Mexico Economy Hangs Tough, with Solid but Slower Growth

February 8, 2017

Mexico’s economy posted solid growth in the fourth quarter. Gross domestic product (GDP) growth dipped from 4 percent annualized in the third quarter to 2.4 percent in the fourth quarter, according to the government’s advance estimate. Recent data on employment, retail sales and exports showed continued expansion, but industrial production was flat. Inflation held steady in December, while the peso depreciated further. The consensus 2017 GDP growth forecast is 1.6 percent.

Output Growth Decelerates

Mexico’s GDP grew 2.4 percent annualized in the fourth quarter, although at a slower pace than the third, with higher activity mostly driven by growth in the service sector (Chart 1). Service-related activities (including trade, transportation and business services) rose 2.8 percent, while goods-producing industries (including manufacturing, construction, utilities and mining) were flat. Agricultural output grew 1.6 percent in the fourth quarter.

Exports Increase in December

Exports rose 3.8 percent in December after growing 4.5 percent in November. Three-month moving averages of total and manufacturing exports show consistent growth since mid-2016 (Chart 2). For the year as a whole, total exports and manufacturing exports were 3.1 and 2.5 percent below 2015 levels, respectively. Oil exports turned around earlier in 2016 after a long decline, but the reversal was driven by rising oil prices, not higher volume. Despite the turnaround, 2016 oil exports were still 21 percent below 2015 totals.

Manufacturing Production Expands Further

Mexico’s industrial production (IP) was flat in November after growing 0.2 percent in October; however, manufacturing production ticked up and has been rising since early 2016. U.S. IP grew 0.9 percent in December after falling 0.7 percent in November. Based on the three-month moving average, Mexico’s manufacturing IP has accelerated while total IP shows signs of deceleration (Chart 3). Total IP, which includes manufacturing, construction, oil and gas extraction, and utilities, has
been growing more slowly than manufacturing IP since 2014.

**Retail Sales Continue Growing**

Retail sales expanded 1 percent in November after growing 1.7 percent in October. November sales were up an impressive 10.6 percent year over year. The smoothed data (three-month moving average) clearly show a sharp acceleration in sales revenue throughout 2016 (Chart 4). Despite this, the consumer confidence measure worsened in November and December.

**Job Growth Remains Solid**

Formal-sector employment—jobs with government benefits and pensions—grew at an annualized rate of 2.6 percent in December (Chart 5). Job growth slowed to 3.6 percent in the fourth quarter, down from 5.1 percent in the third. Nonetheless, employment growth in 2016 was 4.1 percent (December over December)—faster than the 3.8 percent growth in 2015.

**Peso Loses Ground Against the Dollar in December**

The Mexican currency averaged 21 pesos per dollar in December, a 2 percent drop from November (Chart 6). The peso has lost 17 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 and policy and economic uncertainty generated following the U.S. presidential election.

**Foreign-Owned Government Debt Stable**

Despite recent economic uncertainty and market volatility, mainly reflected in the peso/dollar exchange rate, the share of peso-denominated government debt held abroad has remained relatively stable around 35 percent (Chart 7). The extent of nonresident holdings of
government debt reflects Mexico’s exposure to international investors, whose holdings could reverse if they perceive a sudden change in market sentiment toward Mexico.

**Inflation Holds Steady in December, but Above Target**

Inflation was 3.3 percent in December, the same as in November, coming in above Banco de México’s long-term inflation target of 3 percent (Chart 8). Prices excluding food and energy rose 3.4 percent over the last 12 months. Mexico’s central bank raised its benchmark interest rate by 50 basis points to 5.75 in December, the sixth time the central bank raised rates between December 2015 and December 2016. Banco de México Governor Agustín Carstens has made it clear that the central bank will not hesitate to use interest rate increases and currency interventions as needed to strengthen the peso and stabilize prices.

—Jesus Cañas

………………………………………………………………………………………………………

**About the Author**

Cañas is a senior business economist in the Research Department at the Federal Reserve Bank of Dallas.