Economic Update

MEXICO

Federal Reserve Bank of Dallas

Economic Outlook Stable Despite Weaker Third-Quarter Data

December 22, 2017

The consensus Gross Domestic Product (GDP) growth forecast for 2018 remained at 2.3 percent despite a downward revision of third quarter 2017 growth. Forecasters are predicting a bounceback in activity in the fourth quarter; 2017 GDP growth is still expected to come in at 2.1 percent.

More recent data are mixed. Exports, industrial production and retail sales all declined while employment growth remained strong. The peso weakened slightly against the dollar in November, and inflation ticked up.

Revisions Further Depress Third-Quarter Output Growth

Revisions to Mexico's third-quarter GDP estimate brought annualized quarterly growth to -1.2 percent, down from -0.8 percent (*Chart 1*). Service-related activities (wholesale and retail trade, transportation and business services) declined 0.4 percent. Goods-producing industry output contracted -2.4 percent. Agricultural output grew 1.9 percent.

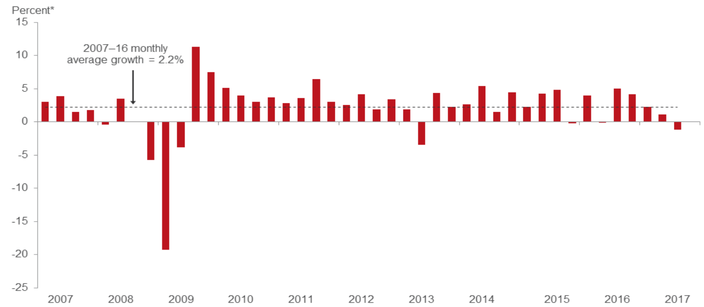
Total and Manufacturing Exports Slip in October, Petroleum Exports Rise

Total exports fell 0.7 percent in October. Manufactured-goods exports declined 1.3 percent while oil exports jumped 5.2 percent. In the last two months, the three-month moving average shows consecutive gains for oil exports and consecutive declines for total and manufacturing exports (*Chart 2*). On a year-to-date basis, exports grew 7.2 percent through October while manufacturing exports rose 6.4 percent compared with the same period last year. Oil exports were up 19.7 percent in the first 10 months of 2017 compared with the same period a year ago. The rise in oil exports this year stems largely from higher oil prices, not increased volume of exports.

Industrial Production Declines in October

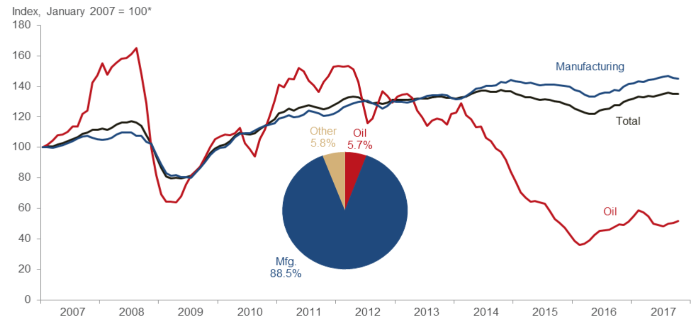
Mexico's industrial production (IP), which includes manufacturing, construction, oil and gas extraction, and utilities, dropped 0.2 percent in October. Manufacturing IP slid 0.6 percent. The declines follow weak September readings when IP fell 0.4 percent and manufacturing IP dipped 0.3 percent. As a result, the three-month moving average fell for both measures. The moving average measure of total IP has fallen for seven consecutive months (*Chart 3*). In the U.S., IP rose 0.3 percent in November after a 1.1 percent jump in October.

Chart 1
Third-Quarter Gross Domestic Product Revised Down



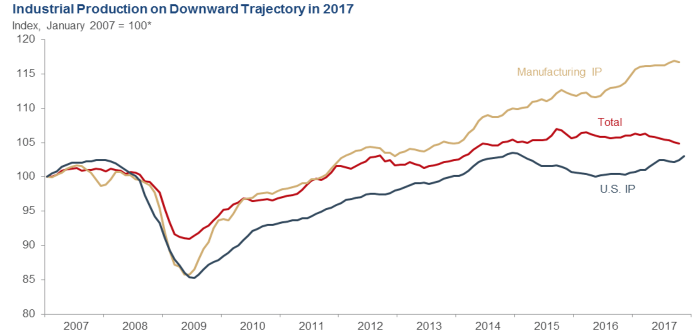
*Quarter/quarter, real pesos; seasonally adjusted, annualized rate.
NOTE: Data through third quarter 2017.
SOURCE: Instituto Nacional de Estadística y Geografía (National Institute of Statistics and Geography).

Chart 2
Oil Exports Grow, Total and Manufacturing Exports Slip



*Seasonally adjusted, three-month moving average; real dollars.
NOTE: Data for lines and pie chart are through October 2017. Shares may not sum to 100 due to rounding.
SOURCE: Instituto Nacional de Estadística y Geografía (National Institute of Statistics and Geography).

Chart 3
Industrial Production on Downward Trajectory in 2017

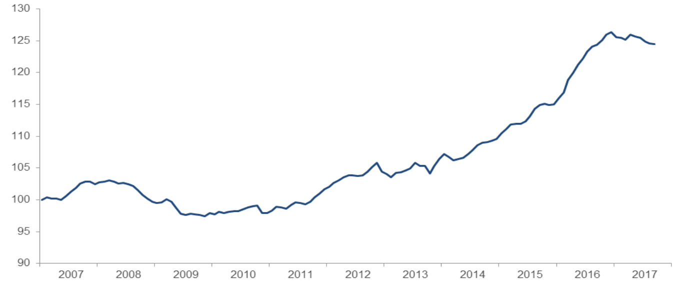


*Seasonally adjusted, three-month moving average.
NOTES: Data for Mexico's manufacturing and total IP are through October 2017. Data for U.S. IP are through November 2017.
SOURCES: Instituto Nacional de Estadística y Geografía (National Institute of Statistics and Geography); Federal Reserve Board.

Retail Sales Fall in September

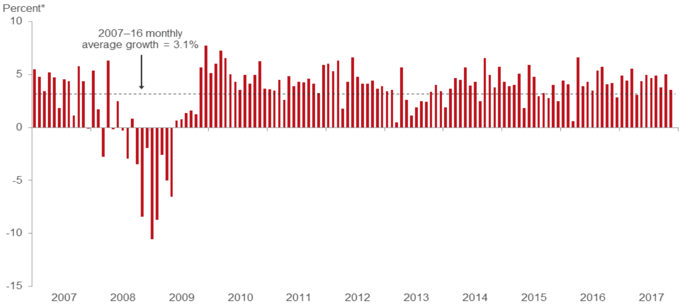
Retail sales slid 0.4 percent in September. Positive growth in August and July kept the three-month moving average flat (*Chart 4*). Momentum in retail sales has diminished since early this year, mainly due to high inflation (which has pushed prices higher and real wages lower), increasing interest rates that have raised the cost of credit, and depressed consumer confidence. Consumer confidence improved in November after slipping in October.

Chart 4
Momentum in Retail Sales Moving Average Obscures September Dip
Index, January 2007 = 100*



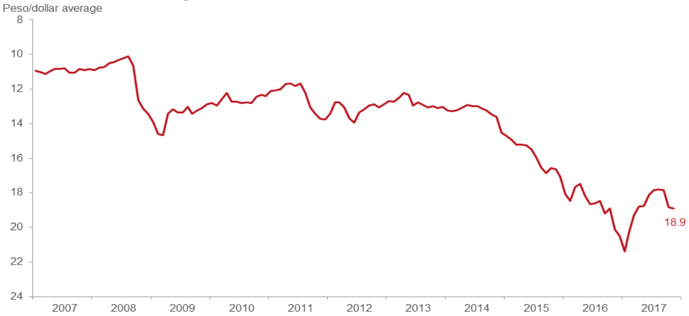
*Seasonally adjusted, three-month moving average; real pesos.
NOTE: Data are through September 2017.
SOURCE: Instituto Nacional de Estadística y Geografía (National Institute of Statistics and Geography).

Chart 5
Above-Trend Job Growth Continues
Percent*



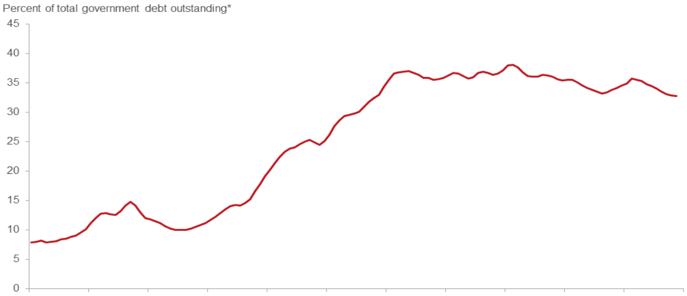
*Month/month; seasonally adjusted, annualized rate.
NOTE: Data are through November 2017.
SOURCE: Instituto Mexicano del Seguro Social (Mexican Social Security Institute).

Chart 6
Peso Loses Some Ground Against Dollar in November
Peso/dollar average



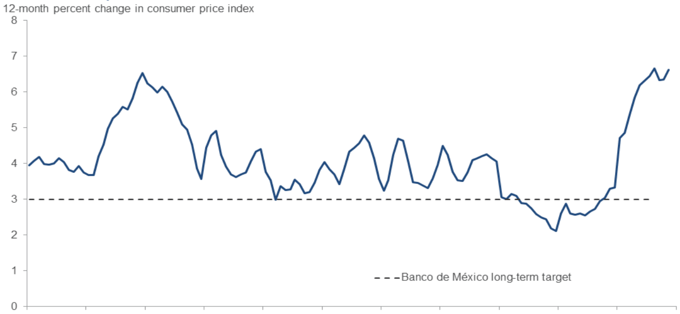
NOTE: Data are through November 2017.
SOURCE: Banco de México.

Chart 7
Foreign-Owned Government Debt Share Ticks Down
Percent of total government debt outstanding*



*Three-month moving average.
NOTE: Data are through November 2017.
SOURCE: Banco de México.

Chart 8
Inflation Ticks Up in November
12-month percent change in consumer price index



NOTE: Data are through November 2017.
SOURCE: Instituto Nacional de Estadística y Geografía (National Institute of Statistics and Geography).

Rapid Job Growth Continues in November

Formal-sector employment—jobs with government benefits and pensions—grew at an annualized rate of 3.5 percent in November (*Chart 5*). Monthly growth has exceeded its 10-year average for seven consecutive months. Year-to-date growth stands at 4.5 percent annualized. Employment growth was 4.1 percent (December over December) in 2016 and 3.8 percent in 2015.

Peso Slightly Weaker Against the Dollar in November

The Mexican currency averaged 18.9 pesos per dollar in November, a 0.5 percent depreciation from October (*Chart 6*). Nevertheless, the peso is up over 13 percent since January. The Mexican currency initially weakened last year in anticipation of increases in U.S. interest rates as well as policy and economic uncertainty following the U.S. presidential election.

Foreign-Owned Government Debt Ticks Down in November

In November, as in most months of 2017, the share of peso-denominated government debt held abroad fell. The foreign-owned government debt share was near 36 percent at the beginning of the year. By November, the share had fallen to 32.8 percent (*Chart 7*). The extent of nonresident holdings of government debt reflects Mexico's exposure to international investors, whose holdings could quickly reverse if they perceive a change in market sentiment toward Mexico.

Inflation Ticks Up in November

The 12-month change in the Mexico consumer price index (CPI) rose to 6.6 percent in November, up slightly from 6.4 percent in October. Inflation remains far above Banco de México's long-term target of 3 percent (*Chart 8*). CPI core inflation (excluding food and energy) rose 4.9 percent over the 12 months ending in November.

On Dec. 14, Banco de México increased its benchmark interest rate to 7.25 percent in response to the pickup in inflation. Mexico's central bank attributed the recent deterioration of the peso-dollar exchange rate and the associated acceleration in prices to NAFTA renegotiation hurdles as well as U.S. monetary policy tightening. New Banco de México Governor Alejandro Díaz de León was appointed to a four-year term on Dec. 1.

—Jesus Cañas and Alexander T. Abraham

About the Author

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