Overview

Mexico’s GDP grew by 2.3% YoY in Q1 2018. On a quarter-over-quarter basis (compared to Q4 2017), Mexico’s GDP increased by 1.1%.

Household consumption edged up to 3.5% YoY in Q1 2018. It was supported by 1) a tighter labor market with unemployment at its lowest level (3.1% in May 2018) since January 2006, and 2) an increase in real wages as a result of a decrease in inflation.

Gross Fixed Capital Formation (GFCF) grew 1.5% YoY in Q1 2018 after three consecutive quarters of contraction. Construction continued to contract (-0.5% YoY), but the contraction was less than in previous quarters. This could be partially related to the reconstruction process taking place after the earthquake in September 2017.

After five consecutive months of the consumer price index ebbing constantly, the reading for June showed a slight uptick to 4.6% YoY from 4.5% YoY the previous month. The increase in transportation prices as a result of higher fuel prices could be among the main reasons behind the increase in prices during June.

At its June meeting, the Central Bank decided to raise the policy rate to 7.75% after pausing its hiking cycle in April and May. The decision came amid growing concerns over inflation and its convergence to the target.

It is expected that Mexican GDP growth will accelerate in 2018. Ebbing inflationary pressures and tighter labor markets could continue to support household spending. In addition to this, manufacturing exports will continue to be supported by healthy US demand. Uncertainties remain regarding NAFTA renegotiation and policy changes (if any) that will be proposed by Lopez Obrador, and both could weigh on GDP growth in 2019 and beyond.
1. GDP

Mexico’s GDP grew by 2.3% YoY in Q1 2018 (Figure 1). On a quarter-over-quarter basis (compared to Q4 2017), Mexico’s GDP increased by 1.1%.

Mexico’s GDP growth was driven by an increase in consumption and investment (Figure 2).

Consumption

Consumption grew 3.2% YoY in Q1 2018, an acceleration from the previous quarter (Figure 3).

Household consumption edged up to 3.5% YoY in Q1 2018. It was supported by 1) a tighter labor market with unemployment rate at its lowest level since January 2006, and 2) an increase in real wages as a result of a decrease in inflation (Figure 4).
Investment

Gross Fixed Capital Formation (GFCF) grew 1.5% YoY in Q1 2018 after three consecutive quarters of contraction (Figure 5). This was driven by an increase in investment in machinery and equipment (4.4% YoY), mainly led by the increase in imported goods. Construction, on the other hand, continued to contract (-0.5% YoY), but the contraction was less than in previous quarters. This could be partially related to the reconstruction process taking place after the earthquake in September 2017.

Foreign direct investment (FDI) inflows decreased by 24.7% YoY in Q1 2018 (Figure 6). This is mainly explained by the decrease in FDI inflows to the manufacturing sector. Uncertainties coming from the NAFTA re-negotiation and presidential elections could be among the main reasons for the decrease in FDI inflows during Q1 2018.
Exports and Imports

Exports of goods continued to experience a favorable performance during Q1 2018 (11.1% YoY) (Figure 7). The expansion of exports was mainly driven by manufacturing exports that have experienced steady growth since Q1 2017. This is in line with the improvement of global economic activity.

Imports of goods also increased in Q1 2018 (9.8% YoY) (Figure 8). The increase in imports of intermediate goods is consistent with the increase in manufacturing exports. Imports of capital goods increased 12.8% YoY, the largest expansion since Q1 2012.

2. Inflation and Monetary Policy

After five consecutive months of the consumer price index ebbing constantly, the reading for June showed a slight uptick to 4.6% YoY from 4.5% YoY the previous month (Figure 9). The increase in transportation prices as a result of higher fuel prices could be among the main reasons behind the increase in prices during June. Meanwhile, core CPI decreased slightly to 3.6% YoY from 3.7% YoY the month before.

At its June meeting, the Central Bank decided to raise the policy rate to 7.75% after pausing its hiking cycle in April and May. The decision came amid growing concerns over inflation and its convergence to the target.
3. Exchange rate

The Mexican peso has been volatile (Figure 10). During Q1 2018, the peso was appreciating, but starting in mid-April and continuing until just before the presidential election (June 29) the Mexican peso depreciated 9.5% during this period. From July 2 to July 27, the Mexican peso appreciated (7.7%) partially as a result of the elected president, Manuel Lopez Obrador, and his team’s message that they will implement prudent policies and work closely with business.

4. Outlook

It is expected that Mexican GDP growth will accelerate in 2018. Ebbing inflationary pressures and tighter labor markets could continue to support household spending. In addition to this, manufacturing exports will continue to be supported by healthy US demand. Uncertainties regarding NAFTA renegotiation and policy changes (if any) that will be proposed by Lopez Obrador could weigh on GDP growth in 2019 and beyond.