Mexico's Macroeconomic Performance: Q2 2019 GDP and Current Monthly Indicators

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Overview

During Q2 2019, Mexico's GDP decreased by 0.8% YoY, marking the first contraction since Q4 2008. The weakness of the components of the domestic demand, principally the fall in investment and consumption, is the main reason for Mexico's GDP decrease during this period.

Consumption decreased 0.6% YoY in Q2 2019, a deceleration from the previous quarter, marking its first fall since Q4 2009. Both government and household consumption registered a decrease (-2.3% YoY and -0.3% YoY respectively).

Regarding investment, gross fixed capital formation (GFCF) decreased 7.3% YoY in Q2 2019, the sharpest fall since Q4 2009. Both public and private investment decreased during this period (-14.5% YoY and -6.2% YoY, respectively).

In September, Mexico's CPI increased 3.0% YoY, a deceleration from the previous month (3.2% YoY). The lower price of gasoline was the main reason for Mexico's CPI deceleration.

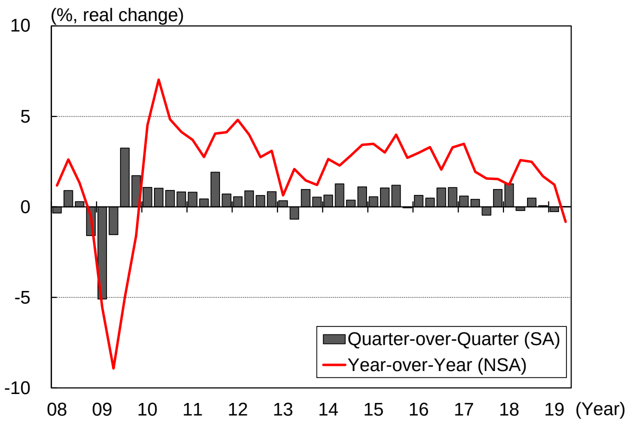
At its September meeting, the Central Bank decided to decrease the policy rate to 7.75% for the second consecutive time. The Central Bank stated that the decision was based on moderating inflationary pressures, a greater-than-expected widening of the output gap and the rate cut by the US Federal Reserve.

It is expected that Mexican GDP growth will decelerate in 2019 in comparison to the previous year. For 2020, GDP growth is expected to accelerate in comparison to 2019, but growth is expected to continue to be weak. Consumption is expected to continue to be the main driver of economic growth due to the recent rate cuts implemented by the Central Bank. On the other hand, investment could continue to be negatively affected by uncertainty over Lopez Obrador's economic policies.

1. GDP

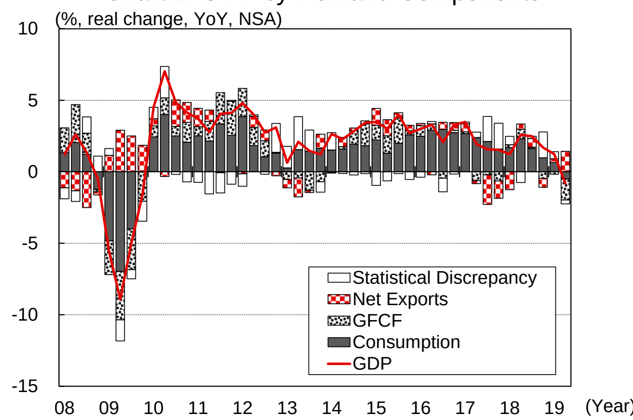
During Q2 2019, Mexico's GDP decreased by 0.8% YoY, marking the first contraction since Q4 2008 (Chart 1). The quarter-over-quarter growth rate was flat, at 0.0%. The weakness of the components of domestic demand, in particular the fall in investment and consumption, is the main reason for Mexico's GDP decrease during this period (Chart 2).

Chart 1: GDP Growth



Source: INEGI (National Institute of Statistics and Geography), MUFG Economic Research Office

Chart 2: GDP by Demand Components



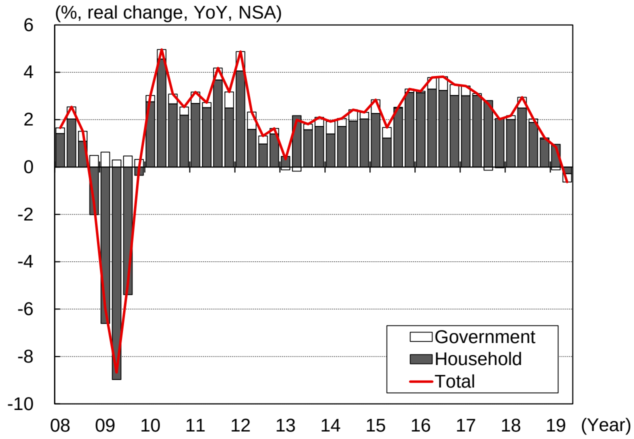
Note: GFCF stands for Gross Fixed Capital Formation.
Source: INEGI, MUFG Economic Research Office

Consumption and Investment

Consumption decreased 0.6% YoY in Q2 2019, a deceleration from the previous quarter and marking its first contraction since Q4 2009 (Chart 3). Both government and household consumption decreased (-2.3% YoY and -0.3% YoY, respectively). Government consumption decreased partially as a result of the austerity measures implemented by the government. Meanwhile, the fall in household consumption could be explained by a significant slowdown of jobs added to the economy during this period (in Q2 2019, only 20,158 jobs were added while during the same period last year 107,578 jobs were added).

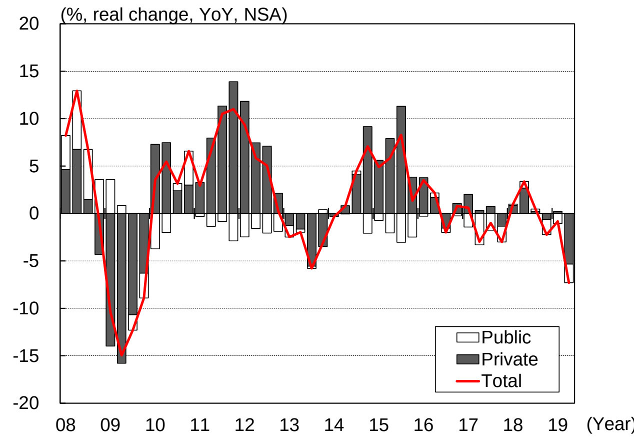
Regarding investment, gross fixed capital formation (GFCF) decreased 7.3% YoY in Q2 2019, the sharpest fall since Q4 2009 (Chart 4). Both public and private investment decreased during this period (-14.5% YoY and -6.2% YoY, respectively). While the government transition and government austerity measures are behind the contraction in public investment, private investment may have been affected by internal and external factors such as uncertainty over Lopez Obrador's government agenda, the delay in the ratification of USMCA and the global economic slowdown.

Chart 3: Consumption



Source: INEGI, MUFG Economic Research Office

Chart 4: Gross Fixed Capital Formation

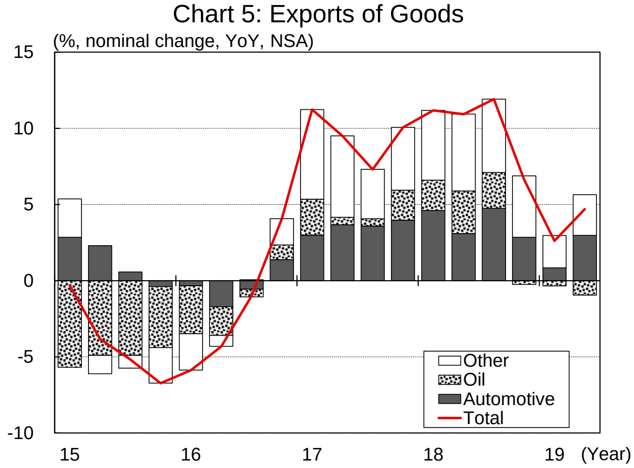


Source: INEGI, MUFG Economic Research Office

Exports and Imports

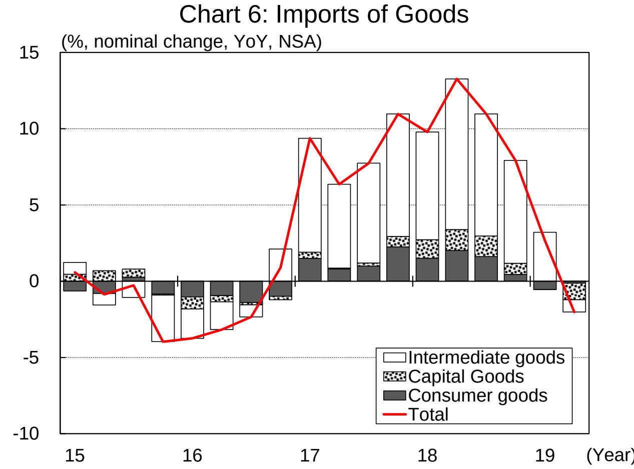
Exports of goods grew 4.7% YoY in Q2 2019 (Chart 5), an acceleration from the previous quarter. This acceleration could be explained in part by the increase in automotive exports (9.7% YoY in Q2 2019 from 2.6% YoY the previous quarter). Imports of goods decreased 2.0% YoY in Q2 2019 (Chart 6), a deceleration in comparison to the previous quarter. All import components decreased, which is in line with the poor investment situation and the decrease in household consumption.

Chart 5: Exports of Goods



Source: Bank of Mexico, MUFG Economic Research Office

Chart 6: Imports of Goods



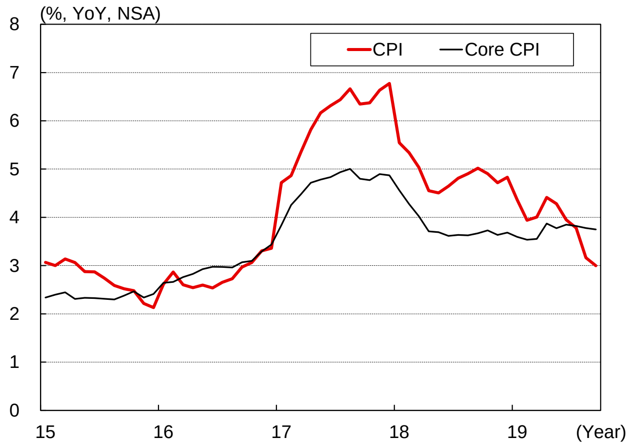
Source: Bank of Mexico, MUFG Economic Research Office

2. Inflation and Monetary Policy

In September, Mexico's CPI increased 3.0% YoY a deceleration from the previous month (3.2% YoY) (Chart 7). The CPI reached the policy target rate of 3.0% for the first time since September 2016. The lower price of gasoline was the main reason for Mexico's CPI deceleration. Growth in core CPI held steady at 3.8% YoY for the fifth consecutive month.

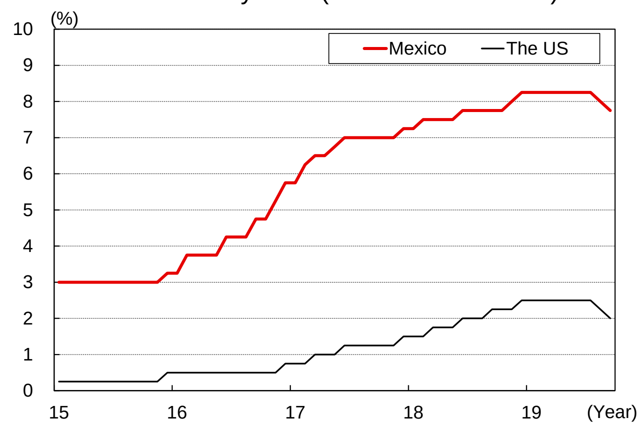
At its September meeting, the Central Bank decided to decrease the policy rate to 7.75% for the second consecutive time (Chart 8). The Central Bank stated that the decision was based on moderating inflationary pressures, a greater than expected widening of the output gap and the rate cut by the US Federal Reserve.

Chart 7: CPI



Source: INEGI, MUFG Economic Research Office

Chart 8: Policy Rate (Mexico and The US)



Source: Bank of Mexico, Federal Reserve of the United States, MUFG Economic Research Office

3. Outlook

It is expected that Mexican GDP growth will decelerate in 2019 in comparison to the previous year. For 2020, GDP growth is expected to accelerate in comparison to 2019, but growth is expected to continue to be weak. Consumption is expected to continue to be the main driver of economic growth due to the recent rate cuts implemented by the Central Bank. On the other hand, investment could continue to be negatively affected by uncertainty over Lopez Obrador's economic policies. Inflation is expected to finish the year within the target range of the Central Bank (2.0%-4.0%) and is expected to remain at that level throughout 2020. The weakening of aggregate demand is the main factor for the moderation in inflation.

With regards to USMCA (US, Mexico and Canada Agreement), Canada and the US have yet to begin the ratification process[1] and the likelihood of ratification of USMCA in 2019 is decreasing with each passing day[2]. While the actual impact of USMCA ratification on Mexican GDP growth is still uncertain, it is expected to be limited[3]. There does exist a more unlikely but higher risk scenario in which the US withdraws from NAFTA in case ratification of the trade deal does not happen. This scenario would likely have a larger negative impact on the Mexican economy. The development of this situation will be closely monitored going forward.

[1] Mexico became the first country to ratify the agreement on June 19, 2019.

[2] Canada has indicated it will wait to approve the agreement until after its October 21 federal election. For the US, the prevailing view is that if the bill is not introduced in Congress by the end of November, the vote on the bill will likely not occur until after the 2020 election.

[3] In a recent publication entitled "NAFTA to USMCA: What is gained?", the IMF concluded that although the new provisions of the deal are expected to negatively impact the manufacturing sector and exports, this impact is expected to be counterbalanced by improved goods market access that is expected to increase consumption.