01

Global Economic Outlook
3Q23
Main messages

Recent developments

The global economy is easing at different paces across regions: incoming data are more favorable in the US, slightly worse than forecast in the EZ and negative in China. Still, even though rate tightening cycles seem to be over, persistent inflation amid tight labor markets paved the way for the Fed and the ECB to maintain a hawkish tone, while leaving doors open for further hikes, if inflation proves to be more persistent than expected.

Growth outlook

A soft-landing is expected, with global growth declining from 3.5% in 2022 to around 2.9% in 2023 and 3.0% (+0.1pp) in 2024. In the US, resilient domestic demand paves the way for higher growth forecasts and makes a recession less likely. In China, growth prospects deteriorated significantly and risks augmented, but extra measures are expected to support confidence and prevent a hard-landing. In the Eurozone, a timid GDP expansion, slightly below previous forecasts, is now anticipated.

Inflation and rates outlook

Inflation is likely to continue slowing ahead, allowing the Fed and the ECB to skip further rate hikes over the next few months. Still, it will continue above targets, and upward risks will remain alive, making rate cuts unlikely in the short-run and favoring a reduction of central bank balances.
GDP growth is losing momentum; labor markets and excess savings are still supportive, especially in the US

GDP: REAL GROWTH (*)
(Q/Q %)

(*) BBVA Research growth estimation for 3Q23.
Source: BBVA Research based on data from Haver.
The service sector is losing some of its strength, adding to the weakness in manufacturing; labor markets remain robust despite the recent moderation.

PMI INDICATORS: MOST RECENT FIGURES (*)
(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)

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

(*) Most recent data: Aug/23 in China. Sep/23 in the US and in the EZ.
Source: BBVA Research based on data from Haver.
Inflation has been slowing thanks to base effects, easing of bottlenecks and declining commodity prices (despite the recent oil upward trend)

**INFLATION: CPI**
(Y/Y %)

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

Oil prices raised 25% in last three months on supply cuts, but remain over 2022 levels

Source: BBVA Research based on data from Haver.
Core inflation keeps going down in the U.S.

**CORE INFLATION: CPI**
(Y/Y %)

![Graph showing core inflation for US, Eurozone, and China from January 2020 to July 2023. The graph indicates a downward trend in core inflation over the period.]

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

![Graph showing wage growth for US and Eurozone from January 2020 to July 2023. The graph shows fluctuations in wage growth over the period.]

Source: BBVA Research based on data from Haver.

Fed and ECB rate hike cycles seem to be over, but doors are open for extra raises if inflation surprises upwards.

**POLICY INTEREST RATES (*)**

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

**US AND GERMAN SOVEREIGN YIELDS: 2Y AND 10Y**

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Source: BBVA Research based on Bloomberg.
Despite higher interest rates and a stronger US dollar, financial tensions remain relatively low; the US banking turmoil has eased.

US DOLLAR INDEX: DXY

(%)

BBVA RESEARCH FINANCIAL TENSIONS INDEX

(INDEX: HISTORIC AVERAGE = 0)

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

Source: BBVA Research based on Bloomberg.
Global growth is likely to soft land while monetary policy will remain restrictive for a longer than usual period to help inflation ease towards targets

**BBVA RESEARCH BASELINE SCENARIO: GDP GROWTH, INFLATION AND POLICY INTEREST RATES (*)**

(GDP GROWTH: %, INFLATION: YOY %, EOP, POLICY INTEREST RATES: %, EOP)

- **Global growth**: from 3.5% in 2022 to 2.9% (+0.0pp) in 2023 and 3.0% (+0.1pp) in 2024
- **Inflation** will remain high, but will trend down as demand weakens and given no extra supply shocks
- **Monetary tightening cycle** is likely over in the US and the EZ, but rate cuts are not around the corner

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(*) In the case of the Eurozone, interest rates on refinancing operations. Source: BBVA Research based on Bloomberg data.
US: growth resilience signs make a recession unlikely ahead, postponing the prospects for the beginning of the easing cycle to mid-2024

- GDP forecasts revised up on robust domestic demand: solid consumption and resilient investment (boosted by housing market recovery as well as IRA and CHIPS acts).

- Inflation expected to reach 2.9% in Dec/23 and 2.4% in Dec/24; upside risks are still relevant.

- Fed: inflation improvement will prevent extra rate rises (but a hike is still possible in 4Q23); an easing cycle from Jun/24 is likely to take rates to 4.75% in Dec/24.

- Risks: a recession or financial stress on tight monetary conditions and persistent inflation, presidential elections.

**US: GDP GROWTH (%)**

- 2021: 5.9
- 2022: 2.1
- 2023(f): 2.3
- 2024(f): 1.5

(f): forecast.
Source: BBVA Research
Risks: the soft-landing scenario could be potentially derailed by problems in China and the effects of the still high inflation and interest rates

MAIN RISKS

Recession and financial stress on tight monetary conditions
- mainly under more persistent inflation (on labor tightness, second-round effects, higher energy prices, etc.)

A hard-landing in China
- due to real estate problems, low confidence, US-China confrontation, deflation, etc.
- potential financial spillovers

MAIN UNCERTAINTIES

- Geopolitical and political tensions
- US-China rivalry and deglobalization
- Climate change and energy transition
- Social tensions and populism
Domestic demand to remain stronger than expected in 2H23 with carryover effect in 2024
Consumption will continue to be resilient in a context of a cumulative gains in real wage bill and lower trend in savings

The balance of deposits (short- and long-term) held by households has declined significantly since 2021 and is still 7.6% below its pre-pandemic trend.

Source: BBVA Research/INEGI/BANXICO.
Manufacturing has been resilient, especially in the automotive sector. External demand will slow, but gradually.

After several months of slowdown, the ISM index of new orders in the U.S. has been showing signs of improvement in recent periods.
Positive outlook for the industrial relocation process boosts private investment; construction gains momentum from the public sector

Construction in the public sector grows driven by the government's flagship projects (refinery and Tren Maya). Private sector construction lags behind (16% below January 2019 level).
The labor market continues to show signs of strength, which has been a significant factor in bolstering the economic growth outlook.

The robustness of the labor market has significantly boosted household consumption growth.
Despite a gradual slowdown in job creation, we expect the strength of the labor market to persist this year.

Our employment forecasts are improving in the medium term as the effects of nearshoring are gradually being felt.
Upward revision to our 2023 GDP growth estimate to 3.2% due to strong domestic demand. Positive effect for 2024: upward revision to 2.6%

Main drivers: 2Q23 and 2H23 better than expected, with resilience of consumption and investment (+income, -savings, +machinery and equipment, +public construction). Positive revision of U.S. growth improves outlook for the manufacturing sector.
The internal and external components of the Historical Balance of PSBR (% of GDP) contributed 1.2 and 2.5 pp to the reduction of this ratio, respectively.
The 2024 economic package will close the six-year term without fiscal imbalances

- The 2024 economic package has been built with realistic macroeconomic assumptions.
- The fiscal balance will hold despite the fact that the package proposes a target of -1.2% of GDP for next year's primary balance.
- Nevertheless, it is worrisome that the public deficit of 4.9% of GDP (estimated by the SHCP, Mexico's Ministry of Finance) for next year is the highest since 1990.
- This deficit is also surprising in a context in which the SHCP forecasts GDP growth above potential GDP growth (2.6% vs. 2.4%).
- The SHCP estimates that the Historical Balance of Public Sector Borrowing Requirements (SHRFSP in Spanish) will be 48.8% of GDP at the end of 2024, a level that will not cause any problems for the amortizations of sovereign or PEMEX debt.
- Given the expected fragility of public finances in the coming years, it will be necessary for the next Federal Government to design and implement a fiscal reform to increase tax revenue.
Public deficit target for 2024 will be the highest since 1990

TRADITIONAL PUBLIC BALANCE (% OF GDP)

//f means forecast.
Source: BBVA Research / SHCP.
Public debt to increase by more than two percentage points during AMLO's last year; public deficits around 2% of GDP to keep it stable

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

Source: BBVA Research / SHCP.
03

Banxico to keep rates higher for longer: we delay the start of the downward cycle to 1Q24
Inflation continues to cool, now driven mainly by lower core goods inflation.

**HEADLINE INFLATION BREAKDOWN**
(YoY % CHANGE)

**CORE INFLATION BREAKDOWN**
(YoY % CHANGE)

Source: BBVA Research, INEGI.
Although core services inflation is still sticky to the downside...

CUMULATIVE INFLATION OF CORE GOODS

CUMULATIVE INFLATION OF CORE SERVICES

Source: BBVA Research based on data from INEGI.
... the trend indicators continue to point to a more pronounced slowdown in core inflation in the months ahead.

**HEADLINE INFLATION: OBSERVED AND TREND***
(ANNUAL % CHG. AND ANNUALIZED MONTHLY % CHG. OF THE SA INDEX, 3M MOVING AVG.)

**CORE INFLATION: OBSERVED AND TREND***
(% ANNUAL CHG. AND % ANNUALIZED MONTHLY CHG. OF THE SA INDEX, 3M MOVING AVG.)

* Own calculations
Source: BBVA Research based on INEGI data.
We expect inflation to continue to decelerate. We anticipate that inflation will converge with Banxico's target range in 2Q24

**HEADLINE INFLATION FORECASTS**
(Q/Q, % CHANGE, QUARTERLY AVERAGE)

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**CORE INFLATION FORECASTS**
(VARIACIÓN % T/T, MEDIA TRIMESTRAL)

Forecast | 2023Q3 | 2023Q4 | 2024Q3 | 2024Q4 | 2025Q3 | 2025Q4 | 2026Q3 | 2026Q4 |
---------|--------|--------|--------|--------|--------|--------|--------|--------|
3Q23     | 6.1    | 5.2    | 3.7    | 3.5    | 3.5    |        |        |        |
2Q23     | 6.2    | 5.0    | 3.9    | 3.6    | 3.5    |        |        |        |

**INFLATION FORECASTS**
(VARIACIÓN % T/T, MEDIA TRIMESTRAL)

Source: BBVA Research, INEGI, BANXICO.
Banxico to remain cautious in the short term

POLICY RATE AND CORE INFLATION DEVIATION FROM THE TARGET (% and PP)

POLICY RATE AND 12-MONTH CORE INFLATION EXPECTATIONS DEVIATION FROM THE TARGET (% and % PP)

Source: BBVA Research, BANXICO.
We are pushing back the start of a downward cycle to 1Q24. It would be justified to avoid a further unnecessary increase in the ex ante real rate.
Rising long-term yields driven by recent U.S. yield curve dynamics and a global risk-off mood

The gray lines show the weekly yield curves for the last 12 months.
Source: BBVA Research / Haver / Bloomberg.
Higher-for-longer rates amid Banxico’s delayed easing cycle.

The solid (actual) and dotted (forecast) gray line indicates Banxico's overnight target rate. Source: BBVA Research / Haver / Bloomberg.
Mexican peso likely to weaken ahead as interest rate differential narrows

RELATIVE PERFORMANCE OF MAJOR EMERGING MARKET CURRENCIES¹: 2021-22
(INDEX, DEC 31, 2020=100)

RELATIVE PERFORMANCE OF MAJOR EMERGING MARKET CURRENCIES¹: 2023
(INDEX, DEC 31, 2022=100)

¹ Based on a re-weighting of the JP Morgan Emerging Market Currency Index after removing MXN.
Source: BBVA Research, Bloomberg.
We expect the peso to gradually weaken to 18.0 pesos per dollar by the end of the year.

EXCHANGE RATE
(PESOS/USD)

Source: BBVA Research, Bloomberg.
Key points and forecast summary
Key points

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

Upward revision in our growth estimate for 2023 to 3.2% (previously 2.4%); we anticipate a GDP growth of 2.6% for 2024 (previously 1.8%).

- Consumption remains resilient driven by gains in real wages and employment, and the lower savings rate among the highest income deciles.
- Investment shows a positive performance, favored by public investment and the rapid growth of the machinery and equipment component, given the normalization of production.
- The higher dynamism of domestic demand in 2H23 improves the starting point for economic activity next year, added to the better growth outlook for the US.

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 slightly adjusted our forecast for 2024 due to the new economic outlook.
Key points

Inflation and Monetary Policy

The decline in inflation has been driven mainly by lower goods inflation, we anticipate a more pronounced slowdown in core inflation in the incoming months.

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

We foresee that, with inflation declining, Banxico will start a rate-cut cycle in 1Q24 to avoid a further increase in the real ex-ante rate.

- We expect the monetary rate to close 2024 at a level of 8.25%.
- Rates along the yield curve will gradually decline, discounting the easing cycle potentially to be adopted by Banxico.

Exchange rate and economic package 2024

We forecast the exchange rate to close 2023 and 2024 at 18.0 and 18.8 pesos per dollar, respectively.

The 2024 economic package will close the six-year term without fiscal imbalances. Nevertheless, it is worrisome that the public deficit of 4.9% of GDP (estimated by the SHCP, Mexico's Ministry of Finance) for next year is the highest since 1990.

The next federal government will have to carry out a fiscal consolidation and/or design a fiscal reform in order to reduce the deficit to values that are consistent with the stability of the public debt to GDP ratio.
Forecast summary

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