

Mexico Posts Negative Growth in Second Quarter but Outlook Stable

August 15, 2018

Mexico's economy contracted an annualized 0.4 percent in the second quarter. Nevertheless, the consensus growth forecast for 2018 held steady in June at 2.3 percent.

Recent data were mostly weak. Formal employment fell in June for the first time in nine years. Exports and industrial production also declined, and inflation continued to rise. However, retail sales surged, and the peso strengthened against the dollar in July.

Output Falls in Second Quarter

Mexico's second-quarter gross domestic product (GDP) dipped 0.4 percent (annualized) following the first quarter's strong growth of 4.6 percent (*Chart 1*). Goods-producing industries (manufacturing, construction, utilities and mining) fell 1.2 percent. Service-related activities (wholesale and retail trade, transportation and business services) grew 1.2 percent. Agricultural output dropped 8.4 percent; it accounted for about 4 percent of GDP in 2017.

Exports Fall in June but Remain Up Year to Date

Total exports fell 0.8 percent in June, after remaining essentially flat in May. Manufactured-goods exports declined 0.3 percent, while oil exports fell 3.8 percent. Three-month moving averages of total and manufacturing exports have fallen for two months in a row (*Chart 2*). Through June, total exports grew 8.6 percent, with manufacturing exports up 6.5 percent and oil exports up 41 percent compared with the same period last year. The rise in oil exports in 2017 and early 2018 stems largely from higher oil prices, not an increased volume of exports.

Industrial Production Overall Declines, but Manufacturing Picks Up

Mexico's industrial production (IP) index, which includes manufacturing, construction, oil and gas extraction, and utilities, fell 0.1 percent in May following a 0.4 percent drop in April. The manufacturing index rose 2.0 percent in May after falling 2.6 percent in April, and its three-month moving average advanced despite April's negative contribution (*Chart 3*). U.S. IP rose 0.6 percent in June after falling 0.5 percent in May. The correlation between Mexico's IP and U.S. IP has increased considerably since the implementation

Chart 1
Gross Domestic Product Contracts Slightly in Second Quarter

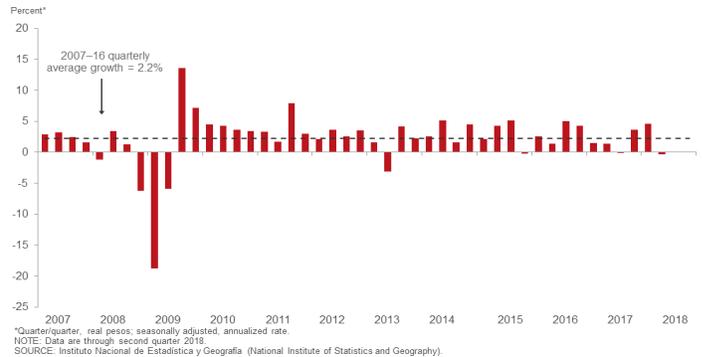


Chart 2
Exports Soften in Recent Months

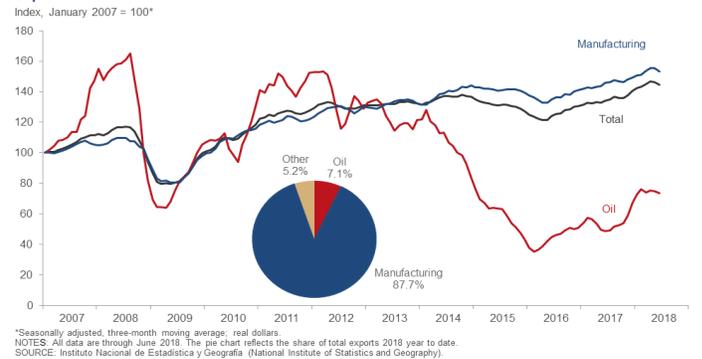
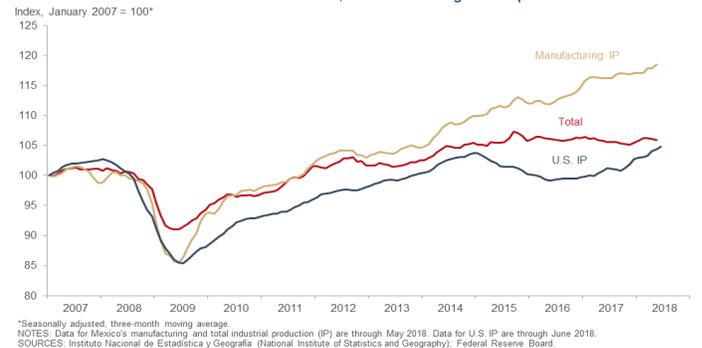


Chart 3
Total Industrial Production Slows in Recent Months, but Manufacturing Moves Up



of the North American Free Trade Agreement due to increased intra-industry trade.

Retail Sales Surge

Retail sales grew 1.0 percent in May after falling 0.8 percent in April. The moving average shows a sharp turnaround from the depressed levels observed during the second half of 2017 (*Chart 4*). Year over year in May, retail sales were up 2.8 percent. Sales were suppressed in 2017 by high inflation (which pushed prices

Chart 4
Retail Sales Show Strength



Chart 5
Job Growth Turns Negative

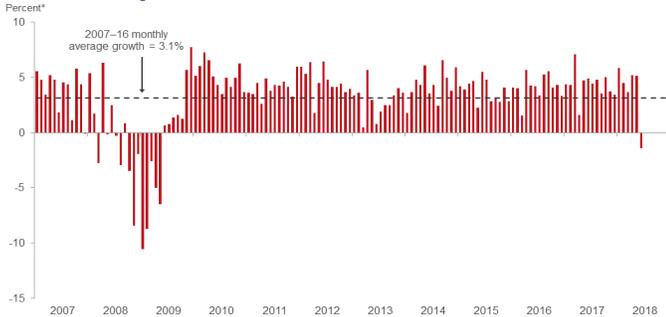


Chart 6
Peso Strengthens in July



Chart 7
Foreign-Owned Government Debt Share Declines Steadily



Chart 8
Inflation Pauses from Steady Descent



higher relative to wages), elevated interest rates that raised the cost of credit and depressed consumer confidence.

Employment Contracts for First Time in Nine Years

Formal sector employment—jobs with government benefits and pensions—decreased at an annualized rate of 1.4 percent in June over May but remain up 4.0 percent year over year (*Chart 5*). This was the first month since the 2009 recession that job growth was negative. The unemployment rate in June was 3.4 percent, about the same as a year ago.

Peso Gains Some Ground in July

The Mexican currency averaged 19 pesos per dollar in July, a 6.8 percent appreciation from June (*Chart 6*). Since January, the peso has inched up 0.9 percent. Year over year, the peso has fallen 6.2 percent against the dollar. The Mexican currency has been under pressure recently as a result of increased uncertainty regarding U.S. trade policy and Mexico’s presidential election.

Foreign-Owned Government Debt Share Ticks Up

The share of peso-denominated Mexican government debt held abroad rose slightly in June to 32 percent. Beginning in February 2017, the share has fallen, although the decline has slowed in recent months (*Chart 7*). The extent of nonresident holdings of government debt is an indicator of Mexico’s exposure to international investors, whose holdings could quickly reverse if they perceive a change in market sentiment.

Inflation Edges Up

The 12-month change in the consumer price index (CPI) was 4.8 percent in July, up slightly from 4.6 percent in June (*Chart 8*). Inflation this year has moved closer to Banco de México’s target of 3 percent. CPI core inflation (excluding food and energy) rose 3.6 percent over the 12 months ending in July. Mexico’s central bank raised its benchmark interest rate by 25 basis points to 7.75 percent on June 21. Higher U.S. interest rates and global trade tensions have increased the peso’s volatility, posing a risk to inflation and leading to tighter monetary policy.

—Jesus Cañas and Benjamin Meier

About the Author

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