Mexico’s economy contracted an annualized 0.8 percent in the third quarter, in part due to the economic disruption following two major earthquakes. Nevertheless, forecasters are predicting a bounceback in the fourth quarter. The consensus growth forecast for 2017 held steady in October at 2.1 percent.

Other data were mixed; employment growth remained strong, retail sales and industrial production improved but exports fell. Inflation decelerated after climbing for 14 consecutive months, although the peso lost ground against the dollar in October.

**Activity Dips in Third Quarter**

Mexico’s gross domestic product fell at a 0.8 percent annualized rate in the third quarter (Chart 1). Quarterly activity has declined one other time in the past four years. Goods-producing industries (manufacturing, construction, utilities and mining) fell 2 percent. Service-related activities (wholesale and retail trade, transportation and business services) dipped 0.4 percent. Agricultural output grew 2 percent.

**Total and Manufacturing Exports Tick Down in September, Petroleum Exports Rise**

Total exports fell 0.4 percent in September. Manufactured goods exports, which have been consistently growing, dipped 0.9 percent, while oil exports jumped 4.9 percent. Recent deceleration in export growth is apparent in the three-month moving average (Chart 2). Year to date through September, the picture is brighter with total exports up 7.4 percent relative to the same period in 2016. Manufacturing exports rose 6.6 percent, and oil exports were up 20.9 percent in the first nine months of 2017, compared with the same period a year ago.

**Industrial Production Ticks Up**

Mexico’s industrial production (IP), which includes manufacturing, construction, oil and gas extraction, and utilities, grew 0.3 percent in August. Manufacturing IP ticked up 0.6 percent from July to August. Looking at a smoothed measure, the three-month moving average for manufacturing IP increased, while it continued falling for total IP (Chart 3). In the U.S., IP rose 0.3 percent in September after two months of declines.

**Retail Sales Rise in August**

Retail sales rose 0.2 percent in August after growing 0.3 percent in July. Dragged down by weak readings in the first half of 2017, the three-month moving average has yet to turn up (Chart 4). Momentum in retail sales has diminished since early this year, mainly due to depressed consumer confidence, high inflation (which has pushed prices higher and real wages lower) and increasing interest rates that have raised the cost of credit. Consumer confidence slipped in October after improving in September.
Job Growth Maintains Strong Pace

Formal-sector employment—jobs with government benefits and pensions—grew at an annualized rate of 3.6 percent in September (Chart 5). Monthly growth has exceeded its 10-year average for five consecutive months. Year-to-date growth stands at 4.5 percent. Employment growth was 4.1 percent (December over December) in 2016 and 3.8 percent in 2015.

Peso Loses Ground Against Dollar in October

The Mexican currency averaged 18.8 pesos per dollar in October, a 5.2 percent drop from September (Chart 6). Nevertheless, the peso is up nearly 14 percent since January. The Mexican currency initially weakened last year in anticipation of increases in U.S. interest rates as well as policy and economic uncertainty following the U.S. presidential election.

Foreign-Owned Government Debt Ticks Up in September

In September, the share of peso-denominated government debt held abroad rose for the first time since February. The foreign-owned government debt share was near 36 percent in the beginning of 2017 and remained more than 2 percentage points lower through September (Chart 7). The extent of nonresident holdings of government debt reflects Mexico’s exposure to international investors, whose holdings could quickly reverse if they perceive an abrupt change in market sentiment toward Mexico.

Inflation Decelerates After 14-Month Acceleration

Annual inflation decelerated to 6.3 percent in September following consistent acceleration since June 2016 when annual inflation was at 2.6 percent. The latest monthly reading is an important improvement, but inflation remains far above Banco de México’s long-term target of 3 percent (Chart 8). Core inflation (excluding food and energy) rose 4.8 percent over the 12 months ending in September. Mexico’s central bank held its benchmark interest rate steady at 7 percent in its September and November meetings. Banco de México Governor Agustín Carstens has stated that the central bank will use interest rate increases and currency interventions as needed to strengthen the peso and stabilize prices.

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