Mexico's economy contracted slightly in the second quarter. Gross Domestic Product (GDP) fell 1.2 percent after expanding 3.3 percent in the first quarter. Despite weaker quarterly output, more recent monthly data on exports, employment, industrial production and retail sales show improvement. Inflation appears firmly under control, and the peso edged up against the dollar in July. The consensus 2016 GDP growth forecast edged down from 2.4 percent in June to 2.3 percent in July.

Output Falls for First Time in Three Years

Mexico’s GDP contracted at a 1.2 percent annualized rate in the second quarter after growing 3.3 percent in the first quarter (Chart 1). This is the first quarterly decline in output since second quarter 2013. Growth over the first half of 2016 averaged about 1 percent, similar to the U.S. Service-related activities (including trade and transportation) registered no growth in the second quarter, while output from goods-producing industries (including manufacturing, construction and utilities) fell 6.6 percent. Agricultural output dipped 0.4 percent.

Exports Edge Up in June

Overall exports rose 5.9 percent in June after falling 3.1 percent in May. The three-month moving averages of total and manufacturing exports finally turned up after declining throughout last year (Chart 2). Notwithstanding the recent uptick, oil exports were down 38 percent in the first half of 2016 compared with the same period a year ago, and manufacturing exports have fallen 4.6 percent.

Industrial Production Expands After Months of Contraction

Mexico’s industrial production (IP) increased 0.3 percent in May after three consecutive months of declines. U.S. IP grew 0.6 percent in June after falling 0.3 percent in May. The three-month moving average shows Mexico’s total and manufacturing IP plateaued early in the year and then fell (Chart 3). Total IP, which includes manufacturing, construction, oil and gas extraction, and utilities, has been growing slower than manufacturing IP since mid-2014.

Retail Sales Continue Growing

Retail sales expanded 1 percent in May after dipping 0.7 percent in April. Sales were up an impressive 8.9 percent year over year in May. The smoothed data (three-month moving average) clearly show the sharp acceleration in sales revenue in the first five months of 2016 (Chart 4). Consumer confidence also improved in May and June.

Job Growth Remains Strong

Formal-sector employment—jobs with government benefits and pensions—grew at an annualized rate of 4.9 percent in June and was up 3.7 percent year over year (Chart 5). Year-to-date job growth has been nearly the same as in 2015 when employment expanded 3.8 percent (December over December). This is above the recent historical average job gain.

Peso Appreciates Slightly in July

The peso averaged 18.5 pesos per dollar in July, which is 0.6 percent higher than in June (Chart 6). Nevertheless, the peso has lost 14 percent of its value against the dollar on a year-over-year basis. The Mexican currency has been weak.
As a result of the anticipation of further increases in U.S. interest rates, as well as market turmoil resulting from weaker-than-expected global demand, Brexit and the possibility of lower oil prices.

**Inflation Falls in June**

Inflation ticked down to 2.5 percent in June and remains below the central bank's long-term target of 3 percent (Chart 7). Prices excluding food and energy rose 3 percent over the last 12 months. Mexico’s central bank raised its benchmark interest rate by 50 basis points to 4.25 percent in June following the U.K.’s vote to leave the European Union. This tightening followed on the heels of two earlier interest rate hikes in December 2015 and February 2016. Agustín Carstens, Mexico’s central bank governor, has made it clear that the central bank will not hesitate to use interest rate increases and currency interventions if it feels peso weakness will lead to higher inflation.

—Jesus Cañas

**About the Author**

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