MUFG LATIN AMERICA TOPICS

Mexico's Macroeconomic Performance: Q3 2017 GDP and Current Economic Indicators

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Overview

Mexico's GDP grew by 1.5% YoY in Q3 2017, the slowest pace since the fourth quarter of 2013.

Household consumption grew 3.1% YoY in Q3 2017, a deceleration from the previous quarter. One factor that could be behind the slightly lower growth rate of household consumption is the high interest rates that are affecting household debt, principally consumer credit. The performance of household consumption is still robust and was supported by a strengthening of the labor market.

Mexico reported a contraction of 0.8% YoY in Gross Fixed Capital Formation (GFCF) in Q3 2017. While still negative, GFCF experienced an improvement from the previous quarter. The uncertainties from the ongoing negotiation regarding NAFTA remain high and could be one of the factors affecting private investment.

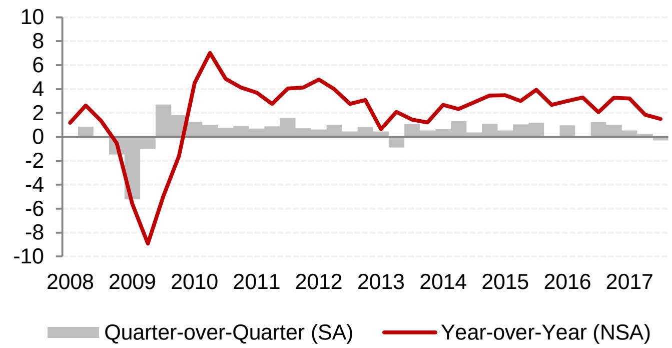
After reaching its highest point in August at 6.7% YoY, inflation has plateaued from August through November. Inflation has continued to remain at a level well above the target range as a result of higher global oil prices, a weak peso and the implementation of the last stage of an energy reform. The Central Bank increased the interest rate to 7.25% at its last meeting in December.

It is expected that Mexican GDP growth will decelerate slightly in 2017 (2.0% YoY) from its growth rate in 2016 (2.3% YoY). For 2018, similar GDP growth is expected (2.0% YoY).

1. GDP, Economic activity

Mexico's GDP grew by 1.5% YoY in Q3 2017, the slowest pace since the fourth quarter of 2013 (Figure 1). On a quarter-over-quarter basis (compared to Q2 2017), Mexico's GDP contracted by 0.3%.

Figure 1: GDP Growth



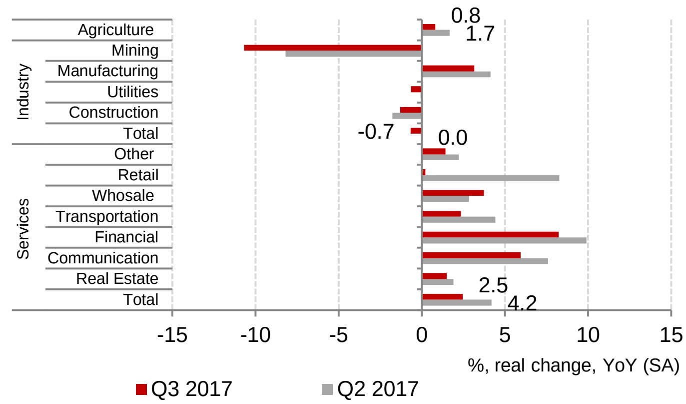
Source: INEGI (National Institute of Statistics and Geography), MUFG

GDP by Sector

On the production side, although the service sector continues to be the main motor of economic growth in Mexico, growing 2.5% YoY in Q3 2017 (Figure 2), its pace of growth was much slower than in Q2 2017 (4.2%). The retail sector suffered the largest slowdown in comparison to the previous quarter.

In contrast, the industry sector contracted (-0.7% YoY) in Q3 2017 with the mining sector contracting 10.7% YoY (making this the fifteenth consecutive quarter in which this sector contracted, and being the main source of overall industry sector contraction). The fall in oil production (-12.0% YoY SA in Q3) as a result of a lack of public investment in the sector and disruptions caused by natural disasters continued to be the main cause of the mining sector contraction.

Figure 2: GDP by Sector



Source: INEGI, MUFG

Consumption

Household consumption grew 3.1% YoY in Q3 2017, a deceleration from the previous quarter (Figure 3).

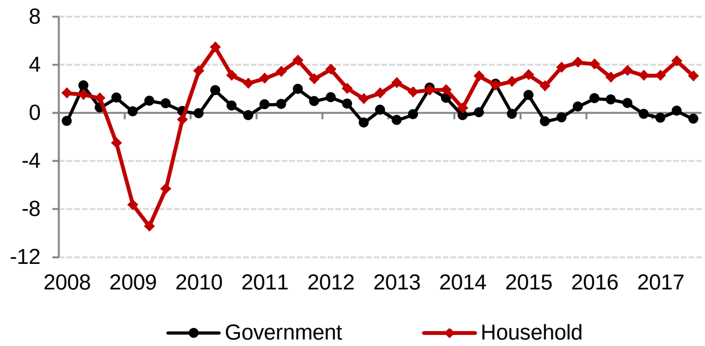
One factor that could be behind the slightly lower growth rate of household consumption is the high interest rates that are affecting household debt, principally consumer credit (Figure 4).

The growth in Q3 2017, although a deceleration in comparison with the growth rate achieved in Q2 2017, was still higher than the average growth over the past 5 years (2.6%). The performance of household consumption is still robust and was supported by a strengthening of the labor market, with solid job creation during the first three quarters of 2017 (Figure 5).

Consumer confidence has been improving and, in November, the index rose to 88.8, about 18 points higher than the low it experienced in January this year (70.3).

Figure 3: Consumption

%, real change, YoY (SA)

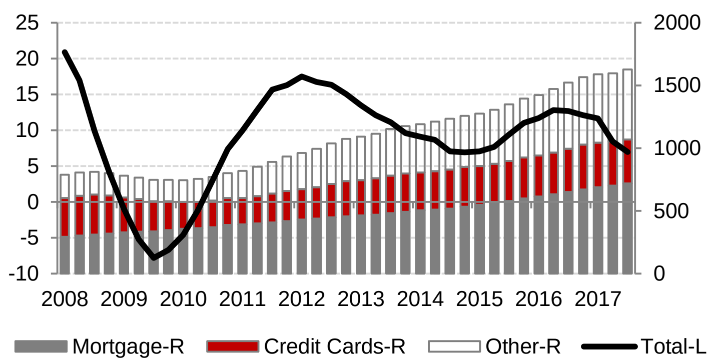


Source: INEGI, MUFG

Figure 4: Household Debt

%, nominal change, YoY

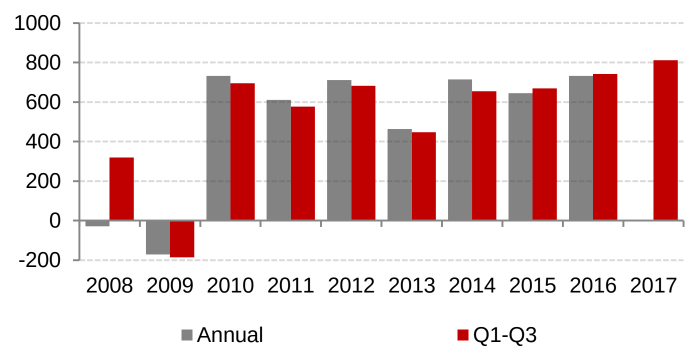
Bn of MX Pesos



Note: Other includes personal loans, automotive and household goods loans and other types of credit. Credit cards and other are part of consumer credit.
Source: INEGI, MUFG

Figure 5: Net Formal Job Creation

Thousands of people (NSA)

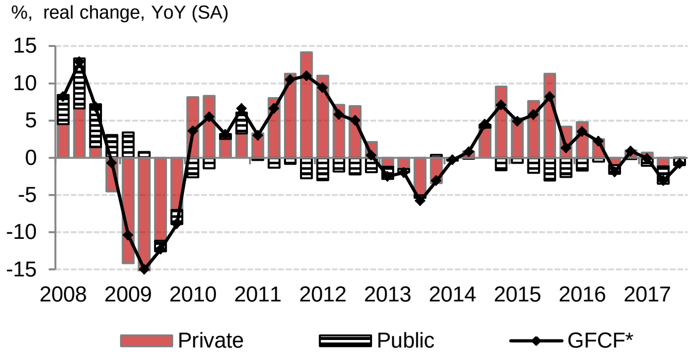


Note: Workers affiliated to the IMSS (Mexican Social Security Institute).
Source: Secretariat of Labor and Social Welfare, MUFG

Investment

Mexico reported a contraction of 0.8% YoY in Gross Fixed Capital Formation (GFCF) in Q3 2017 (Figure 6). While still negative, GFCF experienced an improvement from the previous quarter.

Figure 6: Private and Public Investment Contribution to GFCF



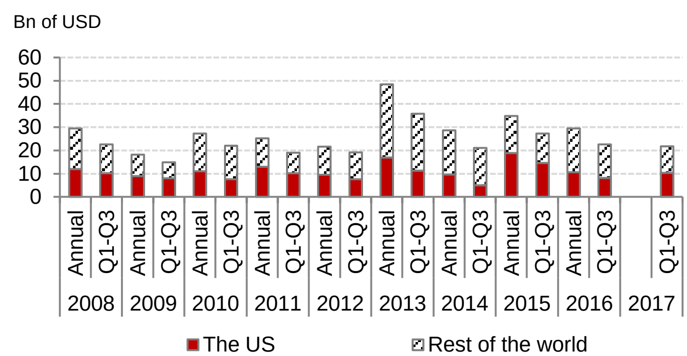
*Gross Fixed Capital Formation
Source: INEGI, MUFG

The factors affecting investment could be the negative tendency of public investment (-5.0% YoY during Q3 2017), due to the government austerity efforts, which are affecting investment in construction. Private investment continued with its lackluster performance. The uncertainties from the ongoing negotiation regarding NAFTA remain high and could be one of the factors affecting private investment.

Business confidence, while still low and on the pessimistic side of the scale, is improving (49.5 points in November, around 7 points higher than in February when it reached its lowest point during 2017).

FDI[1] (Foreign direct investment) inflows decreased around 3.5% the first three quarters of 2017 in comparison with the same period from 2016 (Figure 7). While investment from the US increased 26.7%[2] during the aforementioned period, investment from the rest of the world fell by 20.8%. The sector that has seen the biggest drop in FDI during the first three quarters of 2017 was manufacturing[3], which contracted by 30.0% YoY. It is expected that FDI will decelerate in 2017 and if the uncertainties regarding the NAFTA renegotiations continue, this will likely affect FDI going forward.

Figure 7: Foreign Direct Investment from the US and the Rest of the World



Source: Secretariat of Economy, MUFG

[1] FDI accounted for around 13% of GFCF in 2016.

[2] FDI from the US to the manufacturing sector, principally the automotive sector, increased substantially during Q1-Q3 2017 (14.5%YoY increase for the manufacturing sector as a whole and a 105.2% YoY increase for the automotive sector (automobiles and auto parts)). This could be explained by the increased demand from the US, which is consistent with the increase in exports that the automotive sector experienced during the same period.

[3] The chemical and plastic industries that account for about 15% of the manufacturing sector are the ones that contracted the most (80.0% and 51.1% respectively).

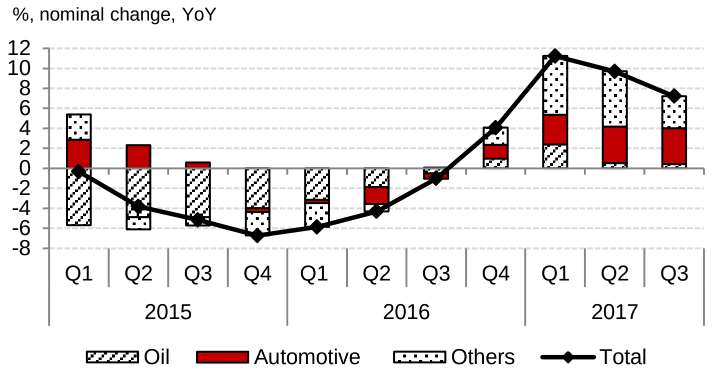
Mexico's external sector

Mexico's current account deficit reached 13.7 Billion of USD (Q1-Q3 2017), which is 32.3% smaller than in the same period in 2016.

The narrowing of the deficit so far in 2017 is mainly due to the gradual recovery of the global economy, resulting in an expansion of exports in 2017 (9.3% YoY Q1-Q3 2017). In particular, automotive exports have experienced steady growth during the first three quarters of 2017 (Figure 8).

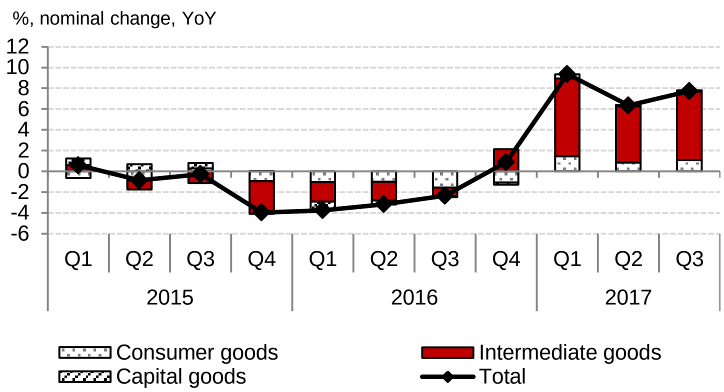
Imports also registered an increase (although less than that of exports) throughout the first three quarters of 2017 (Figure 9). The increase in imports of intermediate goods is consistent with the increase in manufacturing exports. The slowdown of imports of capital goods corresponds to the fall in investment highlighted in the previous section.

Figure 8: Contribution by Sector to Exports of Goods



Source: Bank of Mexico (Central Bank of Mexico), MUFG

Figure 9: Contribution by Sector to Imports of Goods



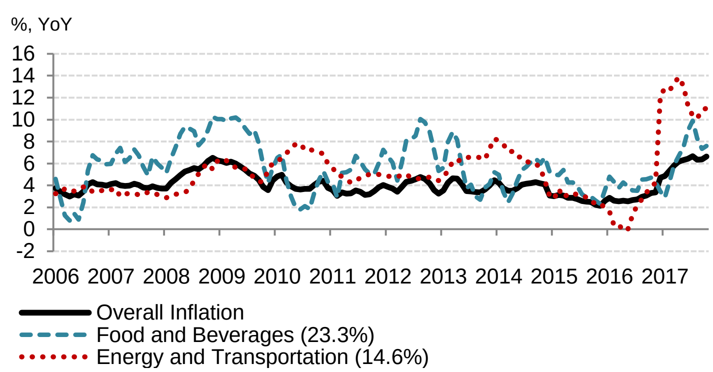
Source: Bank of Mexico, MUFG

2. Inflation and Monetary Policy

After reaching its highest point in August at 6.7% YoY, inflation has plateaued from August through November (Figure 10).

Inflation has continued to remain at a level well above the target range as a result of higher global oil prices, a weak peso and the implementation of the last stage of an energy reform (the final liberalization of energy prices took place in November 2017).

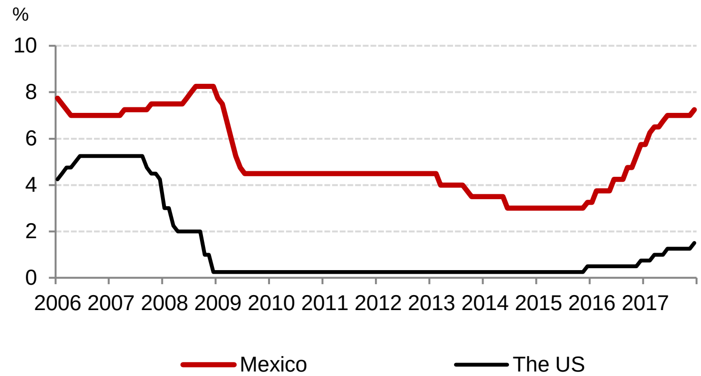
Figure 10: Food and Beverages Prices, Energy and Transportation Price and Overall Inflation



Note: The number in the bracket is the weight on overall inflation (2010).
Source: INEGI, MUFG

The Central Bank increased the interest rate to 7.25% at its last meeting in December (Figure 11). This is consistent with higher than average inflation and also mirrors the recent increases in interest rates in the US, where the Federal Reserve is in the process of normalizing its monetary policy.

Figure 11: Policy Rate (Mexico and The US)



Source: Bank of Mexico, Federal Reserve of USA, DataStream, MUFG

3. Overall Outlook

It is expected that Mexican GDP growth will decelerate slightly in 2017 (2.0% YoY) from its growth rate in 2016 (2.3% YoY). A contributing factor to this slowdown could be the two earthquakes Mexico experienced in September.

For 2018, similar GDP growth is expected (2.0% YoY). Household consumption has been more resilient than expected. Nonetheless, household consumption is expected to decelerate as high inflation dents purchasing power and credit conditions tighten due to the increases in interest rates. Investment is expected to contract in 2017, but it is expected to have a slight rebound in 2018. The construction sector may begin to dig out of the big hole it has been in and could be buoyed by the reconstruction that will take place because of the earthquake. Investment in the energy sector could also increase due to the energy reform that was recently implemented.

The inflation rate is expected to end 2017 above the upper band of the inflation target, and to decrease to around the upper band of the target by the end of 2018.

There will be presidential elections in Mexico in July 2018.

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