BBVA Research

Mexico Economic Outlook

June 2023

Creating Opportunities

01

Global Economic Outlook 2Q23

Creating Opportunities

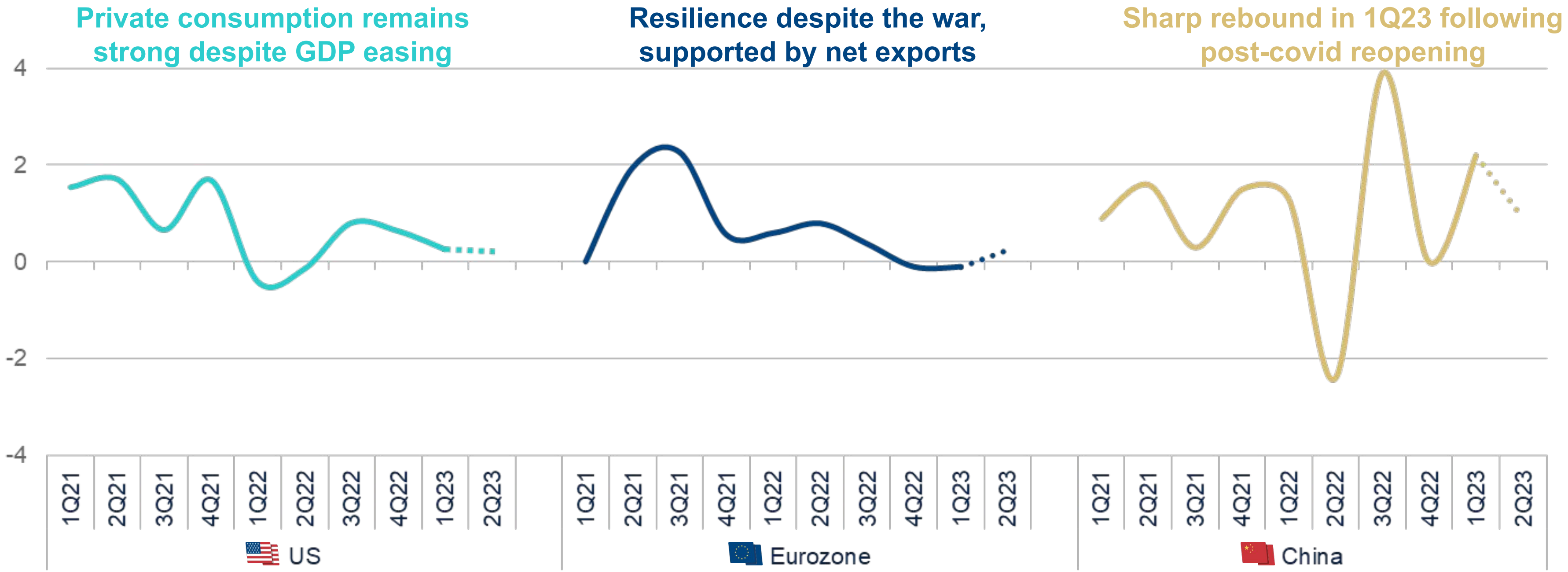
Growth and inflation are easing, but remain resilient, spurring a monetary tightening that continues to cause episodes of financial volatility

RECENT DEVELOPMENTS IN THE WORLD ECONOMY

Growth resilience	Inflation persistence	Restrictive monetary policy	Financial stress
Slow growth deceleration on tight labor markets and lingering post-covid effects.	Lower inflation on eased energy prices and bottlenecks, but sticky core inflation.	Central banks focused on inflation; policy rates at (or close to) peak, but higher for longer.	Bank turmoil, with contagion mostly limited to US regional banks (no financial dominance).

GDP growth is slowing down in the US, remains very moderate in the EU and has rebounded significantly more than expected in China in 1Q23

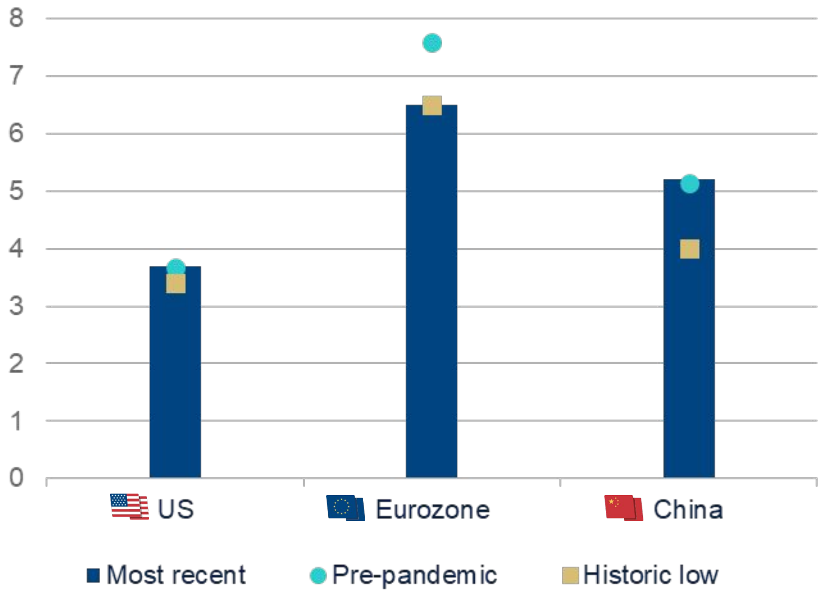
GDP: REAL GROWTH
(Q/Q %)



(*) BBVA Research growth forecasts for 2Q23.
Source: BBVA Research based on data from Haver.

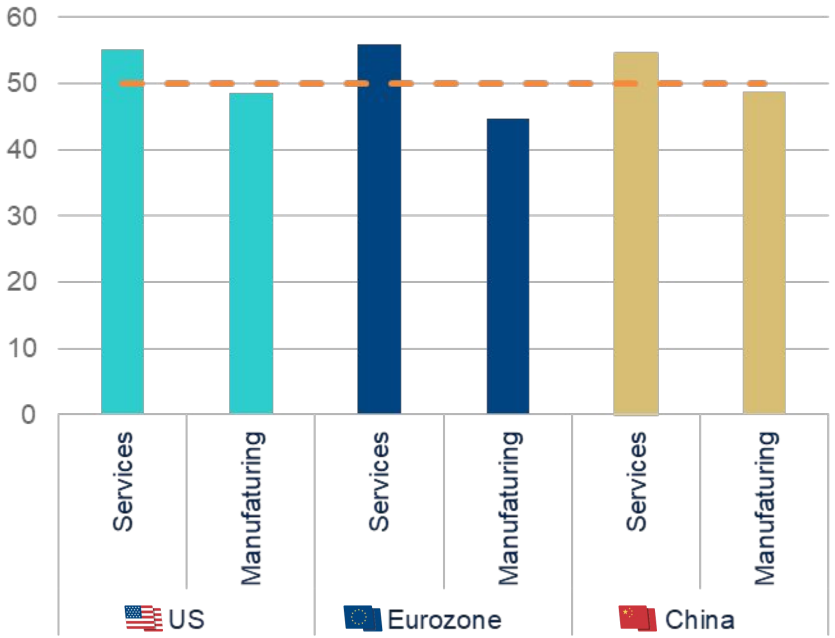
Activity dynamism, mainly in private consumption and the services segment, has been supported by strong labor markets and lingering reopening effects

UNEMPLOYMENT RATE (*)
(% OF THE LABOR FORCE)



(*) Most recent data: May-23 in the US, Apr-23 in China and in the EZ. Pre-pandemic: 2019 average.
Historic low: lowest level since Jan-04
Source: BBVA Research based on data from Haver.

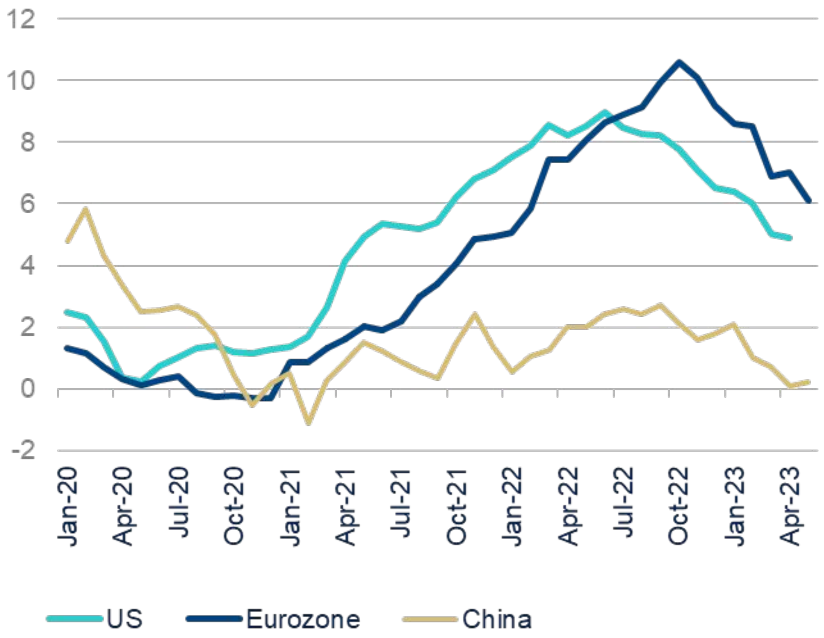
PMI INDICATORS: MAY/23
(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)



Source: BBVA Research based on data from Haver.

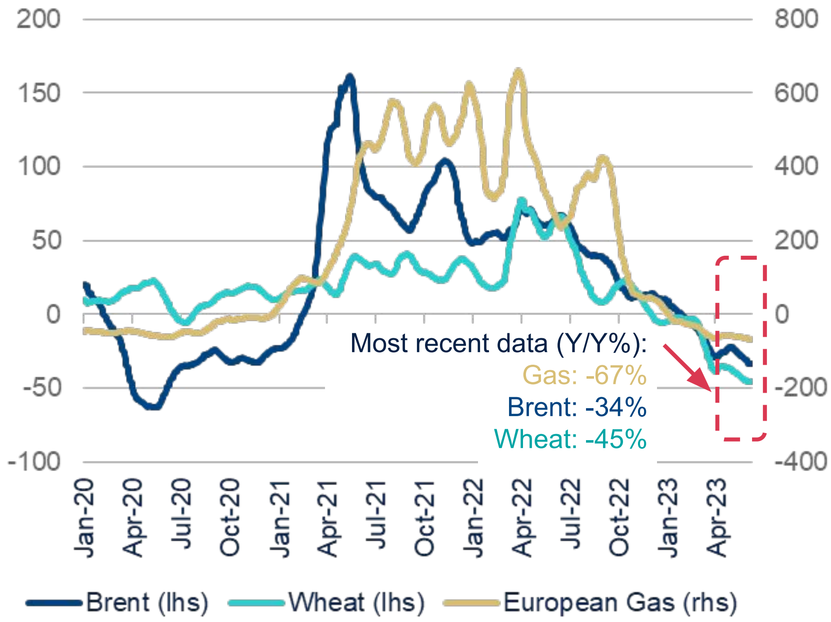
Headline inflation has been trending downwards, favored mainly by lower energy prices, the easing of supply bottlenecks and favorable base effects

INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on data from Haver.

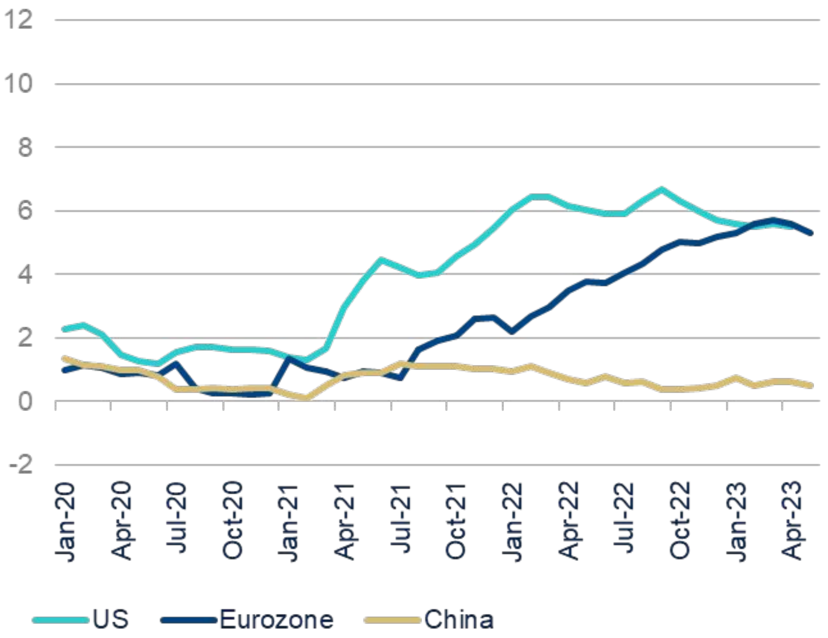
COMMODITY PRICES
(Y/Y %, 30-DAYS MOVING AVERAGE)



Source: BBVA Research based on data from Haver.

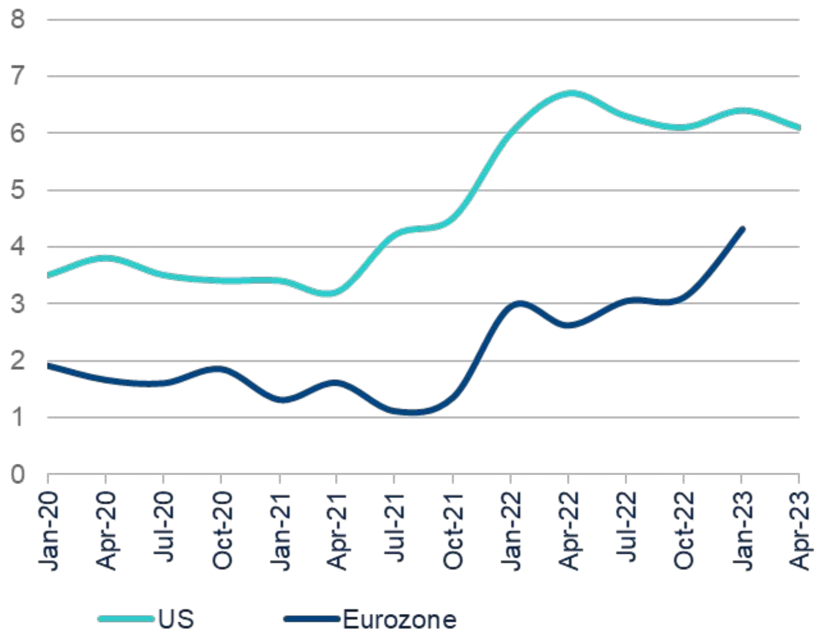
Core inflation has stabilized at high levels in a context where robust demand has favored some (limited) second-round effects

CORE INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on data from Haver.

WAGE GROWTH (*)
(Y/Y %, QUARTERLY DATA)

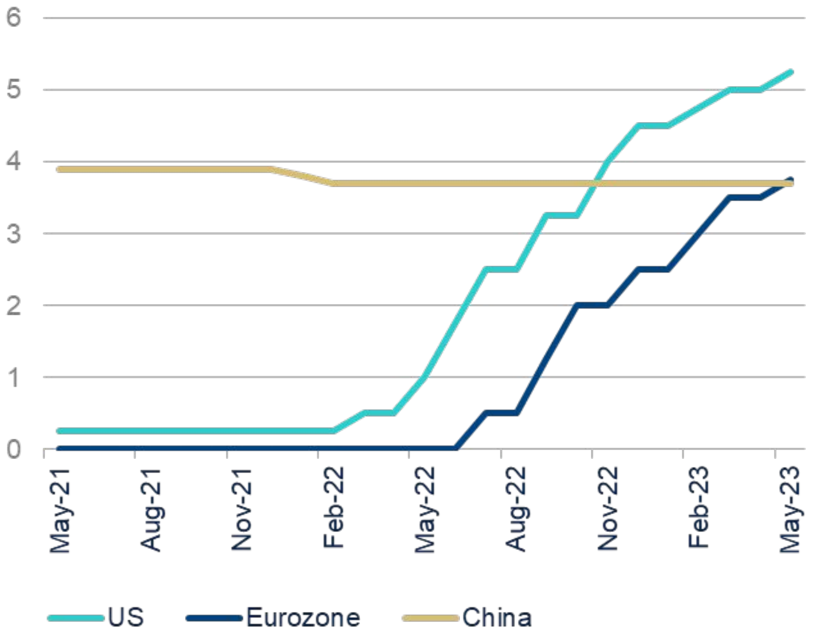


(*) US: Atlanta Wage Tracker; 2Q23 data represents data for Apr/23 only. EZ: negotiated wages.
Source: BBVA Research based on data from the Fed and Eurostat.

The sharp reversal of monetary conditions continues to pave the way for episodes of instability in financial markets

POLICY INTEREST RATES (*)

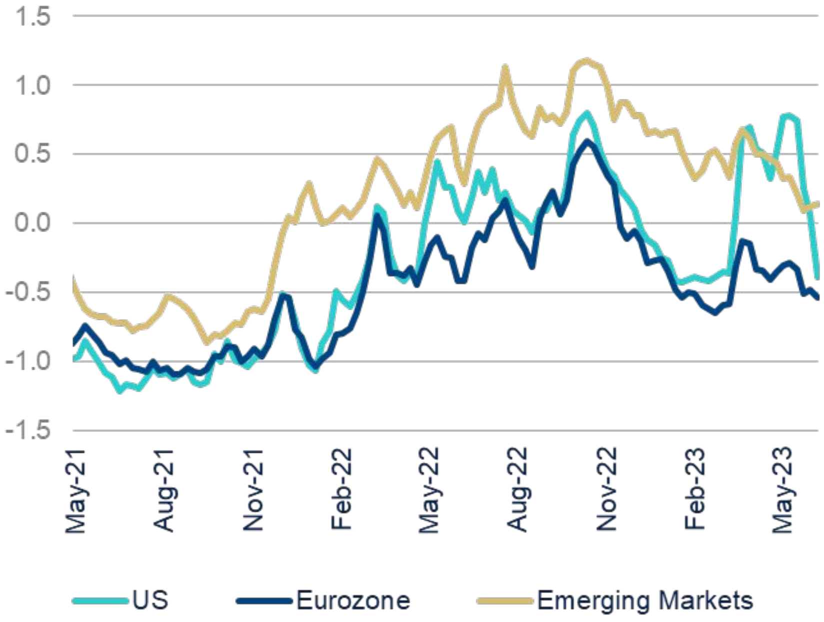
(%)



(*) Refi rates in the case of the ECB.
Source: BBVA Research based on data from Bloomberg.

BBVA FINANCIAL TENSIONS INDEX

(INDEX: HISTORIC AVERAGE = 0)

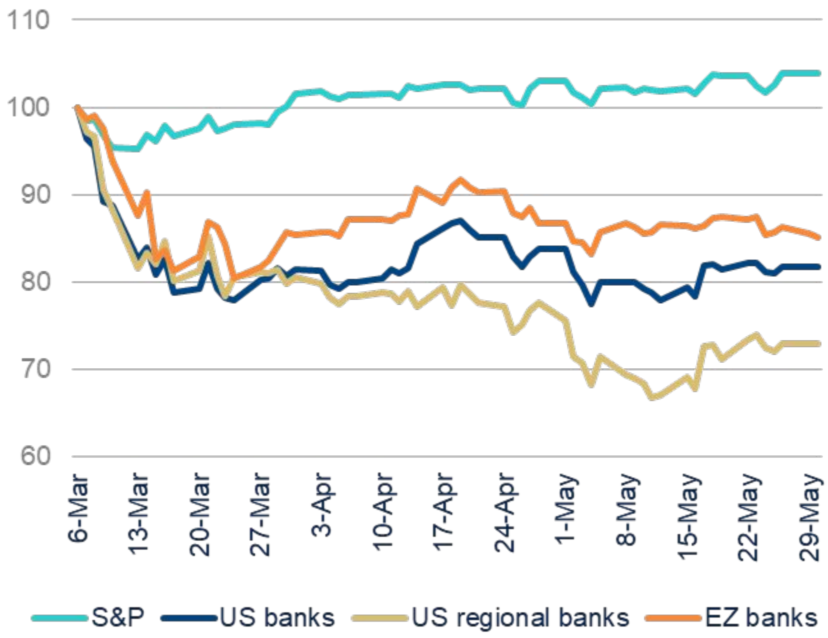


Source: BBVA Research based on Bloomberg.

Bank stress, driven by deposit outflows and asset losses, has boosted credit tightening; policy reaction has limited contagion, prevented financial dominance

EQUITY MARKETS

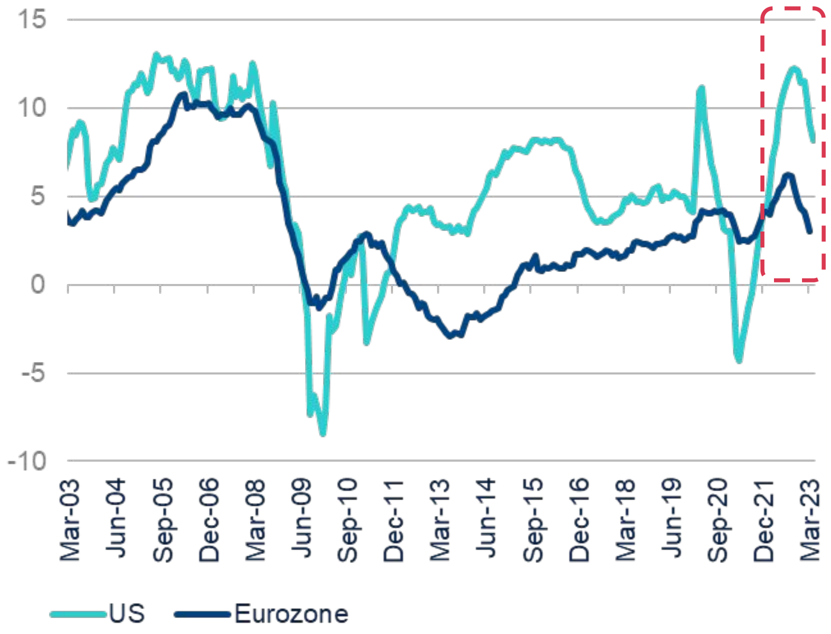
(INDEX: MARCH 6TH = 100)



Source: BBVA Research based on Bloomberg.

LENDING BY COMMERCIAL BANKS

(YOY %, MONTHLY DATA)



Source: BBVA Research based on data from FRED and ECB.

Reinforced prospects for growth and inflation easing despite recent resilience: credit tightening amid banking stress likely to add to monetary tightening

BBVA RESEARCH BASELINE SCENARIO

High-for-long interest rates

Restrictive monetary stance, also on credit tightening and liquidity withdrawal; cautious policy reversal from 1Q24 (or later).

Growth slowdown

Labor markets and demand will eventually ease, driving growth down despite supply normalization.

Gradual disinflation

Contained commodity prices and limited second round effects, but inflation above targets for some time.

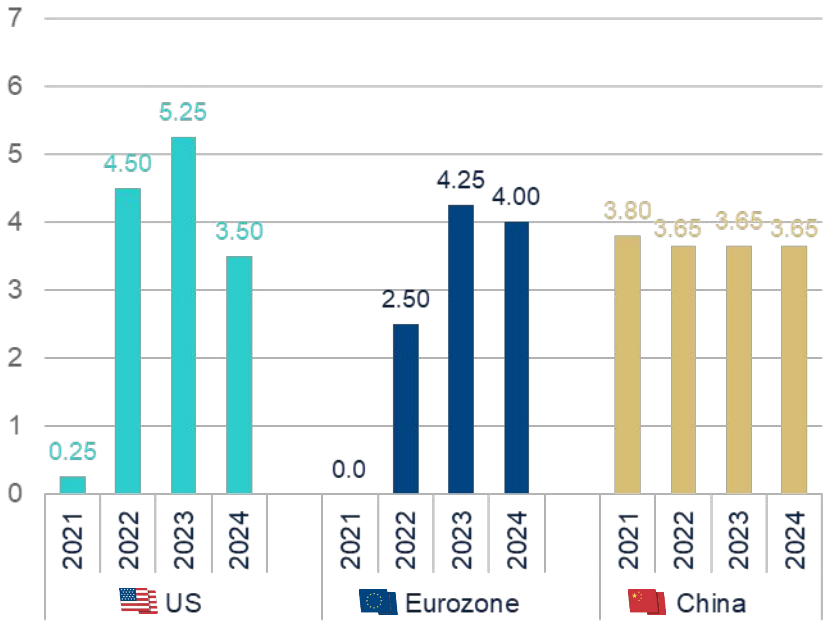
Financial volatility

Relatively high volatility and limited flows to riskier assets; US banks stress, with no contagion to large banks or abroad.

Central banks will remain focused on inflation despite banking stress: after reaching restrictive levels, rates will likely remain unchanged for a long period

MONETARY POLICY INTEREST RATES (*)

(%, END OF PERIOD)

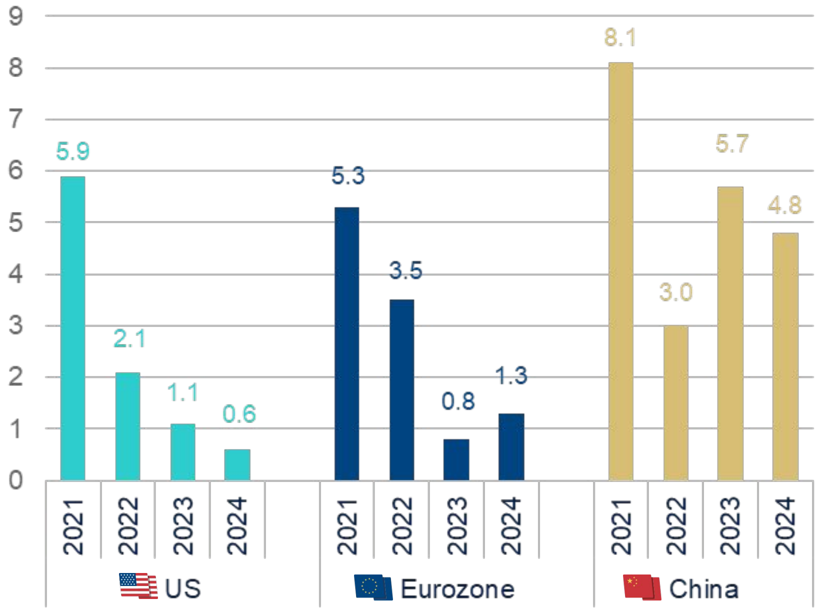


(*) In the case of the Eurozone, interest rates on refinancing operations.
Source: BBVA Research based on Bloomberg data.

- Central banks are likely to use policy rates to fight inflation and liquidity tools to address bank stress; financial dominance is not expected, but is a risk.
- The rate hiking cycle is presumably over in the US (but one more hike is possible) and closer to its end in the EZ, where at least two more hikes are likely.
- Easing cycles are not likely before 1Q24 in the US and 4Q24 in the EZ.
- Still, Fed and ECB will maintain quantitative tightening programs in place, with a gradual and predictable liquidity withdrawal pace.
- Credit tightening and, eventually, fiscal policy are likely to help monetary policy to reign in on inflation.

GDP forecasts: up in 2023 on robust demand and easing supply shocks, but down in 2024 on the lagged impact of tighter monetary and credit conditions

GDP: ANNUAL GROWTH IN REAL TERMS (*)
(%)



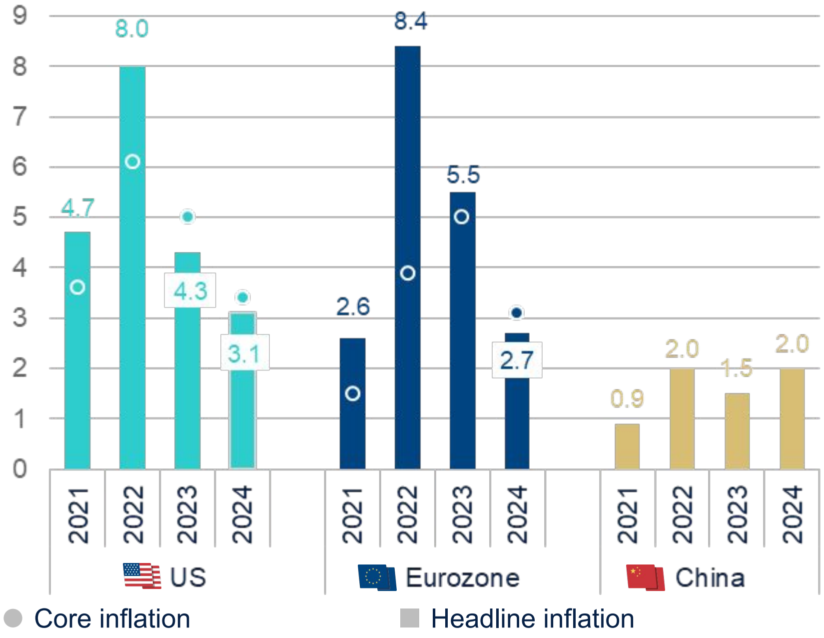
(*) Previous forecasts: 0.8% in 2023 and 1.8% in 2024 in the US, 0.6% in 2023 and 1.6% in 2024 in the Eurozone, 5.2% en 2023 and 5.0% in 2024 in China.
Source: BBVA Research.

- 2023 upward revisions (US: 0.3pp, EZ: 0.2pp, CHN: 0.5pp) on supportive incoming data reflecting strong private consumption (mainly in the US and China) and lower energy prices (mainly in the EZ).
- 2024 downward revisions (US: -1.2pp, EZ: -0.3pp, CHN: -0.2pp) on effects of tighter monetary policy and less supportive credit conditions, to which the recent banking stress is likely to contribute.
- Vanishing reopening effects, easing fiscal support and financial volatility are also likely to hit growth.
- Global growth to slow from 3.4% in 2022 to 2.9% (+0.2pp) in 2023 and 2.9% (-0.3pp) in 2024.

Inflation will continue to ease, but will be more persistent than previously expected; it will be over the targets for long in the US and EZ

INFLATION:CPI

(Y/Y %, PERIOD AVERAGE)



Source: BBVA Research.

- Supply improvement (lower commodity prices, bottleneck normalization) and monetary tightening will pave the way for a further decline in inflation: headline inflation has peaked; core inflation is set to soon ease more significantly.
- Still, the dynamism of private consumption amid tight labor markets will favor (contained) increases in wages and profit margins, slowing inflation's downward trend.
- In China, price pressures remain under control despite the post-covid recovery due to favorable commodity prices, supply recovery and private sector "balance sheet recession".

In an uncertain context, the risk that high inflation and tight monetary conditions triggers a recession or financial instability has increased lately

MAIN RISKS

PERSISTENT INFLATION AND TIGHT MONETARY POLICY:

- strong demand
- tight labor markets
- China recovery
- higher commodity prices

FINANCIAL INSTABILITY
(contagion from US banking stress, vulnerabilities in real estate and leverage markets, non-banking sector, etc.)

GLOBAL RECESSION

MAIN UNCERTAINTIES

GEOPOLITICAL TENSIONS

US-CHINA RIVALRY (DEGLOBALIZATION, ETC)

ENERGY TRANSITION AND CLIMATE CHANGE

SOCIAL TENSIONS AND POPULISM

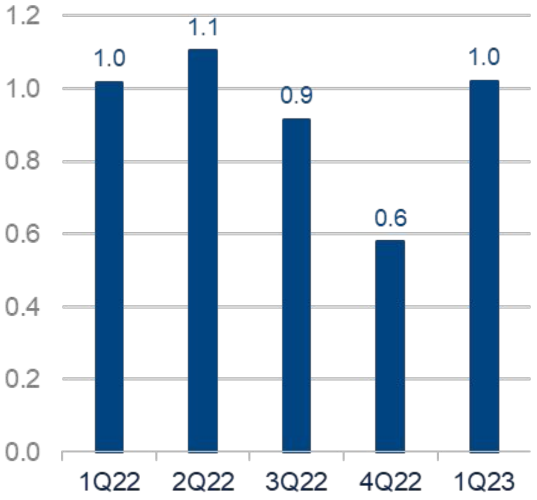
BBVA Research

02

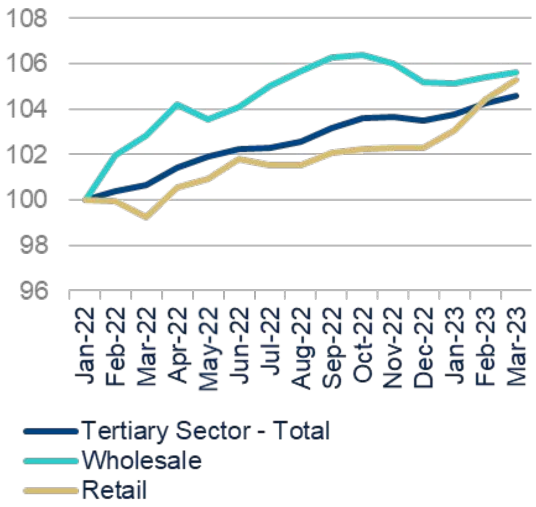
Domestic demand drives growth in 2023; downward revision for 2024

2023: strong start to the year, with consumer momentum and resilience in manufacturing

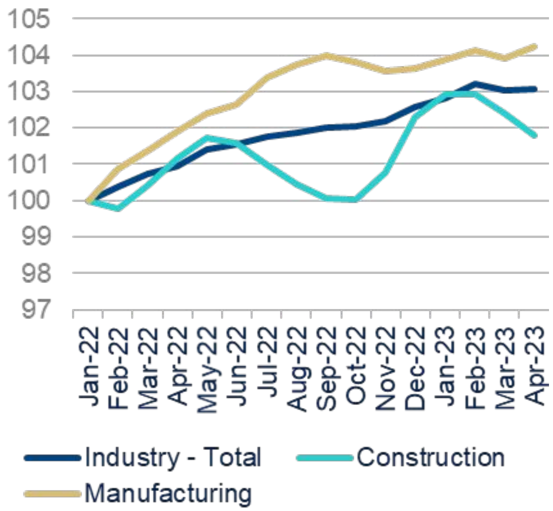
GDP
(QoQ%, REAL, SA)



TERTIARY SECTOR: SELECTED COMPONENTS (3-MONTH ROLLING AVERAGE, INDEX JAN/2022=100)



INDUSTRY: SELECTED COMPONENTS (3-MONTH ROLLING AVERAGE, INDEX JAN/2022=100)

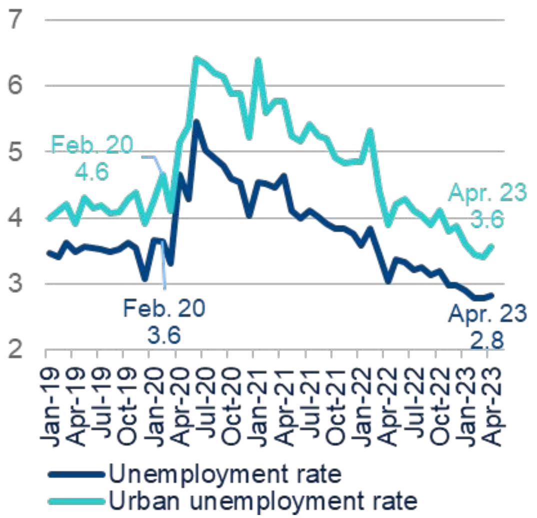


Source: BBVA Research / INEGI.

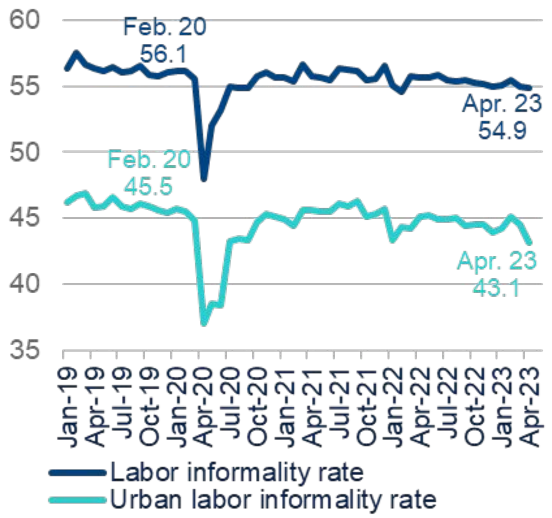
External demand slows, but more gradually than anticipated.

Boost is explained by a strong labor market: low unemployment, contained labor informality and sustained formal job creation

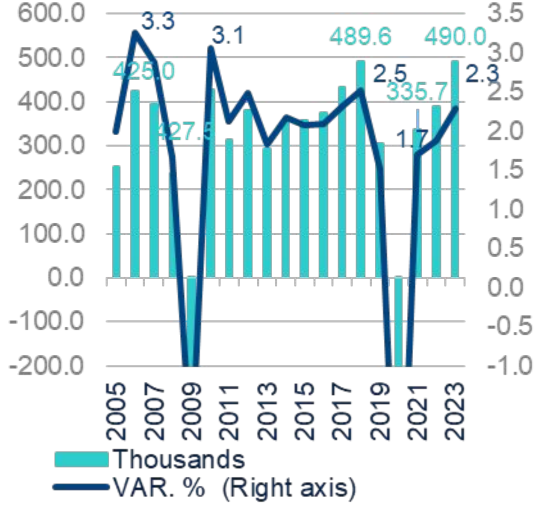
UNEMPLOYMENT RATE
(% OF EAP, SA)



LABOR INFORMALITY RATE (% EMPLOYED, SA)



JOBS AFFILIATED WITH THE IMSS
(CUM. CHG., JAN-MAY)

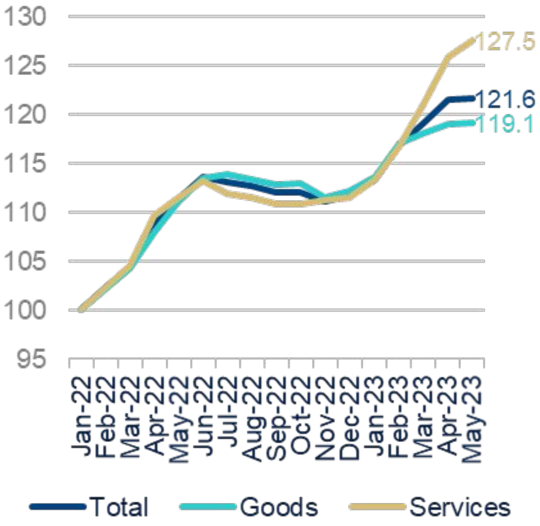


Source: BBVA Research, INEGI.

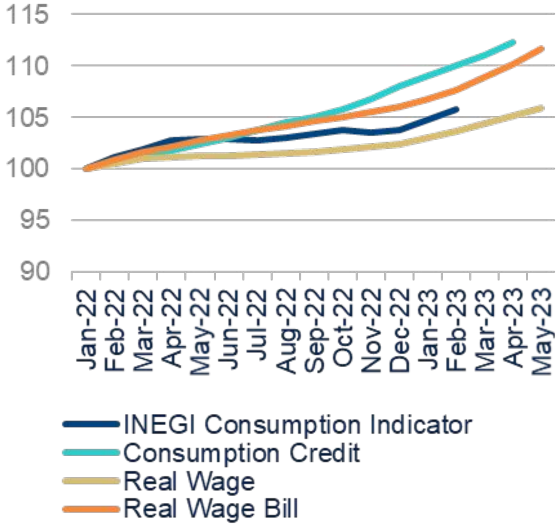
The labor market has shown strength given the economic dynamics at the end of 2022 and beginning of 2023, exceeding job creation expectations.

Consumption: dynamism continues in 2Q23 driven by real wage and formal employment gains

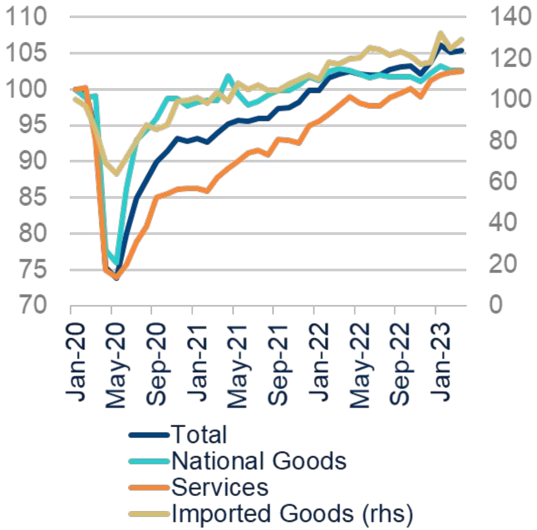
BBVA CONSUMPTION INDICATOR
(3-MONTH ROLLING AVERAGE, INDEX JAN/2022=100 REAL, SA)



CONSUMPTION AND ITS DETERMINANTS
(3-MONTH ROLLING AVERAGE, INDEX JAN/2022=100 REAL, SA)



INEGI CONSUMPTION INDEX: COMPONENTS (INDEX JAN/2020=100, REAL, SA)

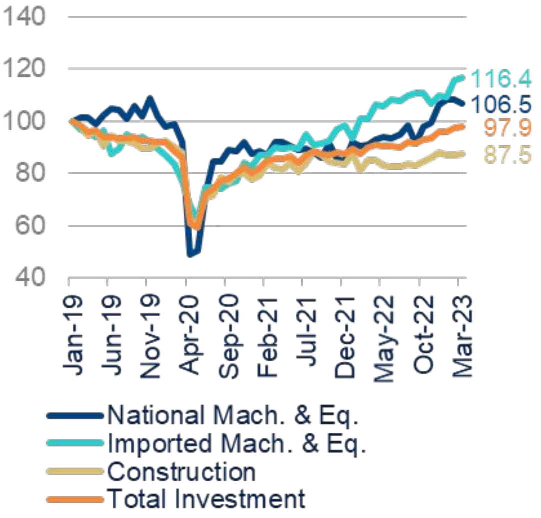


Source: BBVA Research / INEGI.

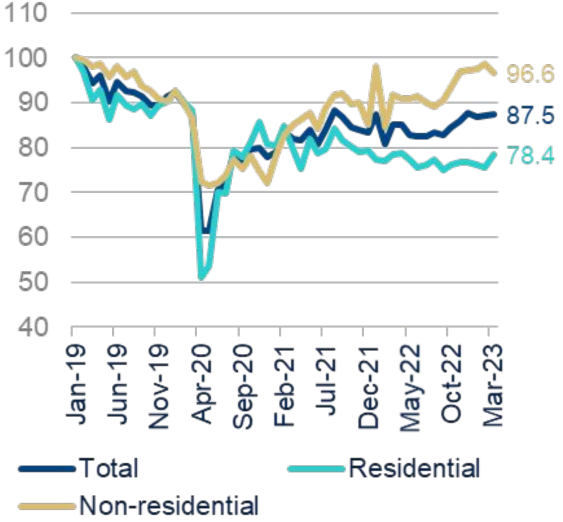
Households have gradually increased their leverage level, but it is still 1.1% below its pre-pandemic level (Jan-2020).

Investment: boost in machinery and equipment amid the normalization in manufacturing. Non-residential construction above Jan-19 level

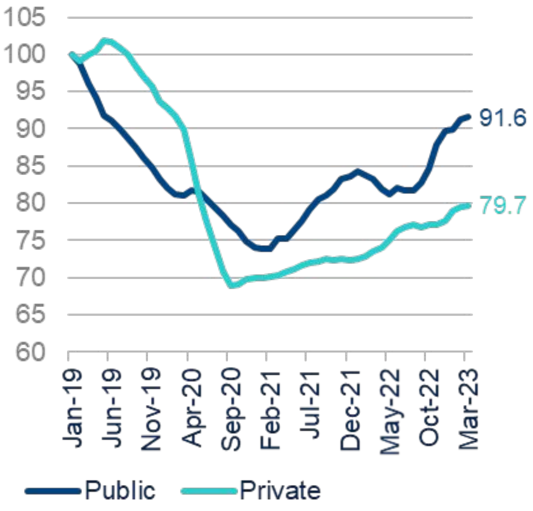
GROSS FIXED INVESTMENT AND CAPITAL GOODS IMPORTS
(INDEX JAN/2019=100)



CONSTRUCTION: COMPONENTS
(INDEX JAN/2019=100)



NON-RESIDENTIAL CONSTRUCTION
(6-MONTH ROLLING AVERAGE, INDEX JAN/2019=100 REAL, SA)

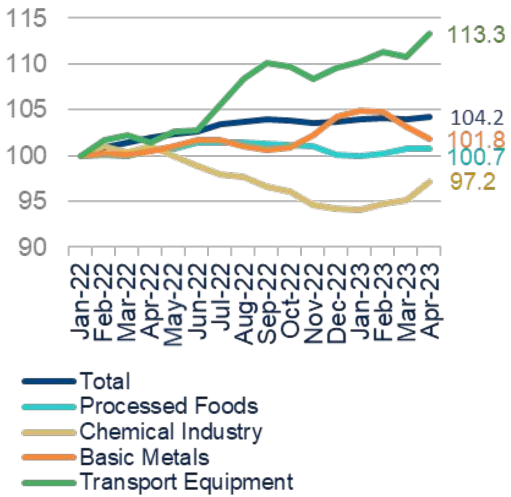


Source: BBVA Research, INEGI.

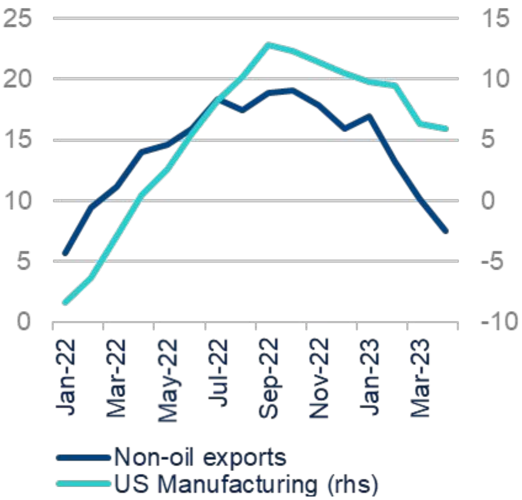
The public sector drives non-residential construction; the residential segment 27% below its Jan-19 level, keeping total investment 2% below that the same threshold.

Manufacturing: slowdown more gradual than expected. Further decline should the U.S. recession be deeper than anticipated

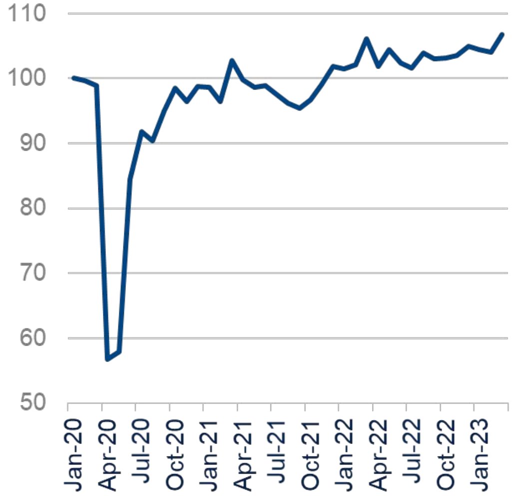
MANUFACTURING: SELECTED SECTORS (3-MONTH ROLLING AVERAGE, INDEX JAN/2022=100)



NON-OIL EXPORTS & US AUTOMOTIVE MANUFACTURING (% Y/Y, 6-MONTH ROLLING AVERAGE)



MANUFACTURING: CAPACITY UTILIZED (INDEX JAN/2020=100)

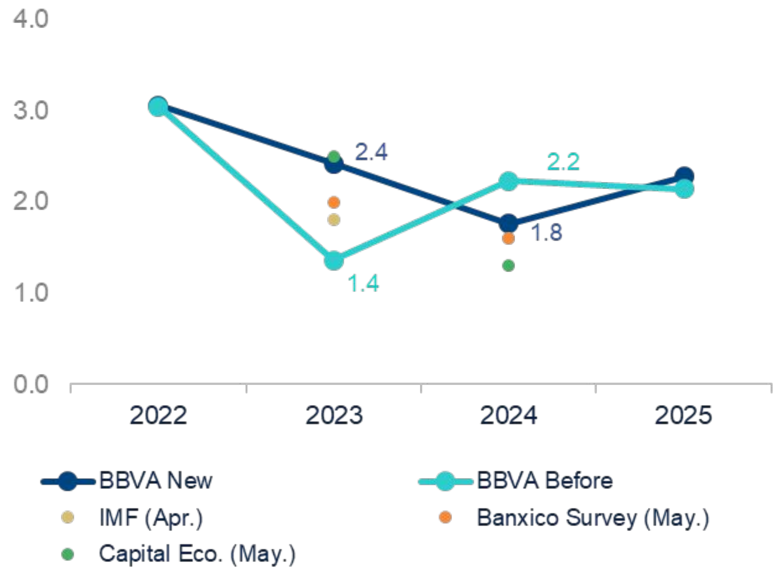


Source: BBVA Research / INEGI.

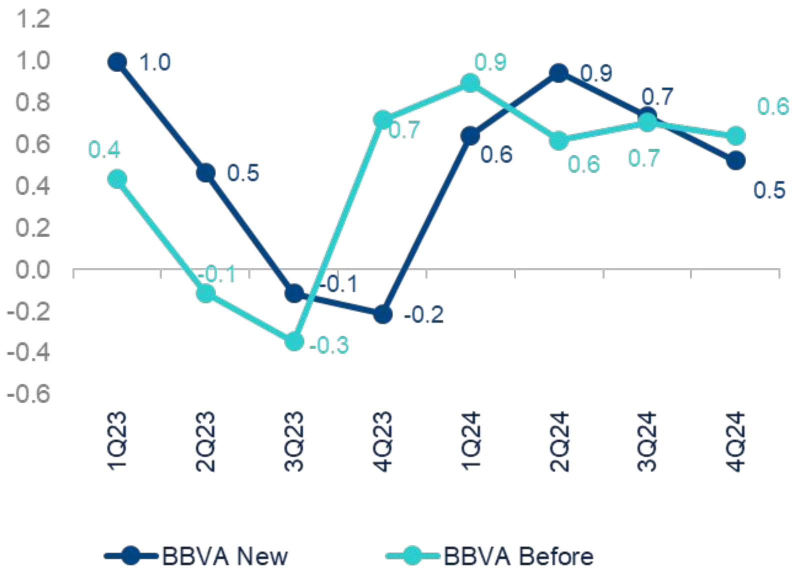
Relocation of production to Mexico would improve the long-term outlook for manufacturing.

2023: resilience of private consumption. Slowdown in external demand in 2H23

GDP
(ANNUAL % CHANGE, SA, REAL)



GDP
(QoQ%, REAL, SA)

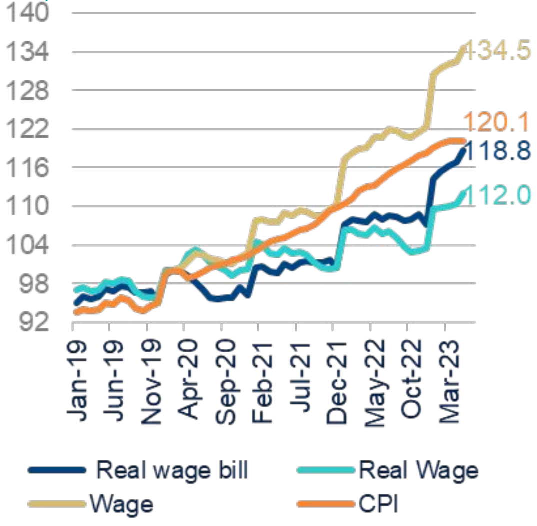


Source: BBVA Research / INEGI.

Carry-over effect into 2024; GDP should grow 1.8% next year.

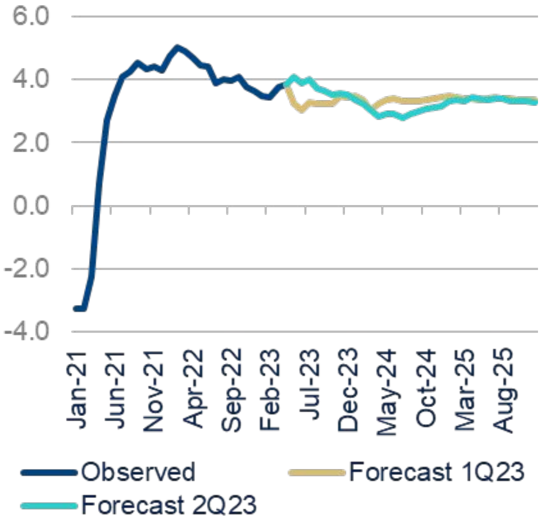
Based on the economic growth scenario, our outlook for formal job creation improves by the end of 2023

REAL WAGES AND REAL TOTAL WAGE BILL, IMSS (INDEX FEB-20 = 100)

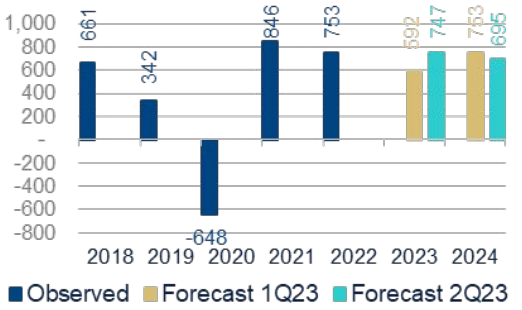


Source: BBVA Research, IMSS.

JOBS AFFILIATED WITH THE IMSS (CUM. CHANGE, %)



JOBS AFFILIATED WITH THE IMSS (ANNUAL CHANGE EOP, THOUSANDS)



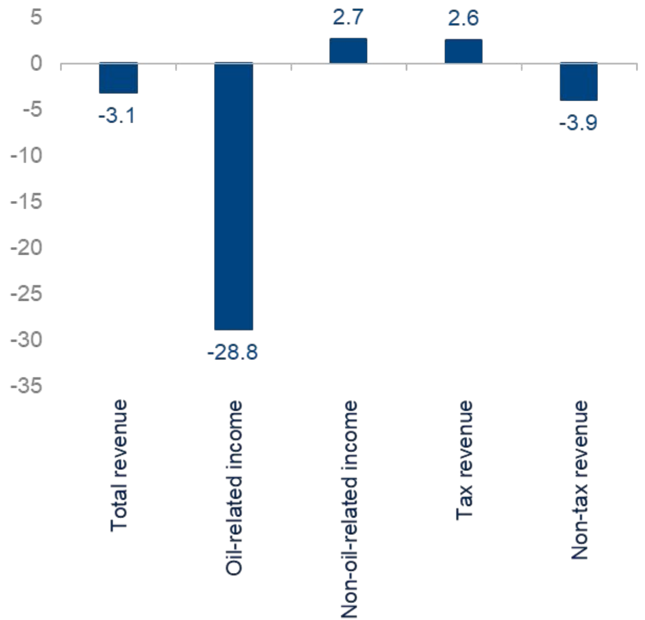
Forecast	2023	2024	2025
Thousands, EoP			
2Q23	**747**	**695**	**750**
1Q23	592	753	764
Annual Change, % EoP			
2Q23	**3.5**	**3.1**	**3.3**
1Q23	2.8	3.4	3.4

The job-creation dynamic will continue to support the real total wage bill, which will benefit from the expectation of lower inflation.

Total revenue was affected by the drop in oil revenues; discretionary expenditure more than offset the sharp increase in financial costs

GOVERNMENT REVENUES AND MAIN COMPONENTS IN JANUARY-APRIL 2023

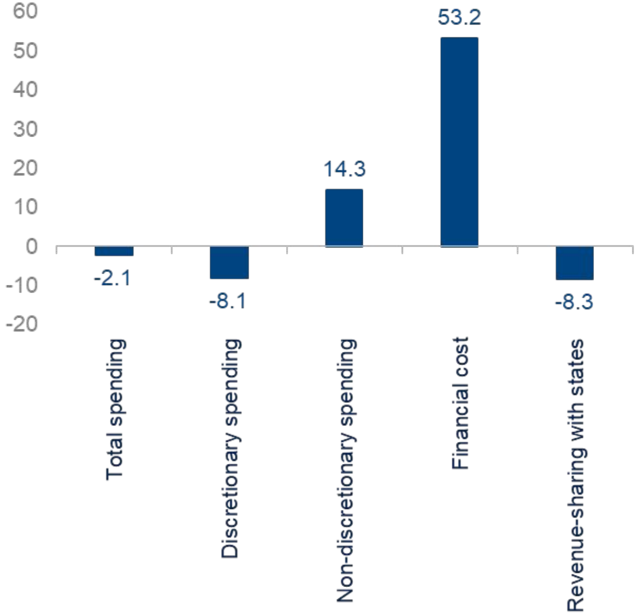
(ANNUAL REAL CHANGE, %)



Source: BBVA Research / SHCP.

PUBLIC EXPENDITURE AND MAIN COMPONENTS IN JANUARY-APRIL 2023

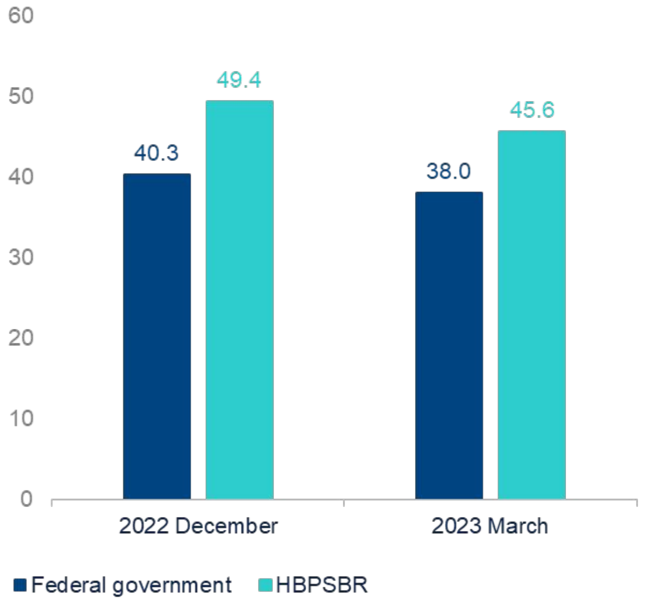
(ANNUAL REAL CHANGE, %)



Source: BBVA Research / SHCP.

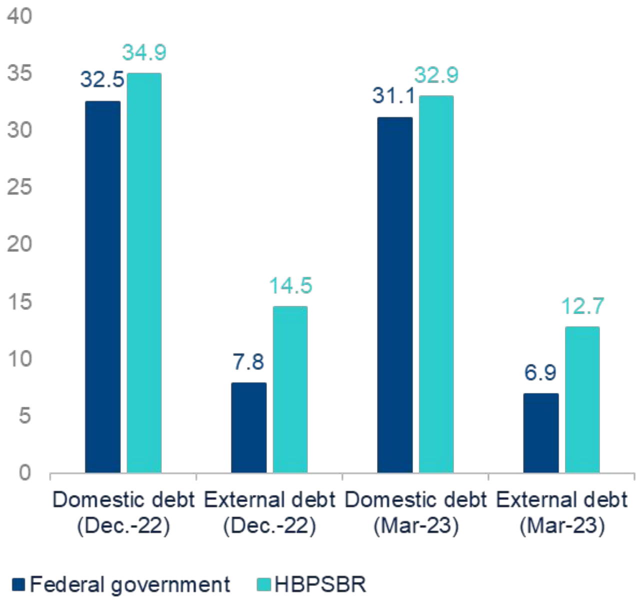
The 2.0 and 1.8 pp drop in the internal and external component of the Historical Balance of PSBR (% of GDP), respectively, contributed to the drop in the ratio

PUBLIC DEBT
(% GDP)



Source: BBVA Research / SHCP.

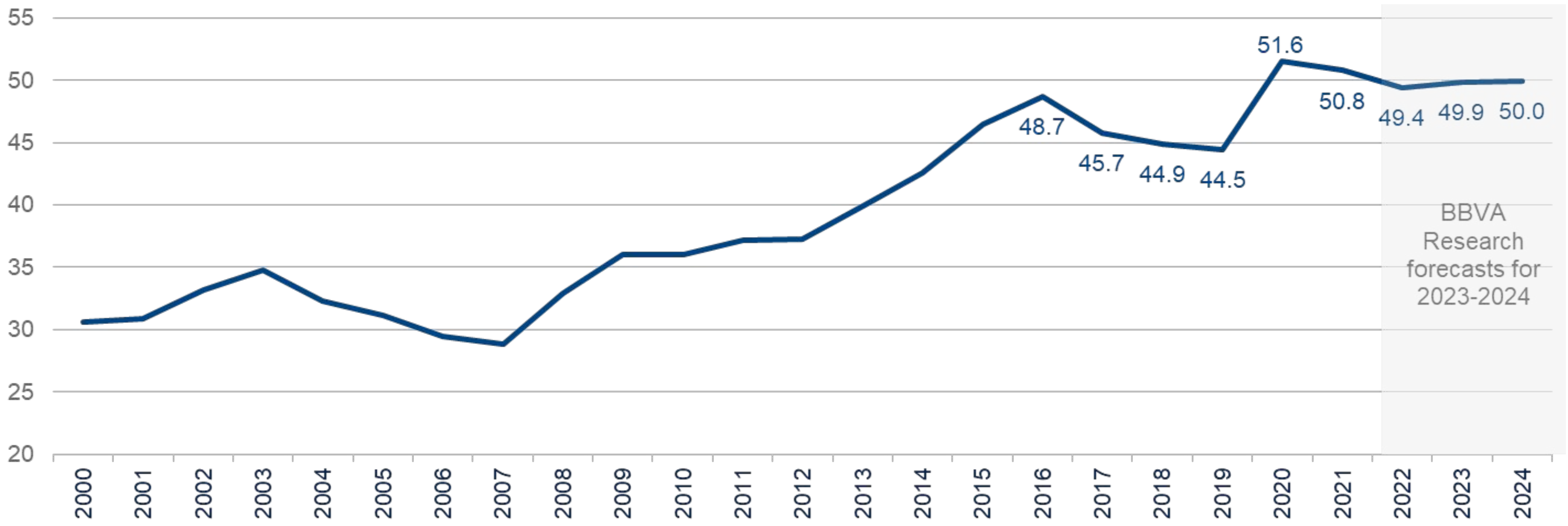
DOMESTIC AND FOREIGN PUBLIC DEBT
(% GDP)



Source: BBVA Research / SHCP.

Public debt (as a % of GDP) will remain stable in 2023-24 and therefore the risk of losing the investment grade will be very limited

HISTORICAL BALANCE OF THE PUBLIC SECTOR BORROWING REQUIREMENTS
(% GDP)



Source: BBVA Research / SHCP.

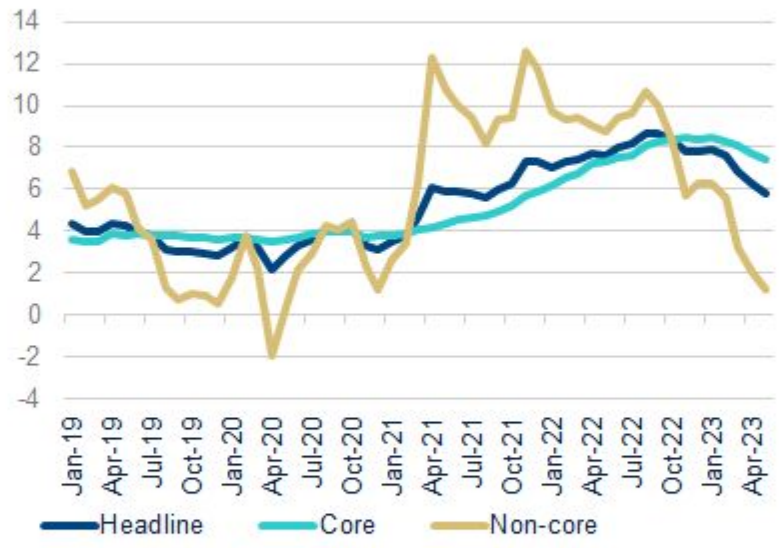
Research

03

We expect the start of a rate cut cycle in 4Q23

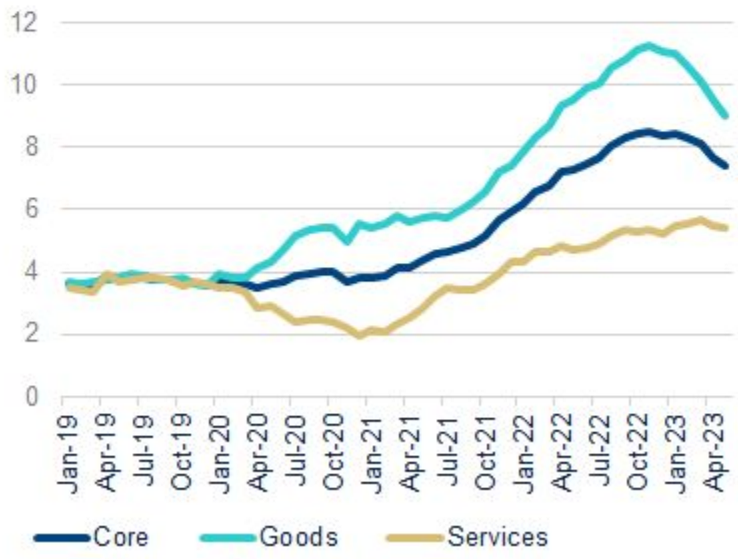
The decline in inflation has been driven mainly by lower non-core inflation...

HEADLINE INFLATION BREAKDOWN
(ANNUAL % CHANGE)



Source: BBVA Research, INEGI.

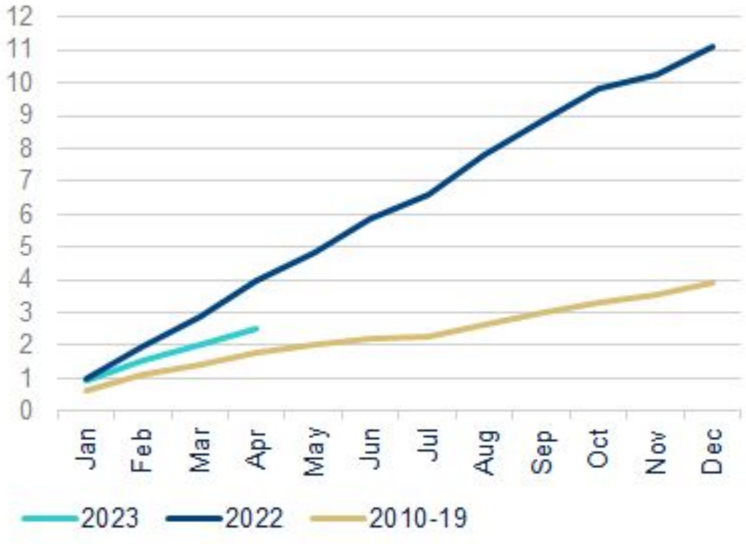
CORE INFLATION BREAKDOWN
(ANNUAL % CHANGE)



Source: BBVA Research, INEGI.

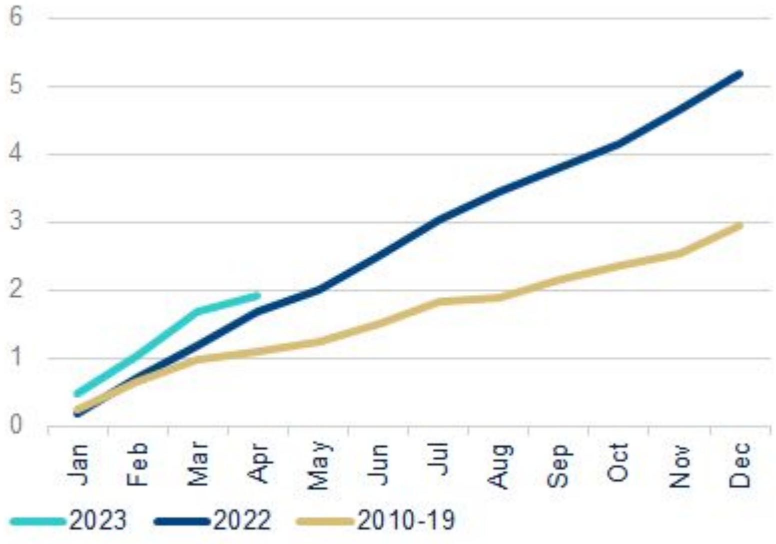
… but the pace of the slowdown in core inflation has also gained traction….

CUMULATIVE INFLATION PER YEAR: GOODS
(%)



Source: BBVA Research based on INEGI data.

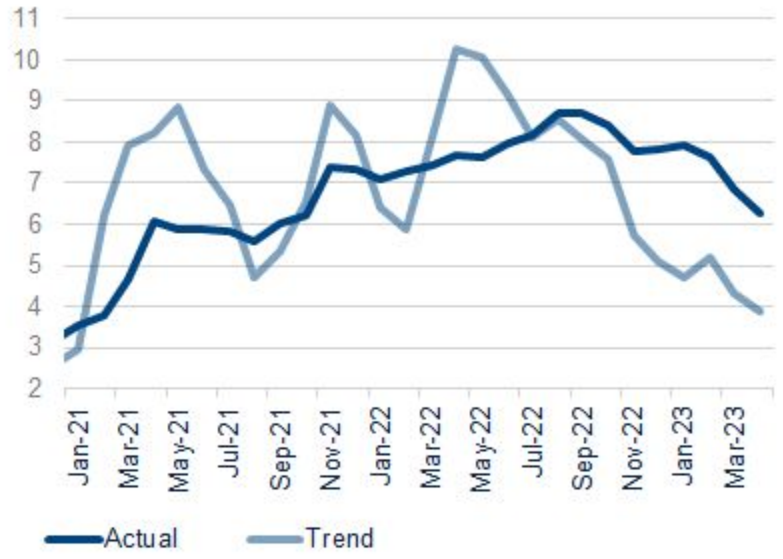
CUMULATIVE INFLATION PER YEAR: SERVICES
(%)



Source: BBVA Research based on INEGI data.

… and trending measures point to a more pronounced slowdown...

HEADLINE INFLATION AND TREND*
(ANNUAL % CHANGE AND MONTHLY % CHANGE ANNUALIZED SA, 3MRA)



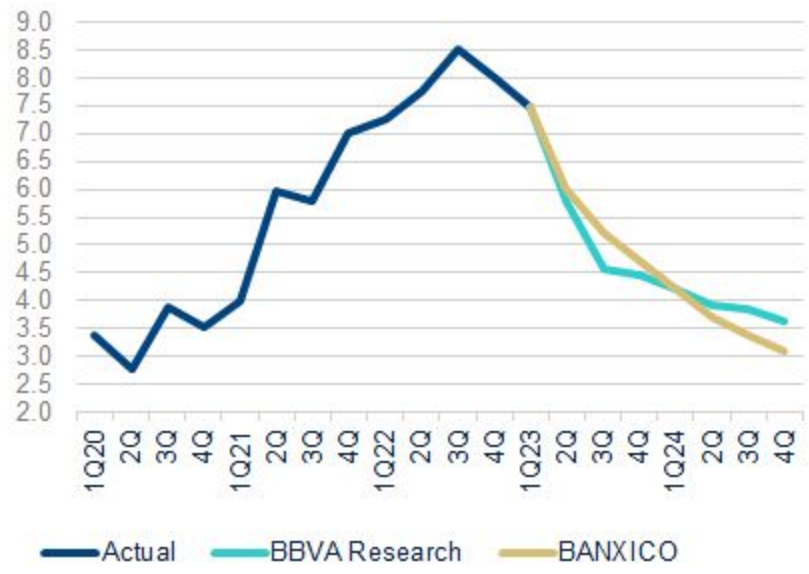
* Three-month rolling average of the annualized monthly change in the seasonally adjusted series; own calculations.
Source: BBVA Research based on INEGI data.

CORE INFLATION AND TREND*
(ANNUAL % CHANGE AND MONTHLY % CHANGE ANNUALIZED SA, 3MRA)

* Three-month rolling average of the annualized monthly change in the seasonally adjusted series; own calculations.
Source: BBVA Research based on INEGI data.

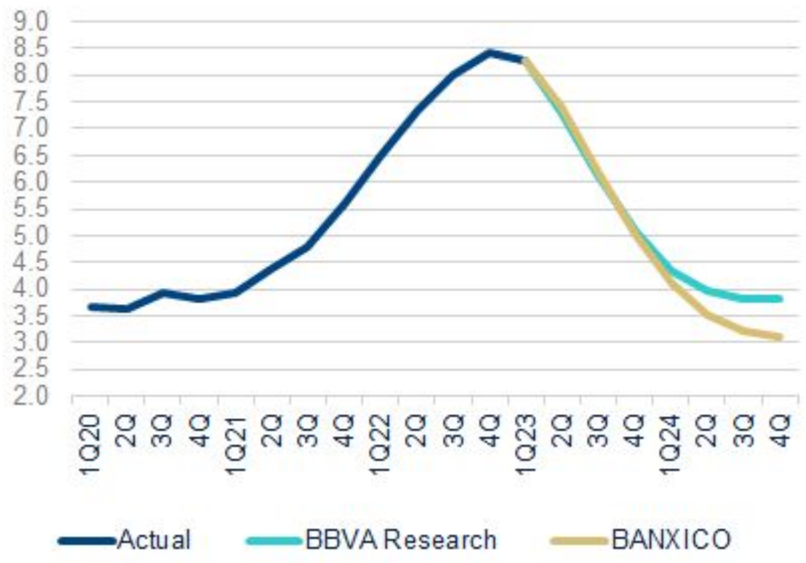
… as foreseen in our baseline scenario, and as anticipated by Banxico.

HEADLINE INFLATION FORECASTS
(ANNUAL % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research, INEGI, BANXICO.

CORE INFLATION FORECASTS
(ANNUAL % CHANGE, QUARTERLY AVERAGE)

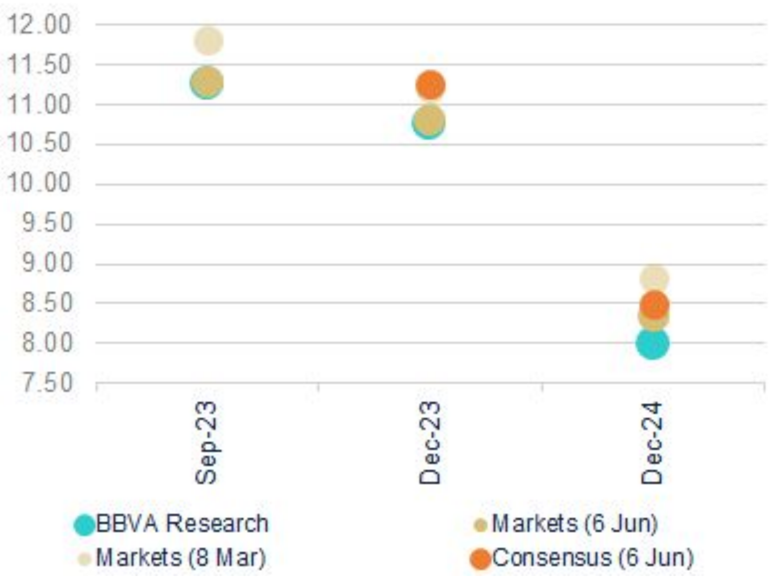


Source: BBVA Research, INEGI, BANXICO.

We expect that with inflation falling Banxico will start a rate cut cycle in 4Q23 to avoid a further increase in the real ex-ante rate

MONETARY POLICY RATE OUTLOOK: BBVA RESEARCH VS. CONSENSUS AND MARKET

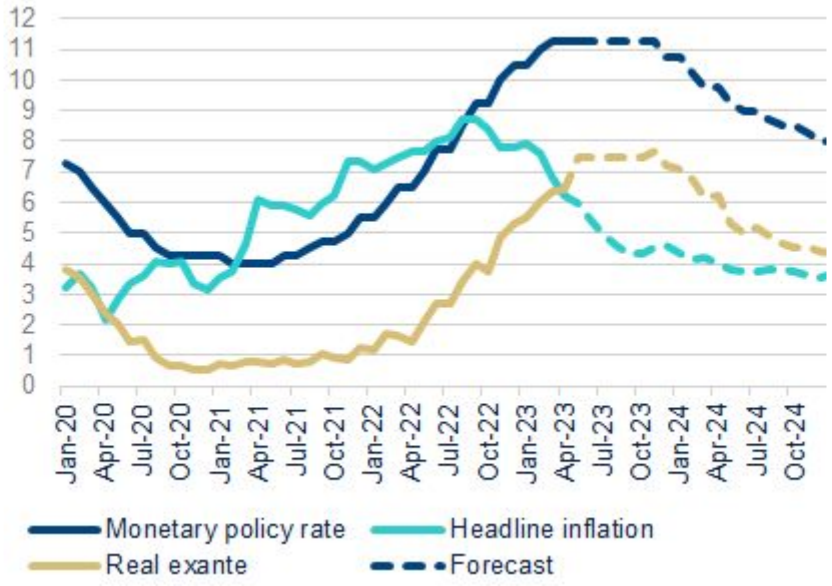
(%)



Latest available data: June 6.
Source: BBVA Research; Banamex and Bloomberg surveys.

MONETARY POLICY RATE OUTLOOK

(%)

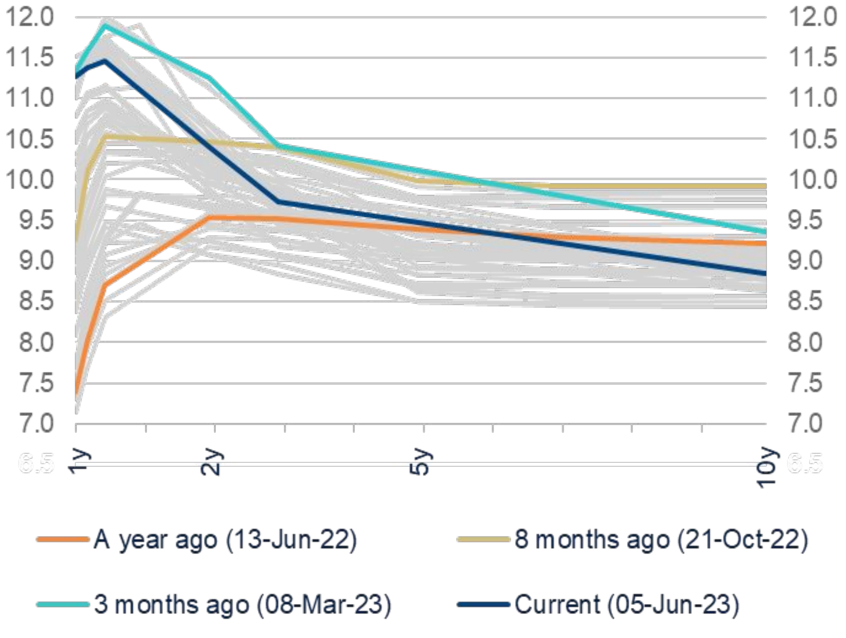


Source: BBVA Research, BANXICO, Bloomberg.

We expect the yield curve to remain inverted for the remainder of this year and next, but in a gradual flattening process

MEXICO SOVEREIGN YIELD CURVE

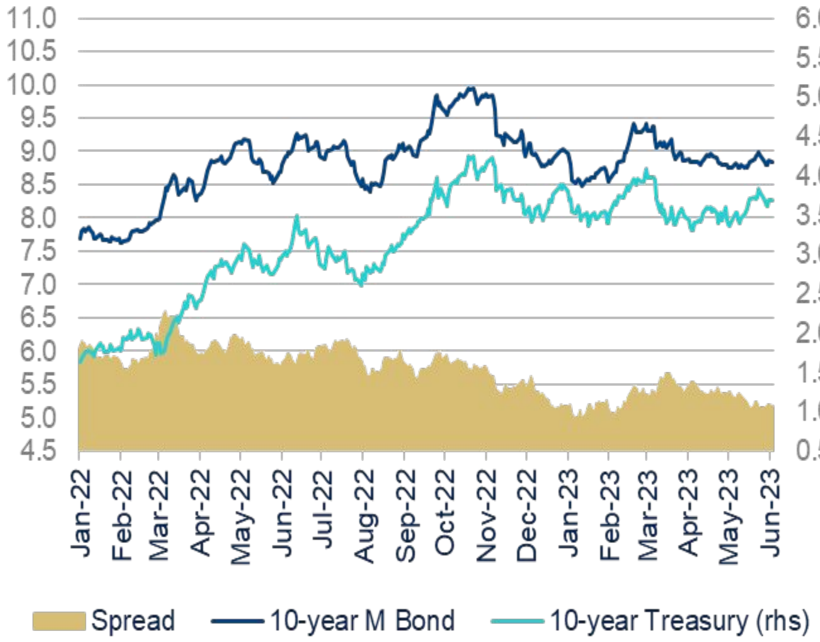
(%)



Source: BBVA Research based on Bloomberg data.
The gray lines show the weekly yield curves for the last 12 months.

MEXICO AND US 10-YEAR YIELD CURVE

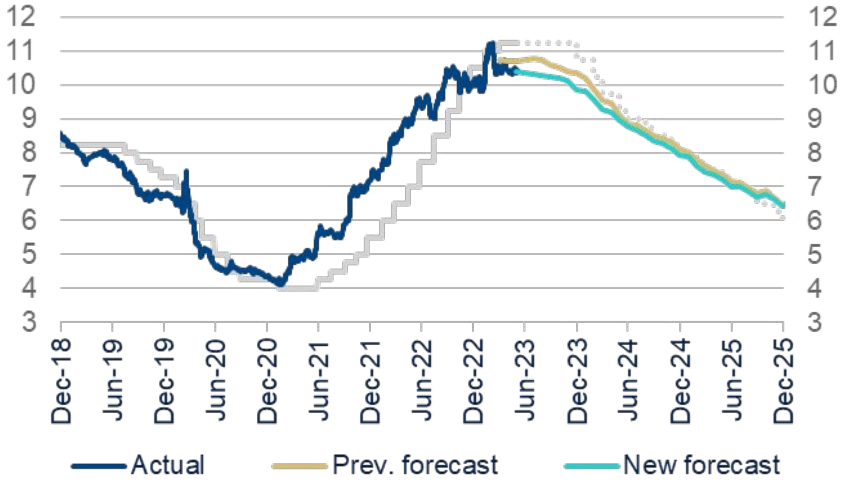
(%)



Source: BBVA Research with data from Bloomberg and Haver Analytics.

Rates along the yield curve will gradually decline discounting the eventual easing cycle to be adopted by Banxico

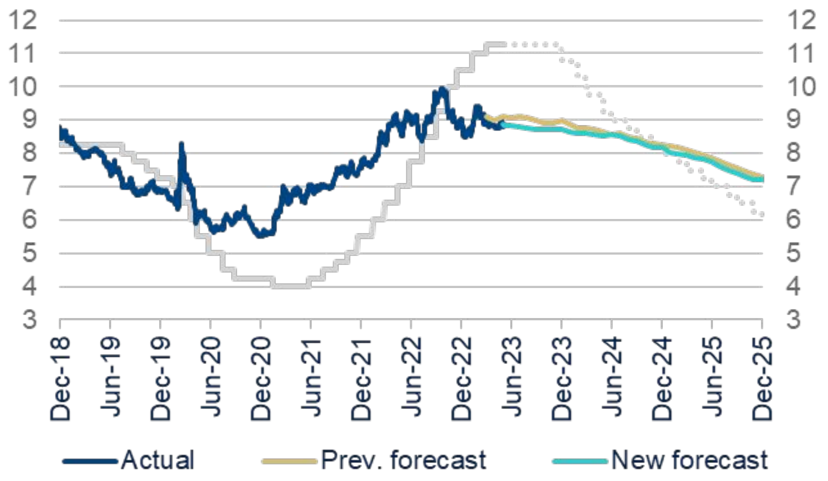
MEXICO 2-YEAR BOND YIELD
(%)



Mexico 2-year bond	23	24	25
Current forecast	**9.9**	**7.9**	**6.4**
Previous forecast	10.4	8.1	6.5

Source: BBVA Research with data from Bloomberg and Haver Analytics.
The solid (real) and dotted (forecast) gray line indicates Banxico's target 1-day rate.

MEXICO 10-YEAR BOND YIELD
(%)

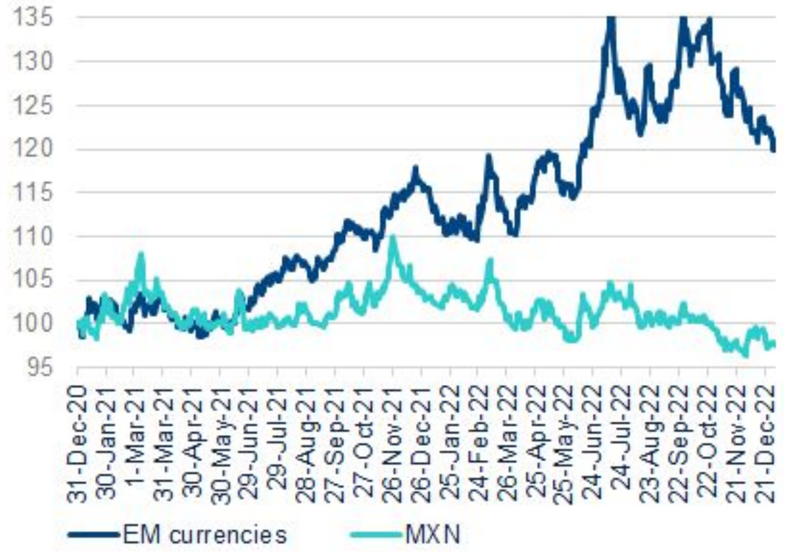


Mexico 10-year bond	23	24	25
Current forecast	**8.7**	**8.2**	**7.2**
Previous forecast	9.0	8.2	7.3

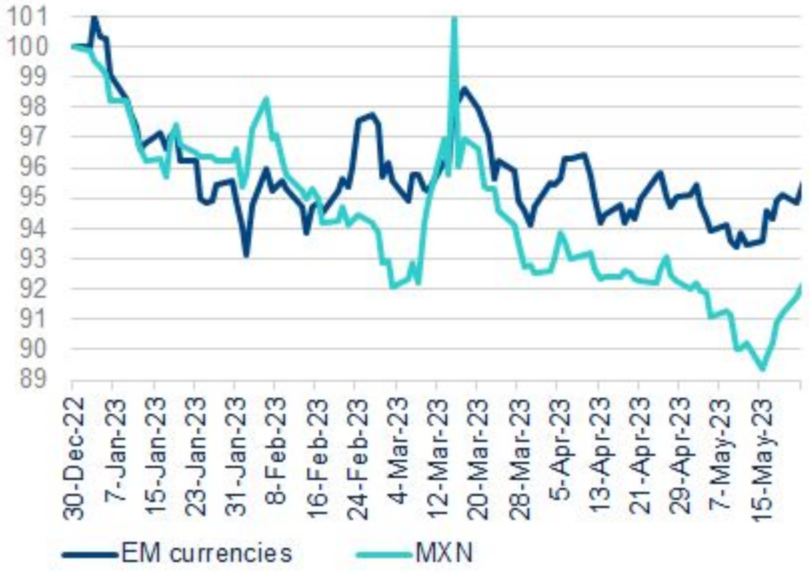
Source: BBVA Research with data from Bloomberg and Haver Analytics.
The solid (real) and dotted (forecast) gray line indicates Banxico's target 1-day rate.

Wide interest rate differential, low current account deficit, and strong fiscal position explain the peso's better relative performance

PERFORMANCE OF THE PESO COMPARED TO THE MAIN EMERGING CURRENCIES* 2021-22
(INDEX, DEC. 31, 2020 = 100)



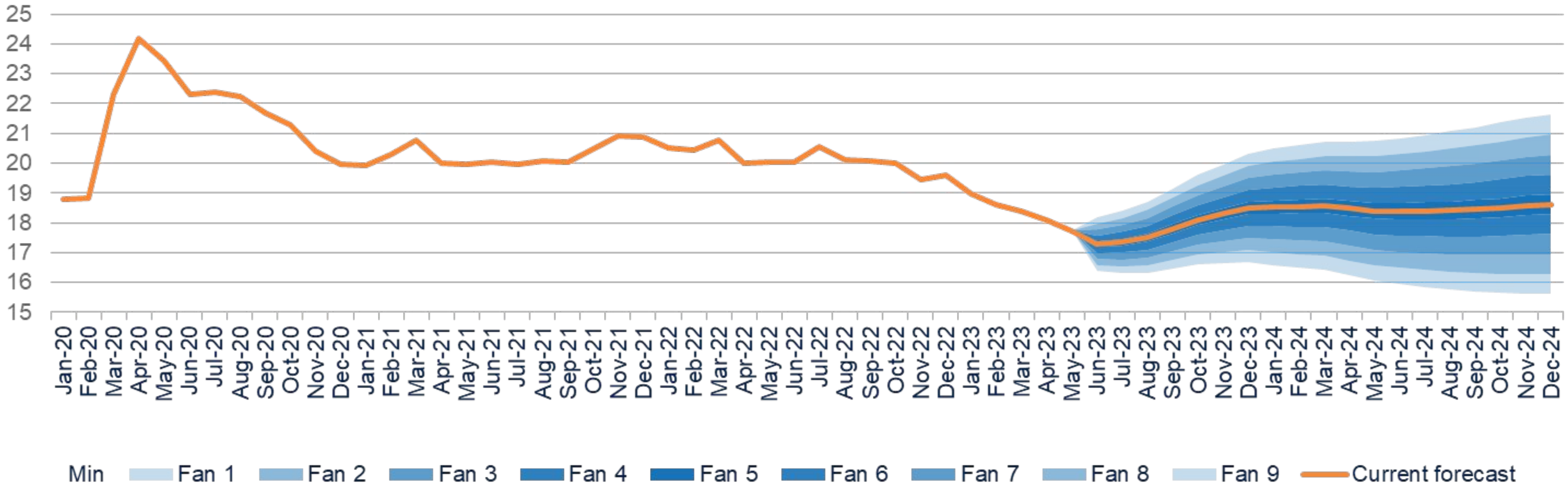
PERFORMANCE OF THE PESO COMPARED TO THE MAIN EMERGING CURRENCIES[1] 2023
(INDEX, DEC. 31, 2022 = 100)



* Based on a re-weighting of the JP Morgan Emerging Market Currency Index after removing the MXN index
Source: BBVA Research, Bloomberg.

We expect the exchange rate to close 2023 at 18.5 MXN/USD, anticipating a gradual depreciation due to inflationary and interest rate differentials

EXCHANGE RATE
(PESOS/USD)



Source: BBVA Research / Bloomberg.

Research

04

Key points and forecast summary

Key points

Recent behavior

Growth and inflation are moderating, but remain resilient, supporting a monetary tightening that continues to cause volatility. The gradual slowdown in the context of robust labor markets and post-pandemic reopening. Lower inflation is due to improvements in energy prices and bottlenecks, but core inflation persists. Central banks focused on inflation; rates at (or near) peak levels but higher for longer.

Growth estimate

Upward revision in our growth estimate for 2023 to 2.4% (previously 1.4%) due to the positive effect of 1H23; slowdown in the second half of the year due to weaker external demand

- Resilient domestic demand drives growth in 2023; the gains in real wages and employment drive private spending; in addition, consumer credit is recovering and remittances are performing well.
- The machinery and equipment segment is showing rapid dynamism in the investment segment, in light of the normalization in manufacturing.
- We anticipate lower growth in 2H23, given the weakening demand for durable goods in the US against a backdrop of high interest rates and tightening financing conditions in that country; the Mexican economy would grow 1.8% in 2024.

Better prospects for job creation in 2023. The expected inflation dynamics and upward employment revision will continue to boost the real total wage bill. We adjusted our forecast for 2024 downward in light of lower expected growth.

Key points

Inflation and Monetary Policy

The decline in inflation has been driven mainly by lower non-core inflation, but the pace of the slowdown in core inflation has also gained traction....

- We expect headline inflation to be 4.6% at the end of this year and core inflation to be 4.8%. We anticipate that both will be below 4.0% as of 2Q24.

We foresee that, with inflation declining, Banxico to initiate a downward cycle in 4Q23 to avoid a further increase in the real ex-ante rate.

- We expect the monetary rate to close 2024 at a level of 8.00%.
- Rates along the yield curve will gradually decline, discounting the eventual easing cycle to be adopted by Banxico.

Exchange rate

We expect the exchange rate to close 2023 at 18.5 MXN/USD, anticipating a gradual depreciation path due to inflationary and interest rate differentials.

Forecast summary

		2020	2021	2022	2023	2024	2025
GDP (Annual chg. %)	new	-8.2	4.9	3.1	**2.4**	**1.8**	**2.3**
	previous				1.4	2.2	2.1
Employment (%, at close)	new	-3.2	4.3	3.7	**3.5**	**3.1**	**3.3**
	previous				2.8	3.4	3.4
Inflation (%, at close)	new	3.2	7.4	7.8	4.6	**3.5**	**3.8**
	previous				4.8	3.5	3.7
Monetary policy rate (%, at close)	new	4.25	5.50	10.50	**10.75**	**8.00**	**6.00**
	previous				11.50	8.50	6.50
Exchange rate (ppd, at close)	new	20.0	20.9	19.6	**18.5**	**18.6**	**18.8**
	previous				19.5	19.7	19.9
M10 (%, at close)	new	5.5	7.6	9.0	**8.7**	**8.2**	**7.2**
	previous				9.0	8.2	7.3
Fiscal balance (% GDP)	new	-2.9	-2.9	-3.4	**-3.9**	**-3.1**	**-2.5**
	previous				-3.6	-2.5	-2.5
Current account (% GDP)	new	2.3	-0.4	-1.0	**-0.6**	**-0.8**	**-1.4**
	previous				-0.8	-1.5	-1.4

Disclaimer

BBVA Research

Mexico Economic Outlook

June 2023

Creating Opportunities