A walk through the Mexican economy
Manuel Sánchez
United States-Mexico Chamber of Commerce, Northeast Chapter
New York and Boston, December 1-2, 2016
Since 2014, Mexican economic activity has slackened, recently touching below long-term average rates.

Mexico: GDP
Annual % change, s.a.

Source: INEGI
Good news has come from private consumption, which has maintained momentum

Mexico: Private consumption
Annual % change, s.a.

s. a. / Seasonally adjusted. */ July-August
Source: INEGI
Dynamic private consumption has been supported by improved labor-market conditions

Mexico: Real wage bill income and employed population
Annual % change, s.a.

s. a. / Seasonally adjusted
Source: INEGI and Banco de México
... as well as growth in remittances and consumer bank lending

Mexico: Remittances in peso terms and consumer bank lending
Real annual % change, s.a.

s.a. / Seasonally adjusted. */ July-August for bank credit
Source: Banco de México
However, oil production has continued to fall

Mexico: Oil production
Annual % change, s.a.

s.a. / Seasonally adjusted. */ October to November 20
Source: Pemex and Haver Analytics
... matched by increasing growth of total gasoline imports

**Mexico: Volume of gasoline imports**

Annual % change, millions of barrels per month, s.a.

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s.a. / Seasonally adjusted. */ Only October

Source: Banco de México and Pemex
... resulting in further deterioration of the oil trade balance

Mexico: Trade Balance
Billions of dollars

Source: Banco de México
Also, manufacturing exports have remained soft.

Mexico: U.S. Dollar value of manufacturing exports

Annual % change, s.a.

- To U.S.
- Total
- To the rest of the world

Source: Banco de México
A backdrop to export performance is some moderation of declining manufacturing production

Mexico and the United States: Manufacturing production
Annual % change, s.a.

s.a. / Seasonally adjusted
* / Only October
Source: INEGI and the U.S. Federal Reserve
Finally, producer confidence is dropping, and investment is contracting

Mexico: Investment and producer confidence¹
Annual % change, 2011 average = 100, s.a.

-1.3
87.4

s.a. / Seasonally adjusted
1/ July-August for Investment and only October for producer confidence. 2/ Manufacturing
Source: Banco de México and INEGI
Analysts’ consensus is for growth in Mexico to continue at a moderate rate next year

### GDP forecasts
Annual % change

<table>
<thead>
<tr>
<th></th>
<th>2014</th>
<th>2015</th>
<th>2016&lt;sup&gt;F&lt;/sup&gt;</th>
<th>2017&lt;sup&gt;F&lt;/sup&gt;</th>
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<tr>
<td>World</td>
<td>2.8</td>
<td>2.9</td>
<td>2.5</td>
<td>2.8</td>
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<tr>
<td>The United States</td>
<td>2.4</td>
<td>2.6</td>
<td>1.5</td>
<td>2.2</td>
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<tr>
<td>Mexico</td>
<td>2.3</td>
<td>2.6</td>
<td>2.0</td>
<td>1.9</td>
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<sup>F</sup> Forecast

Source: Haver Analytics, Consensus Forecasts and Latin American Consensus Forecasts, November 2016
This growth scenario faces downside risks

- An uncertain direction for U.S. economic policies, including the potential implementation of protectionist measures
- Further delay in a recovery of U.S. manufacturing production
- Additional drops in crude oil output
- Further worsening of consumer and producer confidence
- Difficulties for adequate implementation of structural reforms
Recent increased risk aversion has resulted in capital outflows from emerging economies

Emerging economies: Portfolio capital flows

Billions of dollars

1/ Net share and debt purchases by nonresidents in 25 emerging economies

*/ Includes estimates for October and November. Source: IIF
Nonresident holdings of Mexican government securities have been relatively stable

Mexico: NR peso-denominated government securities holdings\(^1\)
Billions of pesos and % of total debt outstanding

1/ Zero coupon bonds, coupon bonds, and inflation-linked bonds. */ To November 16
Source: Banco de México
In 2016, asset prices in emerging economies have behaved relatively well to date.
Mexican market interest rates have faced considerable pressure

Mexico: 10-year interest rate and its spread over U.S. bonds

% and basis points

* / To November 25
Source: Banco de México and Bloomberg
Similarly, the exchange rate has seen steepening of a depreciating trend in place since mid-2014.

Mexico: Exchange rate and implied volatility in options
Pesos per dollar and %

Exchange rate
Implied volatility

* To November 28.
1/ Implied volatility is a market expectation of the volatility for future currency yields
Source: Banco de México and Bloomberg
Future bouts of financial volatility in Mexico cannot be ruled out

- The authorities must focus on what they can change to improve Mexico’s prospects, i.e., what they can do and not what is out of their hands
  
  - A stronger fiscal stance
  
  - Vigilant monetary policy
  
  - Adequate implementation of structural reforms

- Buttressed fundamentals would set the stage for whatever negotiations might be in the offing with the U.S. government
A warning is present in upward pressure on Mexican credit risk perception

Emerging economies: Credit-default risk premium (CDS) by credit rating

Basis points

1/ BBB- sovereigns are India, Italy, Indonesia, Hungary and South Africa. BBB+ economies are Poland, Spain, Thailand and Peru

*/ To November 25. Source: Bloomberg
Inflation, recently at historically low levels, has started to creep upward

**Mexico: Annual inflation**

- **Headline**
- **Noncore**
- **Core**

* / First half
Source: INEGI

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3.33
3.29
3.18
Higher core inflation reflects an increasing trend in goods prices due largely to the impact of peso depreciation.

**Mexico: Annual core inflation**

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*3% target

Source: INEGI
Increasing noncore inflation has resulted mainly from energy price rises.

Mexico: Annual noncore inflation

* 3% target

Source: INEGI

*/ First half
Producer prices may indicate future consumer price pressure

Mexico: INPP\(^1\)
Annual % change

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<thead>
<tr>
<th></th>
<th>INPP</th>
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1/ National Producer Price Index, excluding oil
Source: INEGI
Break-even inflation has jumped above the target, and may suggest some future higher inflation

Mexico: Compensation for inflation and inflation risk implicit in bonds

Source: Own calculations with data from PiP
... as may inflation expectations based on analysts’ surveys

Mexico: Annual inflation expectations
Median, %

Source: Banco de México, Encuesta sobre las Expectativas de los Especialistas en Economía del Sector Privado
Since December 2015, the policy interest rate has been raised five times for a total of 225 basis points

Policy overnight interest rate

Source: Banco de México
Recently, the yield curve has shifted upward across all maturities

Mexico: Yield curve

Source: Banco de México
Rate hikes should be interpreted as preemptive

- So far, inflation remains relatively subdued, although risks are increasing
- Banco de México does not target the exchange rate, and therefore monetary policy should not be judged in terms of its effects on this variable
- The primary objective of monetary policy is control over inflation
- Exchange-rate developments are relevant insofar as they may lead to deviation of inflation from the target
Upside risks for inflation seem to prevail

- Risks
  - Widespread contagion of exchange-rate depreciation to inflation and expectations
  - Reversion of noncore inflation to historical averages
  - Upsurge of aggregate demand pressures, in particular considering uncertainty over the degree of slack in the economy

- These issues could cause the price formation process to unravel, with medium-term consequences

- Caution is all the more important given the time and effort it took for inflation to reach the target
The current environment presents a unique opportunity to reinforce Mexico’s commitment to price stability

- The widening of inflation risks make it all the more necessary to maintain a proactive stance
- Banco de México will remain on the alert for obstacles in the way of consolidation of inflation at the target
- It will also take into account other factors, such as the relative monetary stance with the United States, as well as slack in the economy
Final remarks

- Mexico’s economic activity has diminished, largely reflecting continued drops in producer confidence and investment.

- The most important downward risk for the growth scenario comes from uncertain future U.S. policy.

- International financial volatility has resulted in significant upward pressure on domestic interest rates and more notably, the exchange rate.

- Mexico needs to reinforce its own economic fundamentals.

- Banco de México must continue to keep a watchful stance to maintain consolidation of inflation at the target.
Mejoran las perspectivas económicas mundiales.