

Mexico Economy Expands at a Strong Pace in First Quarter

May 15, 2018

Mexico's gross domestic product (GDP) grew at an annualized 4.5 percent pace in first quarter 2018—its highest quarterly growth since mid-2016. More recent data on exports, employment, industrial production and retail sales also improved. Inflation fell for the third consecutive month in March, and the peso appreciated against the dollar. The consensus growth forecast for 2018 is 2.2 percent.

Output Growth Solid

Mexico's solid GDP growth in the first quarter was mostly driven by increased activity in the service sector (*Chart 1*). Service-related activities (wholesale and retail trade, transportation and business services) rose 4.8 percent, while goods-producing industries (manufacturing, construction, utilities and mining) expanded 2.8 percent. Agricultural output grew 3.2 percent.

Export Growth Returns in March

Total exports rose 2.7 percent in March after falling 2.6 percent in February. Manufactured goods exports grew 2.8 percent, and oil exports slid 2 percent. Three-month moving averages of total and manufacturing exports show consistent growth since late 2017, although oil exports ticked down in early 2018 (*Chart 2*). Over the past 12 months, total exports have increased 9.9 percent, with manufacturing exports up 7.9 percent and oil exports up 31.3 percent. The rise in oil exports over the past year stems largely from higher oil prices rather than an increased volume of exports.

Industrial Production Up Overall, but Manufacturing Stays Flat

Mexico's industrial production (IP), which includes manufacturing, construction, oil and gas extraction, and utilities, ticked up 0.5 percent in February after coming in flat in January. Manufacturing IP was flat in both January and February. As a result, the moving average went up for total IP but moved sideways for manufacturing (*Chart 3*). U.S. IP grew 0.4 percent in both February and March.

Retail Sales Grow in February

Retail sales grew 0.5 percent in February after falling 0.1 percent in January. The moving average shows a tentative recovery from the depressed levels observed

Chart 1
First-Quarter Gross Domestic Product Jumps

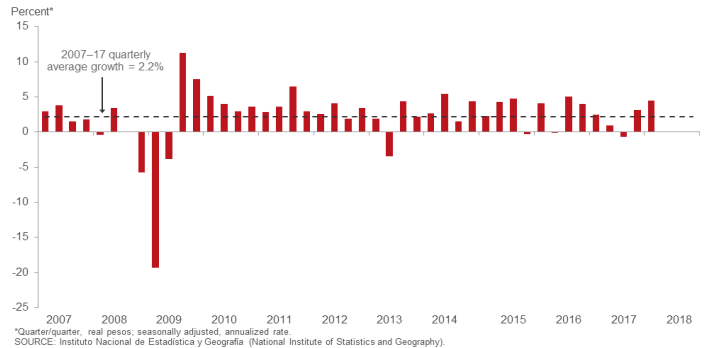


Chart 2
Total and Manufacturing Exports Grow, Oil Exports Slip

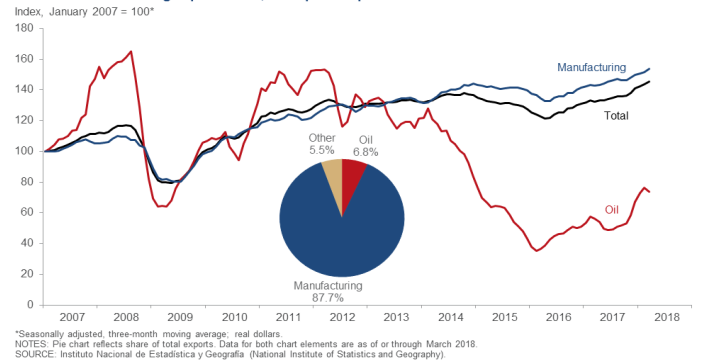
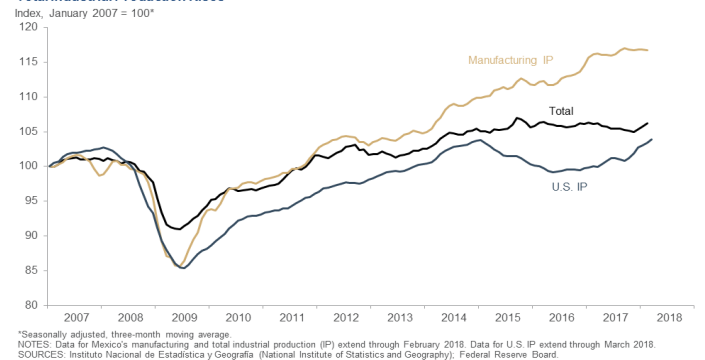


Chart 3
Total Industrial Production Rises



during the second half of 2017 (*Chart 4*). Year over year in February, retail sales were stagnant, falling 0.2 percent. Sales were pressured in 2017 by high inflation (which pushed prices higher and real wages lower), increased interest rates that raised the cost of credit, and depressed consumer confidence.

Chart 4
Retail Sales Strengthen

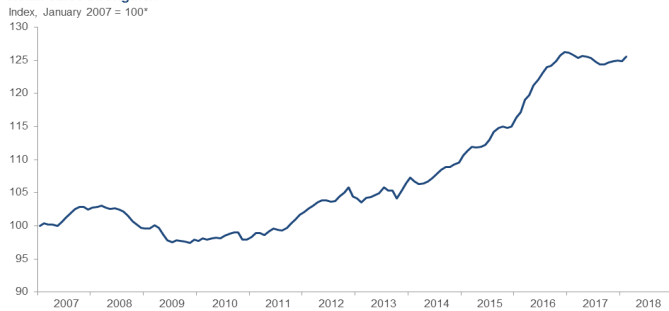


Chart 5
Job Growth Moderates

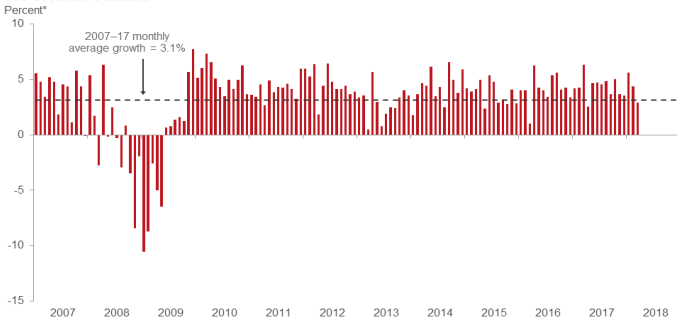


Chart 6
Peso Appreciates Against the Dollar in April



Chart 7
Foreign-Owned Government Debt Share Continues Downward Trend

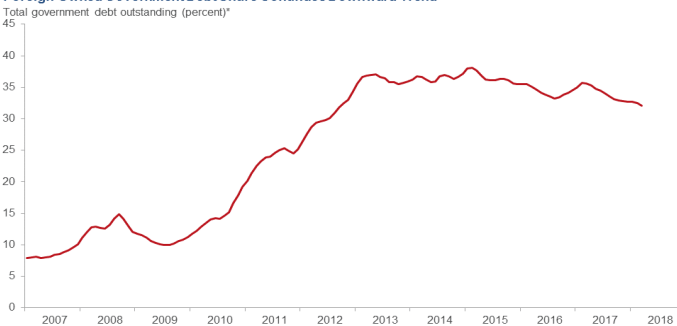


Chart 8
Inflation Continues Cooling



Job Growth Continues in March

Formal sector employment—jobs with government benefits and pensions—grew at an annualized rate of 2.9 percent in March and is up 4.3 percent year to date (annualized) (*Chart 5*). Employment growth was 4.3 percent in 2017 and has averaged 3.1 percent per year since 2007. The unemployment rate in March was 3.2 percent, down from 3.5 percent a year earlier. Strong job growth and falling unemployment point to tightening labor markets.

Peso Gains Ground in April

The Mexican currency averaged 18.4 pesos per dollar in April, a 1.3 percent appreciation from March (*Chart 6*). The peso is up 16.3 percent since January 2017, when the exchange rate reached a historical low of 21.4 pesos per dollar. The Mexican currency initially weakened in 2017 in anticipation of increased U.S. interest rates as well as heightened policy and economic uncertainty around U.S.–Mexico trade.

Foreign-Owned Government Debt Share Ticks Down

The share of peso-denominated government debt held abroad fell slightly in March. About 32 percent of peso-denominated debt is currently held abroad. The share declined in 2017 after moving higher early in the year. The moving average reflects the continuing downward trend (*Chart 7*). The extent of nonresident holdings of government debt indicates Mexico’s exposure to international investors, whose holdings could quickly reverse if they perceive a change in market sentiment.

Inflation Continues to Fall

The 12-month change in the consumer price index (CPI) was 5 percent in March, down from 5.3 percent in February (*Chart 8*). Inflation is moving closer to Banco de México’s long-term target of 3 percent. CPI core inflation (excluding food and energy) rose 4 percent over the 12 months ending in March. Mexico’s central bank last raised its benchmark interest rate by 25 basis points (0.25 percentage points) in February to 7.5 percent.

—Jesus Cañas and Alexander T. Abraham

About the Author

Cañas is a senior business economist, and Abraham is an economic programmer in the Research Department at the Federal Reserve Bank of Dallas.