Mexico’s monetary policy and economic outlook
Manuel Sánchez
United States-Mexico Chamber of Commerce, Los Angeles, CA, November 15, 2013
Monetary policy and economic outlook themes

- Output slowdown and signs of an incipient rebound
- More stringent international financial conditions
- Lower inflation and monetary flexibility
- The possibilities from structural reforms
Since the middle of 2012 the Mexican economy slowed, and in 2Q13 output fell.

Real GDP
Quarterly and annual change, %, s. a.

s. a. / Seasonally adjusted
Source: INEGI
The origin of the declining growth seems to have lied first in softer external demand and then in a contraction of domestic investment.

Real aggregate demand
Quarterly change, %, s. a.

Exports of goods and services
Investment

Source: INEGI
As for external demand, the slowing of manufacturing exports translated into stagnant factory output

Manufacturing
2008 = 100, s. a.

Dollar value of exports
Real production (left axis)

s. a. / Seasonally adjusted and trend
Source: Banco de México and INEGI
As for investment, rising purchases of machinery and equipment have not compensated for the fall in construction investment.

Total fixed investment
2008 = 100, s. a.

- Construction
- Machinery and equipment

s. a. / Seasonally adjusted and trend
Source: INEGI
... which mainly reflects lower expenditures in public works and private housing building

Real construction output
2008 = 100, s. a.

s. a. / Seasonally adjusted and trend. The seasonal adjustment and the trend were prepared by Banco de México with data from INEGI
Source: INEGI
These shocks have weakened labor market conditions

Real wage bill and employment
2008 = 100, thousands

Source: Own calculations with data from INEGI
Lower consumer confidence has coincided with the first decline of consumption during the post-crisis period.

Retail sales and consumer confidence
2008 = 100, s. a.

s. a. / Seasonally adjusted and trend
Source: INEGI and Banco de México
Economic activity decelerated in spite of extraordinarily favorable financial conditions in the first part of the year.

Yield curve

%  

- December 30, 2011
- December 31, 2012
- May 10, 2013

Source: Proveedor Integral de Precios (PiP)
The financial bonanza was shared with other emerging markets

Emerging economies: accumulated capital inflows

Billion U.S. dollars

1/ Equity and debt
Source: Emerging Portfolio Fund Research
... largely as a result of expansionary monetary policies in advanced countries

Central bank assets
2007 = 100, local currency

Source: Haver Analytics

Mexico’s monetary policy and economic outlook
Mexico has been one of the preferred destinations of portfolio capital flows

Emerging economies: foreign holdings of local government bonds

Percentage of total government securities in circulation

New Zealand
Peru
Malaysia
Mexico
Poland
Turkey
Thailand
Korea
Brazil

1/ Federal government debt issued on the domestic market, in local currency
Source: Selected countries’ central banks and finance ministries
Since May, market anticipation of tapering translated into lower asset prices for emerging markets, including Mexico.

**Yield curve**

<table>
<thead>
<tr>
<th>Period</th>
<th>May 10, 2013</th>
<th>September 18, 2013</th>
<th>November 14, 2013</th>
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<tbody>
<tr>
<td>1-day</td>
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<tr>
<td>1-month</td>
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<td>3-month</td>
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<td>6-month</td>
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<td>1-year</td>
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<td>3-year</td>
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<td>5-year</td>
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<td>7-year</td>
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<td>10-year</td>
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<td>20-year</td>
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<td></td>
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<tr>
<td>30-year</td>
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</tbody>
</table>

Source: Proveedor Integral de Precios (PiP)
It is likely that international financial conditions will be less benign in the future

- So far financial adjustments have occurred in an orderly way
  - Capital outflows were not extraordinary
  - Foreign holdings of government bonds declined only modestly
  - Foreign exchange market remained highly liquid

- However, given the uncertainty over the future course of U.S. monetary policy, new bouts of volatility cannot be ruled out
Some indicators suggest that economic activity might have somewhat picked up in 3Q13

**Global Economic Activity Indicator**

2008 = 100, s. a.

s. a. / Seasonally adjusted
Source: Mexican National Accounts System (SCNM), INEGI

**Manufacturing**

2008 = 100, s. a.

Dollar value of exports
Production (left axis)

s. a. / Seasonally adjusted
Source: Banco de México and INEGI

**Services production**

2008 = 100, s. a.

s. a. / Seasonally adjusted
Source: Mexican National Accounts System (SCNM), INEGI

**Construction investment**

2008 = 100, s. a.

s. a. / Seasonally adjusted
Source: INEGI
The 2014 fiscal package will impact inflation, economic activity, and the use of financial resources

### Estimated effects of fiscal package for 2014

<table>
<thead>
<tr>
<th></th>
<th>Effects</th>
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<tbody>
<tr>
<td>Annual inflation (end of year)</td>
<td>40 basis points</td>
</tr>
<tr>
<td>GDP growth</td>
<td>0.2 percentage points</td>
</tr>
<tr>
<td>Increase in public sector borrowing requirements</td>
<td>1.2 percentage points of GDP</td>
</tr>
</tbody>
</table>

Source: Banco de México (2013), *Informe sobre la Inflación Julio – Septiembre 2013*, November
The economy is expected to recover gradually in 2014 and 2015

GDP forecast
Annual growth, %

1/ Maximum, average and minimum

Source: Banco de México (2013), Encuesta sobre las expectativas de los especialistas en economía del sector privado, October; Banco de México (2013), Informe sobre la Inflación Julio – Septiembre 2013, November; and Latin-American Consensus Forecasts, October
Downside risks to this scenario seem to prevail

- A pause in the U.S. economic recovery
- Heightened global risk aversion
- Further deterioration of the construction sector in Mexico
- Weakening consumer confidence
During the last decade, monetary policy has been focused on achieving a 3 percent permanent inflation target

Monetary policy interest rate
Annual, %

1 / Since January 21, 2008
Source: Banco de México
Annual headline inflation has consistently remained below historical levels

Source: INEGI
Monetary accommodation during 2013 has not endangered the convergence to the 3 percent inflation target

- Factors behind monetary policy decisions
  - Significant deceleration of the economy
  - Foreseeable decline in inflation

- Given the current fiscal policy no further cuts in the policy interest rate are warranted in the future
  - Closing future output gap
  - Real monetary policy interest rate already close to zero
In 2013, after a temporary spike resulting from agricultural price shocks, annual inflation has recently fallen.
The persistent gap between medium- and long-term inflation expectations and the target remains a challenge.
Short-term inflation risks should continue to be monitored

- Second-round effects from
  - Higher than expected impact from tax changes
  - Higher financial volatility
  - Upward pressures from non-core price components
Mexico should tackle the most important problem that has inhibited long-term economic growth

### Mexico: growth accounting\(^1\)

**Average annual change, %**

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<tbody>
<tr>
<td>GDP per capita</td>
<td>3.4</td>
<td>0.8</td>
</tr>
<tr>
<td>Total factor productivity</td>
<td>2.8</td>
<td>-0.6</td>
</tr>
<tr>
<td>Capital contribution</td>
<td>0.6</td>
<td>0.7</td>
</tr>
<tr>
<td>Labor contribution</td>
<td>0.0</td>
<td>0.6</td>
</tr>
<tr>
<td>Labor intensity</td>
<td>0.2</td>
<td>-0.1</td>
</tr>
<tr>
<td>Proportion of working-age population</td>
<td>-0.2</td>
<td>0.7</td>
</tr>
</tbody>
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The current reform agenda seeks to bring significant productivity gains

- Some salient features
  - Hiring and firing flexibility will increase labor productivity
  - Competitive conditions for teachers may eventually favor the quality of education
  - The entry of new players could provide wider and cheaper access to telecommunications services
  - Private participation in energy may lower key input prices

- Full benefits require
  - Efficient secondary legislation
  - Adequate implementation
Summary

- Sustained economic recovery will require the support of external demand and the revival of the construction industry
- It is likely that international financial conditions will be less supportive in the future
- Medium- and long-term inflation expectations have remained stable in spite of recent spikes in agricultural prices
- Given the current fiscal policy no further cuts in the policy interest rate are warranted in the future
- Adequate implementation of structural reforms may foster long-term economic growth
Mejoran las perspectivas económicas mundiales