

MACROECONOMIC ANALYSIS

Economic pessimism and the inflation spike affect consumer confidence

Arnulfo Rodríguez / Carlos Serrano

- **The consumer confidence index fell by 26% in annual terms during January 2017, which represents the biggest annual contraction in the history of the index.**
- **All five components of the index posted sharp YoY % drops in January.**
- **More negative sentiments on both the current and future economic situation of the country were the main drivers behind the January's sharp annual drop in the consumer confidence index.**
- **The third driver, though not far behind the second one, was the consumer sentiment on the economic future of the household.**
- **In contrast, the annual declines in the consumer confidence index during the global economic recession of 2008-2009 were mainly due to the more negative sentiment on the possibility for purchasing home appliances.**
- **Using microdata from the National Consumer Confidence Survey (ENCO), a diffusion index was designed to measure consumer inflation expectations.**
- **This index showed a sharp increase in January, in line with the inflation spike derived from higher energy prices and more pass-through from MXN depreciation to consumer prices.**

Consumer confidence, measured by a diffusion index, has always been below 50 for the period spanning from January 2003 to January 2017

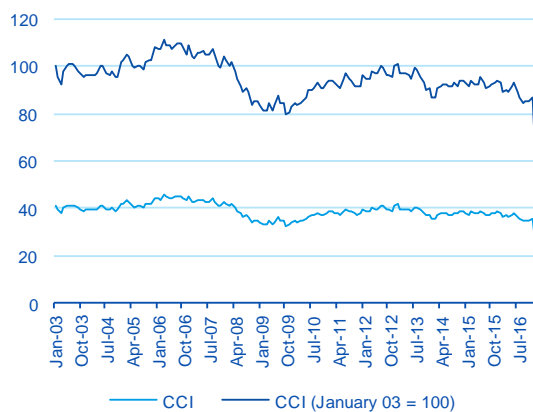
Consumer confidence fell by 26% YoY in January 2017. All the components of the consumer confidence index also showed year-on-year drops in January 2017. The greatest annual contractions were seen in the sub-indices for the economic situation expected for the country in the following 12 months and for the country's current economic situation, with annual declines of 35% and 33% respectively. The "possibility for purchasing home appliances" sub-index was down by 32% YoY, the "economic situation expected for the household in the following twelve months" was down by 20% and the "household's current economic situation" by 13%.

Given that the consumer confidence index is calculated as a simple average of its five components, the increased pessimism about the country's current and future economic situation had an adverse impact on the consumer confidence index of January 2017. The uncertainty about Mexico's economic future in view of the possible changes in its trade relationship with the US has undoubtedly been reflected not only in some macroeconomic variables (higher interest rates, less investment, currency depreciation, higher inflation and less real wage growth) but also in the consumers' perception of the country's economy.

It is important to mention that consumer confidence, measured by a diffusion index, has always been below 50 for the period spanning from January 2003 to January 2017. In other words, Mexican consumers have never shown an expanding confidence in the time period between January 2003 and January 2017 (Figure 1). When analyzing the historical trends of the consumer confidence components, we find that consumers consistently

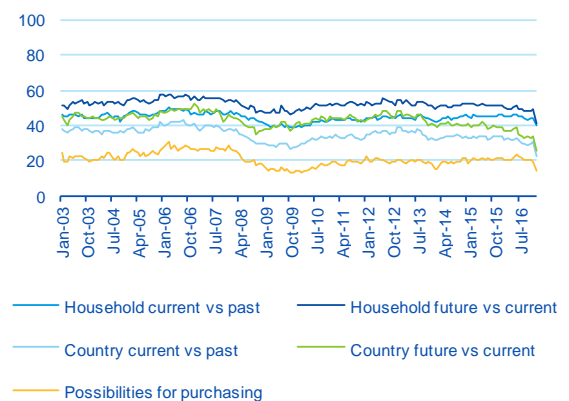
show an expanding optimism about the economic situation expected for the household in the following 12 months since the value of this sub-index is generally above 50. The sub-indices of the other components persistently show a shrinking optimism since its value is most of the time below 50. When comparing across sub-indices, perceptions of the household's current economic situation and of the expected economic situation for the country are generally more positive than those of the country's current economic situation and the possibility for purchasing home appliances (Figure 2).

Figure 1
Consumer confidence (Diffusion index)



Source: BBVA Research with INEGI (national statistics institute) data

Figure 2
Components of consumer confidence (Diffusion index)

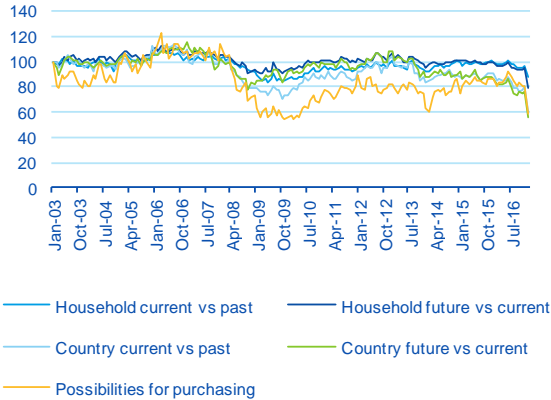


Source: BBVA Research with INEGI (national statistics institute) data

The main cause of a more negative consumer sentiment in January 2017 contrasts with that observed during the global economic recession of 2008-2009

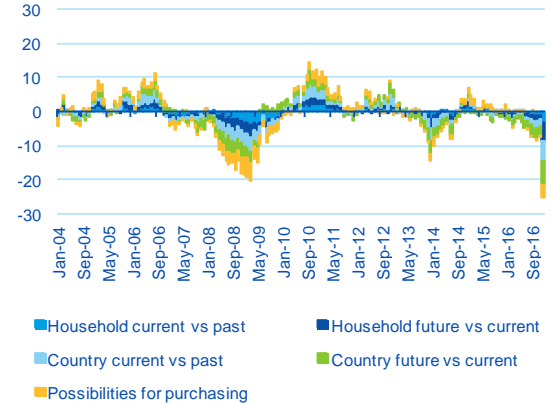
The January 2017 year-on-year sharp fall in this index was higher than that seen during the global economic recession of 2008-2009 or at any other time ever since consumer confidence is measured (Figure 4). This abrupt YoY fall was largely due to a more negative consumer sentiment about the economic future of both the country and the household as well as greater concerns about the country's current economic situation. In contrast, during the global economic recession of 2008-2009, the increased pessimism was primarily about the possibility for purchasing home appliances, followed by consumers' concerns about the country's economic situation at that time and in the future.

Figure 3
Components of consumer confidence
(Diffusion index (January 2003) = 100)



Source: BBVA Research with INEGI (national statistics institute) data

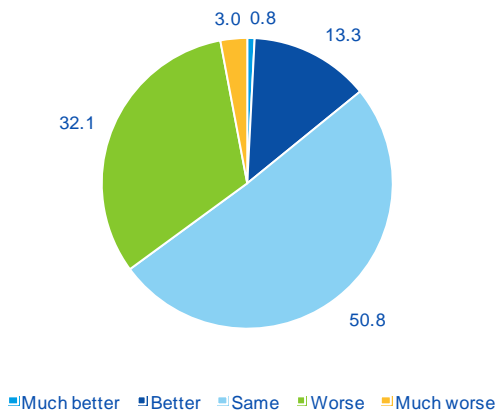
Figure 4
Impact of components on the consumer confidence index
(Percentage points in the YoY % change of the index)



Source: BBVA Research with INEGI (national statistics institute) data

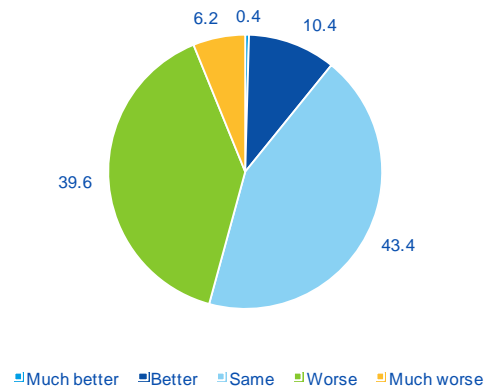
The collapse of consumer confidence in January 2017 can also be seen from a comparative perspective by looking at the answers to each of the five questions used to construct the confidence index. In the case of the answers to the question about the current economic situation of the household compared with the past, 45.8% of the respondents said it was worse or much worse, compared with 35.1% in December 2016 (Figures 5 and 6).

Figure 5
Answers to the question about the household's current economic situation compared with the past in December 2016
(% of total)



Source: BBVA Research with INEGI (national statistics institute) data

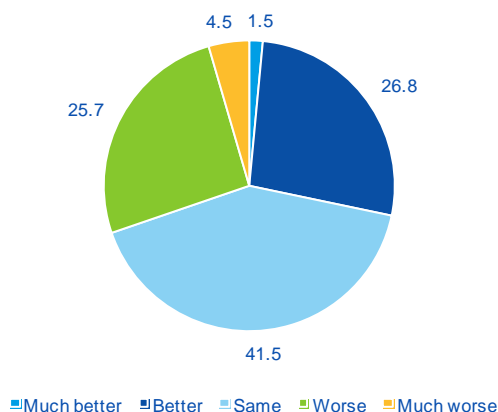
Figure 6
Answers to the question about the household's current economic situation compared with the past in January 2017
(% of total)



Source: BBVA Research with INEGI (national statistics institute) data

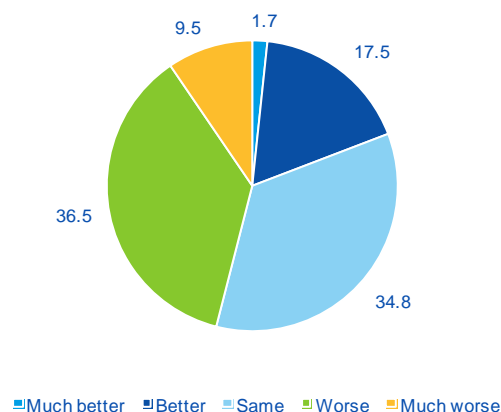
In the answers to the question about the future economic situation of the household compared with the current one, 46.0% of the respondents in the January 2017 survey said it would be worse or much worse, compared with 30.3% in December 2016 (Figures 7 and 8).

Figure 7
Answers to the question about the household's future economic situation compared with the present one in December 2016
(% of total)



Source: BBVA Research with INEGI (national statistics institute) data

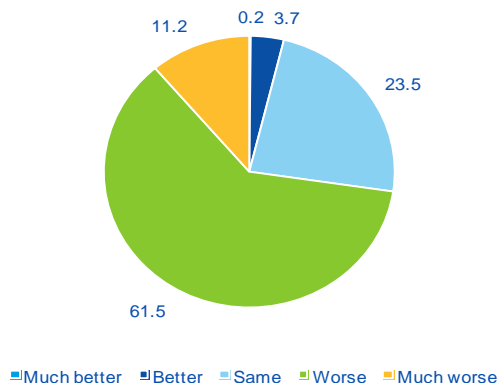
Figure 8
Answers to the question about the household's future economic situation compared with the present one in January 2017
(% of total)



Source: BBVA Research with INEGI (national statistics institute) data

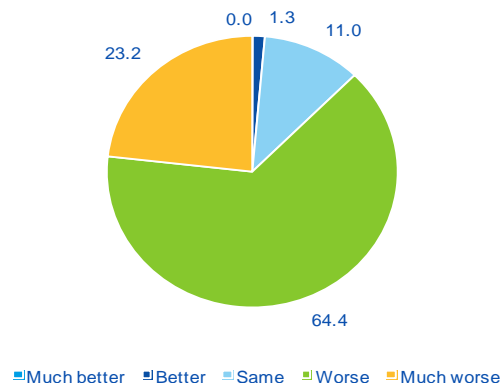
In the answers to the question about the country's current economic situation compared with the past, 87.6% of the respondents in the January 2017 survey said it was worse or much worse, compared with 72.7% in December 2016 (Figures 9 and 10).

Figure 9
Answers to the question about the country's current economic situation compared with the past in December 2016
(% of total)



Source: BBVA Research with INEGI (national statistics institute) data

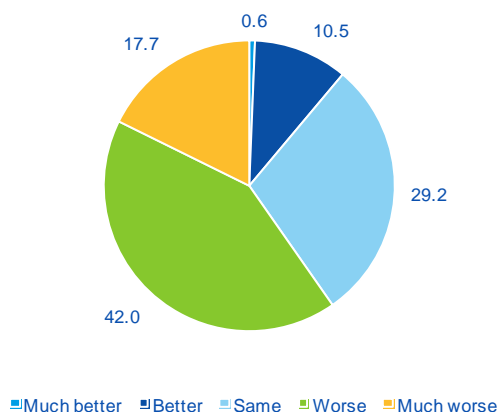
Figure 10
Answers to the question about the country's current economic situation compared with the past in January 2017
(% of total)



Source: BBVA Research with INEGI (national statistics institute) data

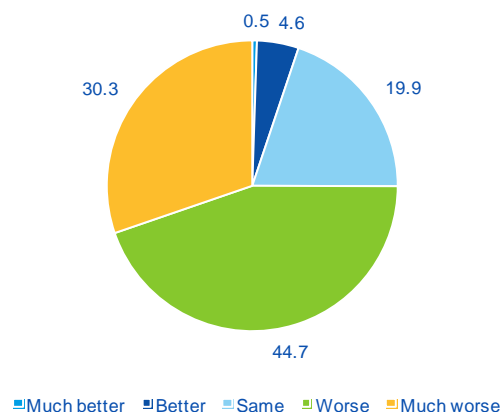
In the answers to the question about the country's future economic situation compared with the present one, 75.0% of the respondents in the January 2017 survey said it would be worse or much worse, compared with 59.7% in December 2016 (Figures 11 and 12).

Figure 11
Answers to the question about the country's future economic situation compared with the present one in December 2016
(% of total)



Source: BBVA Research with INEGI (national statistics institute) data

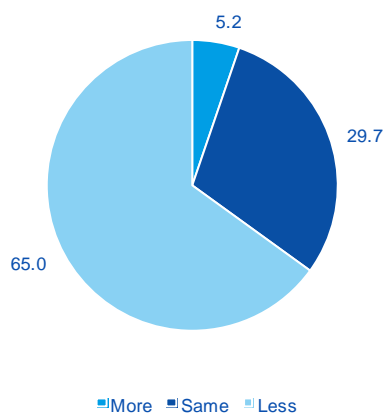
Figure 12
Answers to the question about the country's future economic situation compared with the present one in January 2017
(% of total)



Source: BBVA Research with INEGI (national statistics institute) data

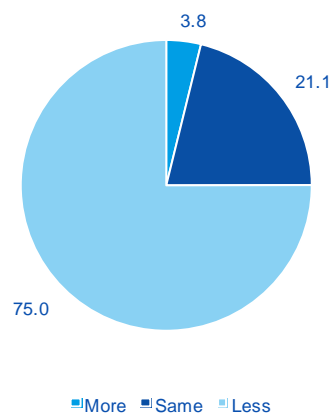
Lastly, in the answers to the question about the possibility for purchasing home appliances, 75.0% of the respondents in the January 2017 survey answered "less", compared with 65% in December 2016 (Figures 13 and 14).

Figure 13
Answers to the question about the possibility for purchasing home appliances in December 2016
(% of total)



Source: BBVA Research with INEGI (national statistics institute) data

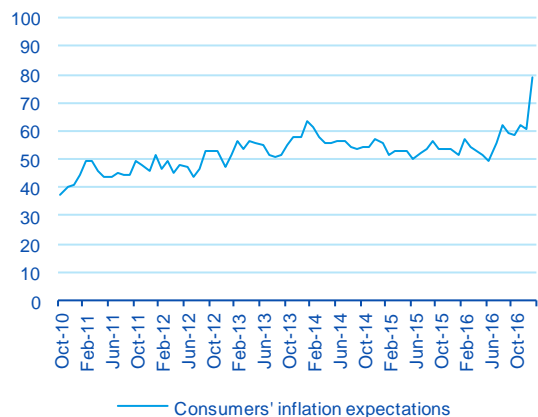
Figure 14
Answers to the question about the possibility for purchasing home appliances in January 2017
(% of total)



Source: BBVA Research with INEGI (national statistics institute) data

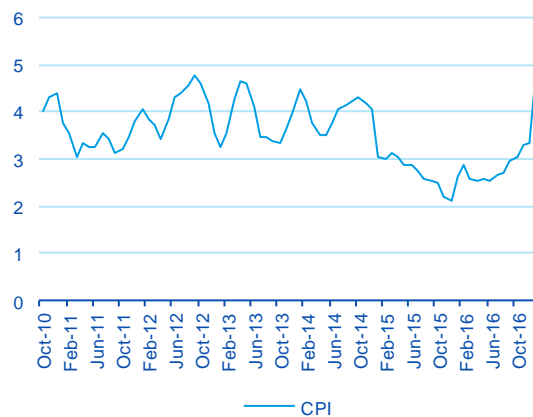
Other qualitatively significant information that can be obtained from the microdata of the National Consumer Confidence Survey (ENCO) includes expectations of price movements. Question No. 12 in the basic questionnaire for this survey asks about expectations for prices to behave in the country in the following twelve months. Taking household expansion factors into account, we calculated a diffusion index with the answers to this question.

Figure 15
Consumers' inflation expectations for the following 12 months (Diffusion index)



Source: BBVA Research with INEGI (national statistics institute) data

Figure 16
National Consumer Price Index (YoY % change)

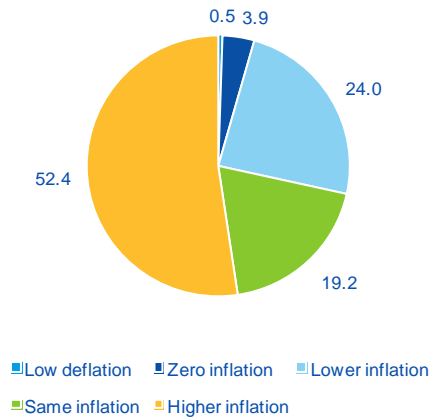


Source: BBVA Research with INEGI (national statistics institute) data

In the particular case of January 2017, we see a significant uptick in expected price movements for the following twelve months (Figure 15). Consumer price inflation also showed a substantial increase in January 2017 as a result of both the increased prices of some energy items, particularly gasoline and natural gas, and more pass-through from currency depreciation to prices (Figure 16). The perception of an economy with higher levels of inflation is indisputably having an adverse effect on consumer confidence.

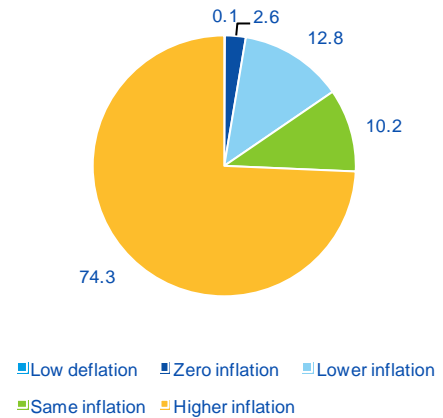
When using a comparative framework to understand the expectations for higher inflation, we see that in the January 2017 survey, 74.3% of the respondents expected higher inflation in the following 12 months, as opposed to 52.4% in December 2016 (Figures 17 and 18).

Figure 17
Answers to the question about how consumers expect prices to evolve over the following 12 months in December 2016
(% of total)



Source: BBVA Research with INEGI (national statistics institute) data

Figure 18
Answers to the question about how consumers expect prices to evolve over the following 12 months in January 2017
(% of total)



Source: BBVA Research with INEGI (national statistics institute) data

Conclusions

The analysis of the behavior of the five components of the consumer confidence index reveals that its significant year-on-year fall in January 2017 was largely due to greater pessimism about the economic future of both the country and the household as well as greater concerns over the country's current economic situation. Consumers have undoubtedly been adversely affected by higher interest rates, lower levels of investment, currency depreciation, higher inflation and lower growth in real wages. The recent behavior of both consumer confidence and the aforementioned macroeconomic variables reflects expectations of adverse effects on Mexico from potential changes in its trade relationship with the US that will not necessarily lead to an adverse scenario. It is worth pointing out that, in contrast to what happened in some months during the recession of 2008-2009, the sharp fall in consumer confidence in January 2017 was not derived mainly from greater pessimism about the possibility for purchasing home appliances. Finally, it is important to take the possible economic implications of a lower level of the consumer confidence index with a degree of caution, since in general in the past the index has not proved to be a reliable predictor of the behavior of private consumption in Mexico.

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