

# A walk through the Mexican economy

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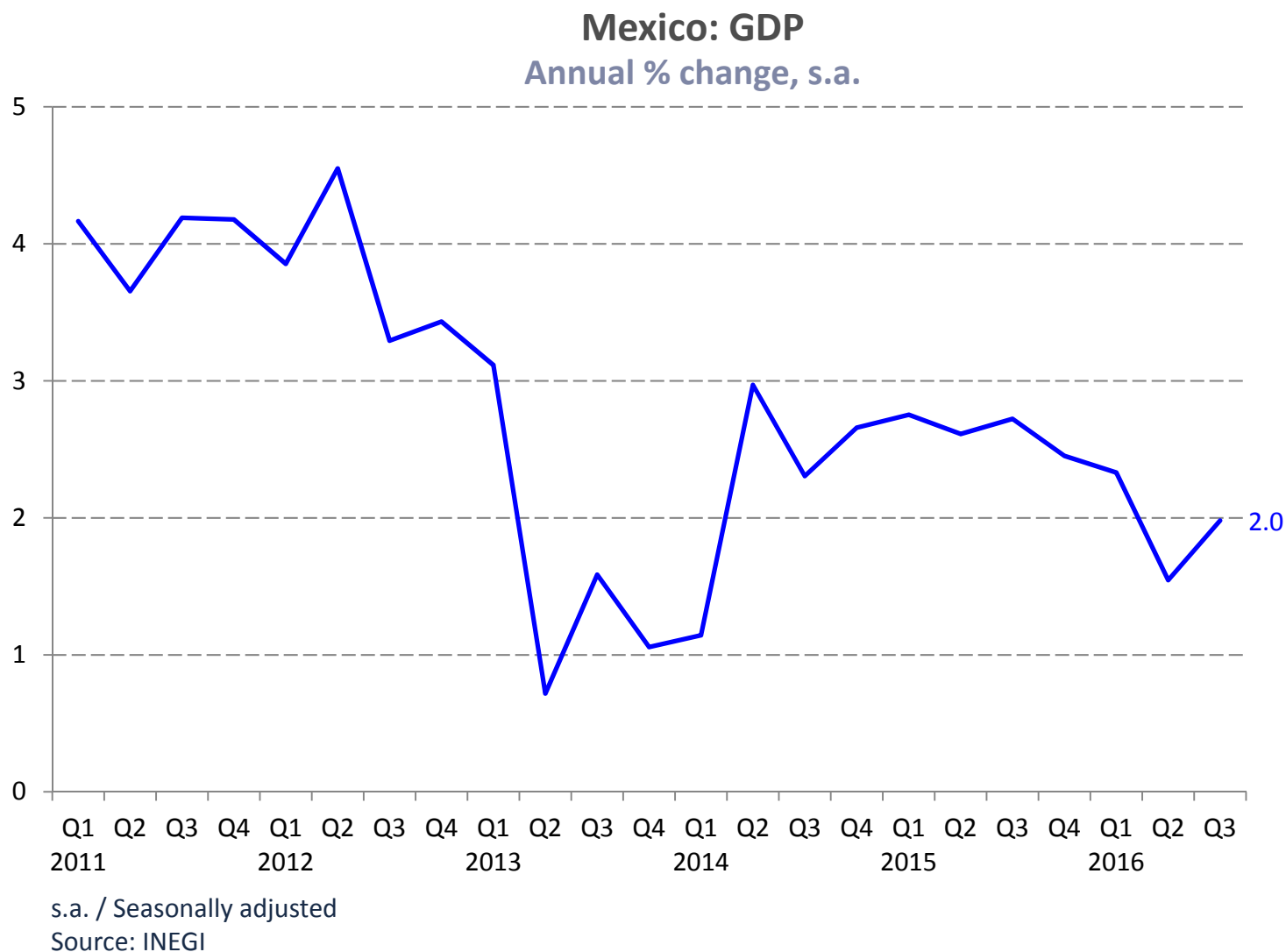
United States-Mexico Chamber of Commerce, Northeast Chapter

New York and Boston, December 1-2, 2016



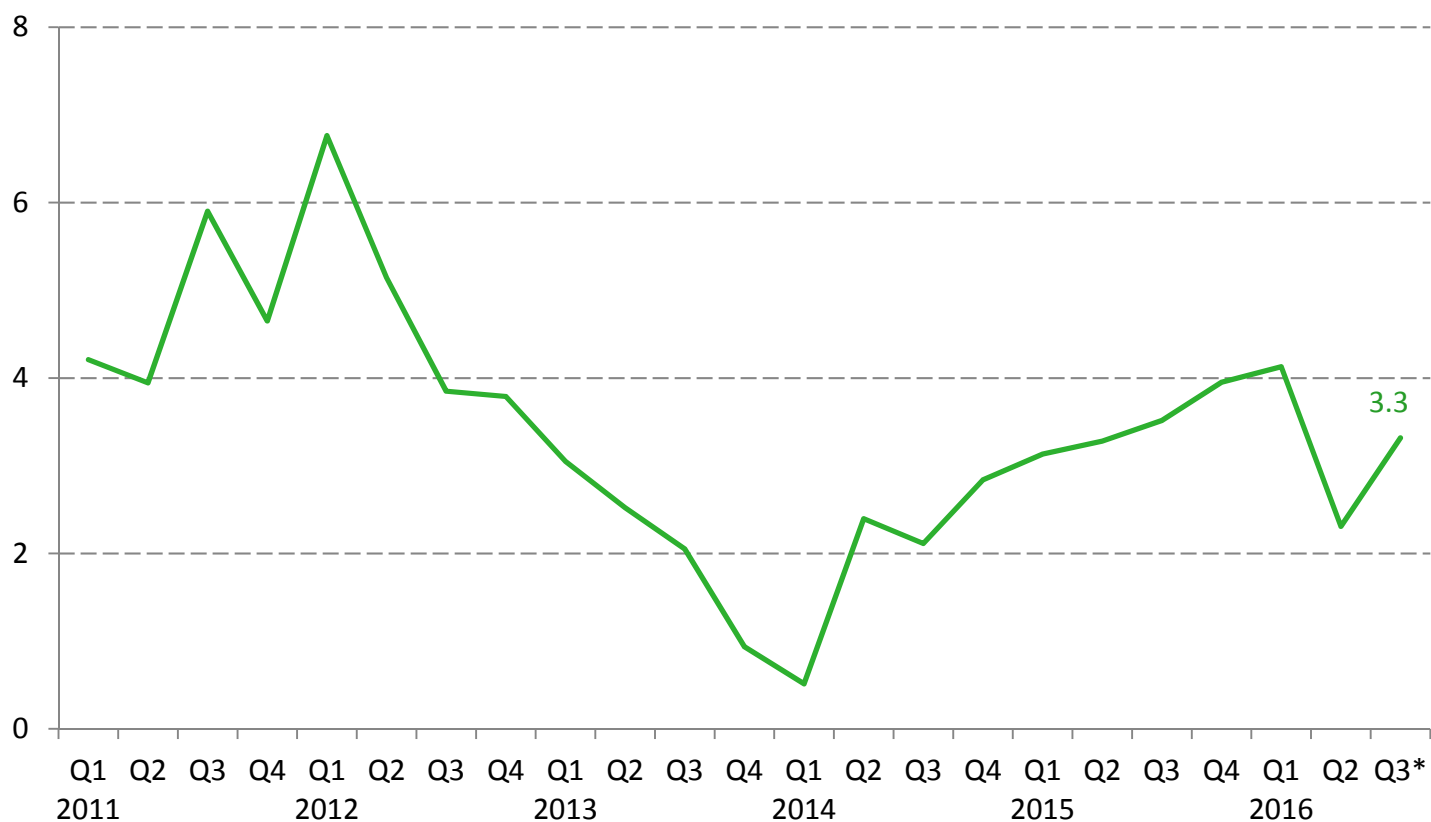
BANCO DE MÉXICO

## Since 2014, Mexican economic activity has slackened, recently touching below long-term average rates



# Good news has come from private consumption, which has maintained momentum

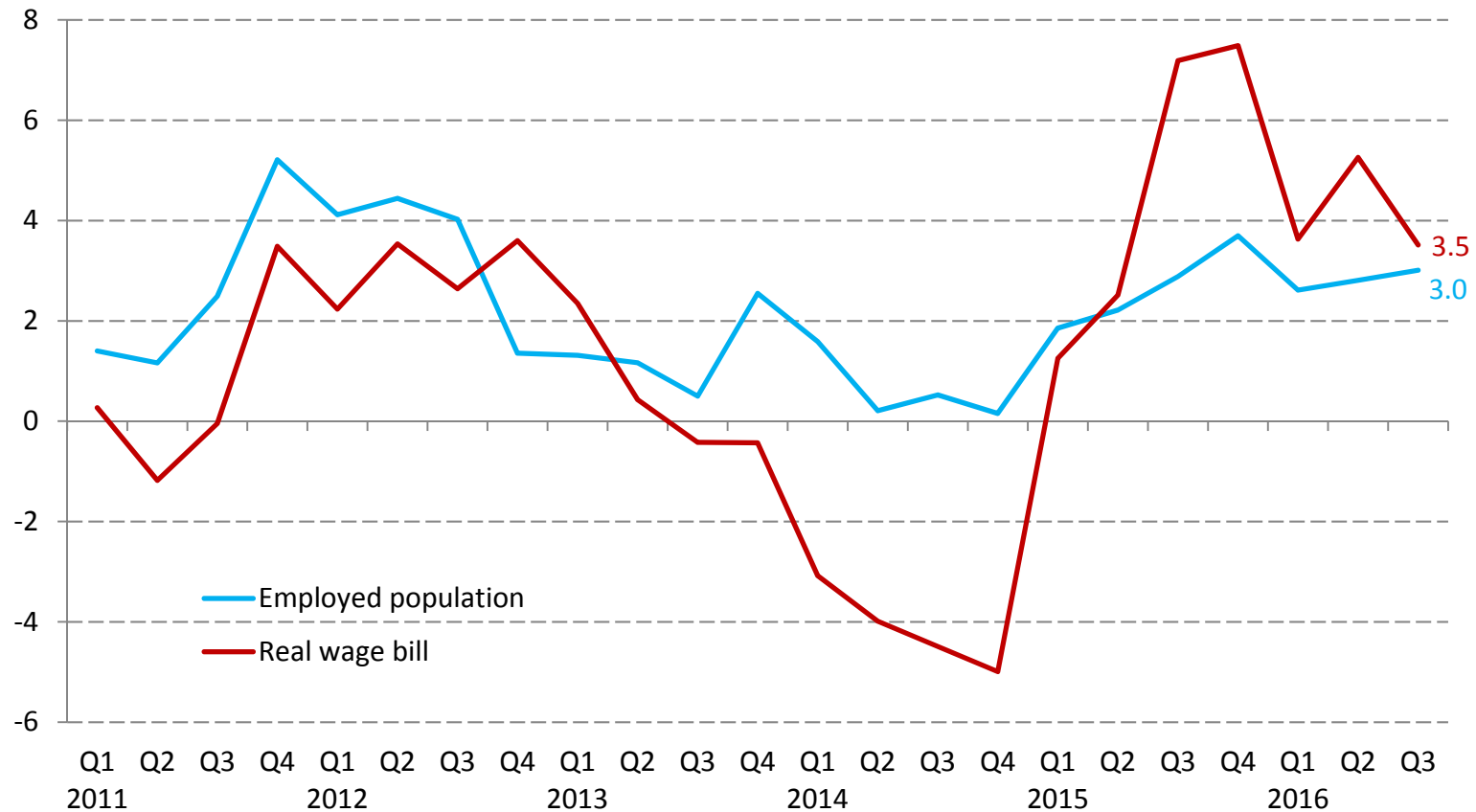
Mexico: Private consumption  
Annual % change, s.a.



s. a. / Seasonally adjusted. \*/ July-August  
Source: INEGI

# Dynamic private consumption has been supported by improved labor-market conditions

Mexico: Real wage bill income and employed population  
Annual % change, s.a.

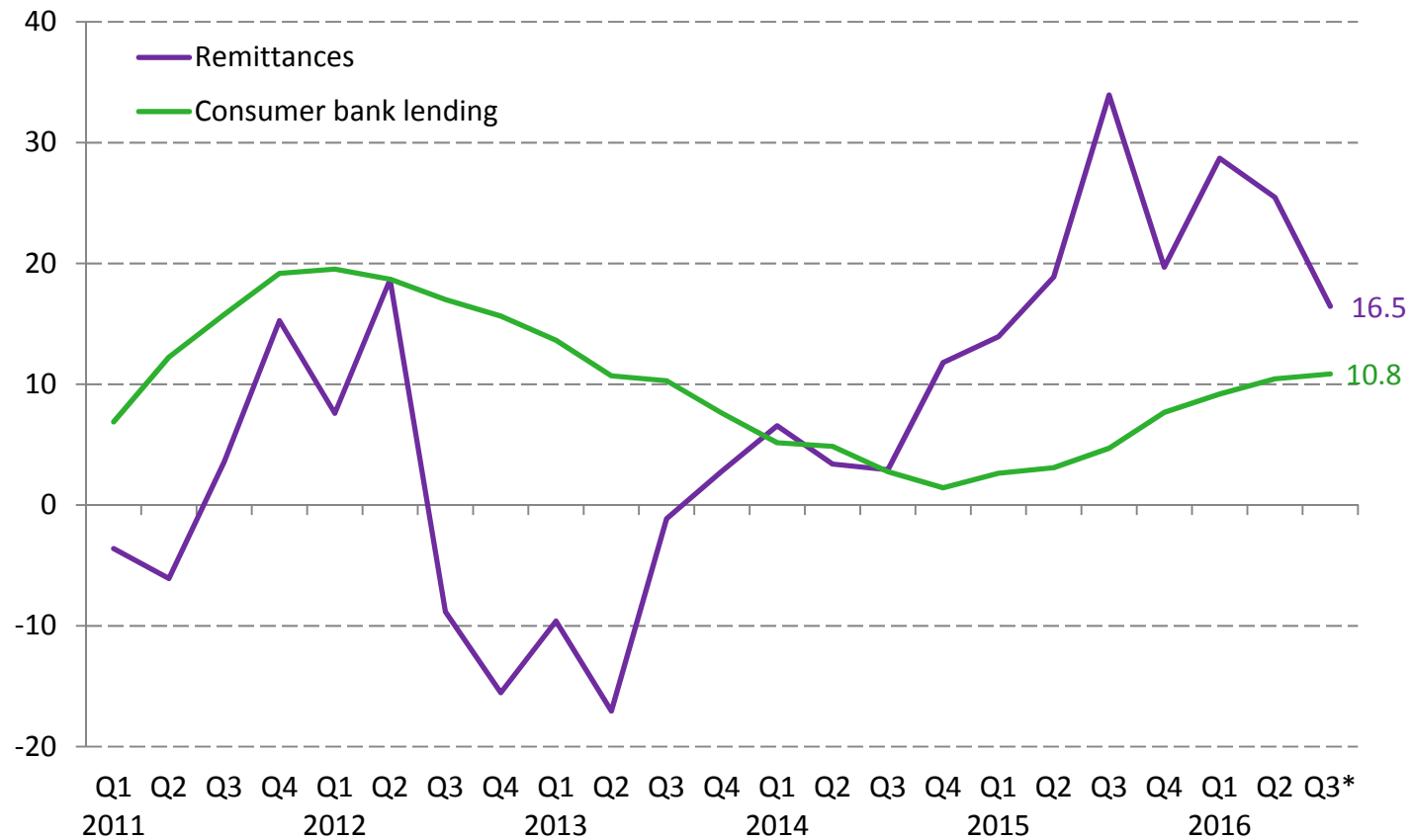


s. a. / Seasonally adjusted

Source: INEGI and Banco de México

## ... as well as growth in remittances and consumer bank lending

Mexico: Remittances in peso terms and consumer bank lending  
Real annual % change, s.a.

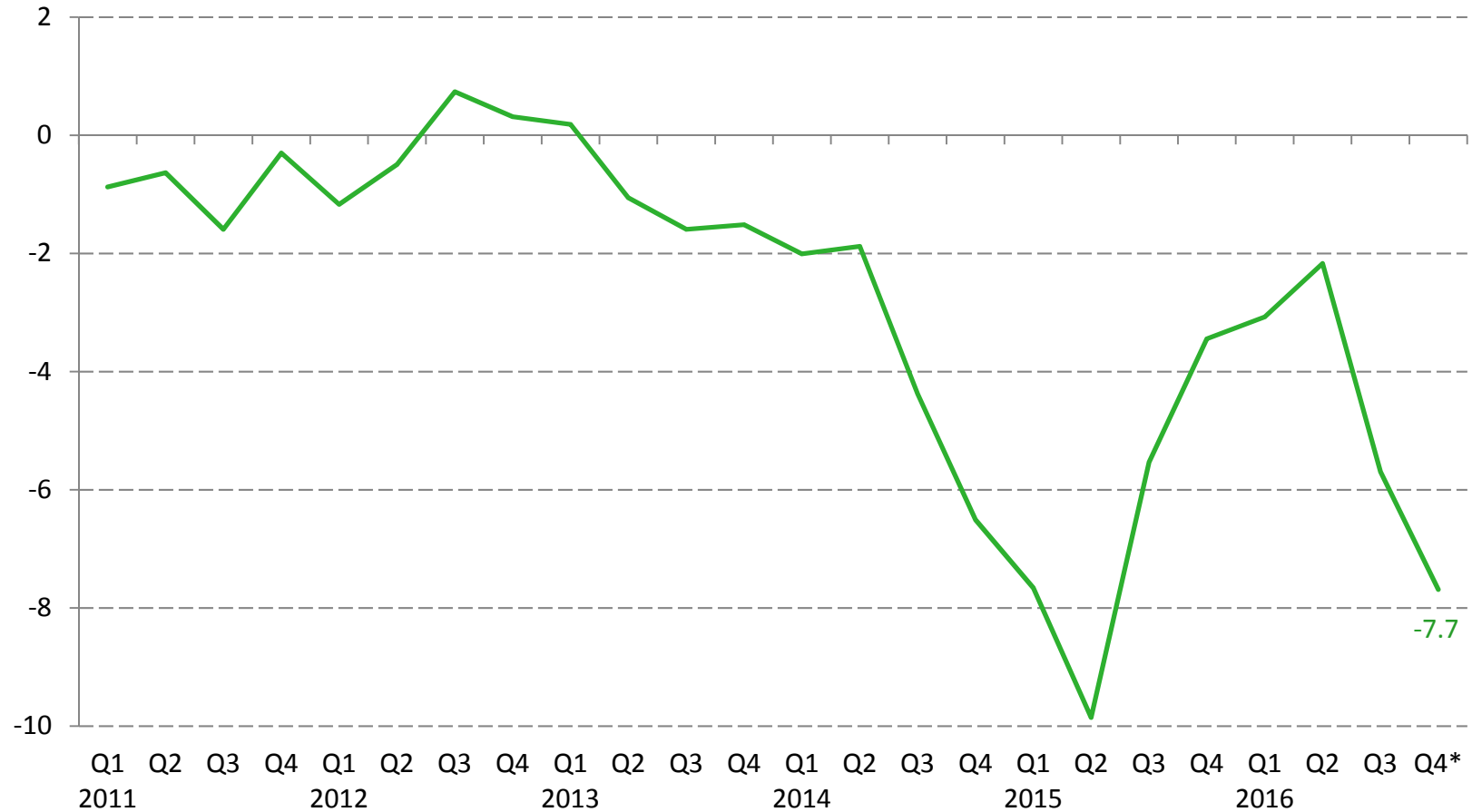


s.a. / Seasonally adjusted. \*/ July-August for bank credit

Source: Banco de México

# However, oil production has continued to fall

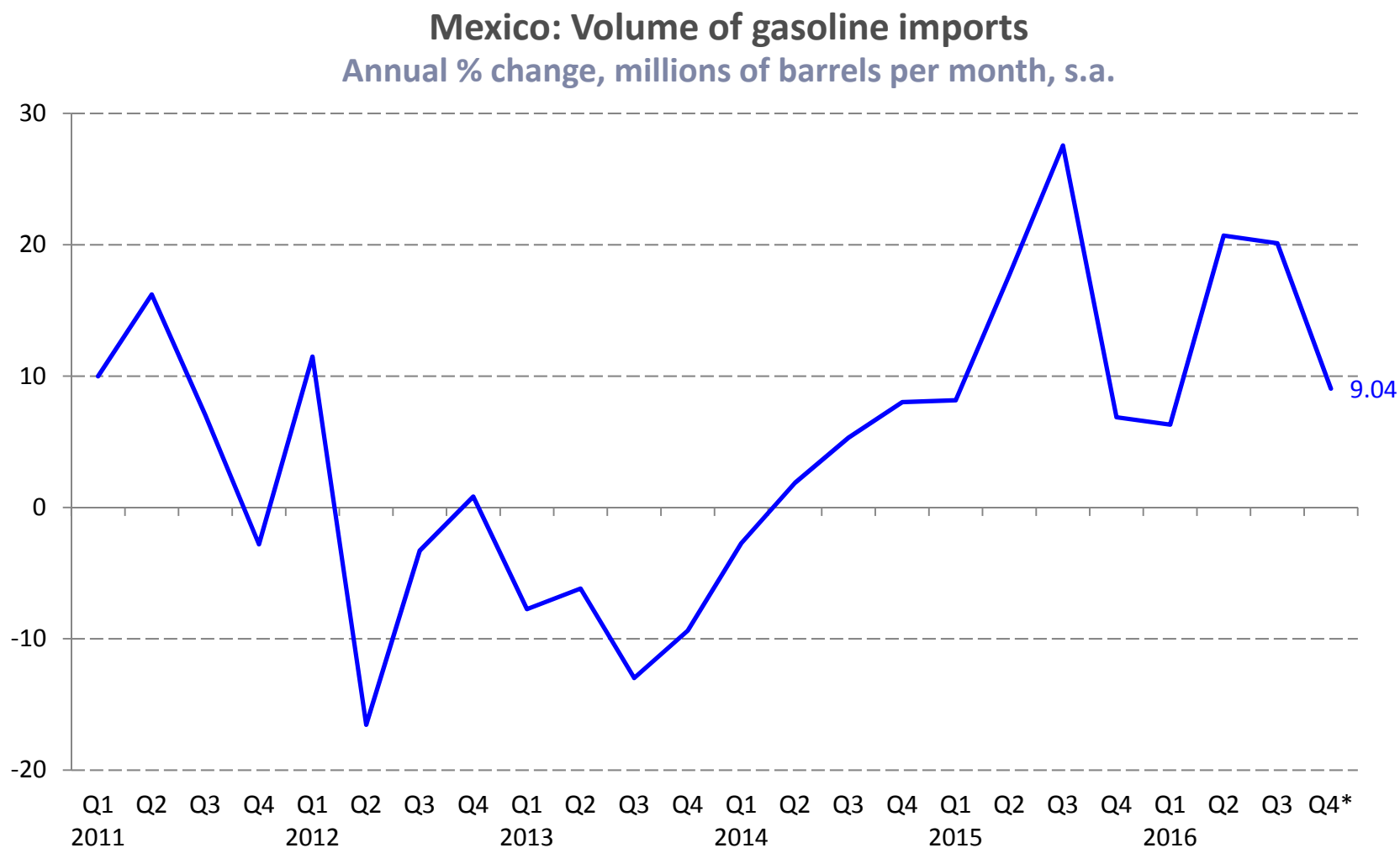
Mexico: Oil production  
Annual % change, s.a.



s.a. / Seasonally adjusted. \*/ October to November 20

Source: Pemex and Haver Analytics

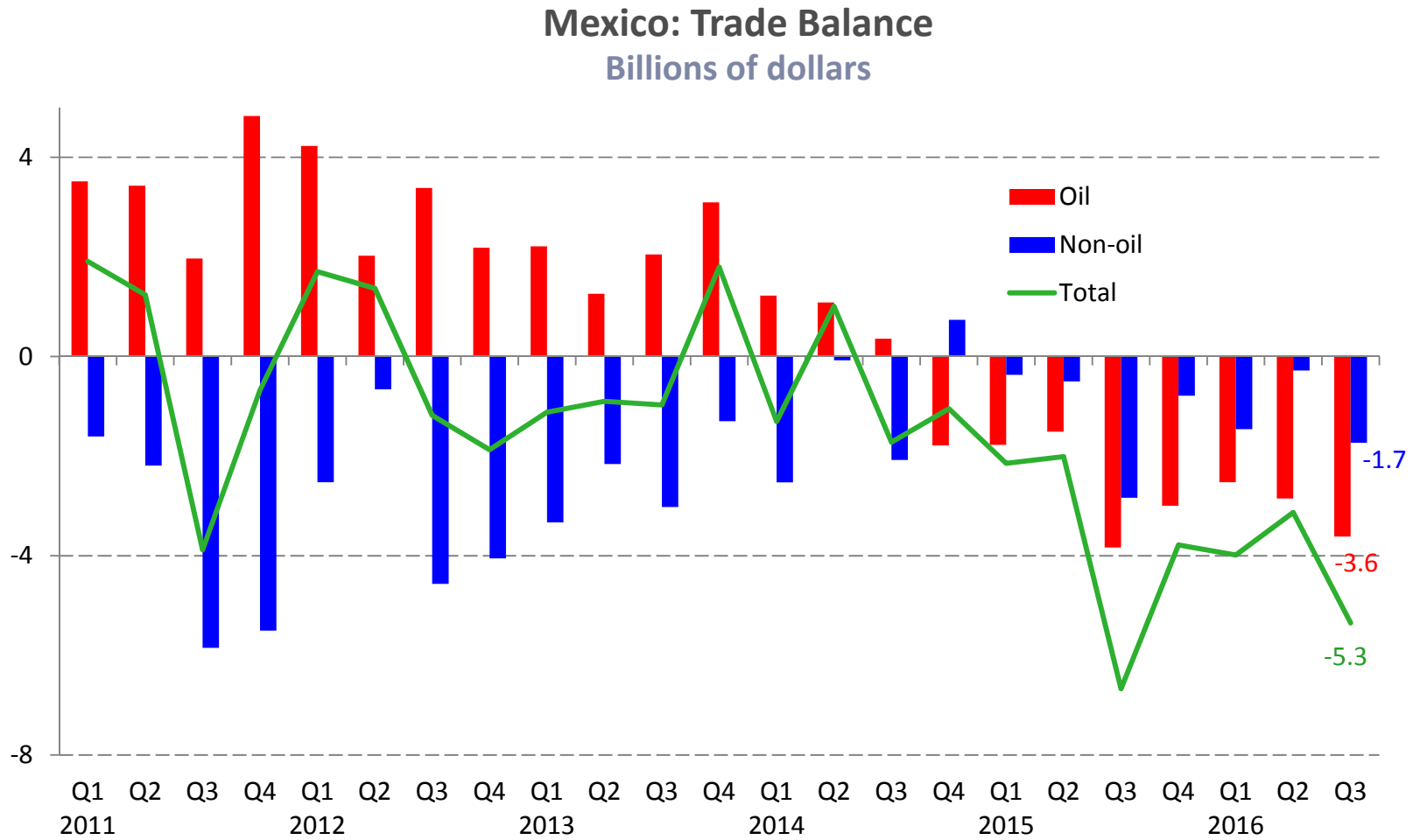
## ... matched by increasing growth of total gasoline imports



s.a. / Seasonally adjusted. \*/ Only October

Source: Banco de México and Pemex

## ... resulting in further deterioration of the oil trade balance

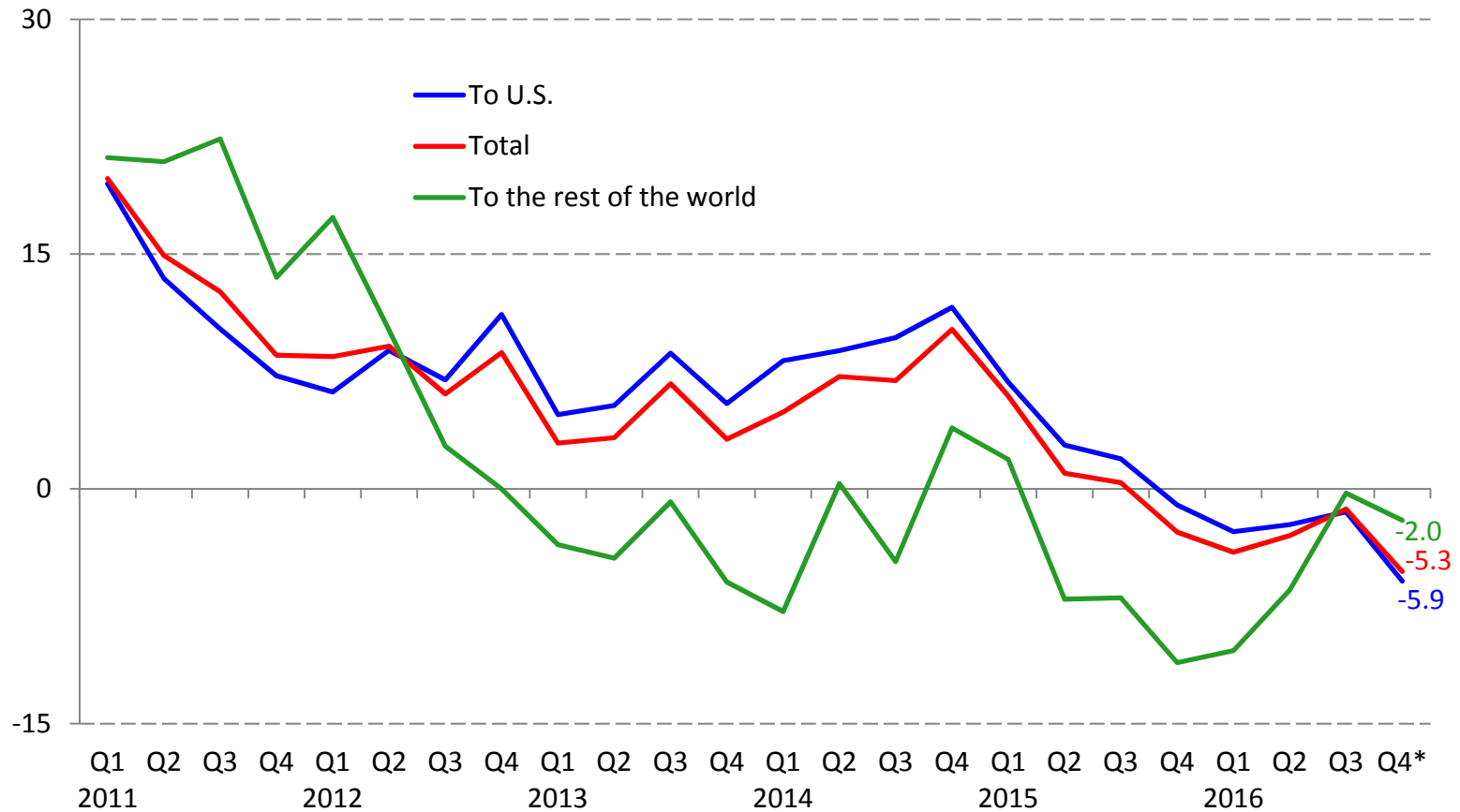


Source: Banco de México



# Also, manufacturing exports have remained soft

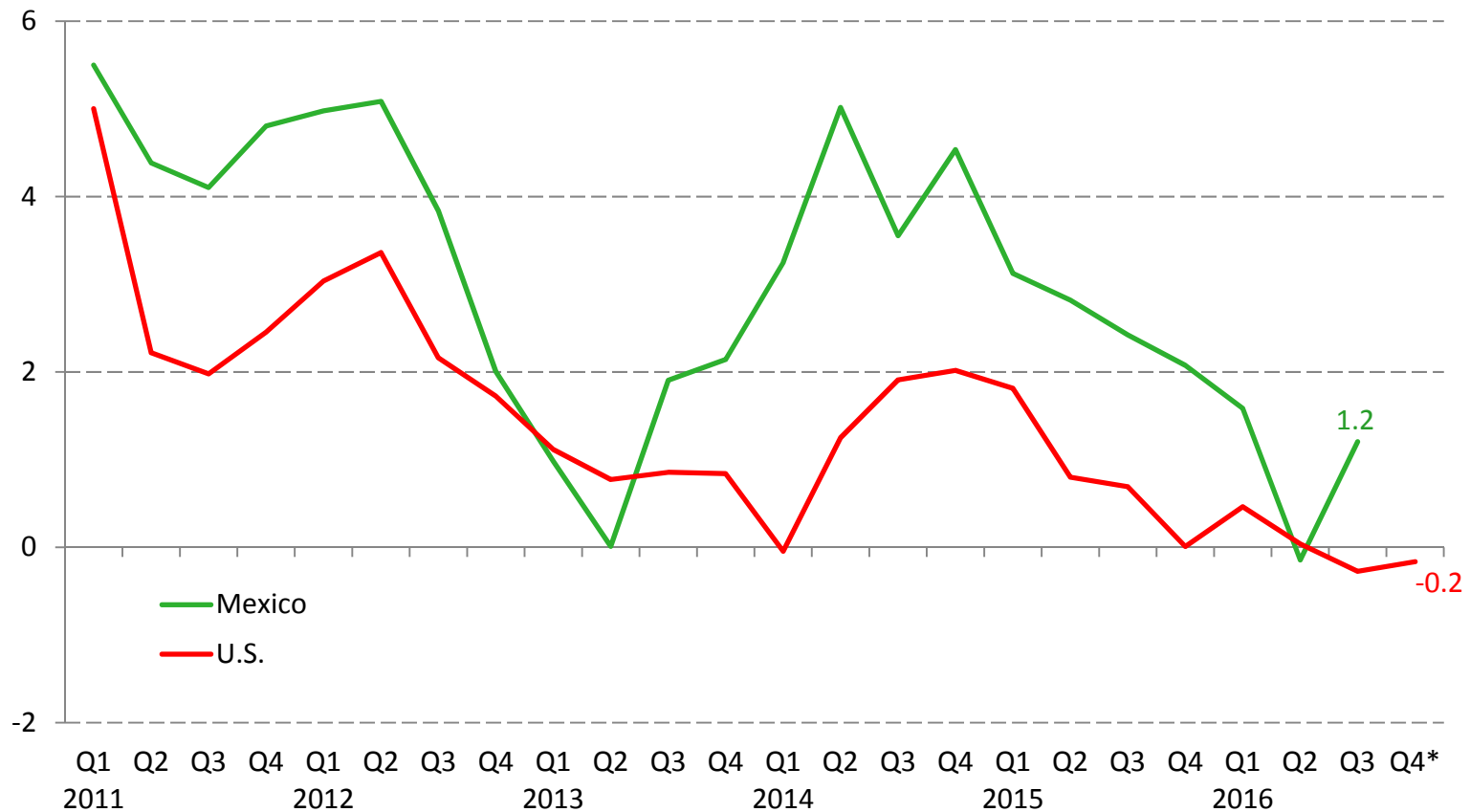
Mexico: U.S. Dollar value of manufacturing exports  
Annual % change, s.a.



s.a. / Seasonally adjusted  
\*/ Only October  
Source: Banco de México

# A backdrop to export performance is some moderation of declining manufacturing production

Mexico and the United States: Manufacturing production  
Annual % change, s.a.



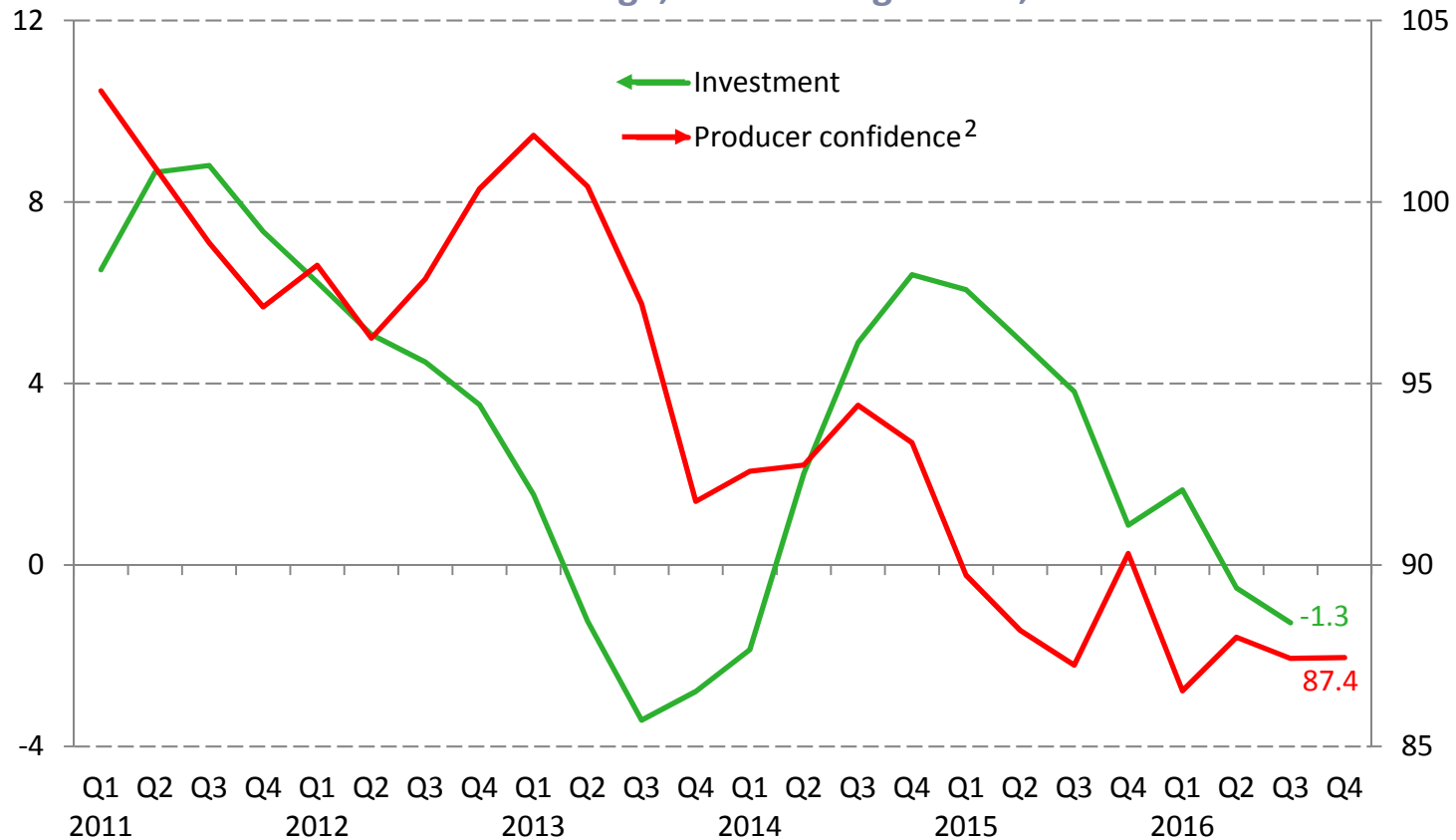
s.a. / Seasonally adjusted

\*/ Only October

Source: INEGI and the U.S. Federal Reserve

# Finally, producer confidence is dropping, and investment is contracting

Mexico: Investment and producer confidence<sup>1</sup>  
Annual % change, 2011 average = 100, s.a.



s.a. / Seasonally adjusted

1/ July-August for Investment and only October for producer confidence. 2/ Manufacturing

Source: Banco de México and INEGI

## Analysts' consensus is for growth in Mexico to continue at a moderate rate next year

### GDP forecasts Annual % change

	2014	2015	2016 <sup>F</sup>	2017 <sup>F</sup>
World	2.8	2.9	<b>2.5</b>	<b>2.8</b>
The United States	2.4	2.6	<b>1.5</b>	<b>2.2</b>
Mexico	2.3	2.6	<b>2.0</b>	<b>1.9</b>

F/ Forecast

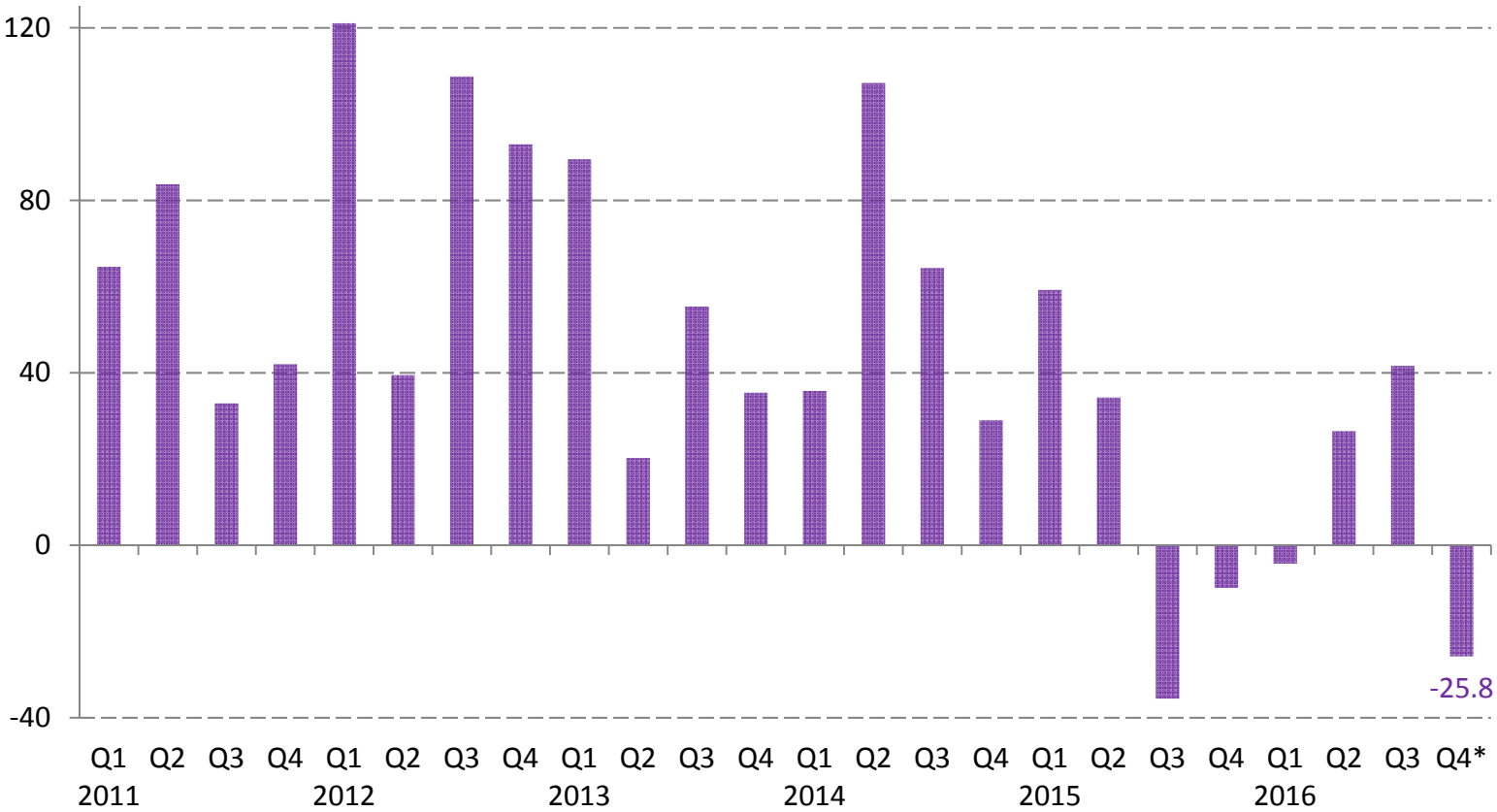
Source: Haver Analytics, Consensus Forecasts and Latin American Consensus Forecasts, November 2016

## This growth scenario faces downside risks

- An uncertain direction for U.S. economic policies, including the potential implementation of protectionist measures
- Further delay in a recovery of U.S. manufacturing production
- Additional drops in crude oil output
- Further worsening of consumer and producer confidence
- Difficulties for adequate implementation of structural reforms

# Recent increased risk aversion has resulted in capital outflows from emerging economies

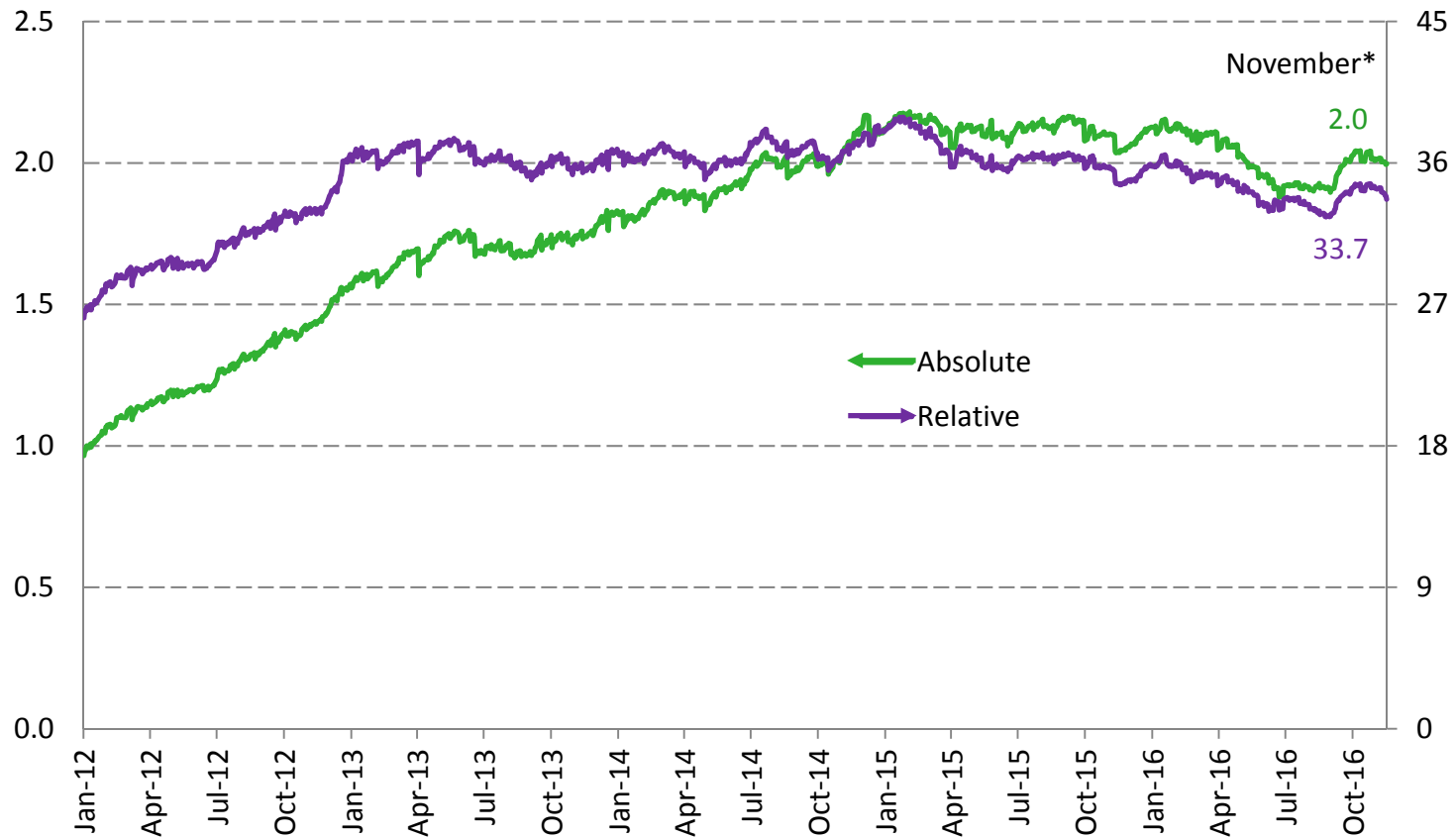
Emerging economies: Portfolio capital flows<sup>1</sup>  
Billions of dollars



1/ Net share and debt purchases by nonresidents in 25 emerging economies  
\*/ Includes estimates for October and November. Source: IIF

# Nonresident holdings of Mexican government securities have been relatively stable

Mexico: NR peso-denominated government securities holdings<sup>1</sup>  
 Billions of pesos and % of total debt outstanding

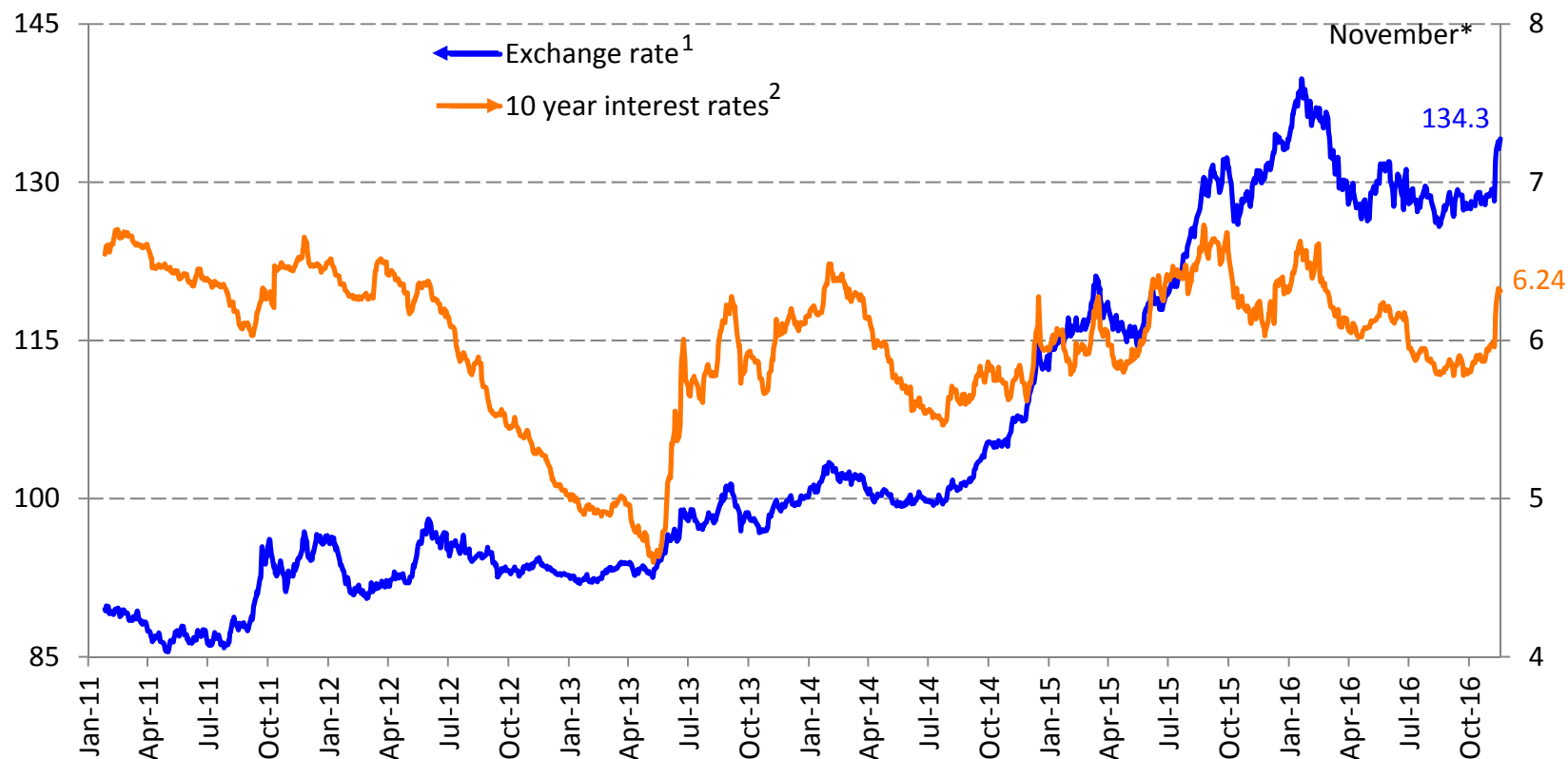


1/ Zero coupon bonds, coupon bonds, and inflation-linked bonds. \*/ To November 16

Source: Banco de México

# In 2016, asset prices in emerging economies have behaved relatively well to date

Emerging economies: Local currency per U.S. dollar and 10-year interest rates  
June 2014 = 100 and %

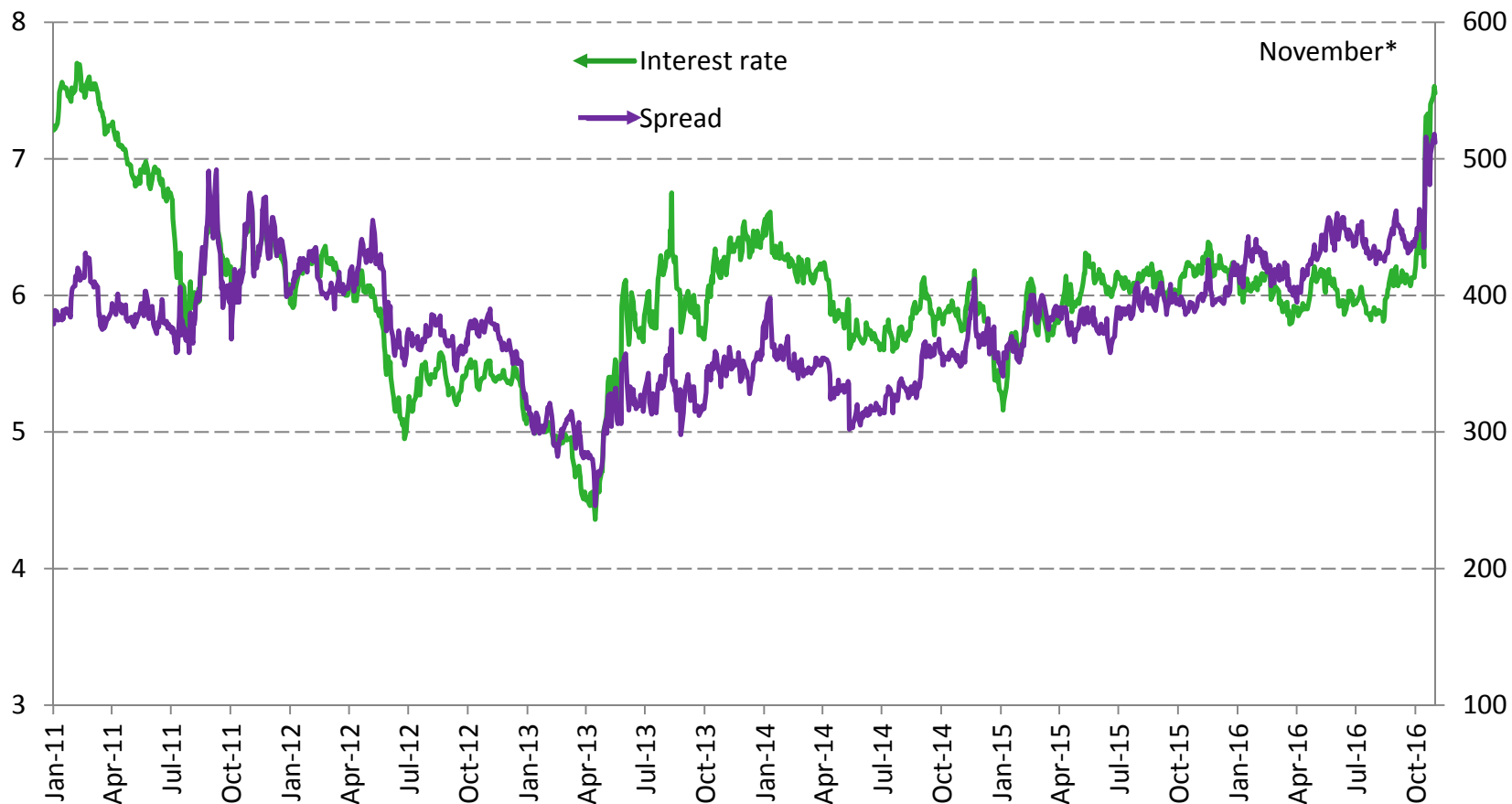


1/ Unweighted average of currencies encompassing the Mexican Peso, Chinese yuan, Russian ruble, Turkish lira, South Korean won, South African rand, Brazilian real, Indian rupiah, Polish zloty, Hungarian florin, Malaysian ringgit, Thai baht, Chilean peso, Indonesian rupiah, Philippine peso, Colombian peso, and Peruvian nuevo sol. 2/ Unweighted average of rates in Brazil, Bulgaria, Chile, China, Colombia, the Czech Republic, Hungary, India, Indonesia, South Korea, Malaysia, Mexico, Nigeria, Peru, the Philippines, Poland, Romania, Russia, South Africa, Thailand, Turkey and Venezuela. \*/ To November 28. Source: Bloomberg



# Mexican market interest rates have faced considerable pressure

Mexico: 10-year interest rate and its spread over U.S. bonds  
% and basis points

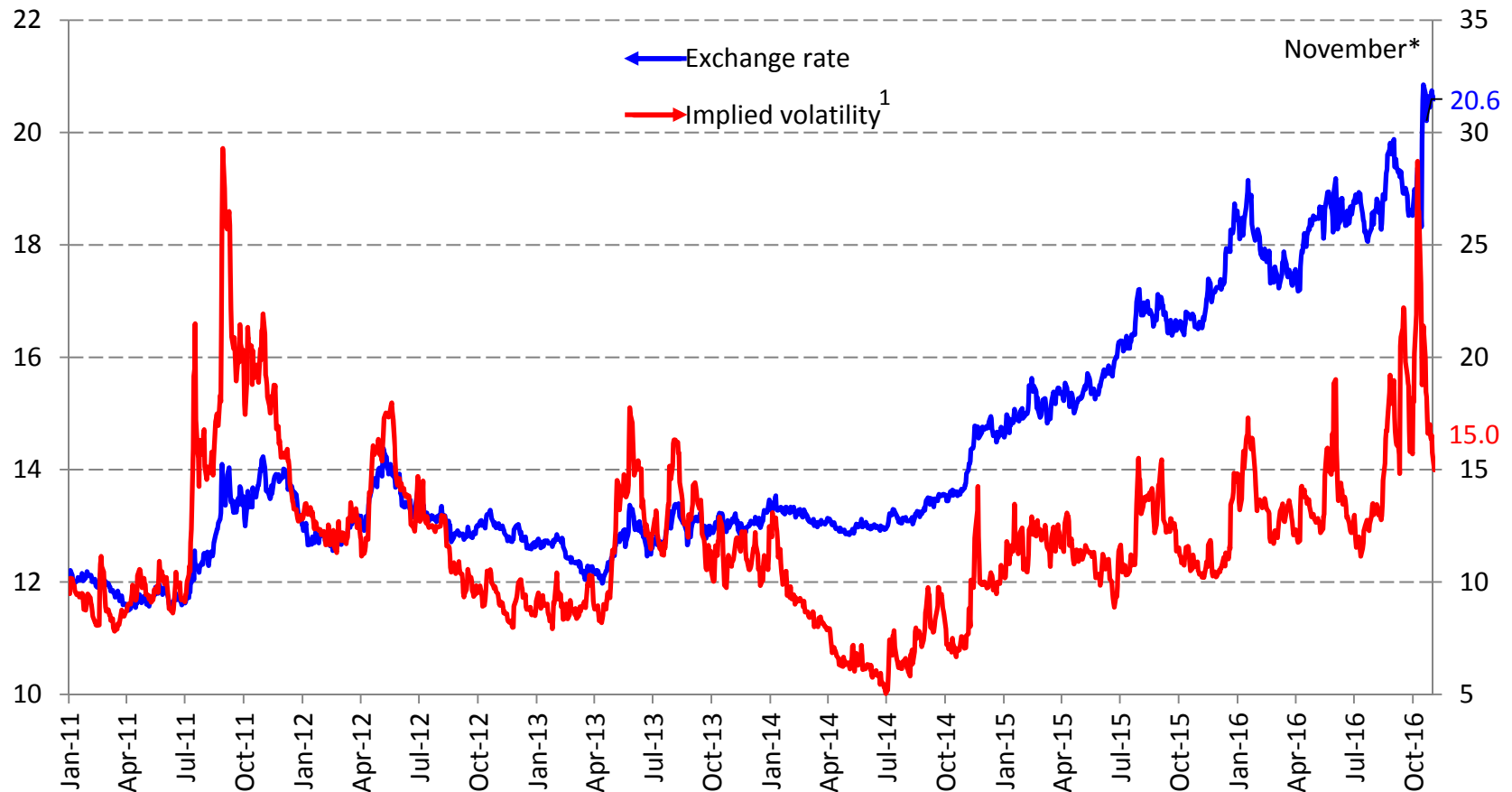


\*/ To November 25

Source: Banco de México and Bloomberg

# Similarly, the exchange rate has seen steepening of a depreciating trend in place since mid-2014

Mexico: Exchange rate and implied volatility in options  
Pesos per dollar and %



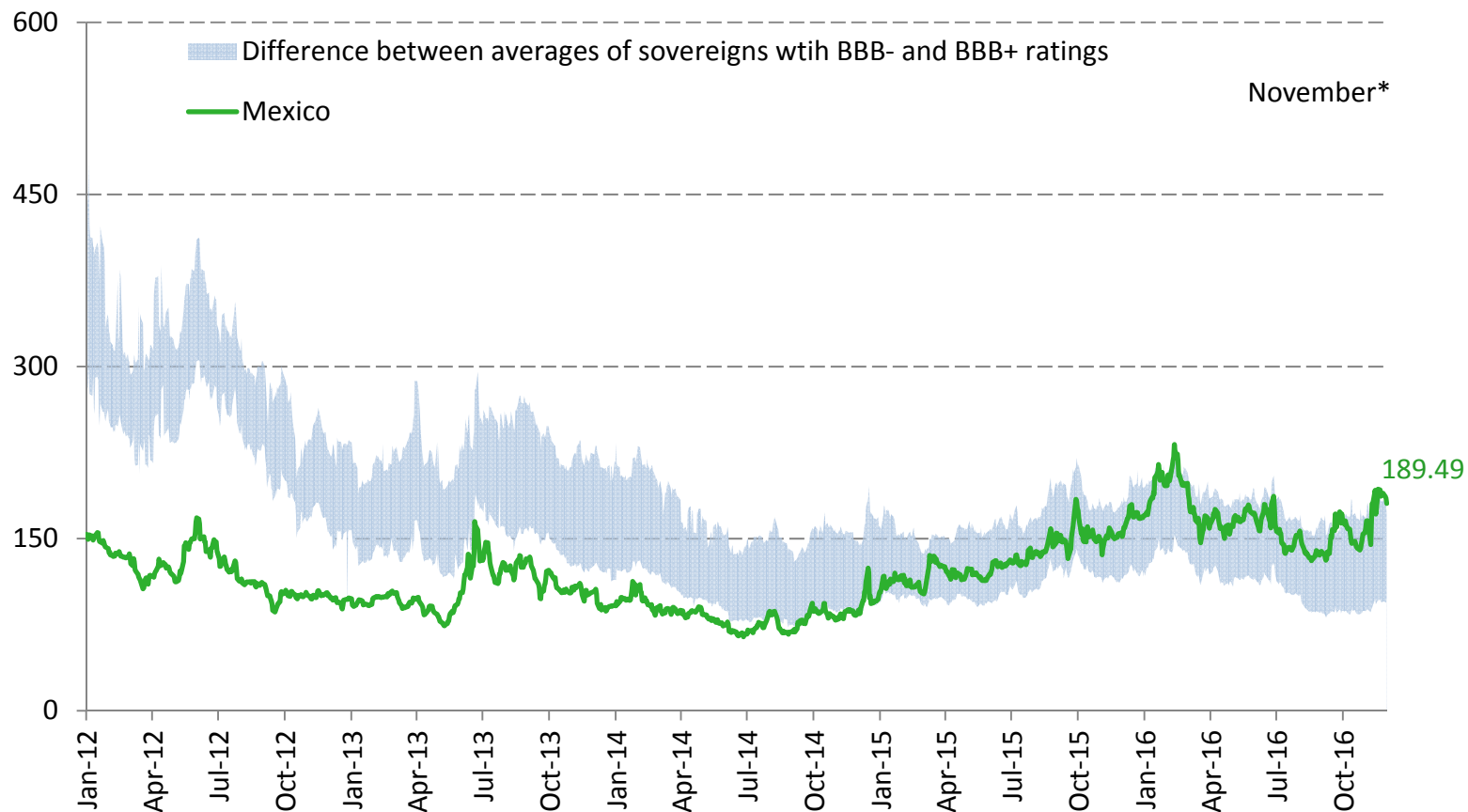
\*/ To November 28. 1/ Implied volatility is a market expectation of the volatility for future currency yields  
Source: Banco de México and Bloomberg

## Future bouts of financial volatility in Mexico cannot be ruled out

- The authorities must focus on what they can change to improve Mexico's prospects, i.e., what they can do and not what is out of their hands
  - ✓ A stronger fiscal stance
  - ✓ Vigilant monetary policy
  - ✓ Adequate implementation of structural reforms
- Buttressed fundamentals would set the stage for whatever negotiations might be in the offing with the U.S. government

# A warning is present in upward pressure on Mexican credit risk perception

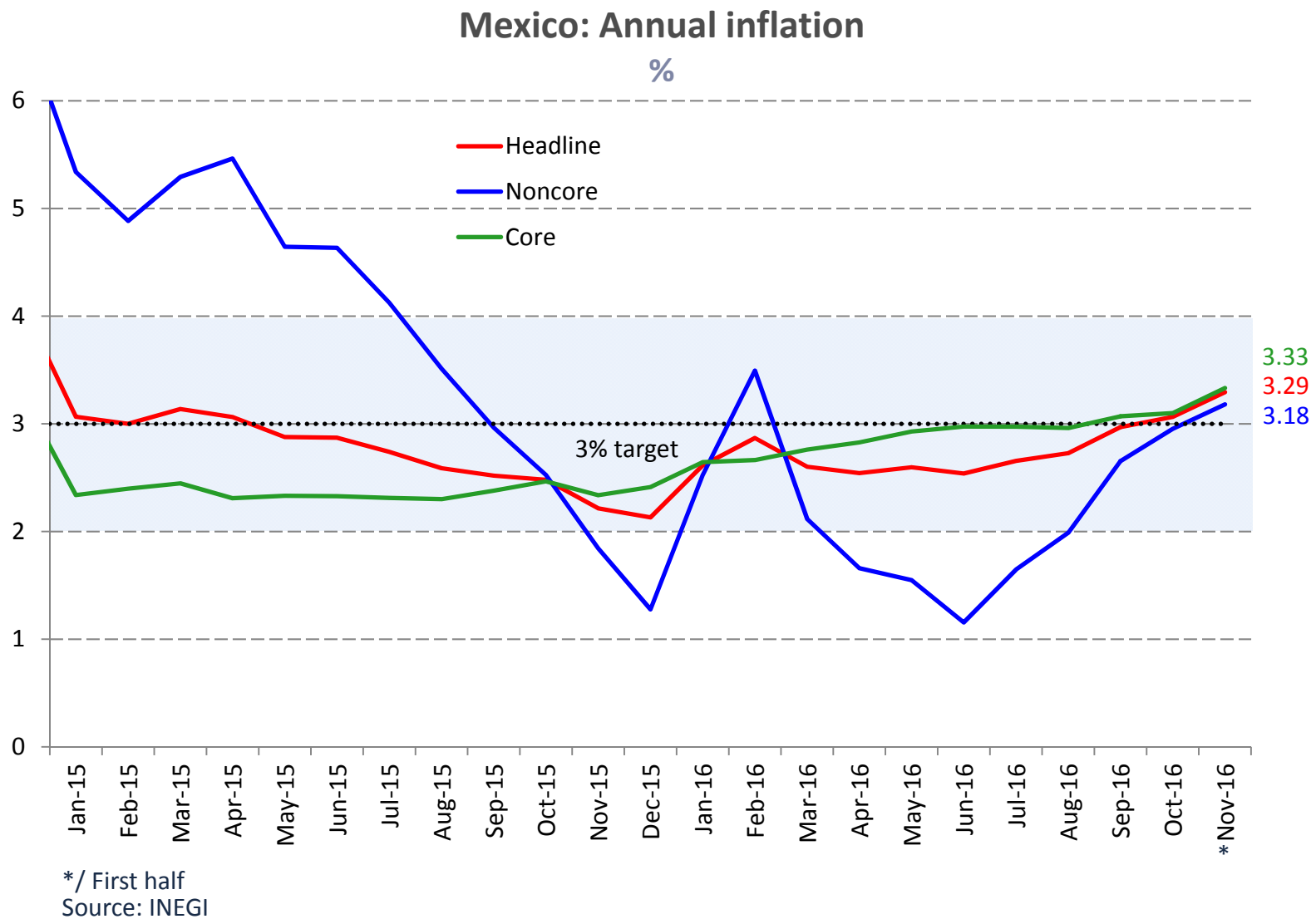
Emerging economies: Credit-default risk premium (CDS) by credit rating<sup>1</sup>  
Basis points



1/ BBB- sovereigns are India, Italy, Indonesia, Hungary and South Africa. BBB+ economies are Poland, Spain, Thailand and Peru

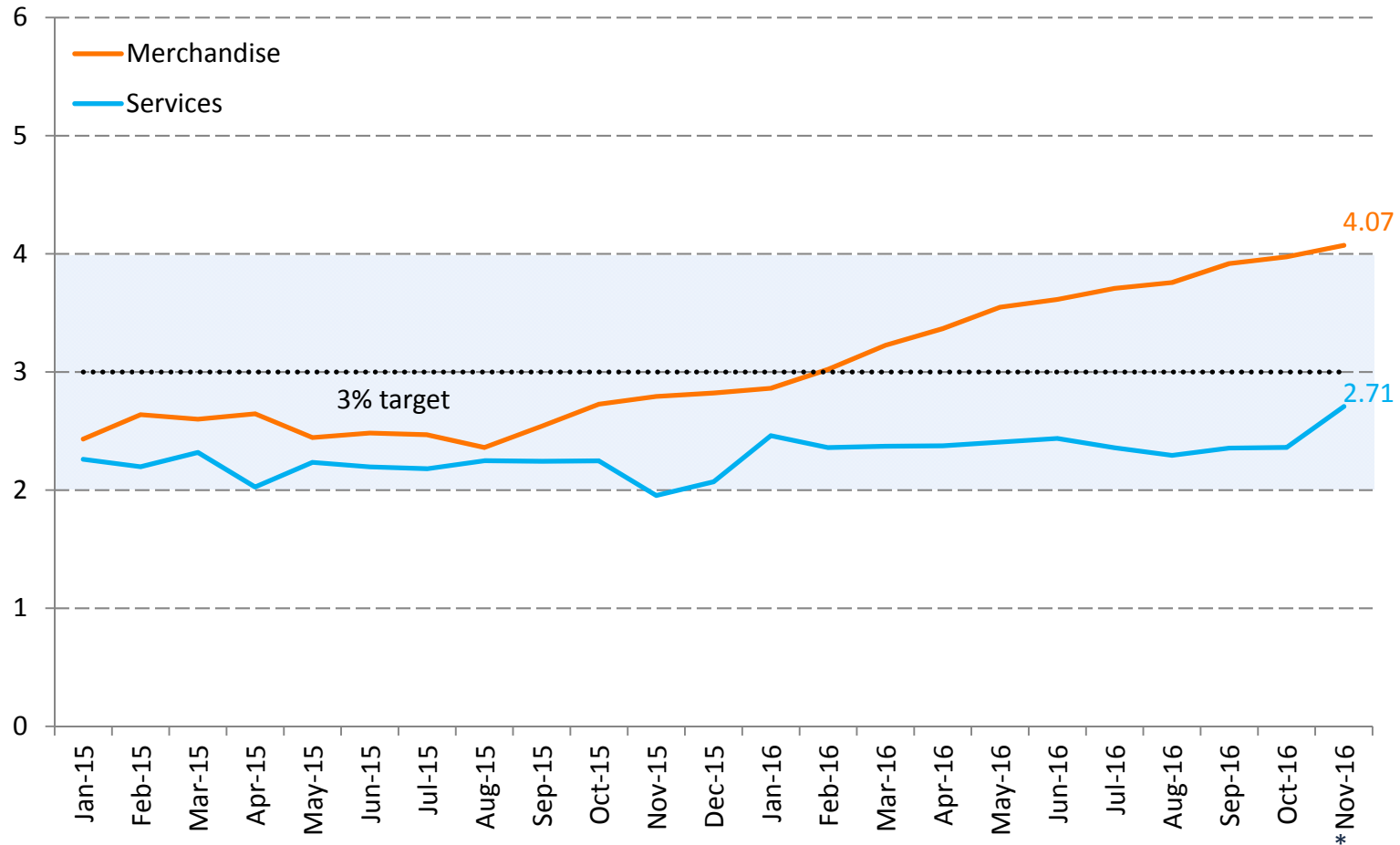
\*/ To November 25. Source: Bloomberg

# Inflation, recently at historically low levels, has started to creep upward



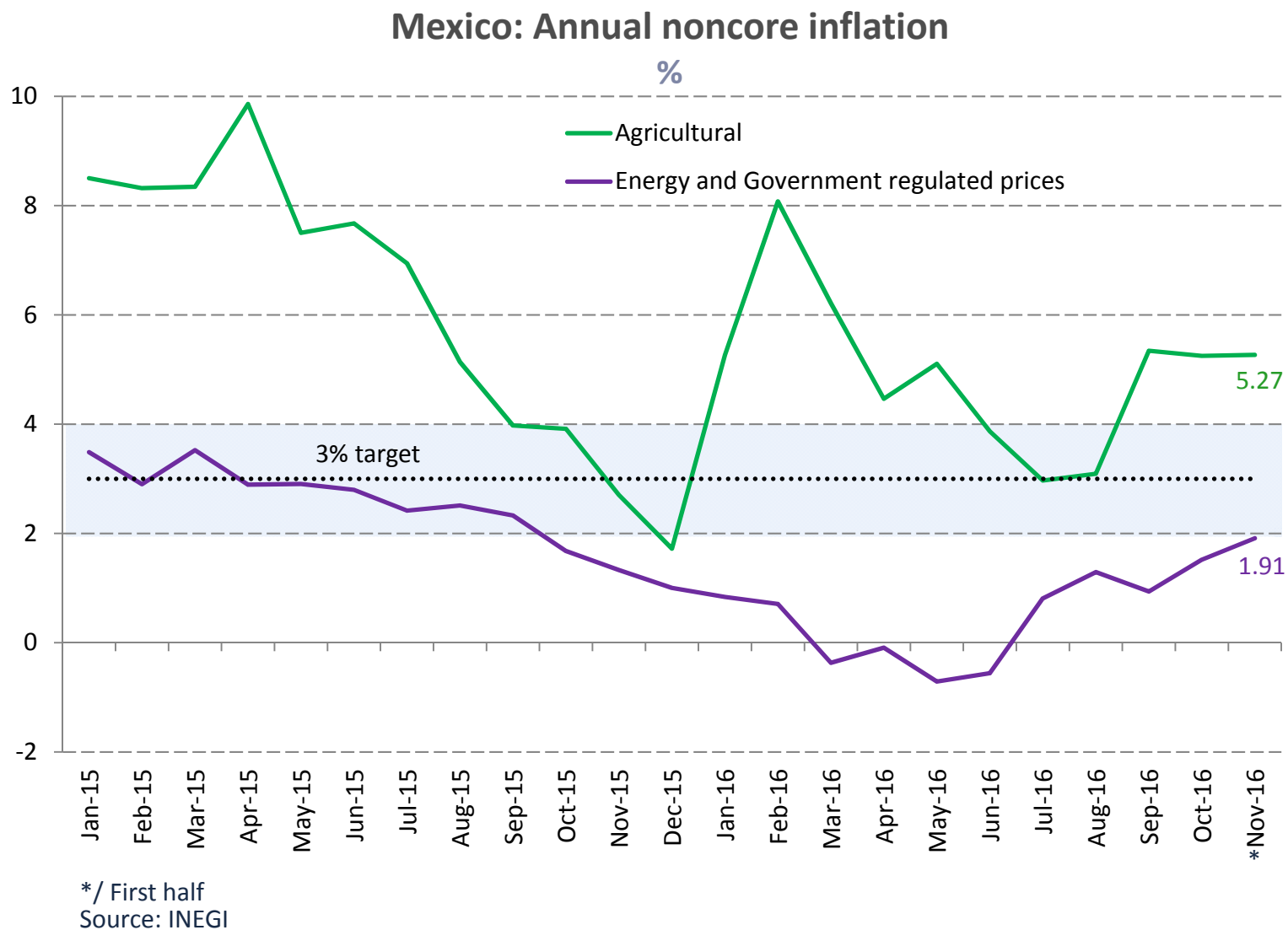
# Higher core inflation reflects an increasing trend in goods prices due largely to the impact of peso depreciation

Mexico: Annual core inflation  
%



\*/ First half  
Source: INEGI

# Increasing noncore inflation has resulted mainly from energy price rises



# Producer prices may indicate future consumer price pressure



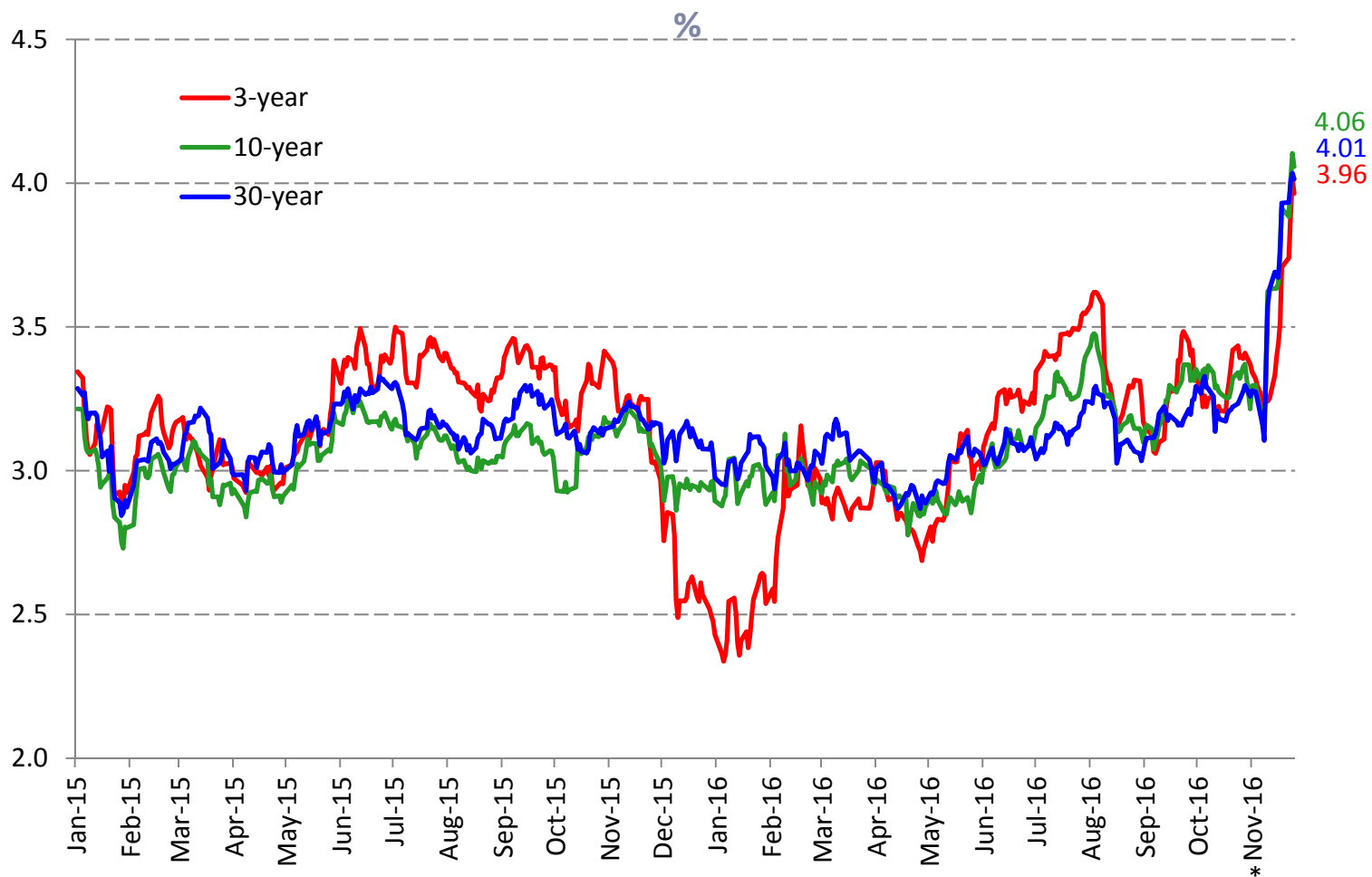
1/ National Producer Price Index, excluding oil

Source: INEGI



# Break-even inflation has jumped above the target, and may suggest some future higher inflation

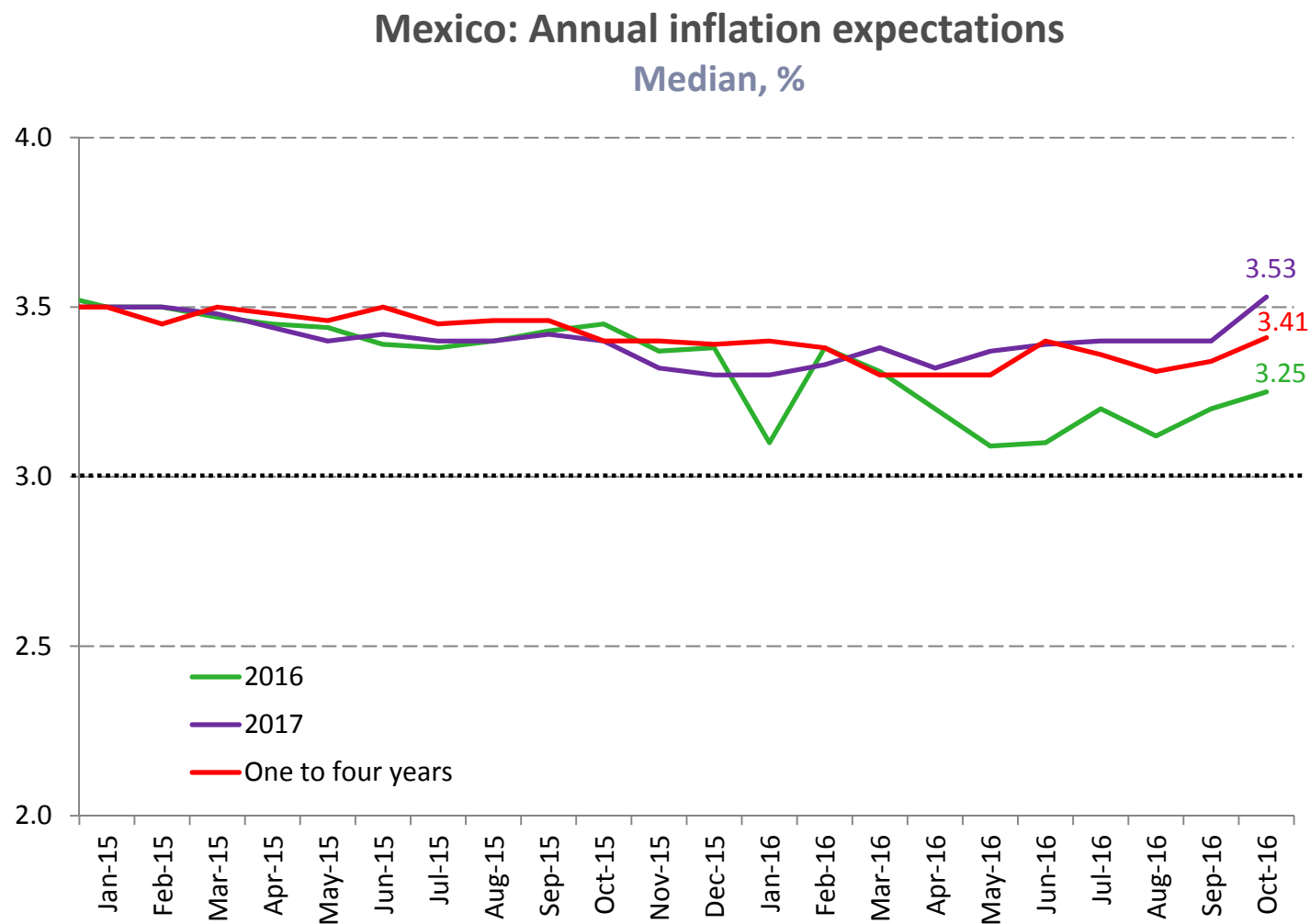
Mexico: Compensation for inflation and inflation risk implicit in bonds



\*/ To November 25

Source: Own calculations with data from PiP

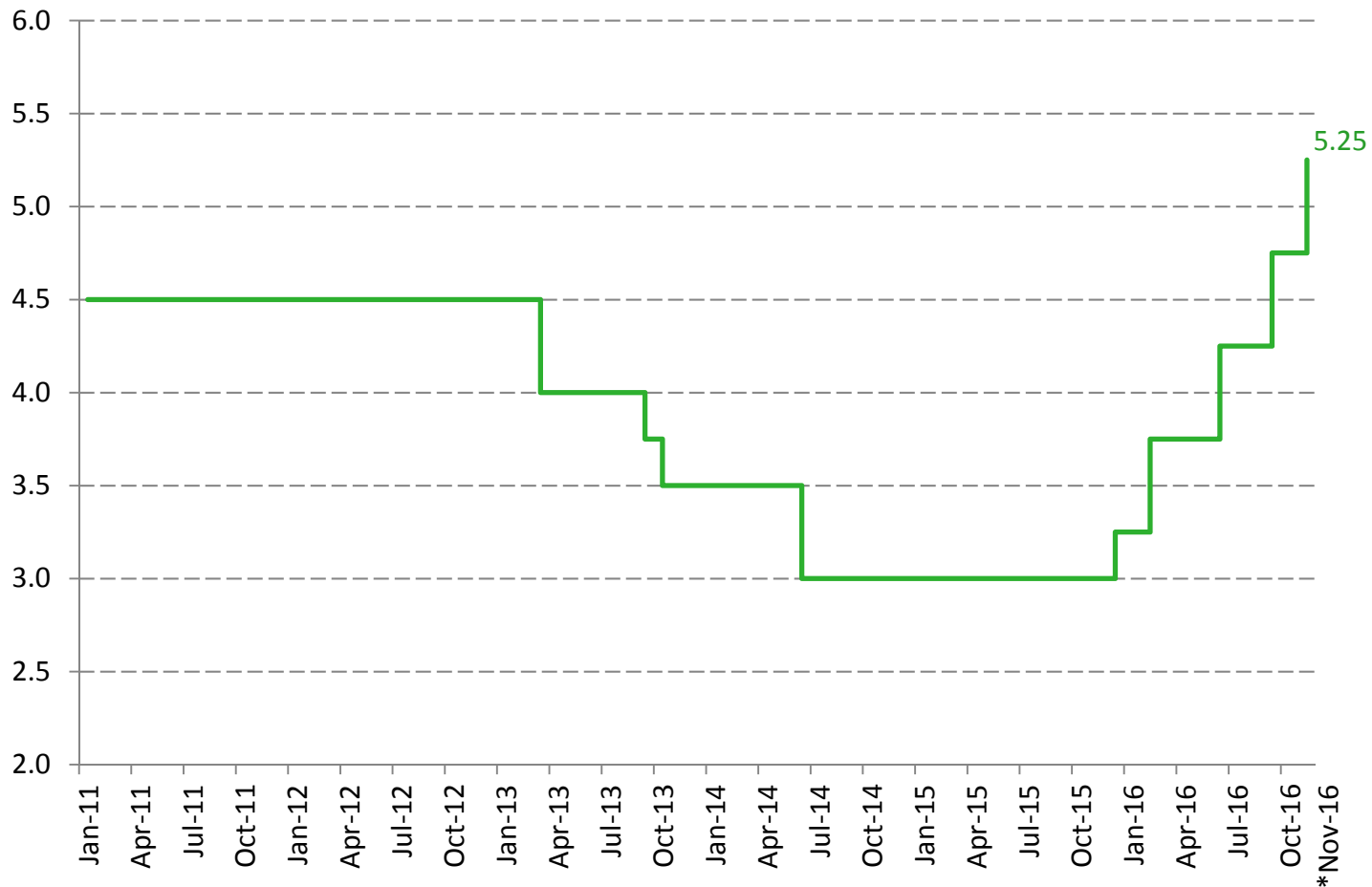
## ... as may inflation expectations based on analysts' surveys



Source: Banco de México, *Encuesta sobre las Expectativas de los Especialistas en Economía del Sector Privado*

# Since December 2015, the policy interest rate has been raised five times for a total of 225 basis points

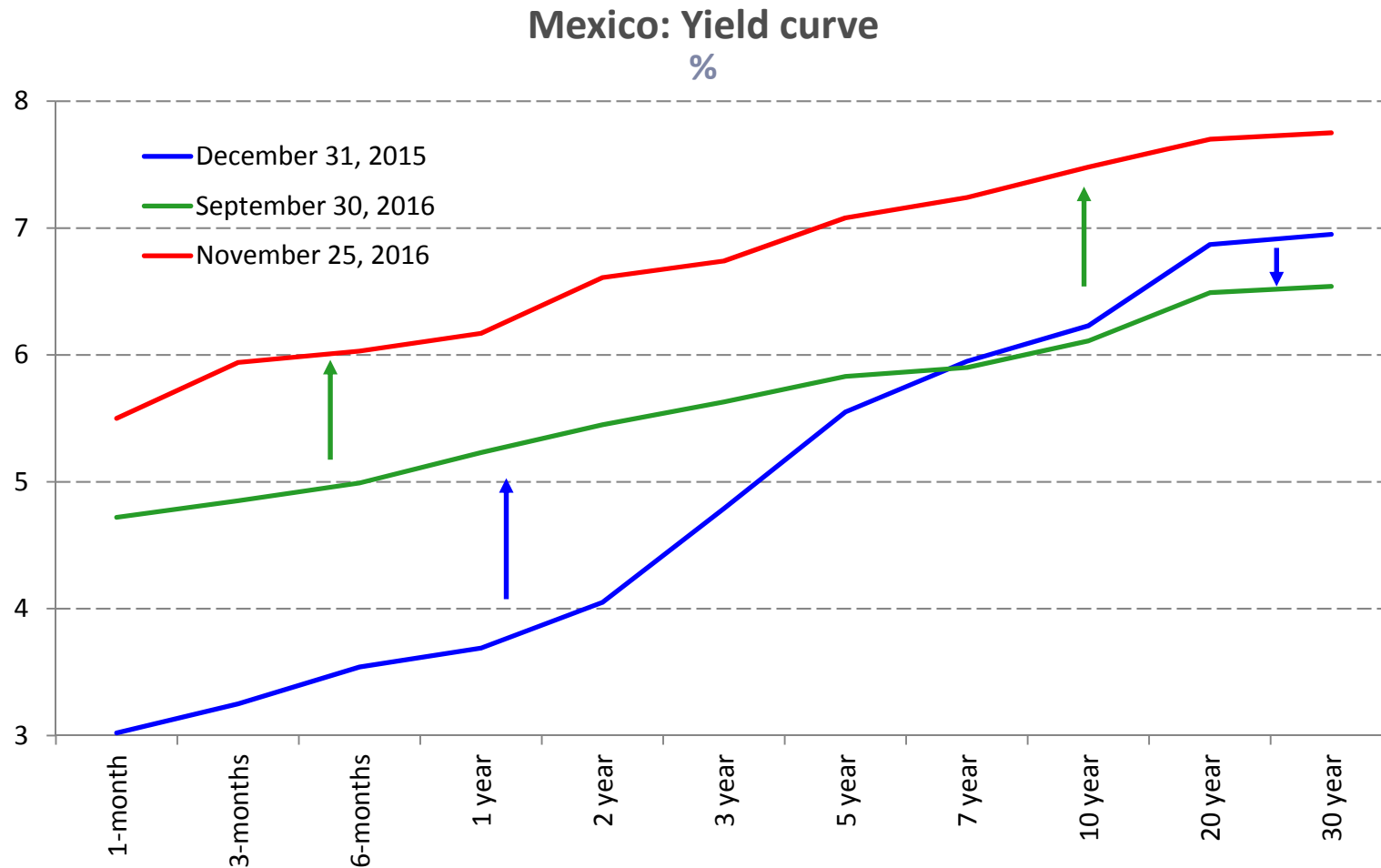
Policy overnight interest rate  
%



\*/ To November 28

Source: Banco de México

# Recently, the yield curve has shifted upward across all maturities



Source: Banco de México

## Rate hikes should be interpreted as preemptive

- So far, inflation remains relatively subdued, although risks are increasing
- Banco de México does not target the exchange rate, and therefore monetary policy should not be judged in terms of its effects on this variable
- The primary objective of monetary policy is control over inflation
- Exchange-rate developments are relevant insofar as they may lead to deviation of inflation from the target

## Upside risks for inflation seem to prevail

- Risks
  - ✓ Widespread contagion of exchange-rate depreciation to inflation and expectations
  - ✓ Reversion of noncore inflation to historical averages
  - ✓ Upsurge of aggregate demand pressures, in particular considering uncertainty over the degree of slack in the economy
- These issues could cause the price formation process to unravel, with medium-term consequences
- Caution is all the more important given the time and effort it took for inflation to reach the target

## The current environment presents a unique opportunity to reinforce Mexico's commitment to price stability

- The widening of inflation risks make it all the more necessary to maintain a proactive stance
- Banco de México will remain on the alert for obstacles in the way of consolidation of inflation at the target
- It will also take into account other factors, such as the relative monetary stance with the United States, as well as slack in the economy

## Final remarks

- Mexico's economic activity has diminished, largely reflecting continued drops in producer confidence and investment
- The most important downward risk for the growth scenario comes from uncertain future U.S. policy
- International financial volatility has resulted in significant upward pressure on domestic interest rates and more notably, the exchange rate
- Mexico needs to reinforce its own economic fundamentals
- Banco de México must continue to keep a watchful stance to maintain consolidation of inflation at the target





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