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Economic Watch

Mexico

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Economic Analysis

Adolfo Albo
a.albo@bbva.com

Juan Luis Ordaz Díaz
juan.ordaz@bbva.com

Juan José Li Ng
juan.li@bbva.com

Why has there been a fall in remittances to Mexico?

- In July 2012 remittances to Mexico reported their first y-o-y fall after 21 months of successive rises; the fall was 2.1% in dollar terms. There was a second fall in August, on a greater scale (-11.6% in dollars).
- There is compelling statistical evidence suggesting that the pattern of remittances to Mexico can largely be explained by two variables: 1) in the long term the employment of Mexican immigrants in the U.S., and 2) in the short term, changes in exchange rate.
- With a higher employment and greater exchange rate depreciation, remittances tend to grow. But when the level of employment is reduced and the exchange rate appreciates remittances tend to decrease.
- The recent fall in remittances is mainly due to a fall in immigrant employment and the relative strengthening of the Mexican peso against the U.S. dollar. This situation is combined with a comparison effect, given that in the second half of 2011 both the exchange rate and employment were on the increase and stood at higher levels, thus prompting higher inflows of remittances over those months.
- Considering the aforementioned context, in September we expect to see a sharp y-o-y fall in remittances, perhaps even higher than the fall seen in August, mainly because in September 2011 extraordinarily high remittances were received, driven by a sharp increase in the exchange rate.
- With the information available so far, we can predict that accumulated remittances in dollars in 2012 might be slightly higher than remittances received in 2011, but the downward trend might continue for a few more months if the weak employment situation continues in the U.S.

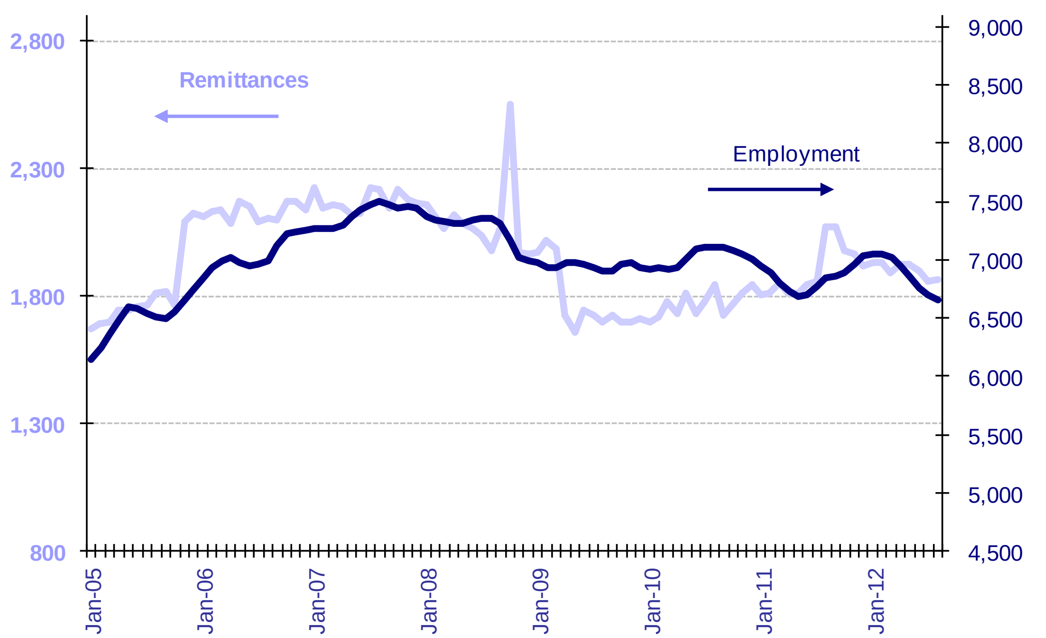
In this ***Migration Economic Watch*** we indicate the most important factors affecting changes in remittances reaching Mexico, explain the reasons for the recent fall in remittances to Mexico, and offer an outlook for remittances in future months. Subsequently, in the next edition of ***Migration Outlook Mexico*** we will explain in depth what is happening to the employment of Mexican immigrants in the U.S., in which sectors and states of the U.S. jobs are being lost, and the reasons for the recent falls in employment.

What factors are behind the changes in remittances in Mexico?

The amount of remittances reaching a certain country is determined by a large number of factors. Some of these factors - such as immigrants' jobs, altruism, immigrants' income and the institutional facilities for sending remittances - have a higher impact on long term remittance levels and trends, while others, such as interest and exchange rates, variables which can change greatly over a short space of time, have greater effects in the short term.

In Mexico, Mexican immigrant employment in the U.S. has been the main reason behind the long-term trend in remittances. Generally speaking, when employment rises, then so do remittances, and vice versa. We can see this phenomenon in the chart below.

Chart 1
Remittances to Mexico and Mexican immigrants employed in the U.S.
(Millions of monthly dollars and Thousands of people)



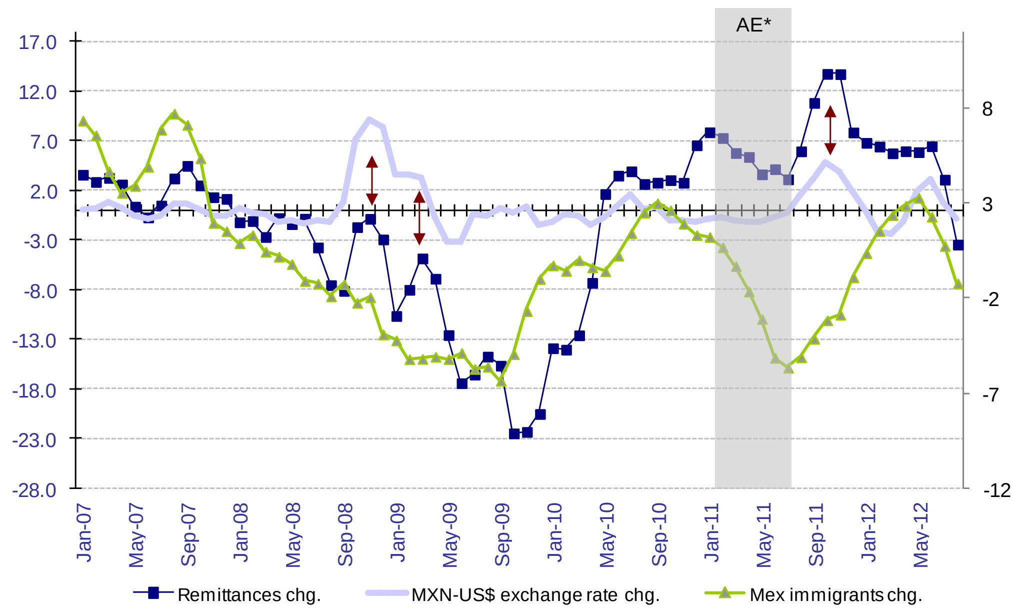
Source: BBVA Research, with figures of the Bank of Mexico and Bureau of Labor Statistics data
Note: Seasonally-adjusted figures using TRAMO-SEATS

Remittances fluctuate around a certain trend: occasionally they might have a downward trend, but they can increase in certain months; and on other occasions, though their trend is upward, they can fall. These movements are caused by temporary events; the most important being changes in exchange rates. In this case the effect is immediate. When immigrants know that the dollars sent by them will be converted into a greater number of pesos, they have more incentives to send more dollars; on the other hand, when their dollars are worth less they will tend to send less while they await a more favorable situation. Consequently, increases in the exchange rate (peso per dollar) have positive effects on remittances, and falls have negative effects. Let us examine a few cases.

Since 2005, the greatest change in the exchange rate took place in October 2008: a monthly increase of 18%, which meant that although remittances had been falling successively month by month, due to falling employment in the U.S., in that month they rose 11.4% y-o-y. Given that September 2008 was such an extraordinary month, we would expect the comparison with the same month of 2009 to show a heavy y-o-y fall, and that is exactly what happened. Remittances fell by around 36% y-o-y in October 2009.

However, the highest fall in the exchange rate since 2005 from one month to another happened in April 2009. From that point on, the peso maintained a trend of almost a year's appreciation against the dollar. During this period, remittances saw the highest year-on-year falls ever recorded, also influenced by the fall in employment of Mexican immigrants in the U.S. Had it not been for the lower exchange rate, the falls would have been slighter. If we compare these figures with those of the same period of 2010, we can observe increases in the latter. This is due to the fact that the exchange rate does not have a negative impact on remittances in this second period, even though there was a phase of lost employment for Mexican immigrants owing to what we have called the "Arizona Effect".[1]

Chart 2
Annual change in remittances to Mexico
(%)



Note: 3-month moving avarage
*Arizona Effect

Source: BBVA Research, with figures of the Bank of Mexico and Bureau of Labor Statistics data
Note: Seasonally-adjusted figures using TRAMO-SEATS

The above cases show how sensitive remittances can be to changes in employment and in the exchange rate. They also indicate that the best situation for remittances comes about when employment and the exchange rate increase, and that the worst case scenario is when both the exchange rate and employment of Mexican immigrants in the U.S. fall. This can be seen in chart 2 above.

Generally speaking, our estimates show that over 70% of the change in remittances reaching Mexico is due to the exchange rate and immigrants' employment in the U.S. Indeed the latter variable accounts for the lion's share, over 40% of the total variation. In the next section we will see what is happening at present.

[1] The "Arizona Effect" refers to the effect on employment of the immigrants who had lawsuits brought against them in different U.S. states which enacted anti-migration laws, and where the first state to do so was Arizona. For further details see the July 2012 edition of ***Migration Outlook - Mexico***

Why did remittances fall in July and August?

As we have seen, improved job numbers for Mexican immigrants in the U.S. and the exchange rate are the main factors shaping remittance patterns. Let us analyze how these two variables have performed recently to see if their pattern corresponds to the changes in remittance flows.

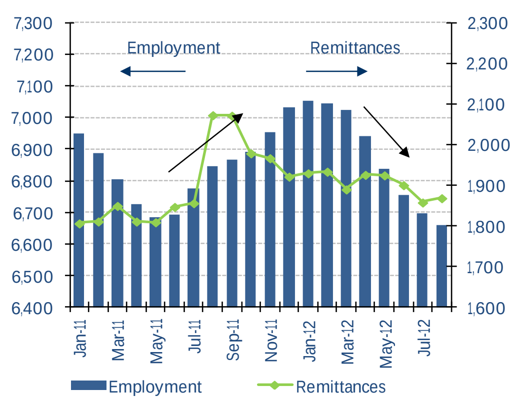
In the second half of 2011, there were rises in both job numbers of Mexican immigrants in the U.S. and the exchange rate. As we saw above, this is the best possible situation for remittances. Remittances therefore increased in the second half of 2011, bringing their accumulated growth throughout 2011 to approximately 7% in dollars, when in the first half of the year they had grown 4.8% y-o-y. In other words, driven by the exchange rate and job numbers in the second half of 2011, remittances increased to almost double their growth seen in the first half of the year.

Recently, the situation for remittances has been the worst possible combination of factors: a falling exchange rate and fewer jobs for Mexican immigrants in the U.S. In July 2012, the exchange rate dropped by 4%. Figures from the *Current Population Survey* show that employment amongst Mexican immigrants also declined 1.4% against the previous year. Remittances responded by falling 2.1% y-o-y in July.

In August 2012, Mexican immigrants' jobs in the U.S. fell in the region of 3.5% y-o-y and the exchange rate by 1.6% against the previous month; in August 2011, however, the exchange rate had risen by over 4%. Therefore, remittances in August 2011 had been fueled by the exchange rate, while in August 2012; there were fewer incentives to send remittances due to employment and the exchange rate. These factors are responsible for the 11.6% fall observed in remittances in that month.

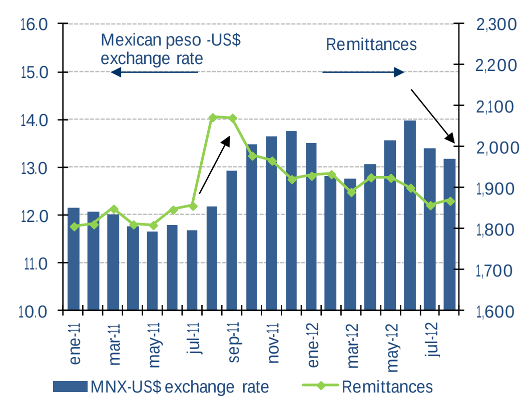
The accumulated flow of remittances over the last 12 months has already passed the turning point, having fallen 1.2% in dollars against June 2012, while Mexican immigrant employment in the U.S. has fallen by over 5% in recent months, and the exchange rate is down by 7% since June 2012.

Chart 3
Mexican immigrants employed in the U.S. and remittances to Mexico
(Thousands of people and Millions of dollars)



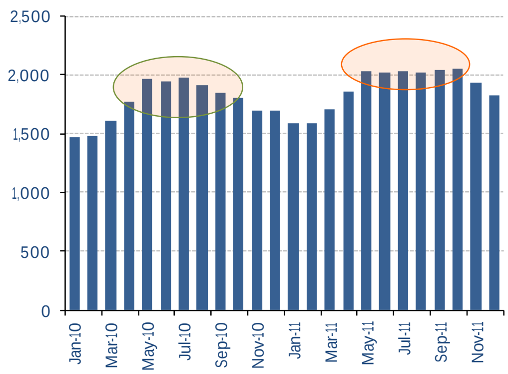
Source: BBVA Research, with figures of Banxico and Bureau of Labor Statistics, Current Population Survey
Note: Seasonally-adjusted figures using TRAMO-SEATS

Chart 4
Exchange rate and remittances to Mexico
(pesos per dollar and millions of dollars)



Source: BBVA Research with Banxico figures
Note: Remittance figures are seasonally-adjusted using TRAMO-SEATS

Chart 5
Remittances to Mexico, 2010-2011
(Millions of dollars a month)



Source: BBVA Research with Banxico figures

Table 1
Variation since the last peak

Variable	Period	Var. %
Accumulated 12-month remittance flow	June - August 2012	-1.2
Exchange rate	June to September 2012	-7.1
Mexican immigrants employed in the U.S.*	February to August 2012	-5.4

Source: BBVA Research, with figures of Banxico and Bureau of Labor Statistics, Current Population Survey
* Seasonally-adjusted figures using TRAMO-SEATS

What pattern do we expect to see for remittances in September?

On 1 November 2012, the Bank of Mexico will release figures on remittances received in Mexico for September this year.

It is important to note that in September last year, the exchange rate rose sharply by over 6% against the preceding month. That situation and the upswing in Mexican immigrants in the U.S, employment seen in the second half of 2011 prompted 21.4% y-o-y growth in remittances in September 2011, the highest increase since 2007. So the strong increase in the exchange rate led to extraordinary income from remittances in that month.

In September 2012, the exchange rate and Mexican immigrants employed in the U.S. remain low, so these two factors would also keep remittances down. Indeed, if we compare remittances received in September 2012 and 2011, with this year's downward trend and the upswing last year, we would expect to see a heavy fall year-on-year which would be even sharper than that seen in August.

What future pattern do we expect to see in remittances?

In principle, accumulated remittances received throughout 2012 might be expected to be slightly higher than those received in 2011, albeit lower than expected at the start of the year. We will have to keep a close eye on forthcoming indicators concerning economic activity and employment in the U.S., in order to determine if the falls in Mexican immigrant employment in the U.S. and in remittance flows to their families in Mexico are due to a trend or if this is merely a temporary phenomenon. This will allow us to have a clearer outlook concerning future remittance patterns.

Factors such as a more adverse situation in Europe, which could affect employment in the U.S., could also have an impact on remittances. Furthermore, the election taking place in November in the U.S., and the possible budget adjustment scenarios - which will depend on who wins the election - could play an important role in the future economic outlook, and thus in the current condition of employment for the population in general and also for Mexican immigrants in the U.S., and, by extension, in remittances. In the next edition of ***Migration Outlook Mexico*** we will conduct a more in-depth analysis of the factors affecting Mexican immigrant employment, an important variable in long-term remittance patterns.