Recent Developments and Outlook for the Mexican Economy
Credit Suisse, 2016 Macro Conference
April 19, 2016
Outline

1 Inflation and Monetary Policy

2 Recent Developments and Outlook for the Mexican Economy

3 Final Remarks
In line with its constitutional mandate, the monetary policy conducted by Banco de México aims at **procuring the stability of the national currency’s purchasing power**, at the lowest cost to society in terms of economic activity.

Thus, an environment of low and stable inflation in Mexico has been achieved:

- In 2015 headline inflation closed at **2.13 percent**.
- During 2016 inflation rebounded due to transitory factors, staying at levels **below 3 percent**.
- Banco de México expects inflation to close 2016 around the **3 percent** permanent target.

To achieve this, the monetary policy conducted by Banco de México has been fundamental. Banco de México has set its monetary policy rate to achieve its permanent target.
Inflation in Mexico showed a downward trend during 2015, reaching a historical minimum. However, at the beginning of 2016 it rebounded due to a transitory increase in some agricultural products’ prices.

![Consumer Price Index](chart.png)

**Consumer Price Index**

**Annual % change**

Source: Banco de México and INEGI.
Long-term inflation expectations implicit in market instruments have diminished.

### Annual Headline Inflation Expectations 1/

1/ It refers to long-term inflation expectations implicit in market instruments. Based on the methodology described in Box 1 “Decomposition of the Break-even Inflation” of the Quarterly Report October-December 2013. Source: Banco de México.
The Board of Governors estimates that the current monetary policy stance is congruent with the consolidation of inflation convergence towards the permanent 3 percent target.

**Monetary Policy Rates**

1/ Before January 20, 2008 it refers to the observed Overnight Interbank Interest Rate.
2/ The upper limit of the target range is showed.

Source: Federal Reserve and Banco de México.
Recent Developments and Outlook for the Mexican Economy

Inflation and Monetary Policy

1

Recent Developments and Outlook for the Mexican Economy

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Final Remarks

3
The international environment has been characterized by a notable weakness in the global economic activity growth rate, which has been reflected in a stagnation of global trade.
- International commodity prices showed an important decrease and remain at low levels.
U.S. indicators point to a moderate growth of economic activity in early 2016 and to weakness in the industrial production.

**Recent Developments and Outlook for the Mexican Economy**

- **U.S.: Gross Domestic Product**
  - Quarterly % change at annual rate, s.a.

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  *Forecast*

  - 4Q 2016

  s.a. / Seasonally adjusted data.

  Source: Bureau of Economic Analysis (BEA) and Blue Chip.

- **Manufacturing Activity in the U.S. and Mexico**
  - % Annual change, s.a.

  **Mexico**

  **U.S.**

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s.a. / Seasonally adjusted data.

Source: Federal Reserve and INEGI.
A growing divergence among advanced economies’ monetary policy stances has been observed, which has been partially reflected in the value of the US dollar.

Advanced Economies:
Expected Monetary Policy Rates 1/

U.S. Dollar Index (DXY) 2/
Index 1-Jan-2013=100

1/ The expected rates are the trajectories implicit in OIS Curves (Overnight Index Swap). Source: Bloomberg with estimates from Banco de México.

2/ DXY index is estimated by the Intercontinental Exchange (ICE) based on the weighted geometric mean of the dollar’s value compared with a basket of 6 other major currencies which are: EUR: 57.6%, JPY: 13.6%, GBP: 11.9%, CAD: 9.1%, SEK: 4.2%, and CHF: 3.6%. Source: Bloomberg.
Episodes of increased volatility in international financial markets have taken place, although depreciation of EMEs currencies has recently reverted.

Emerging Economies

**Implied Volatility in Exchange Rate Options**

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<td>%</td>
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<td>15</td>
<td>20</td>
<td>25</td>
<td>30</td>
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<td>40</td>
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Emerging markets

Mexico

**Nominal Exchange Rate against USD**

Index 01-Jan-2013 = 100

- Brazil
- Colombia
- South Africa
- Chile
- Mexico
- Korea

Source: Bloomberg

1/ Refers to implied volatility in one-month options. 2/ Implied volatility in peso options. 3/ Refers to the simple average of the options for the currencies of: Brazil, Chile, Colombia, Korea, India, Mexico, Peru, Poland, South Africa and Turkey.

Source: Bloomberg
At the beginning of 2016, volatility in international financial markets considerably increased and the external environment faced by the Mexican economy deteriorated. In face of these developments, the Mexican authorities announced on February 17, 2016 in a timely and coordinated manner the following measures, which helped to revert the negative trend of the national currency:

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<th>Banco de México</th>
<th>Foreign Exchange Commission</th>
<th>Ministry of Finance</th>
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<td>50 bp reference rate increase in an extraordinary meeting.</td>
<td>Suspended auctions of U.S. dollars, leaving open the possibility to intervene discretionally in the exchange market in exceptional cases.</td>
<td>A preemptive expenditure cut of 0.7% of GDP in 2016.</td>
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Additionally, the Ministry of Finance on April 1st announced a cut to government expenditure for the 2017 budget by 0.9% of GDP, which will allow to achieve its targeted deficit despite lower oil revenues.
It is expected that from the next year onwards, public debt will begin to gradually diminish.

1/ Refers to the Public Sector Borrowing Requirements Historical Balance.
2/ As percentage of average GDP. e/ Estimates from Ministry of Finance. Doesn't include the use of the surplus of the Central Bank, which should reduce the trajectory.

Source: Ministry of Finance.

3/ A negative (positive) figure indicates a deficit (surplus). From 2000 to 2008 expenditure includes Pemex physical investment through Pidiregas scheme.

e/ 2016 and 2017 figures are estimates from Ministry of Finance.

Source: Ministry of Finance.
Banco de México has remained particularly vigilant to the external environment, given that in the domestic front no signs of aggregate demand pressures on prices have been observed.

**Domestic Environment:**

- Moderate economic growth.
  - The output gap has remained negative and it is expected to be gradually closed in the foreseeable future due to structural reforms.
  - The labor market is gradually recovering.
  - Inflation expectations remain anchored.
The output gap has remained negative and it is expected to remain so in the foreseeable future.

Output Gap \(^1/\)

% of potential output, s. a.

s. a. / Calculated with seasonally adjusted data.
1/ Estimated using the Hodrick-Prescott (HP) filter with tail correction method; see Banco de México (2009), "Inflation Report April–June 2009", p.69. The shaded area is the 95% confidence interval of the output gap, calculated with an unobserved components method.
Source: Calculated by Banco de México with data from INEGI.
Outlook for Economic Activity

Gross Domestic Product
Annual % change

Source: INEGI and Banco de México.

Growth enhancing reforms

In order to promote potential GDP growth, Mexico has also undertaken an ambitious structural reform agenda.

1. Energy
   - Oil
   - Electricity
2. Telecommunication
3. Labor
4. Financial
5. Competition
6. Education
7. Transparency
8. Anti-corruption

A proper implementation of the reforms should boost productivity.
The peso depreciation has not affected the price formation process, meanwhile interest rates have had a favorable behavior.

**Headline Inflation and Nominal Exchange Rate Depreciation: 1978-2016**

- **Annual %**
- **Depréciation**
- **FX Depréciation**
- **Headline Inflation**

**Government Securities’ Interest Rates**

- **%**
- **30 years**
- **2 years**
- **1 year**
- **10 years**
- **3 months**
- **1 day**

1/ Since January 21, 2008, the one-day (overnight) interest rate corresponds to the target for the Overnight Interbank Interest Rate.

Source: Banco de México and Proveedor Integral de Precios (PiP).
The government securities’ holdings by foreign investors have been stable and international reserves remain at high levels.

Government Securities’ Holdings by Foreign Investors 1/
MXN billion

International Reserves
USD billion

Source: Banco de México and International Monetary Fund.

1/ Total includes CETES, bonos, udibonos, bondes and bondes D.
Source: Banco de México.
Outlook for Inflation

Annual Headline Inflation \(^1/\) 

\(\%\)

1/ Quarterly average of annual headline inflation. Source: Banco de México and INEGI.
Final Remarks

- Looking forward, Banco de México’s Board of Governors will remain alert to the performance of all inflation determinants and its expectations for the medium and long term, especially:

  ✓ The exchange rate and its possible pass-through onto consumer prices.

  ✓ The monetary stance of Mexico relative to the U.S.

  ✓ The evolution of the output gap.

→ All of the above, in order to be able to take measures in a flexible manner and whenever conditions demand it, so as to consolidate the efficient convergence of inflation to the 3 percent target.