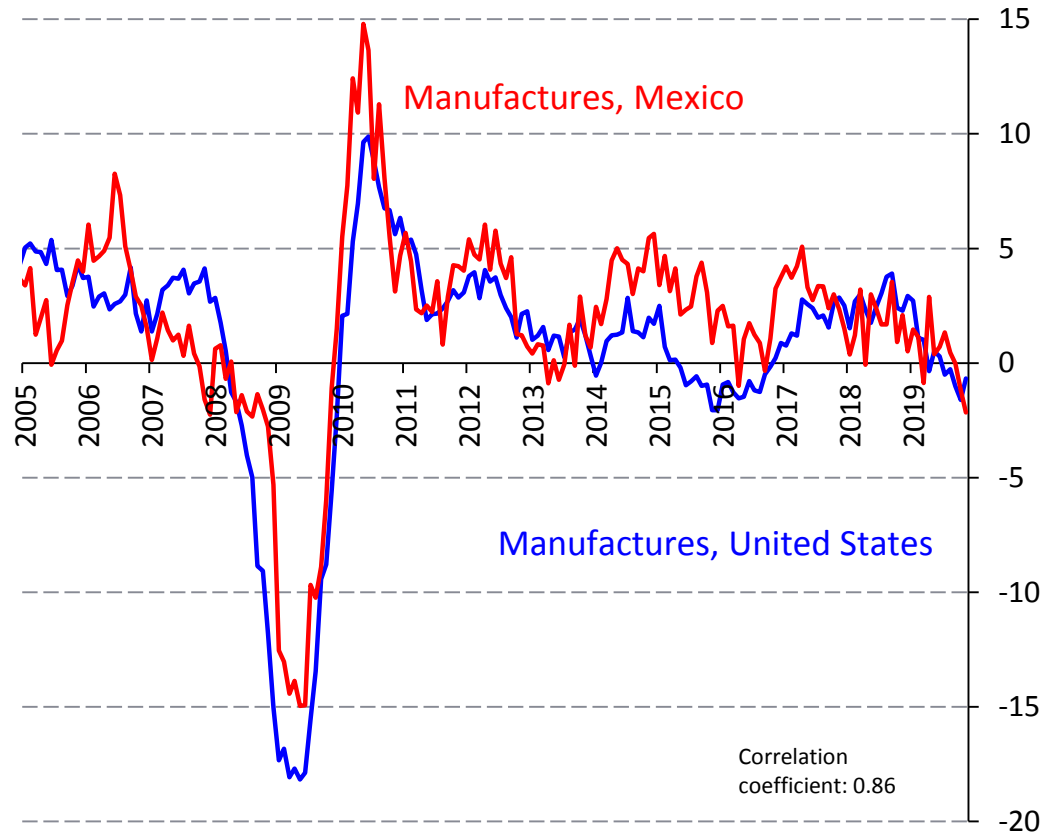d) Restrictive monetary policy.

Weak global economic conditions.

Global Activity Indicators
Annual % change of 3-month moving average and deviation from threshold of 50

World trade

Industrial production

PMI: new orders

October
December

The Mexican economy is closely linked to the US economy.

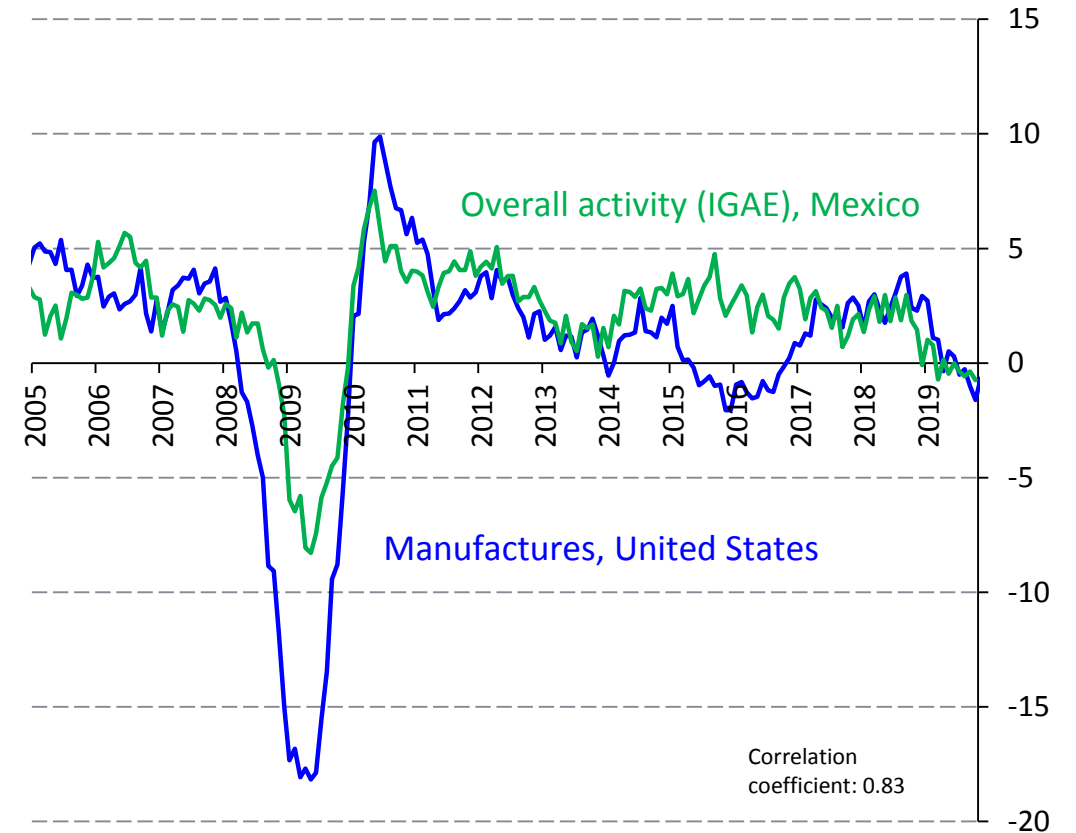### Manufactures (US vs. Mexico)
Annual percentage change from s.a. series

Manufactures, Mexico

Manufactures, United States

Correlation coefficient: 0.86

s.a.\ Data is seasonally adjusted.
Source: Author's own calculations using data from INEGI and Federal Reserve Economic Data (FRED).

US Manufactures vs. Mexico´s Overall Activity
Annual percentage change from s.a. series

Overall activity (IGAE), Mexico

Manufactures, United States
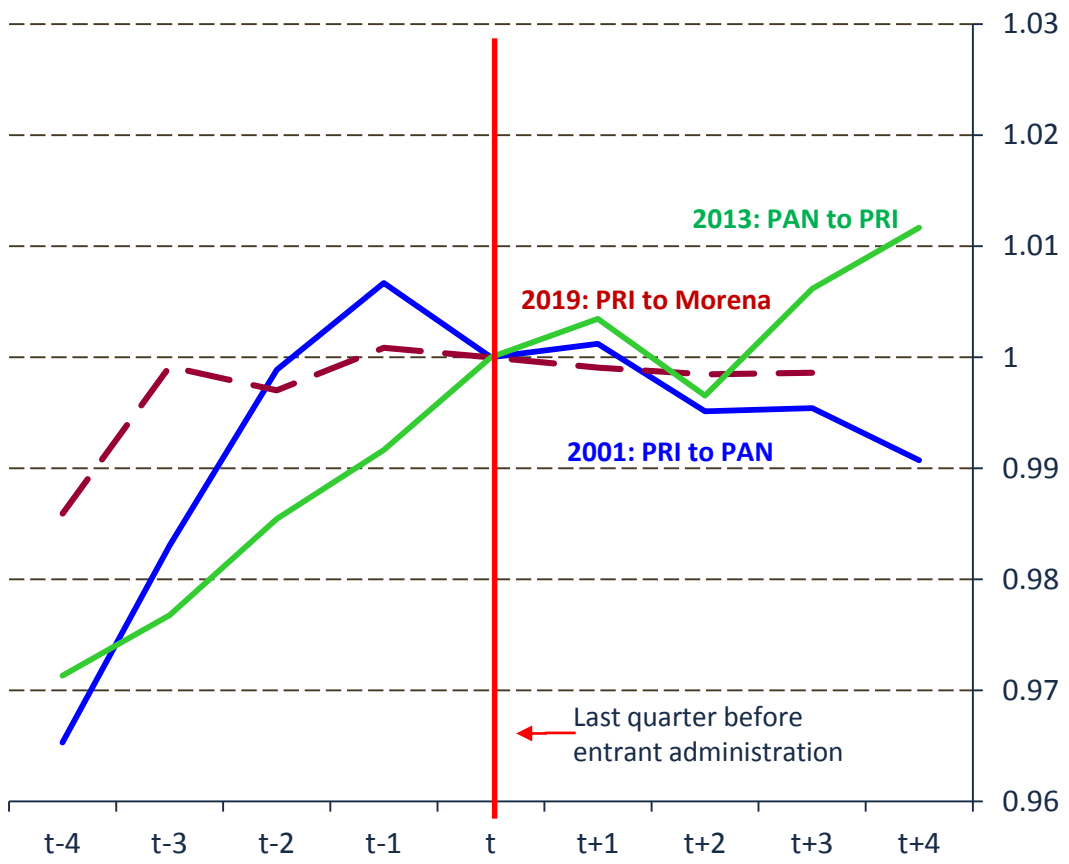
Correlation coefficient: 0.83

s.a.\ Data is seasonally adjusted.
Source: Author's own calculations using data from INEGI and Federal Reserve Economic Data (FRED).

External conditions at the beginning of new administrations.


Mexico's Gross Domestic Product (GDP)
Index=1 for the last quarter before entry of each new administration, s.a.

2013: PAN to PRI
2019: PRI to Morena
2001: PRI to PAN

Last quarter before entrant administration

s.a.\ Data is seasonally adjusted.
Source: Author's own calculations using data from INEGI.

US Manufacturing Output
Index=1 in the last quarter before entry of each new administration, s.a.

2013: PAN to PRI
2019: PRI to Morena
2001: PRI to PAN

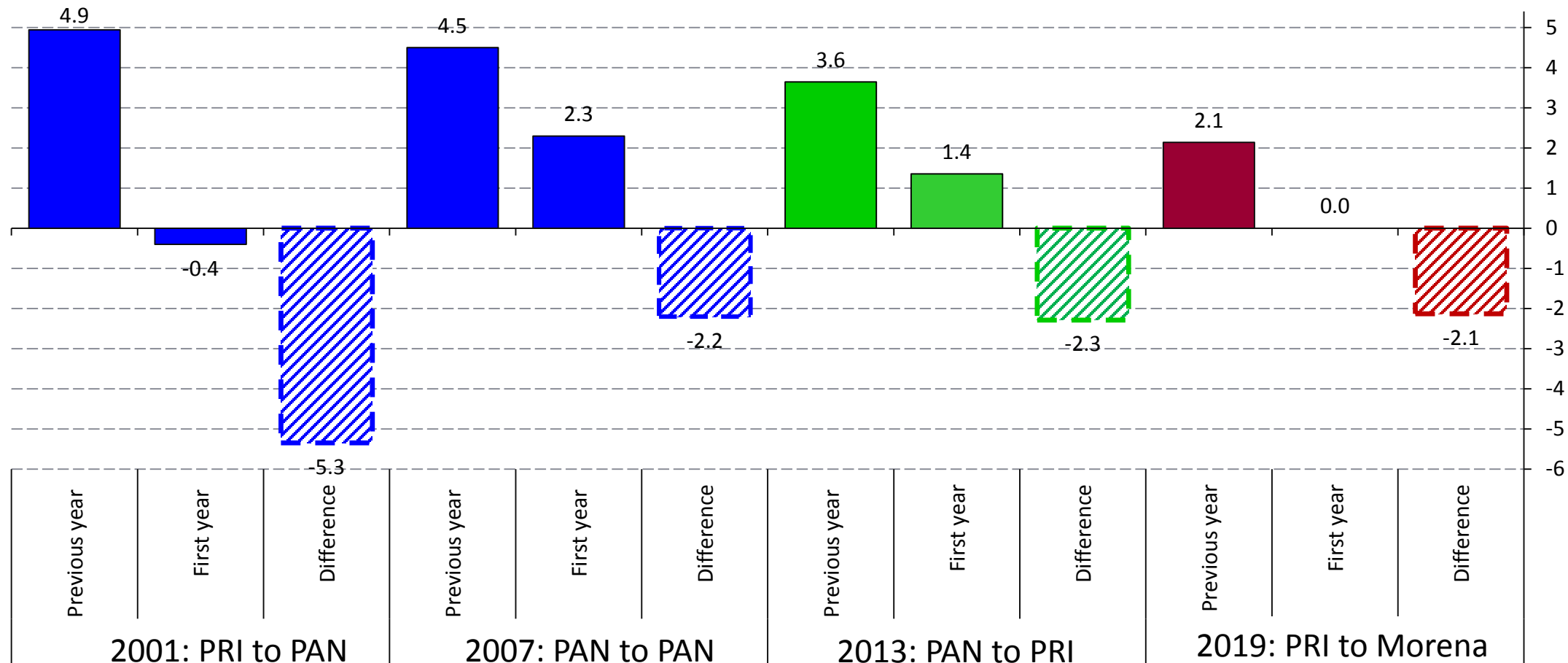Last quarter before entrant administration
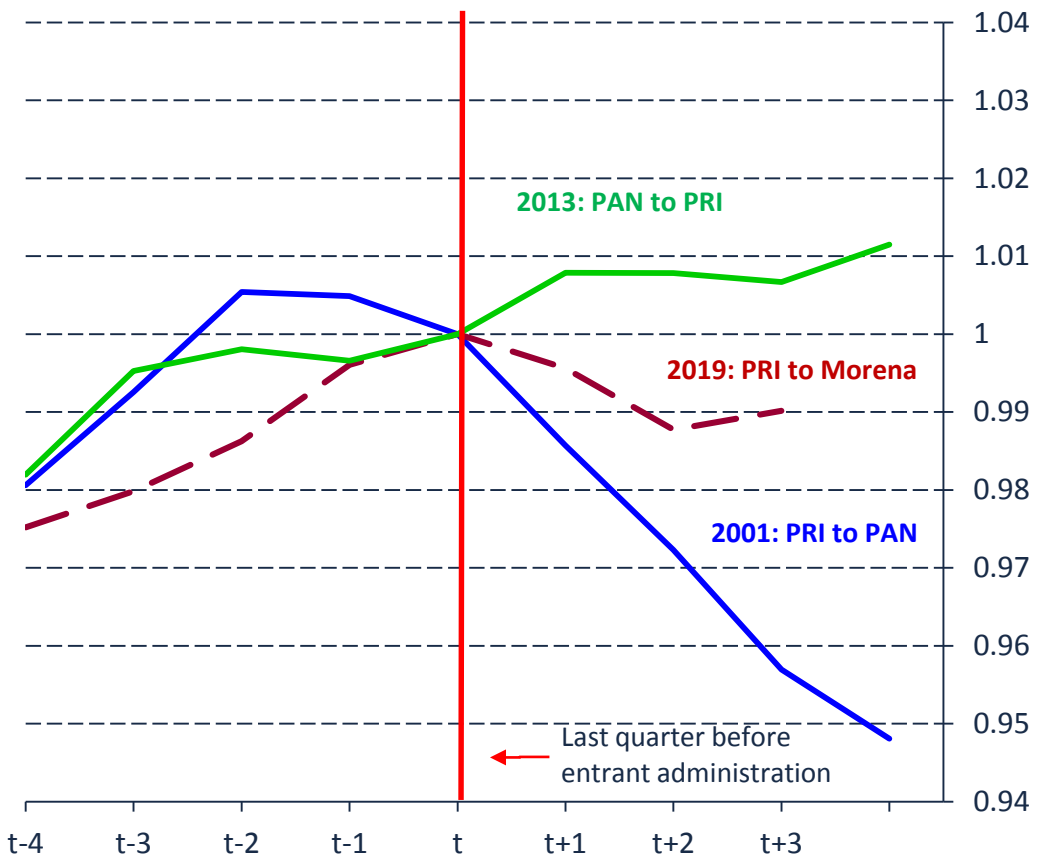
s.a.\ Data is seasonally adjusted.
Source: Author's own calculations using data from Federal Reserve Economic Data (FRED).

The beginning a new federal administration is typically costly for the economy.

Real GDP growth at the beginning of recently elected federal administrations
Annual percentage change, index 2013=100

	2001: PRI to PAN			2007: PAN to PAN			2013: PAN to PRI			2019: PRI to Morena		
	Previous year	First year	Difference	Previous year	First year	Difference	Previous year	First year	Difference	Previous year	First year	Difference
	4.9	-0.4	-5.3	4.5	2.3	-2.2	3.6	1.4	-2.3	2.1	0.0	-2.1

Note: The first year growth rate for 2019 is constructed using the mid-point of the GDP Growth Forecast interval from Banco de Mexico. See Quarterly Report July-September 2019.
Source: Author's own calculations using data from INEGI and Banco de México.

Controversial decisions.

a) Mexico City Airport.

b) Pipe-lines contracts renegotiations.

c) No farm-outs (yet).

d) Some public investment projects.

The real interest rate is high.

## Short-Term Ex-Ante Real Rate and Estimated Range for the Short-Term Neutral Real Rate[1]

%

Short-Term Neutral Real Rate Range in the Long-Term

Short-Term Ex-Ante Real Rate
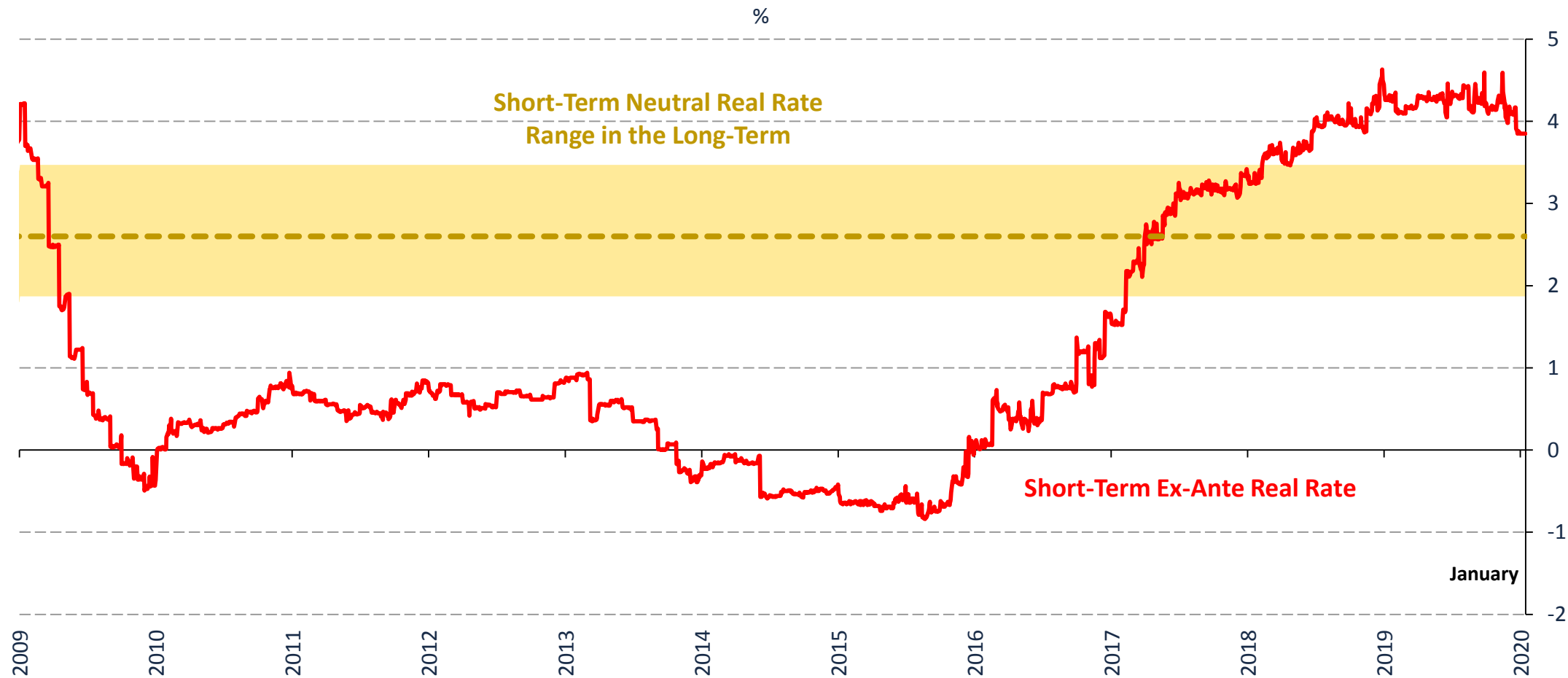
1/ The short-term ex-ante real rate is constructed using the Target for the Overnight Interbank Interest Rate and 12-month inflation expectations from Banco de México Survey. The dotted line corresponds to the midpoint of the range. See box no. 4 in the April-June 2019 Quarterly Report: "Actualización de la tasa neutral de interés de largo plazo en México."
Source: Banco de México.

The real interest rate is high relative to other countries.

## Real Interest Rates across Countries[1]
%
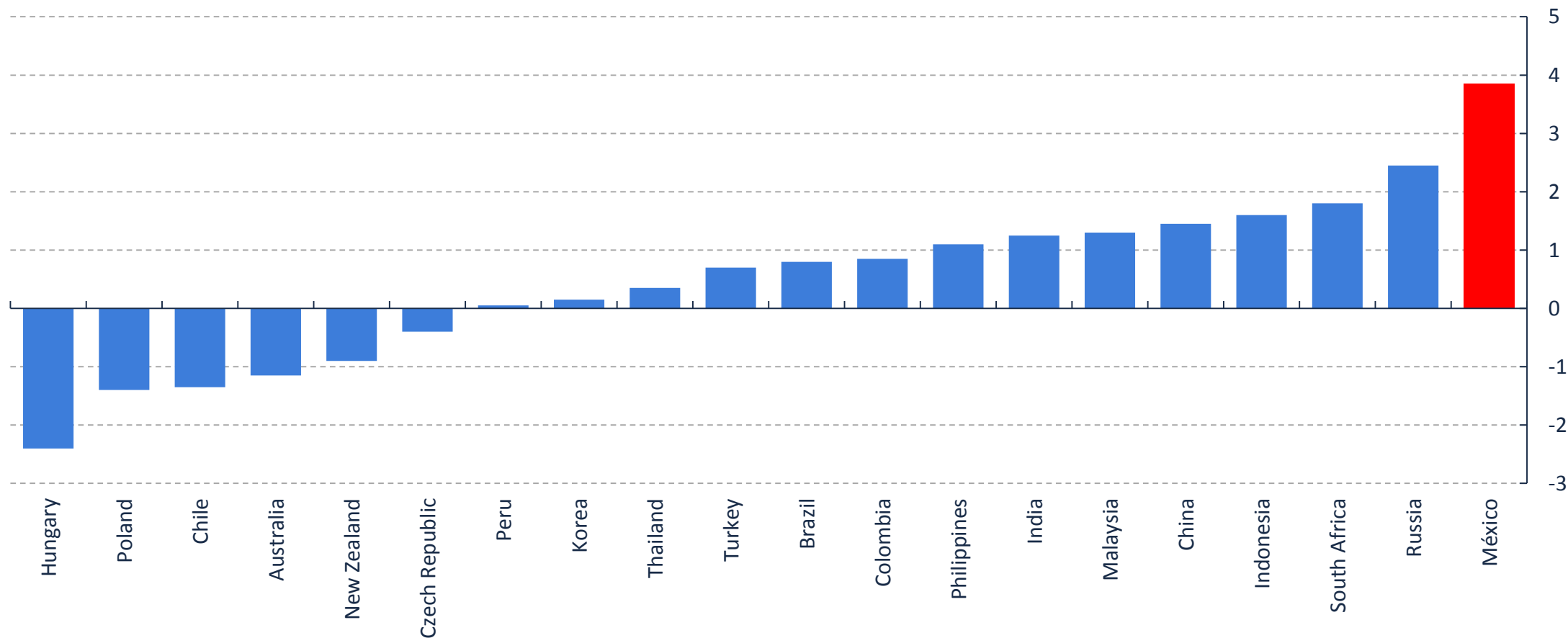
1/ The real interest rate is calculated subtracting the expected inflation for 2020 from the current policy rate as of January 2020.
Source: Author's own calculations using data from Banco de México.

Real policy rates and neutral rates estimates from IMF.

Inflation
(Percent; end of period)

Real Policy Rates and Neutral Rates
(Percent)
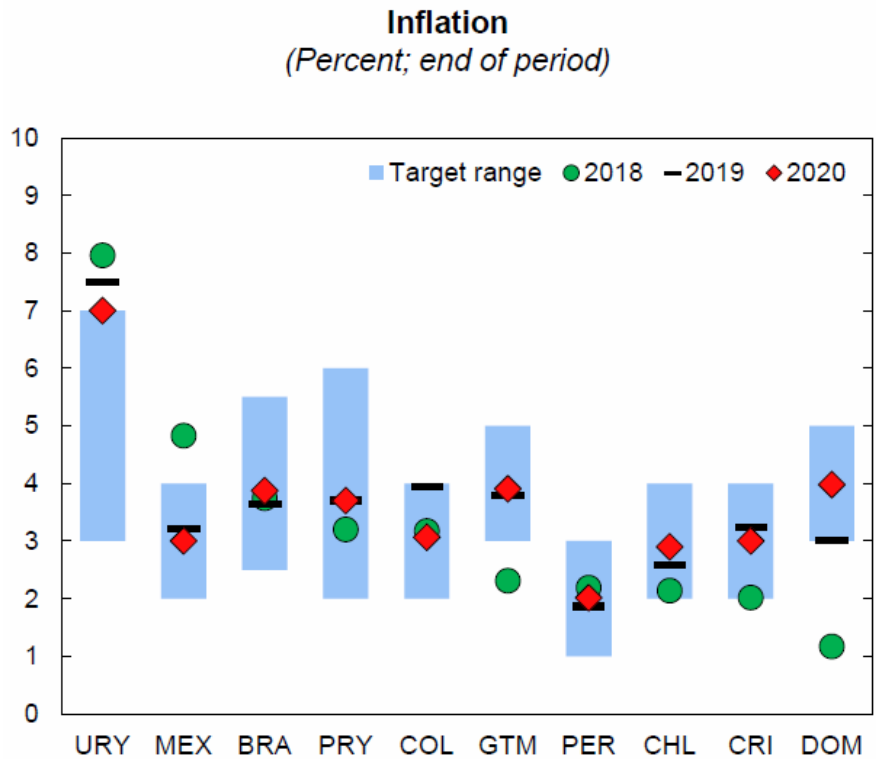
Sources: IMF, World Economic Outlook database; national authorities; and IMF staff calculations.
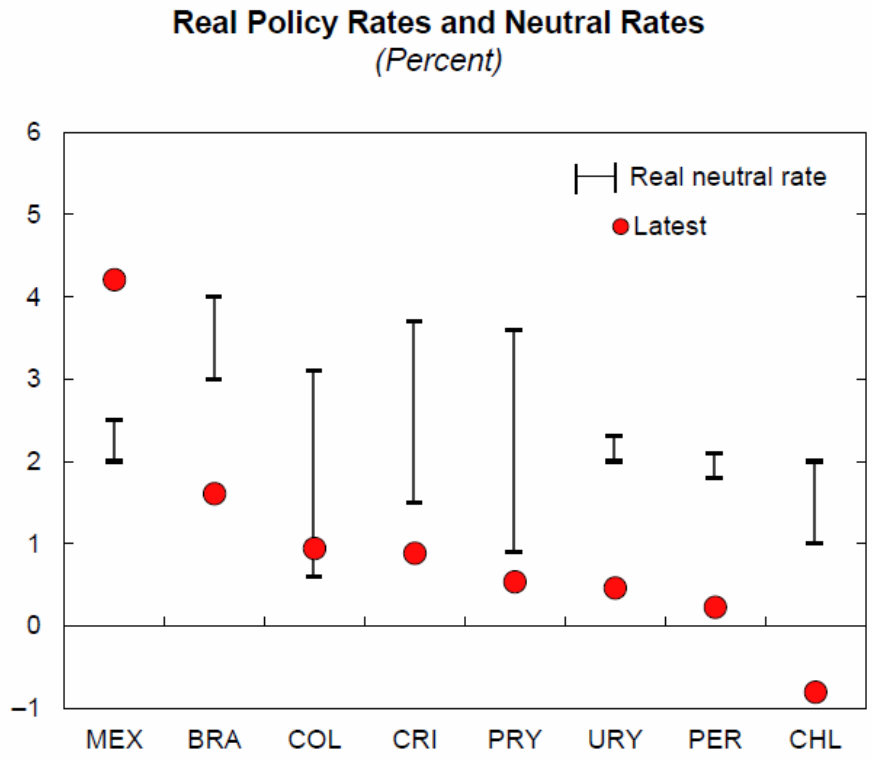
Sources: Consensus Economics; Haver Analytics; national authorities; and IMF staff calculations.
Note: Real (ex ante) policy rates is the difference between the policy rate and the 1-year-ahead inflation expectations. Uruguay does not have a policy rate. Interest rate shown is based on the 1-month nominal yield (letras).
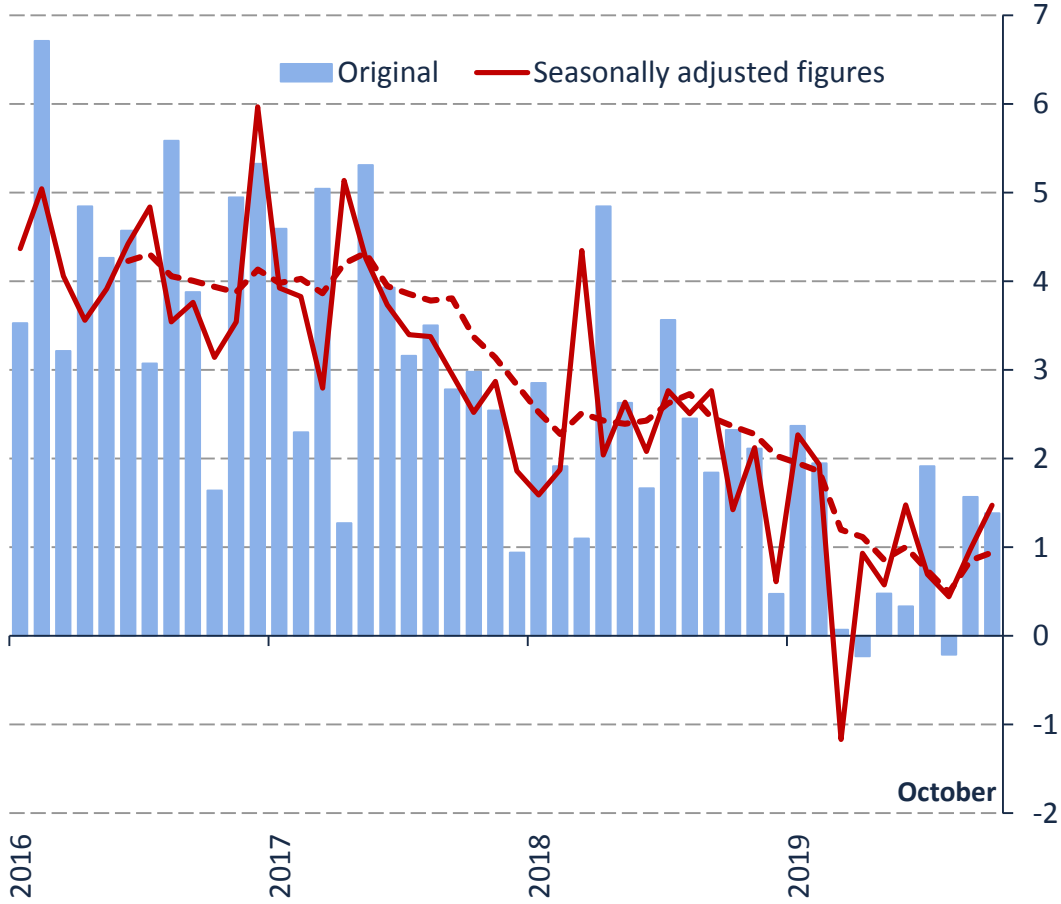
Obtained from IMF report "Regional Economic Outlook: Stunted by Uncertainty", October 2019.

Consumption and investment have been weak since 2016.
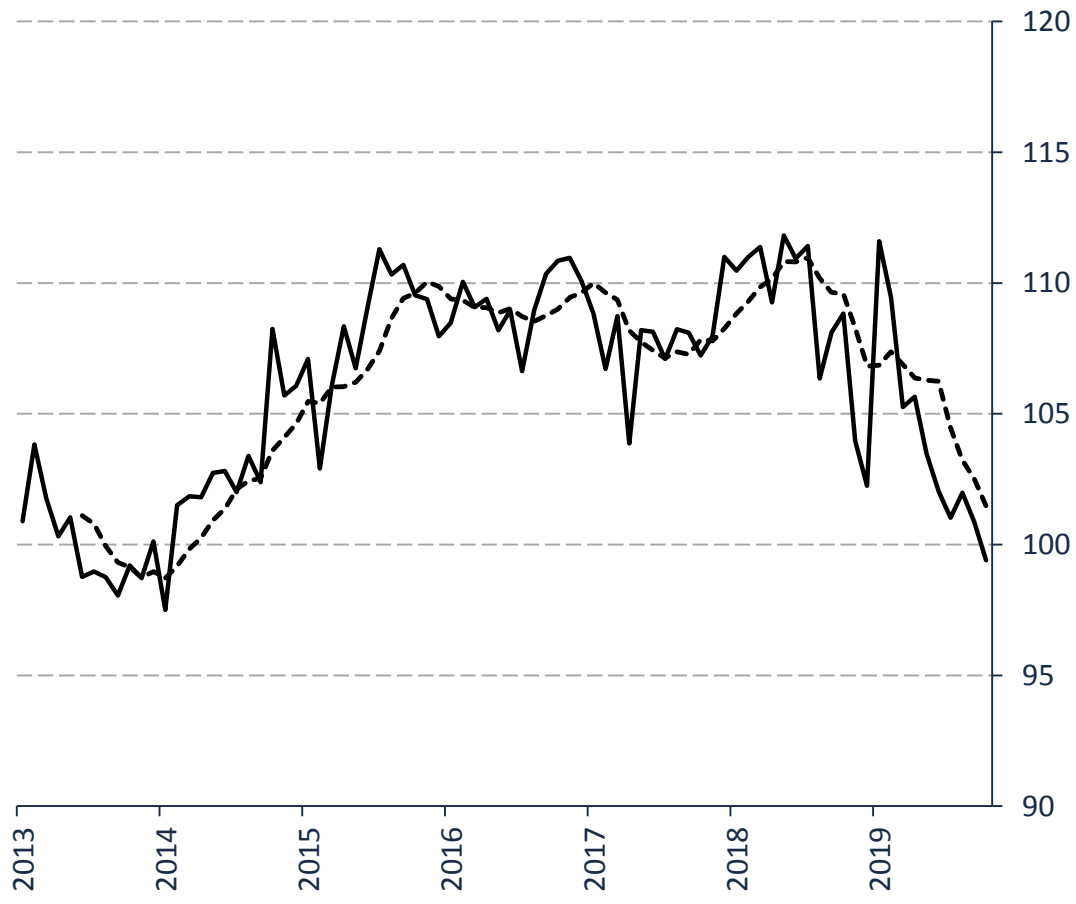
Total Private Consumption
Annual % change and 6-month moving average

Legend: Original (bars) — Seasonally adjusted figures (red line)

October

Source: Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.
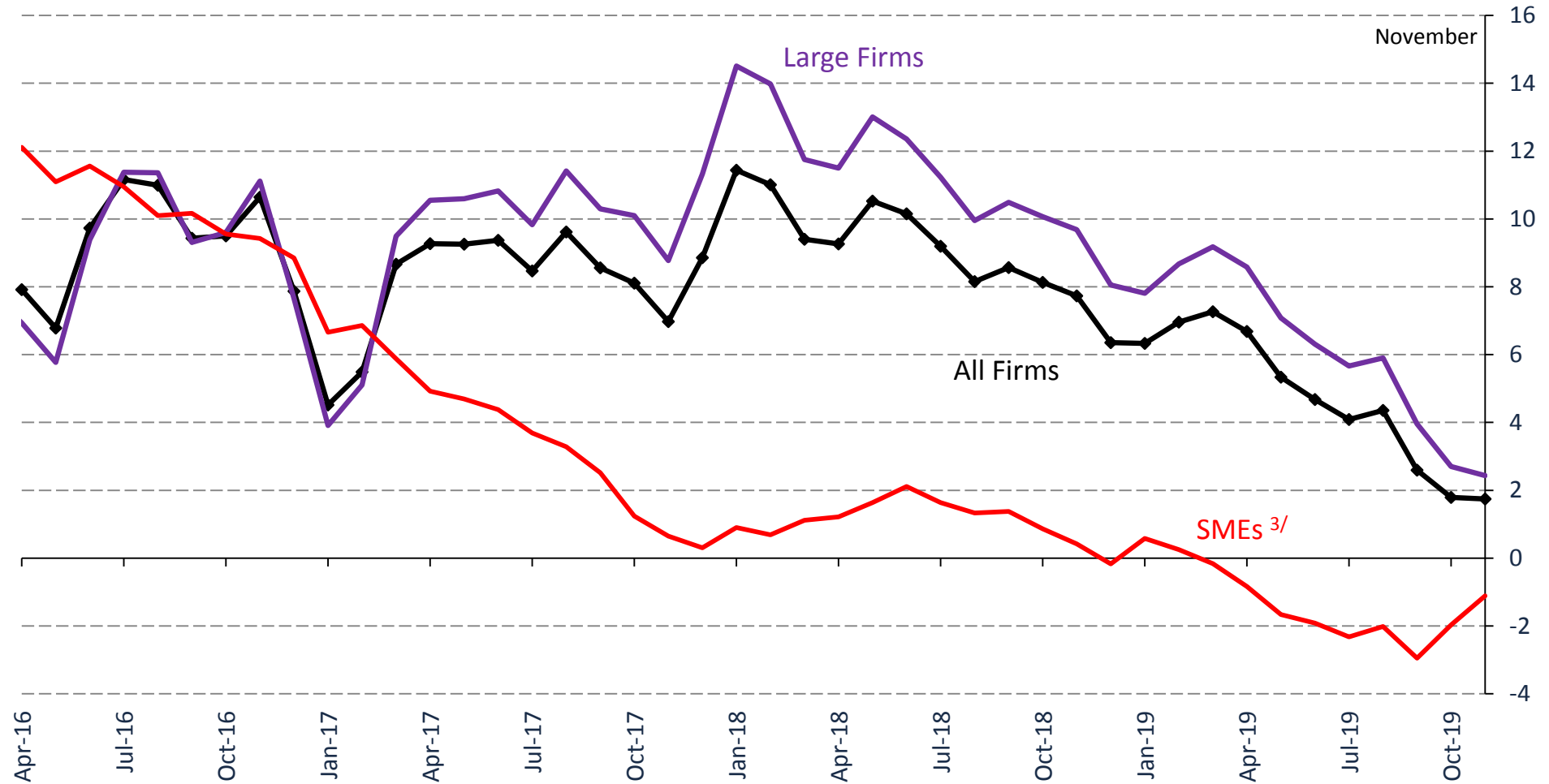
Investment
Index 2013=100, s. a. and 6-month moving average

s. a. / Seasonally adjusted figures.
Source: Mexico's National Accounts System (SCNM, for its acronym in Spanish), INEGI.

Credit growth for non-financial firms has decreased since 2016.

Performing Commercial Banks Credit to Non-Financial Private Firms[1][2]
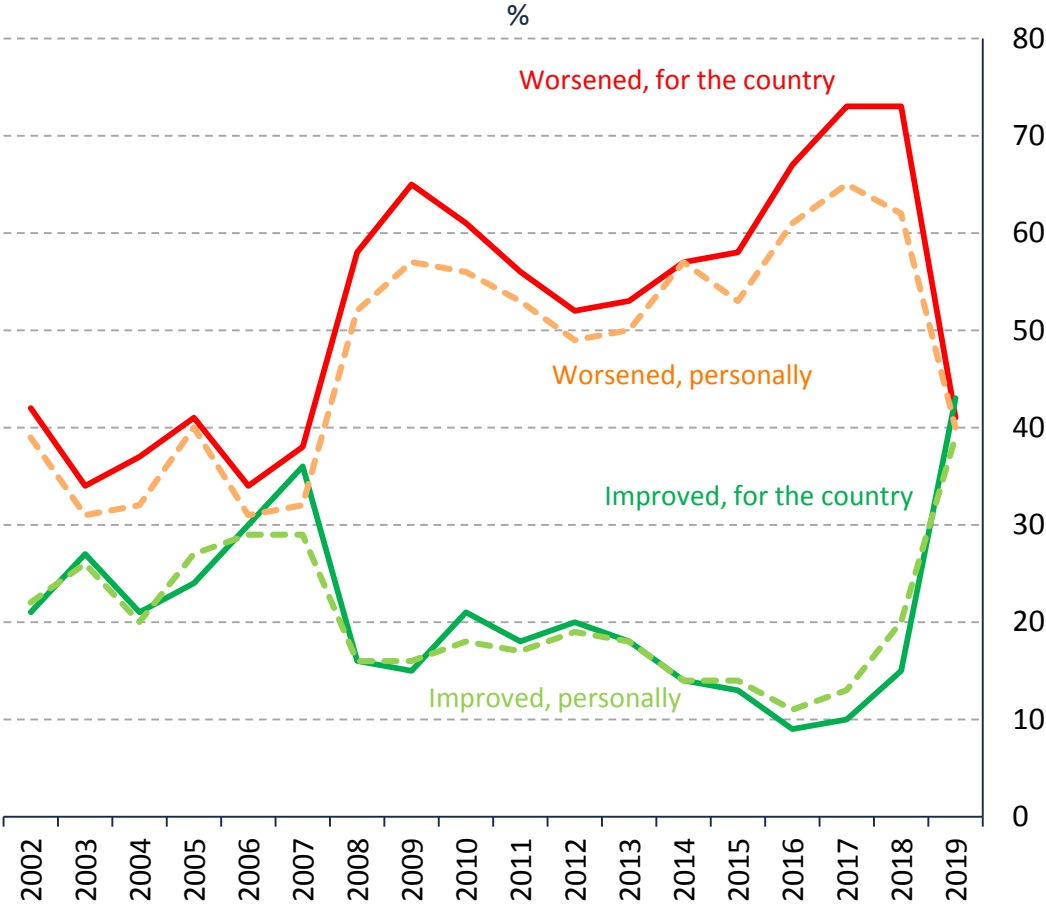Real annual % change

1/ Data adjusted due to exchange rate variations. 2/ It also includes financing granted by multiple-purpose non-bank financial corporations, regulated entities (sofomes E.R.) subsidiaries of banks and financial groups. 3/ Small and medium-sized enterprises (SMEs)
Source: Banco de México.

Outlook for 2020.

a) Reduction in global trade tensions.

b) Approval of USMCA.

c) People are optimistic, which may increase consumption.

d) Margin for reduction in interest rates (unlike other economies).

e) More experienced federal administration.

Household survey shows there is unprecedented <u>optimism</u> in Mexico.

"During the last 12 months, economic conditions have: "

%

Worsened, for the country

Worsened, personally

Improved, for the country

Improved, personally

Source: Household Survey performed by Parametría. Published as "¿Qué mide el Índice de Confianza del Consumidor?" by Francisco Abundis at Milenio website.

"For the next 12 months you expect that economic conditions will: "
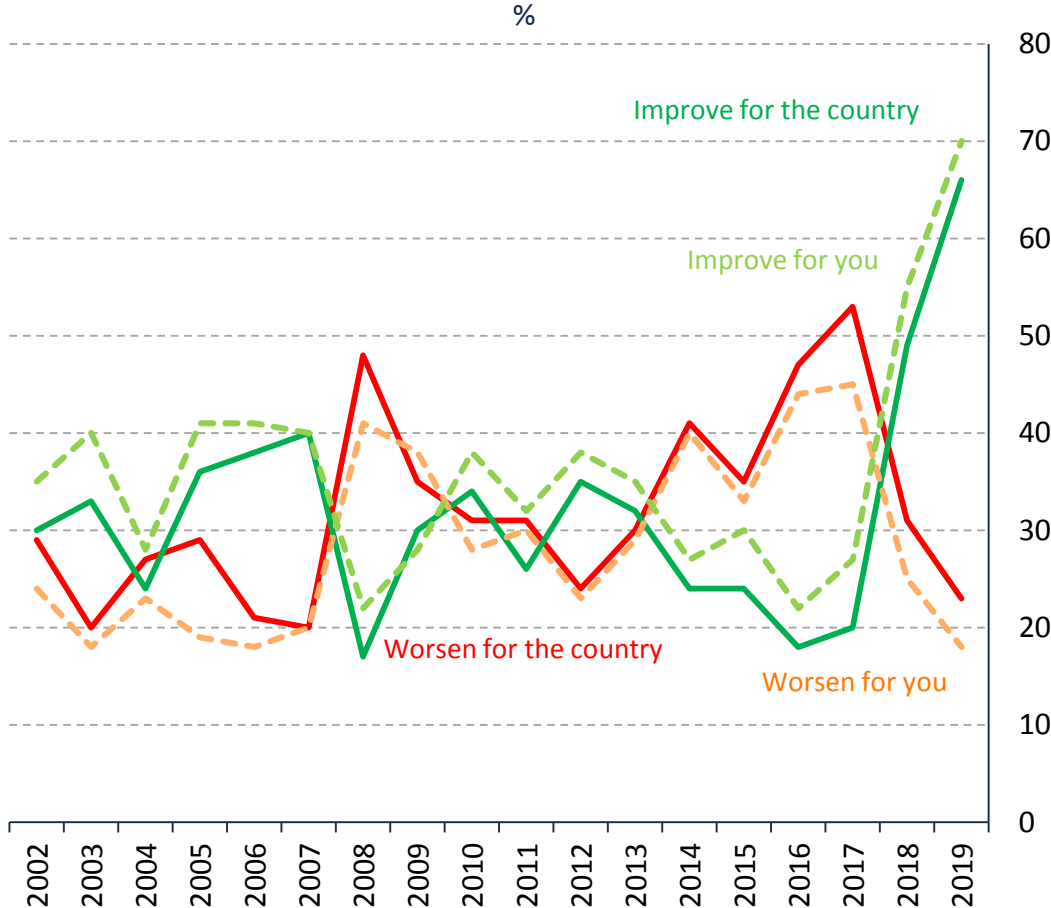
%

Improve for the country

Improve for you

Worsen for the country

Worsen for you

Source: Household Survey performed by Parametría. Published as "¿Qué mide el Índice de Confianza del Consumidor?" by Francisco Abundis at Milenio website.

Consumer confidence, the wage bill and remittances are reaching historical records.
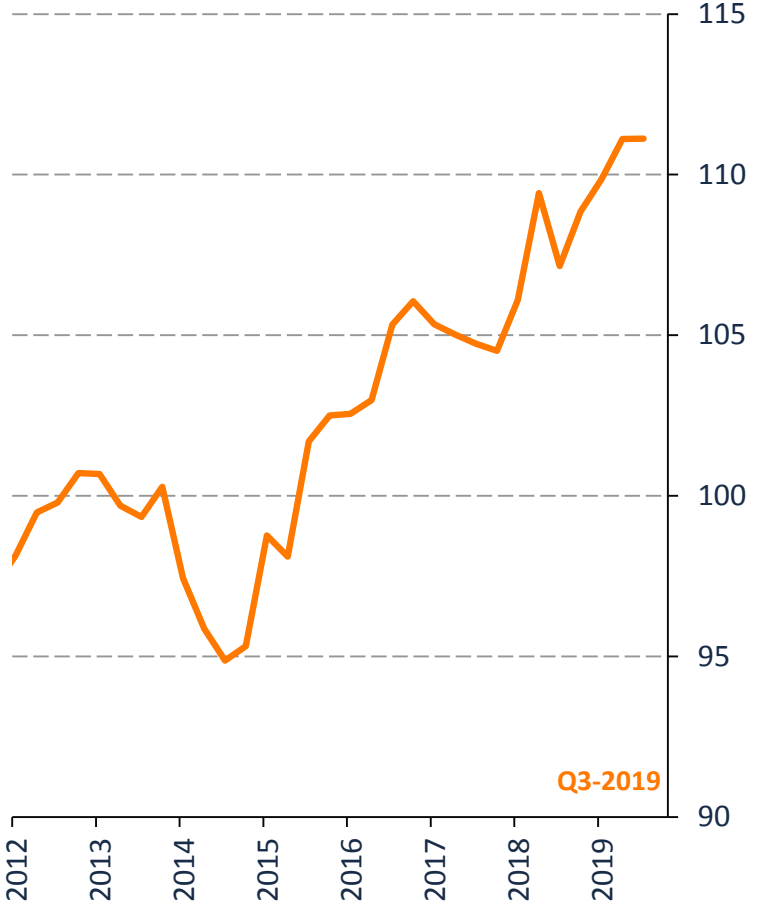
Consumer Confidence
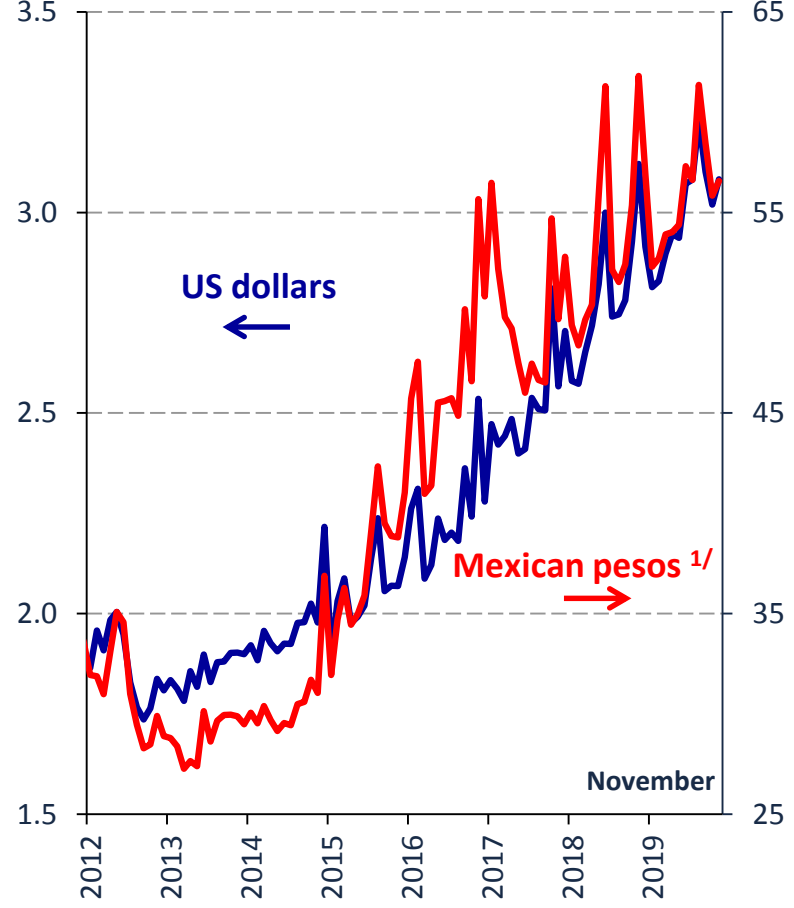### Response balance

December

Total Real Wage Bill
Index 2013=100, s. a.

Q3-2019

Remittances
Billion of USD and of constant pesos, s. a.

US dollars

Mexican pesos [1]

November

s. a. / Seasonally adjusted figures.
Source: Prepared by Banco de México with information from the National Survey of Occupations and Employment (ENOE, for its acronym in Spanish) and the National Survey of Consumer Confidence (ENCO, for its acronym in Spanish), INEGI and Banco de México.

1/ Prices as of the second fortnight of July 2018.
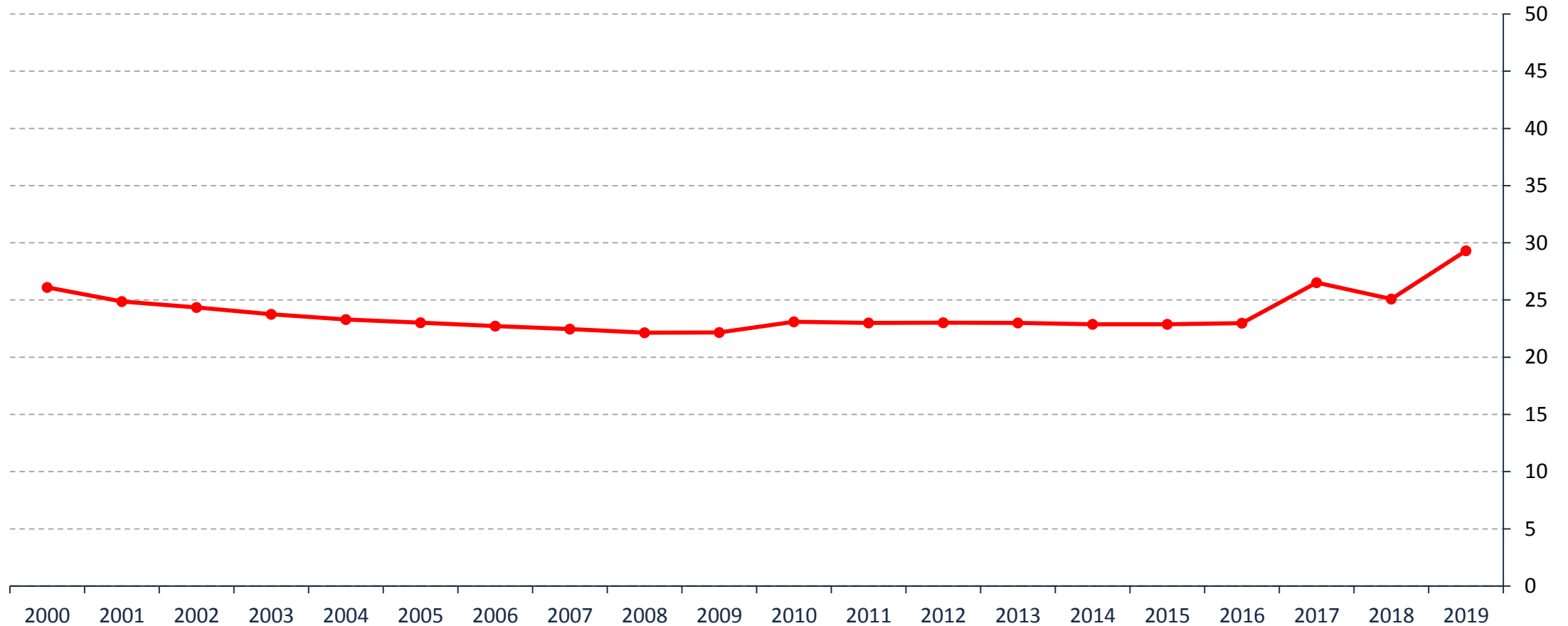Source: Banco de México and INEGI.

Conclusions.

- Mexico has strong macroeconomic fundamentals.

- External conditions for this year seem more favorable.

- Monetary and fiscal policies might become less restrictive.

- There is widespread optimism among the general population.

APPENDIX

Minimum wage relative to mean wage.

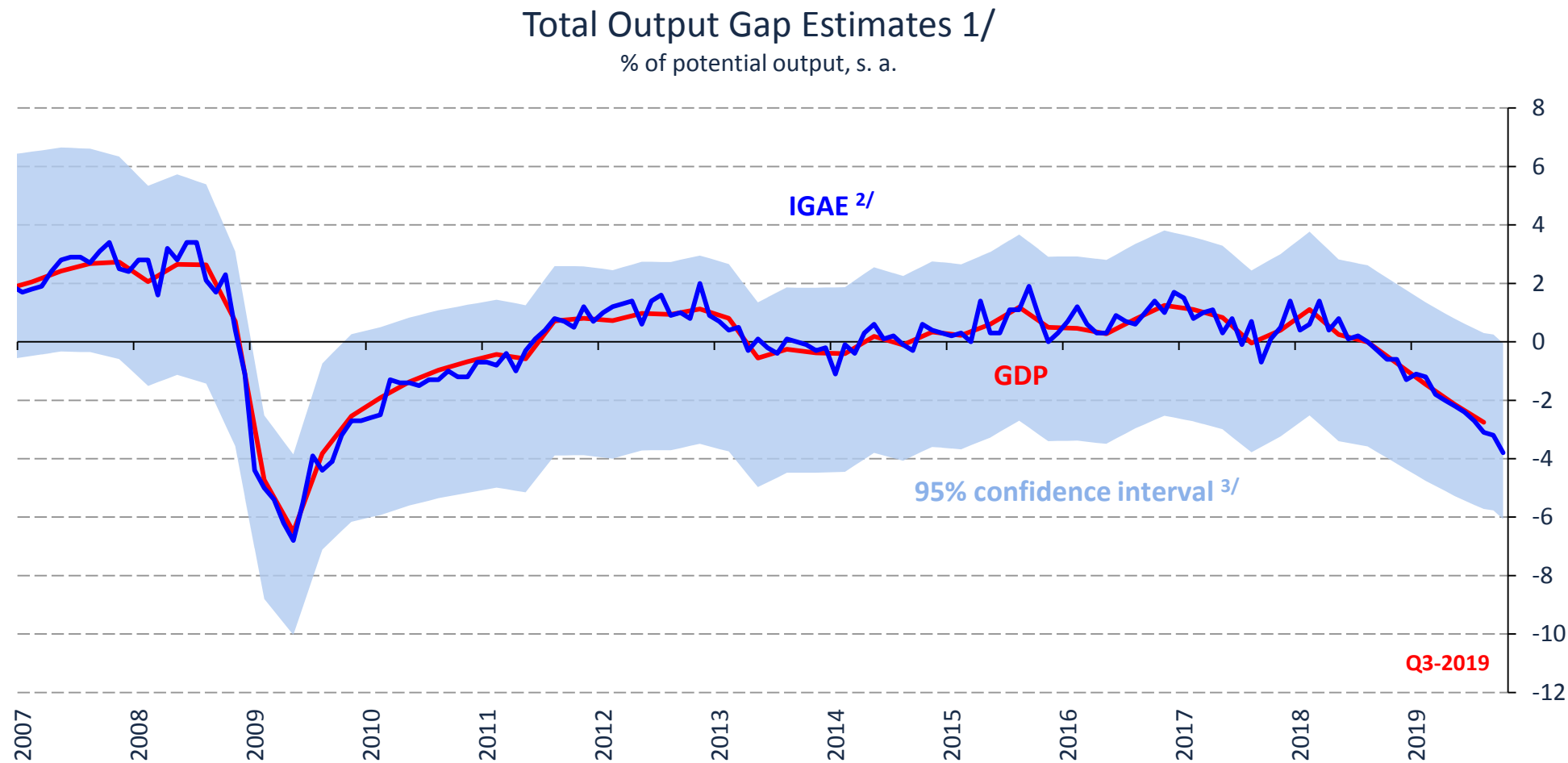Minimum Wage Relative to Mean Wage, 2000-2019 [1]

%

/1 Mean wages are obtained from IMSS data. Starting in 2019, the minimum wage in the northern border differs from that in the rest of the country. Thus, we take a weighted average between the two regions for that year.
Source: Author's own calculations, using data from Minimum Wage National Commission, INEGI and IMSS.

The output gap in Mexico has gone negative.

Total Output Gap Estimates 1/
% of potential output, s. a.

IGAE [2/]

GDP

95% confidence interval [3/]

Q3-2019

Years: 2007, 2008, 2009, 2010, 2011, 2012, 2013, 2014, 2015, 2016, 2017, 2018, 2019

s. a. / Seasonally adjusted data. 1/ Output gap estimated with a tail-corrected Hodrick-Prescott filter; see Banco de México (2009), "Inflation Report (April-June 2009)", p.74.
2/ Global Indicator of Economic Activity (IGAE, for its acronym in Spanish). 3/ Output gap confidence interval calculated with a method of unobserved components.
Source: Prepared by Banco de México with INEGI data.