BBVA Research

Mexico Economic Outlook

December 2023

Creating Opportunities

BBVA Research

01

Global Economic Outlook 4Q23

Creating Opportunities

Main messages

Recent developments

Growth and inflation have been trending downwards, favored by the recent tightening of monetary conditions. The moderation of commodity prices is also allowing inflation to ease, while providing some support to growth. Still expansive fiscal policy and resilient labor markets are backing activity, but making the disinflation process more difficult. Markets have exhibited a positive tone lately, but remain subject to volatility, especially considering that uncertainty remains very high.

Growth outlook

A further deceleration of the global economy is likely moving forward, as monetary conditions will remain tight, fiscal policy will eventually become less expansive, labor markets will continue losing steam and excess savings are set to decline further. However, a deep recession will likely be avoided. Global growth is forecast to decline from 3.4% in 2022 to around 3.0% in both 2023 and 2024.

Inflation and rates outlook

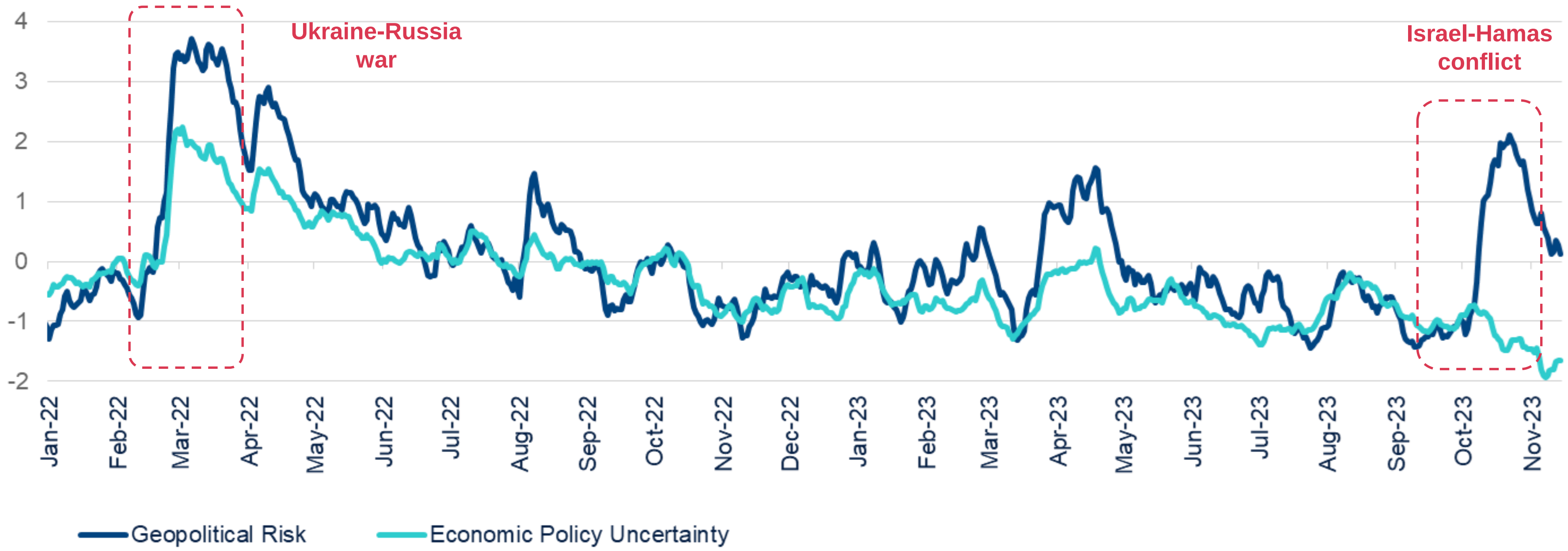
Inflation is also expected to keep easing, continuing its slow convergence to the targets. That will provide some relief to central banks, which are unlikely, however, to embark on interest rate cutting cycles before the middle of 2024: the Fed and the ECB are expected to revise rates gradually down from Jun/24 and Sep/24, respectively, while they continue to reduce liquidity levels.

Risks

Recession and financial stress episodes are still possible given tight monetary conditions, high inflation and growth deceleration. Geopolitical uncertainty is also a source of concern, particularly after the beginning of the Israel-Hamas conflict. Another risk is a hard-landing in China.

Geopolitical risks have increased on the Israel-Hamas conflict, but economic policy uncertainty has remained relatively low

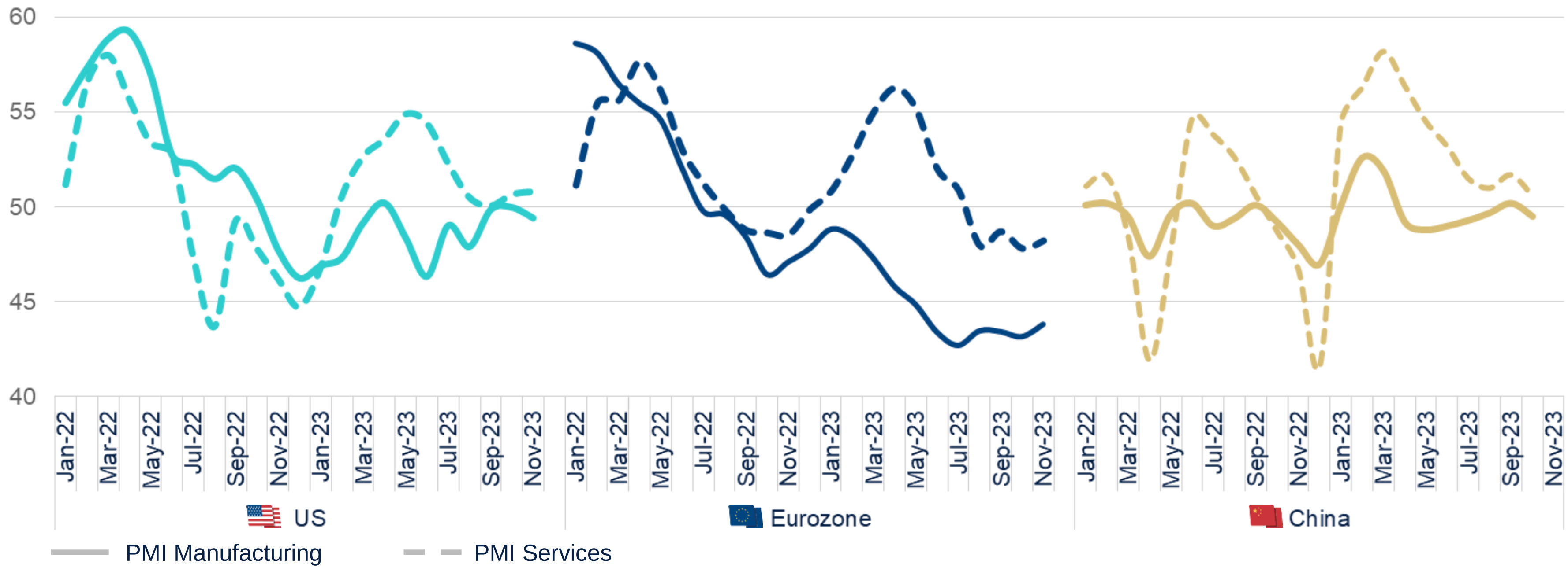
GEOPOLITICAL RISK AND ECONOMIC POLICY UNCERTAINTY IN G3 REGIONS (*)
(INDEXES: AVERAGE SINCE 2019 EQUALS TO 0, 28-DAY MOVING AVERAGE)



(*): US, Eurozone and China.
Source: BBVA Research Geopolitics Monitor.

Growth continues to trend down, mainly in the eurozone: services are still losing momentum, adding to the weakness in manufacturing

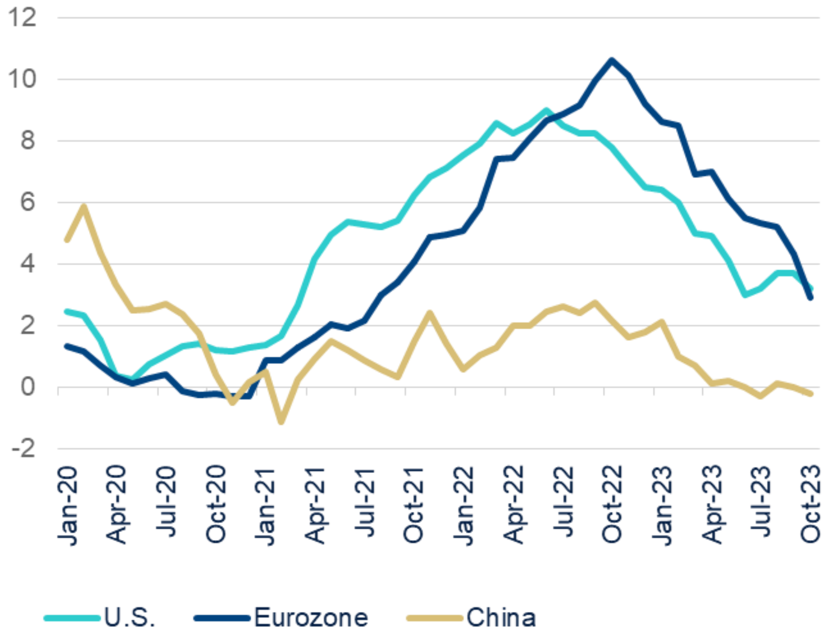
PMI INDICATORS
(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)



Source: BBVA Research based on data from Haver.

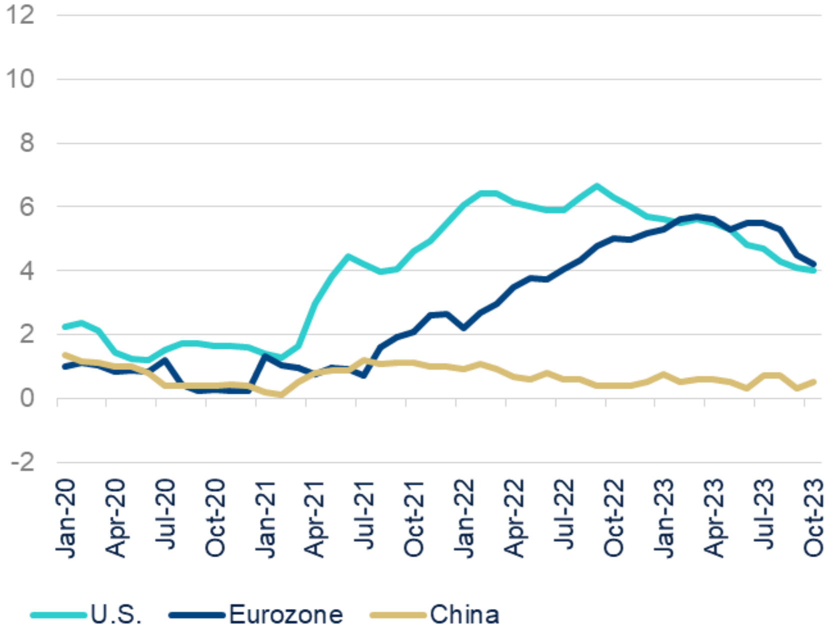
Inflation is also slowing: after the significant decompression of headline figures, there are clearer signs of moderation in (still high) core measures

INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on data from Haver.

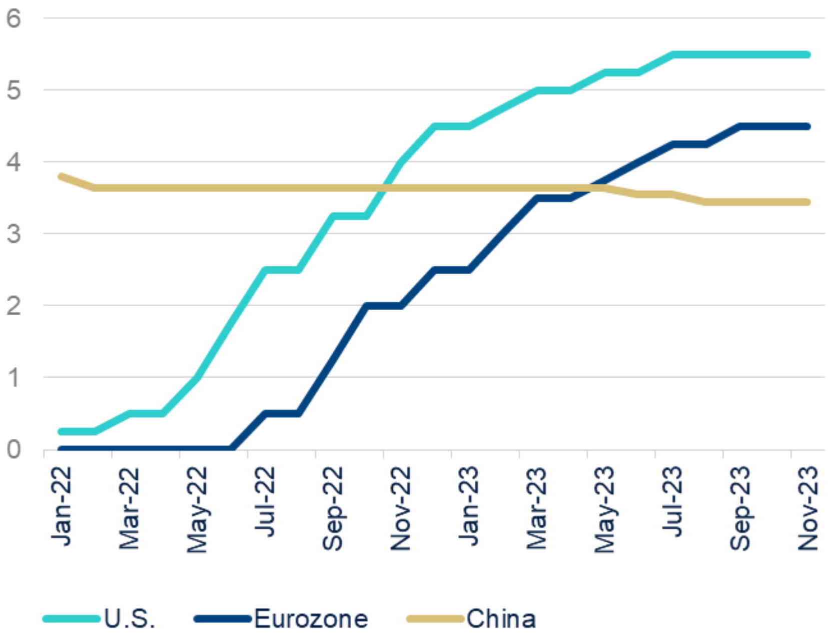
CORE INFLATION: CPI
(Y/Y %)



Source: BBVA Research based on data from Haver.

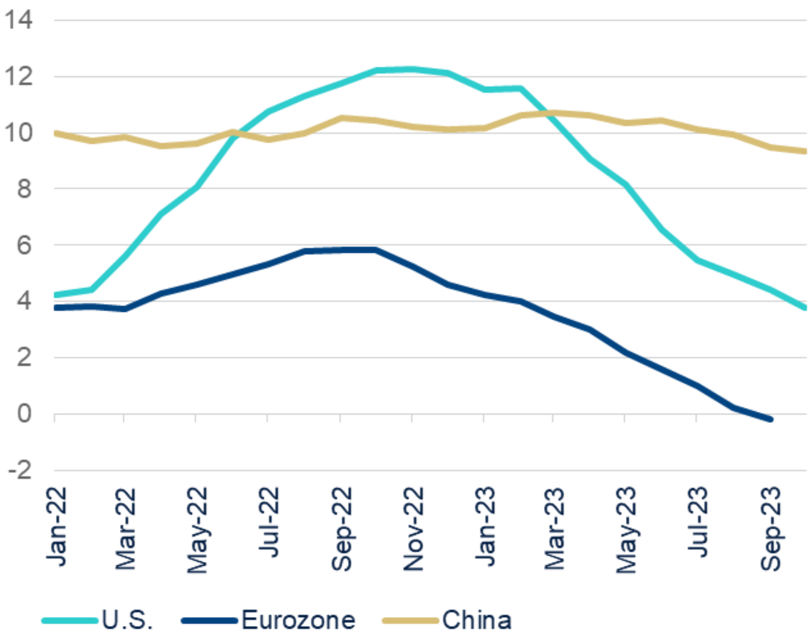
Growth and inflation are easing following the aggressive interest rate hiking cycles -which seem to be over now- and also on the decline of excess savings

POLICY INTEREST RATES (*)
(%)



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

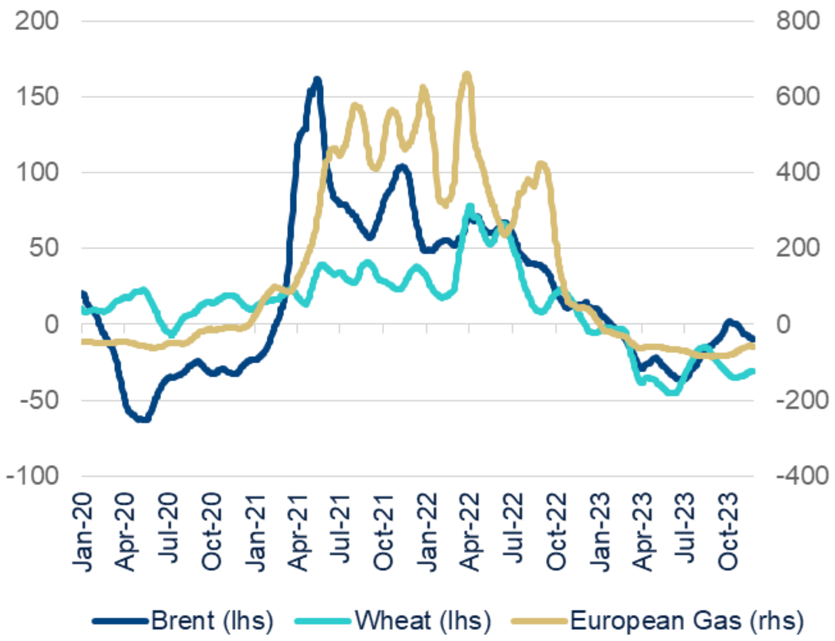
LENDING BY COMMERCIAL BANKS
(YOY %)



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

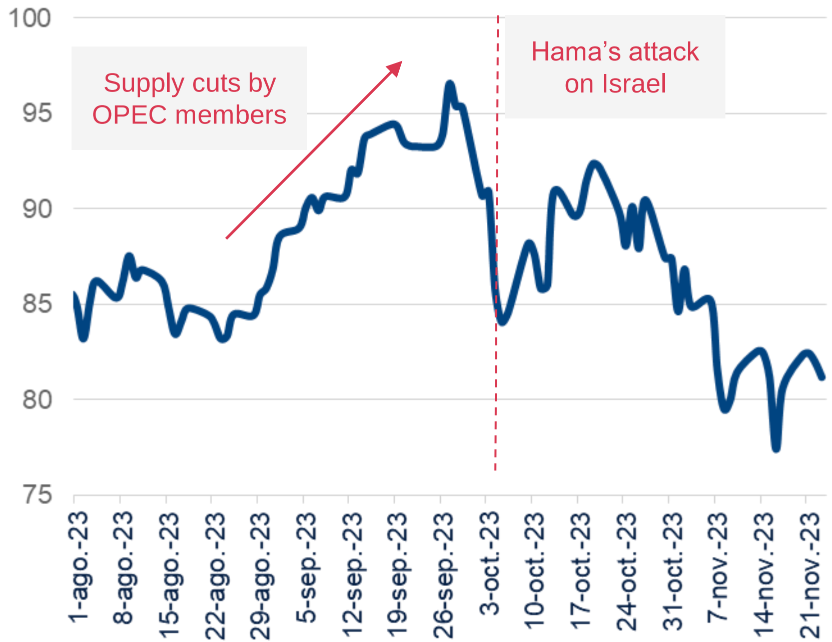
More contained commodity prices (despite Middle-East tensions) are also allowing inflation to ease, while providing some support to economic activity

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



Source: BBVA Research based on data from Haver.

BRENT PRICES
(USD PER BARREL)

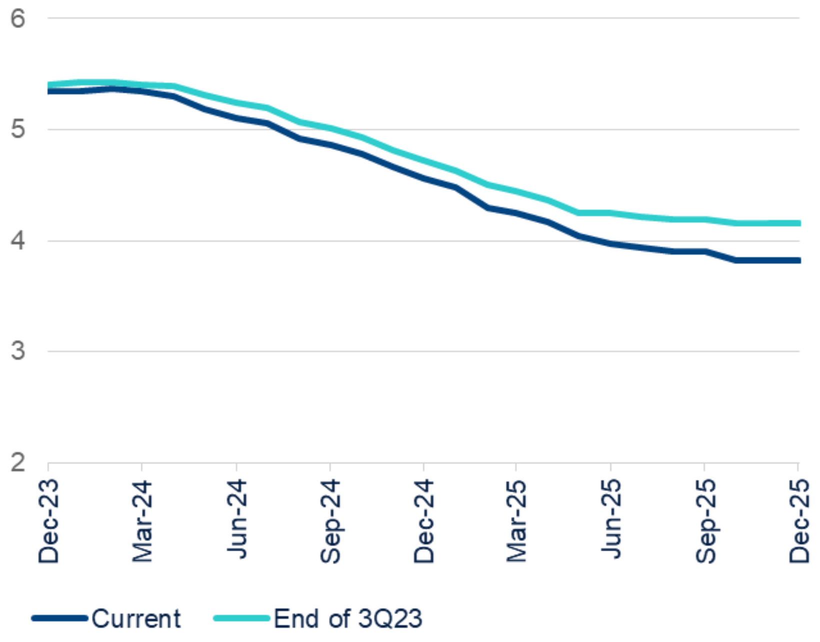


Source: BBVA Research based on data from Haver.

Despite the still hawkish tone exhibited by the Fed and the ECB, markets are now pricing an early and more aggressive monetary easing cycle

FED: IMPLICIT RATE IN FUND FUTURES

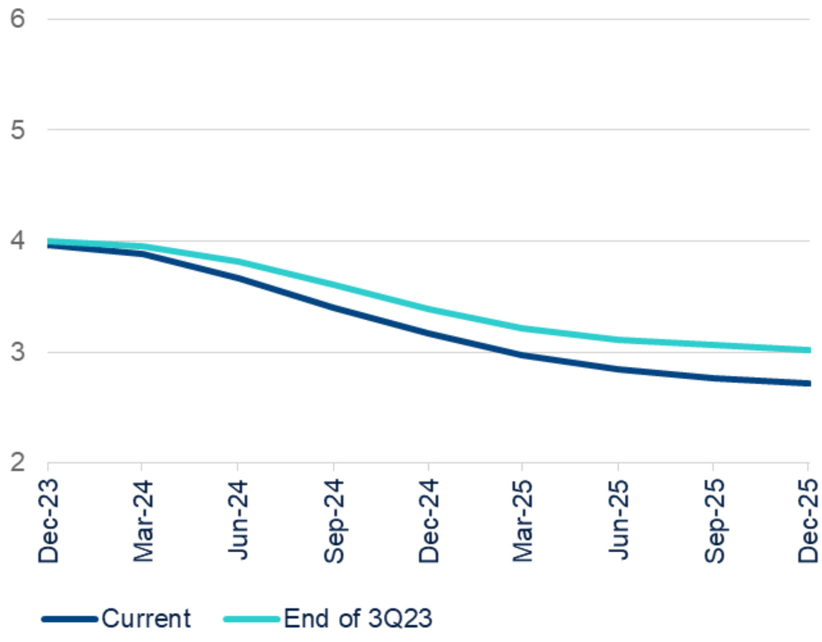
(%)



Source: BBVA Research based on Bloomberg.

ECB: IMPLICIT RATE IN 3-MONTH EURIBOR FUTURES (*)

(%)

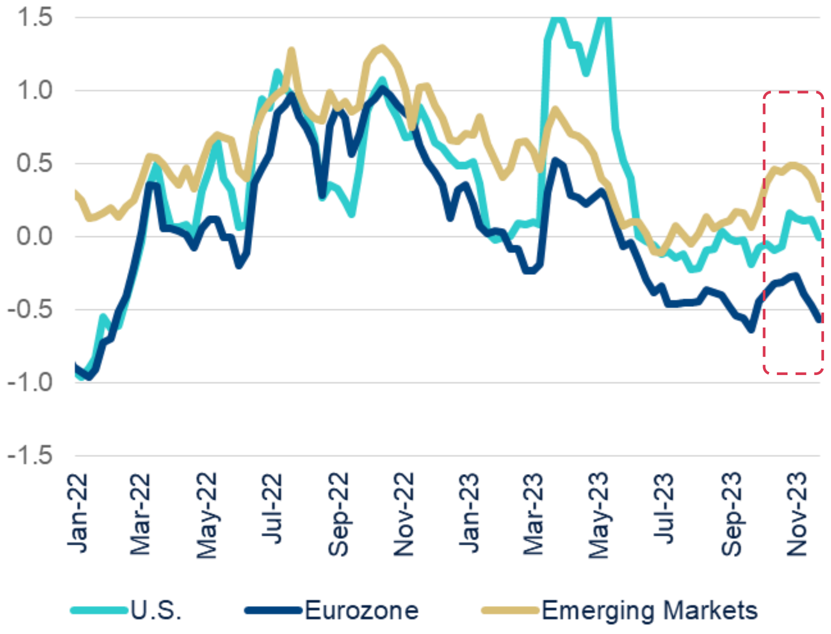


Source: BBVA Research based on Bloomberg.

Financial tensions and sovereign yields have fallen with optimism on inflation and early monetary easing cycle, but markets remain subject to volatility

BBVA RESEARCH FINANCIAL TENSIONS INDEX

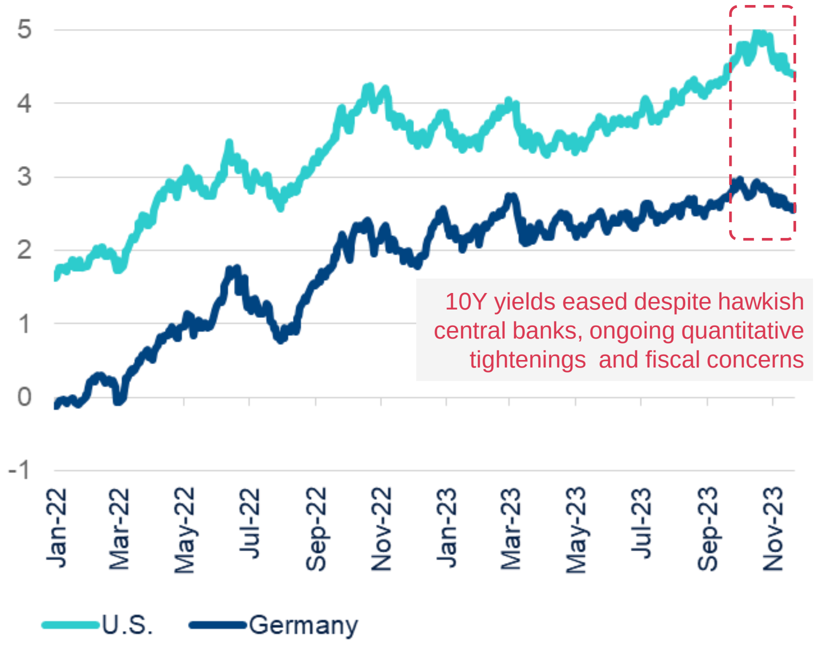
(INDEX: HISTORIC AVERAGE = 0)



Source: BBVA Research based on Bloomberg.

US AND GERMAN SOVEREIGN YIELDS: 10Y

(%)



Source: BBVA Research based on Bloomberg.

A soft landing of both growth and inflation is likely to pave the way for cautious rate-cutting cycles, which are closer now but are not imminent yet

BBVA RESEARCH BASELINE SCENARIO

Growth and inflation slowdown

Growth and inflation will ease on extra demand weakening, given no extra supply shocks, but risks are still significant

Cautious central banks

Fed and ECB rates have peaked but are unlikely to be cut before Jun/24; anyway, quantitative tightening will continue

Financial volatility

Volatility will remain in place on high interest rates, still hawkish central banks and large uncertainty

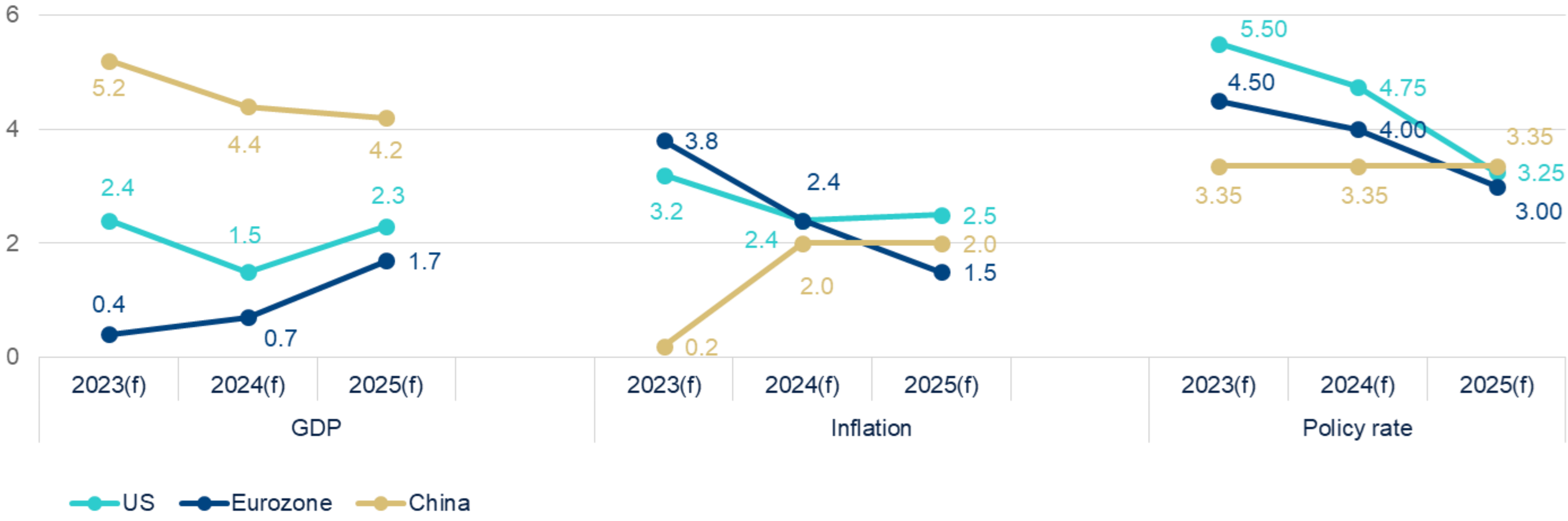
Geopolitical tensions

Rising risks, but large economic effects are not assumed; Middle-East conflict to have limited impact on energy prices

Global growth will be relatively low, while inflation and policy rates will decline without converging to pre-pandemic (ultra-low) levels over the next two years

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

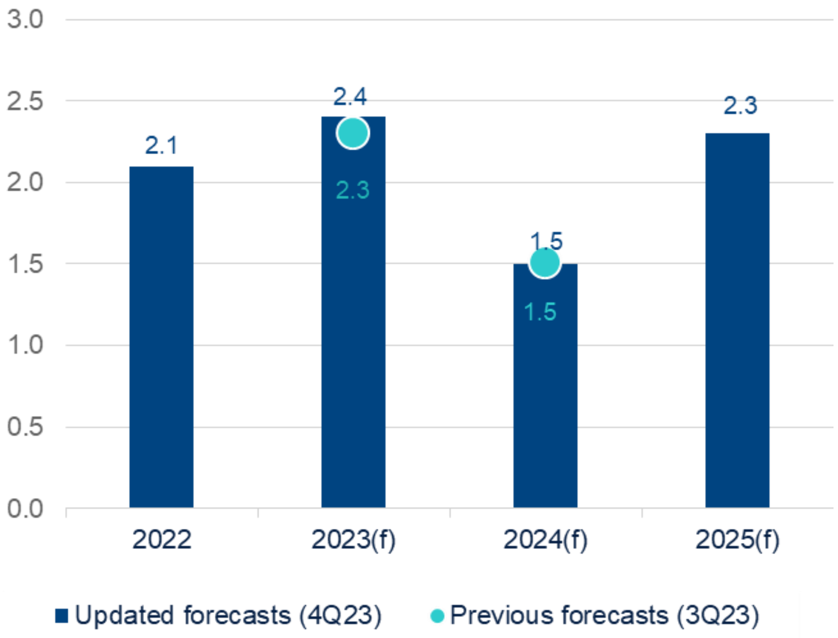
(GDP GROWTH: %; INFLATION: YOY %, END OF PERIOD, POLICY INTEREST RATES: %, END OF PERIOD)



(*) Global GDP growth is forecast to ease from 3.4% in 2022 to around 3.0% (+0.1pp) in 2023, 3.0% (0.0pp) in 2024 and 3.3% in 2025, below the 2000-2022 average (3.6%).
(**) In the case of the Eurozone, interest rates on refinancing operations.
(f): forecasts
Source: BBVA Research based on Bloomberg data.

US: solid domestic demand supports 2023 growth; high interest rates (despite eventual rate cuts from June) likely to weigh more on growth in 2024

US: GDP GROWTH
(%)



(f): forecast.
Source: BBVA Research

- 2023 growth revised up, despite moderation signs: consumption backed by still significant excess savings and strong labor markets; manufacturing is benefiting from bottleneck normalization.
- Growth to ease in 2024 mainly on the lagged effect of the recent monetary tightening.
- Inflation to keep falling as labor markets come into a better balance.
- Fed: the most likely is a pause with gradual cuts from Jun/24; fears of incomplete convergence to the 2% target to prevent earlier cuts.
- Risks: recession or financial stress on high rates, presidential elections and expansive fiscal stance.

Uncertainty on series of economic, political, geopolitical and climate factors

Economic uncertainty	Political uncertainty	Geopolitical uncertainty	Climate uncertainty
Inflation and macro policy mix	**US presidential** elections	**Israel-Hamas** conflict	**El Niño effects** mainly on S. America
Monetary tightening impact, neutral level	**Political tensions** in DMs and EMs	**Ukraine-Russia** war	**Climate disruptions** and weather shocks
Fiscal consolidation	**Populism** and social unrest	**US-China rivalry:** deglobalization, Taiwan	**Energy transition** policies

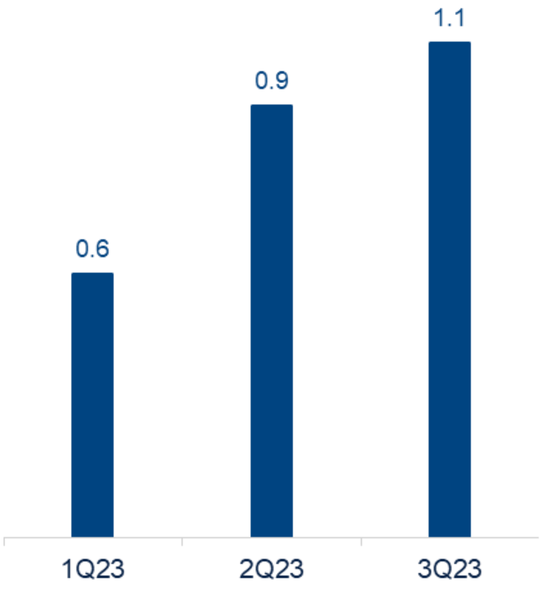
Research

02

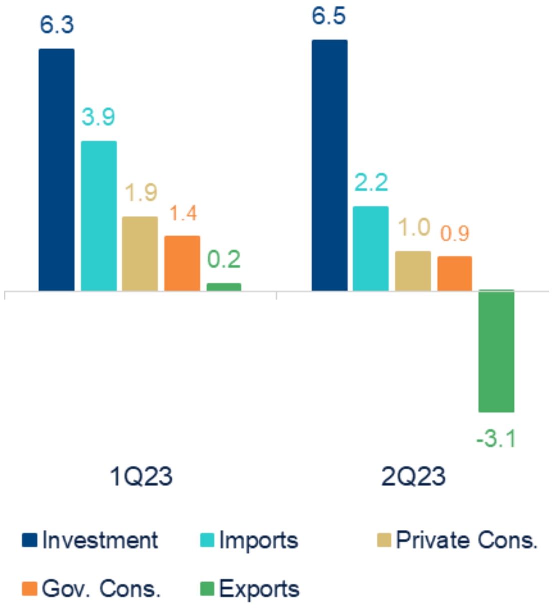
Domestic demand will remain resilient in 2024

GDP was higher than forecast (1.1% in 3Q23), boosted by investment and the resilience of private consumption

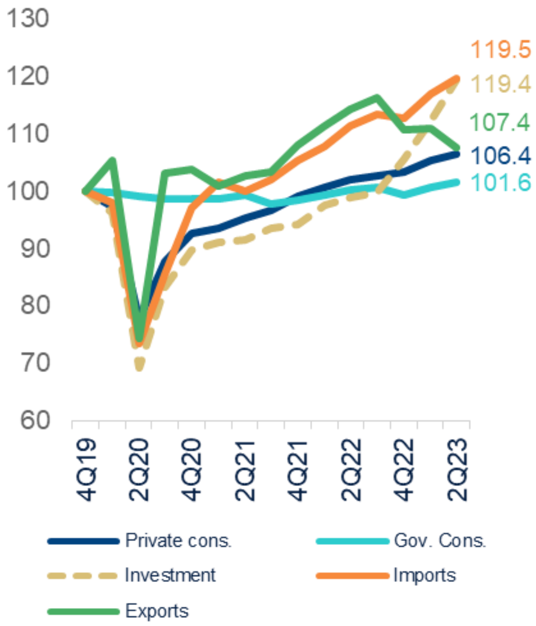
GDP
(% Q/Q, REAL, SEAS. ADJ.)



GDP BY COMPONENT
(% Q/Q, REAL, SEAS. ADJ.)



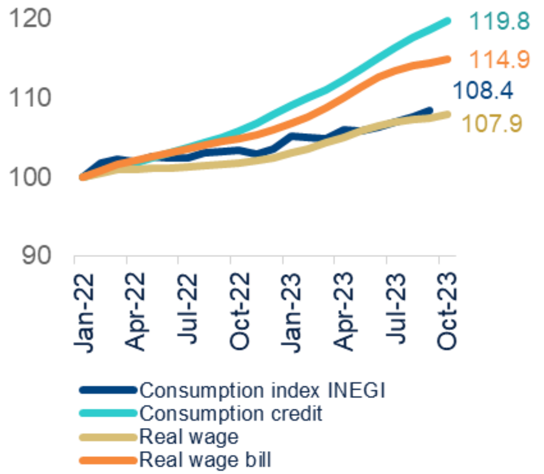
GDP BY COMPONENT
(INDEX 4Q19=100)



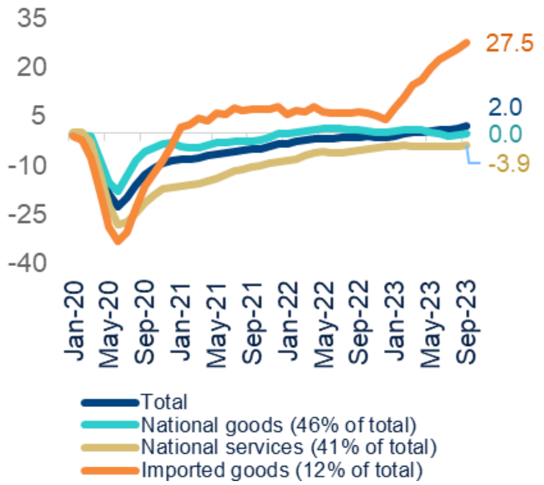
Source: BBVA Research/INEGI/Banxico.

Dynamic consumption due to a propensity to save less, accumulated wage bill gains, and the recovery of credit

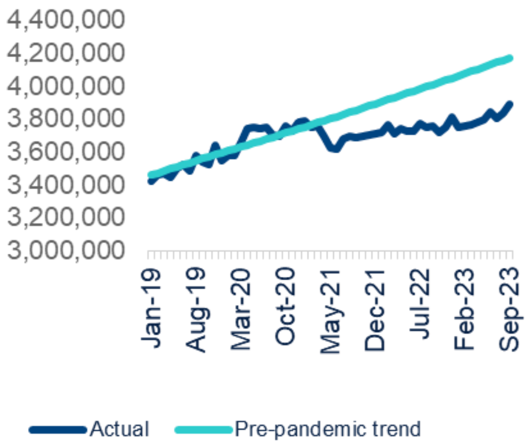
PRIVATE CONSUMPTION AND ITS DETERMINANTS
(3-MONTH MOVING AVERAGE, INDEX JAN/2022=100, REAL, SEAS. ADJ.)



PRIVATE CONSUMPTION: GAP VS. PRE-PANDEMIC TREND
(%, 3-MONTH MOVING AVERAGE)



DEPOSITS IN THE FINANCIAL SYSTEM: HOUSEHOLD BALANCES
(MILLIONS OF MXN, REAL, SEAS. ADJ.)

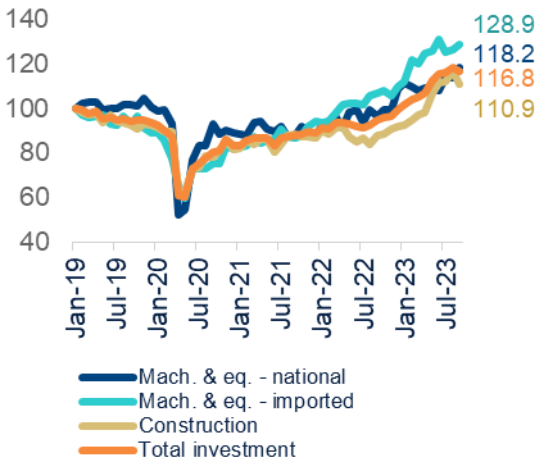


Source: BBVA Research/INEGI/Banxico.

Spending on services remains below its pre-pandemic level

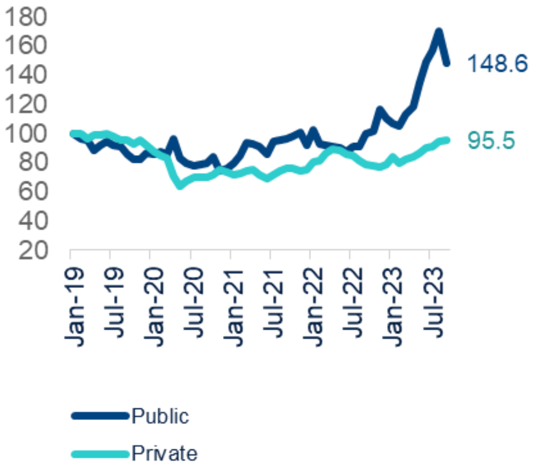
Robust growth in investment amid the outlook of relocation of production and the acceleration of government's flagship projects

GROSS FIXED INVESTMENT
(INDEX, JAN/2019 = 100)



CONSTRUCTION: COMPONENTS
(INDEX, JAN/2019 = 100)

CONSTRUCTION: PUBLIC VS. PRIVATE
(INDEX, JAN/2019 = 100)

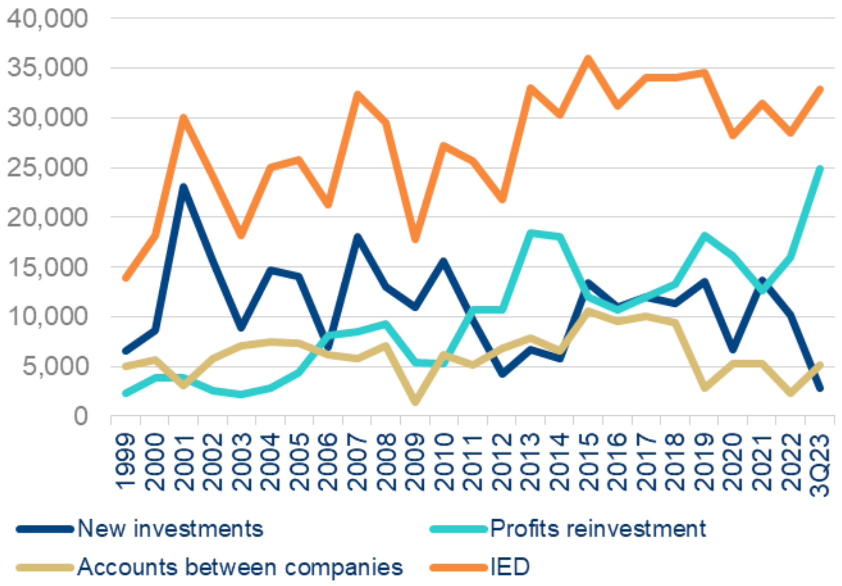


Source: BBVA Research/INEGI.

The boost from the public sector will fade at the start of 2024 as the federal government increases current expenditure ahead of the presidential elections.

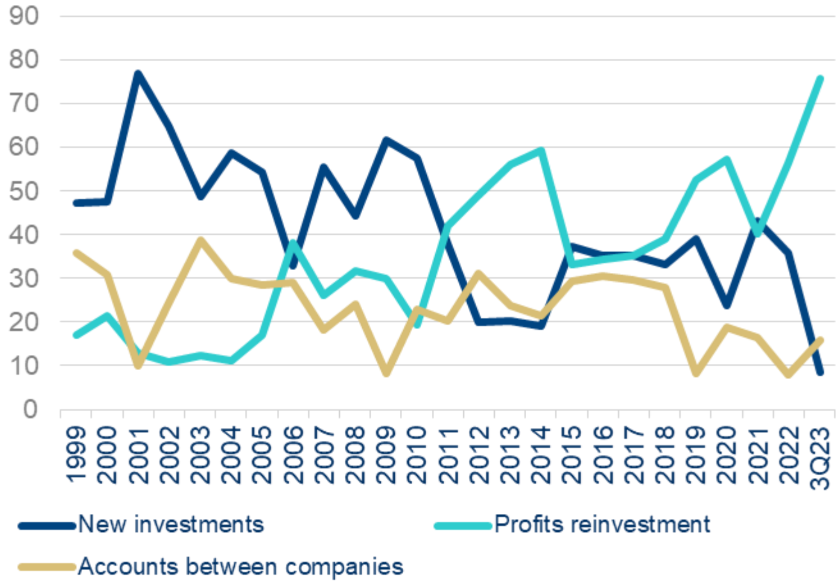
New investment only represents 8.5% of total FDI flows into Mexico in 1Q23-3Q23

FDI FLOWS INTO MEXICO AND MAIN COMPONENTS*
(USD MILLION)



*/ The sale of Grupo Modelo in 2013, the Televisa-Univision merger and the restructuring of Aeromexico have been excluded.
Source: BBVA Research, SE.

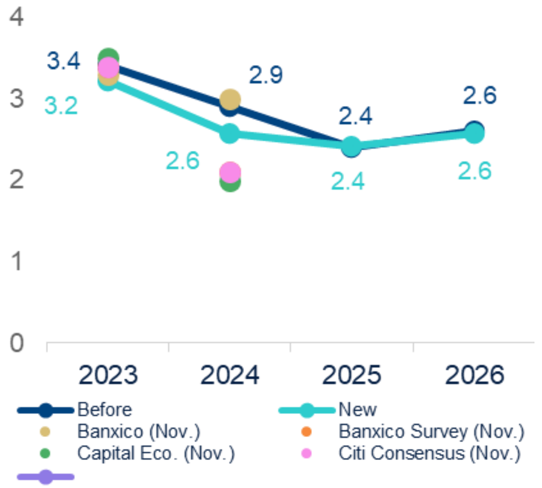
MAIN COMPONENTS OF FDI FLOWS INTO MEXICO*
(% OF TOTAL)



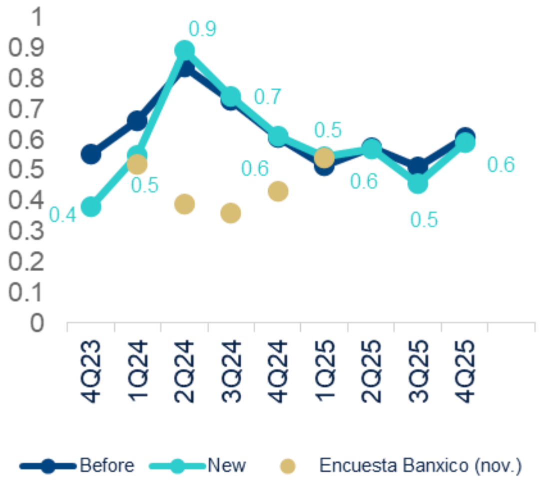
*/ The sale of Grupo Modelo in 2013, the Televisa-Univision merger and the restructuring of Aeromexico have been excluded.
Source: BBVA Research, SE.

Better than expected data for 3Q23 and a positive outlook for 4Q23 have prompted us to revise our growth forecast for 2023 to 3.4% (previously 3.2%)

GDP
(ANNUAL % CHG, SEAS. ADJ., REAL)



GDP
(% Q/Q, REAL, SEAS. ADJ.)



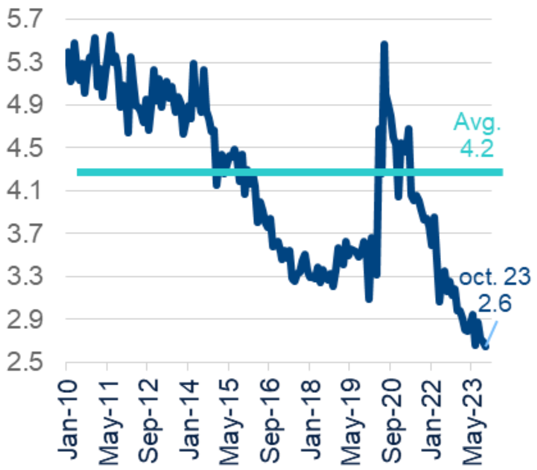
GDP: CONTRIBUTION TO REVISION, 2023-2024
(PP)

Source: BBVA Research/INEGI.

The positive carry-over effect for 2024 will materialize in a year of high public expenditure (amid presidential elections), resilient consumption (+revenue, -savings) and dynamic private investment (nearshoring).

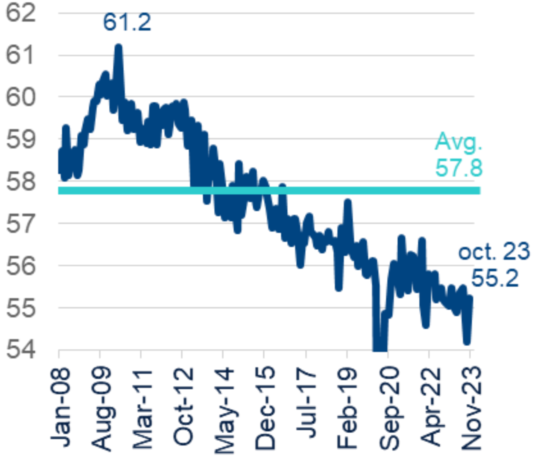
The labor market continues to show strength, but there are signs of a gradual slowdown in formal job creation.

UNEMPLOYMENT RATE (% OF EAP, SA)



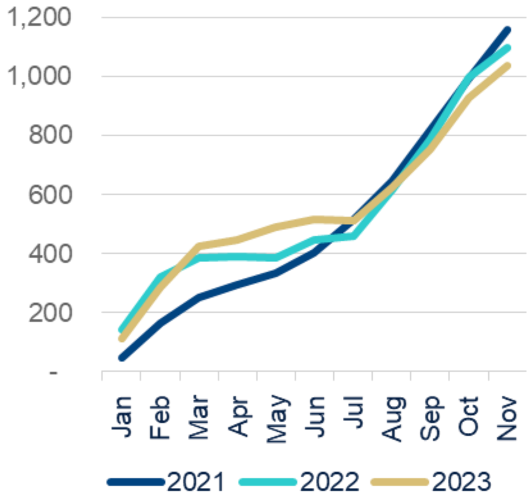
Average from 2005 to 2022.

LABOR INFORMALITY RATE (% EMPLOYED, SA)



Average from 2005 to 2022.

JOBS AFFILIATED WITH THE IMSS (ANNUAL ACCUM., JAN-OCT)

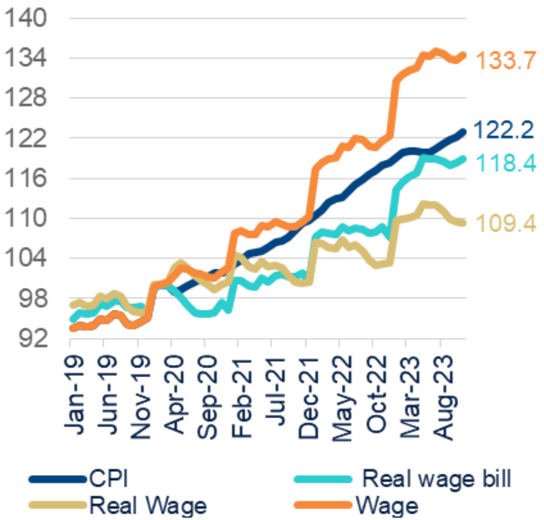


Source: BBVA Research based on data from INEGI and IMSS.

Formal employment is anticipated to experience sustained growth throughout the year's fourth quarter. However, we expect a downward adjustment in December attributed to seasonal factors.

Formal job creation will be strong for the third consecutive year

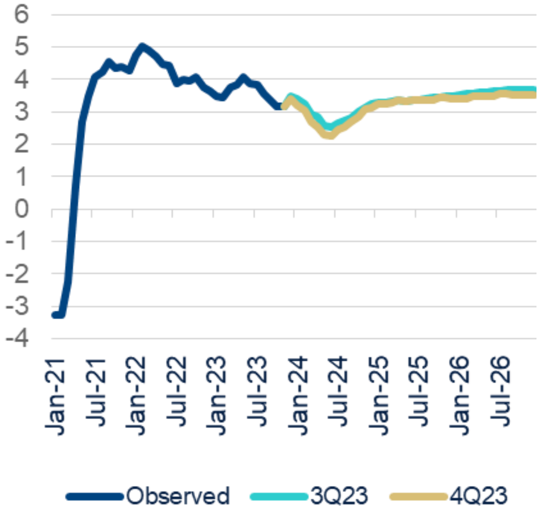
REAL WAGES AND REAL TOTAL WAGE BILL, IMSS (INDEX FEB.-20 = 100)[1]



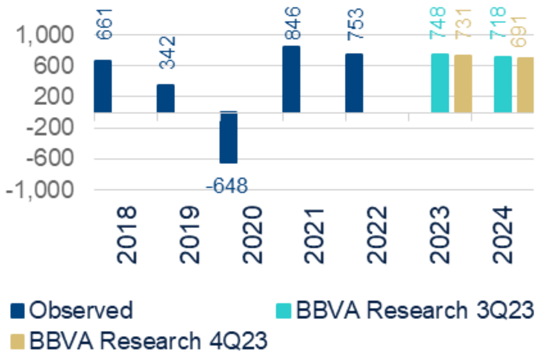
1) Figures at Oct

Source: BBVA Research based on IMSS data.

JOBS AFFILIATED WITH THE IMSS (ANNUAL CHANGE, %)



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

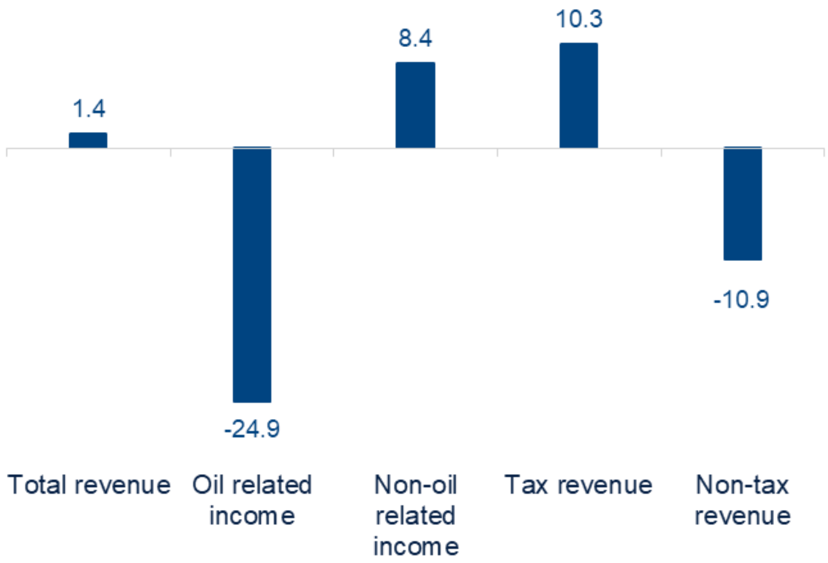


Forecast	2023	2024	2025	2026
Thousands, EoP				
BBVA Research 4Q23	**731**	**691**	**780**	**835**
BBVA Research 3Q23	748	718	800	873
Annual Change, % EoP				
BBVA Research 4Q23	**3.4**	**3.1**	**3.4**	**3.5**
BBVA Research 3Q23	3.5	3.2	3.5	3.7

Although we forecast a gradual slowdown in job creation in 2024, we expect greater dynamism in the medium term as nearshoring becomes more tangible.

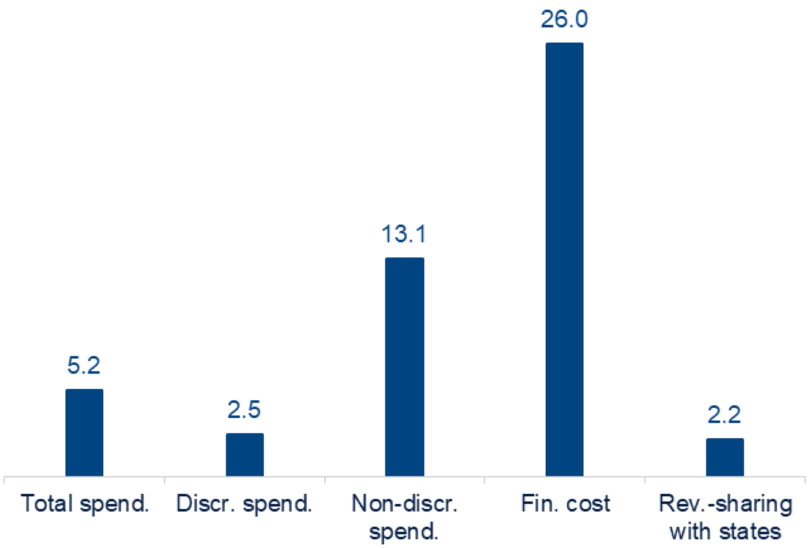
Tax revenue offset the Y/Y fall in oil revenue. Public expenditure was driven by financial costs and discretionary expenditure

GOVERNMENT REVENUES AND MAIN COMPONENTS IN JANUARY-OCTOBER 2023
(% Y/Y REAL)



Source: BBVA Research / SHCP.

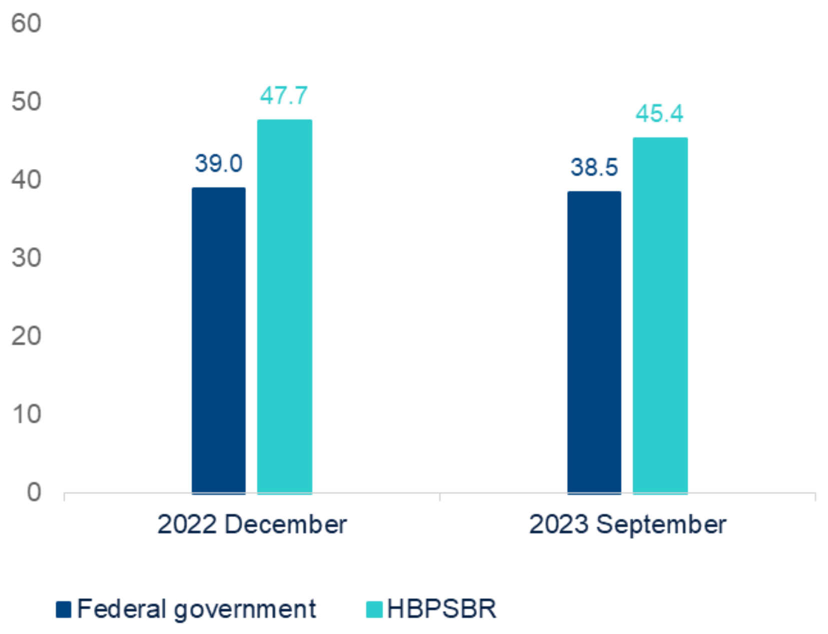
PUBLIC EXPENDITURE AND MAIN COMPONENTS IN JANUARY-OCTOBER 2023
(% Y/Y REAL)



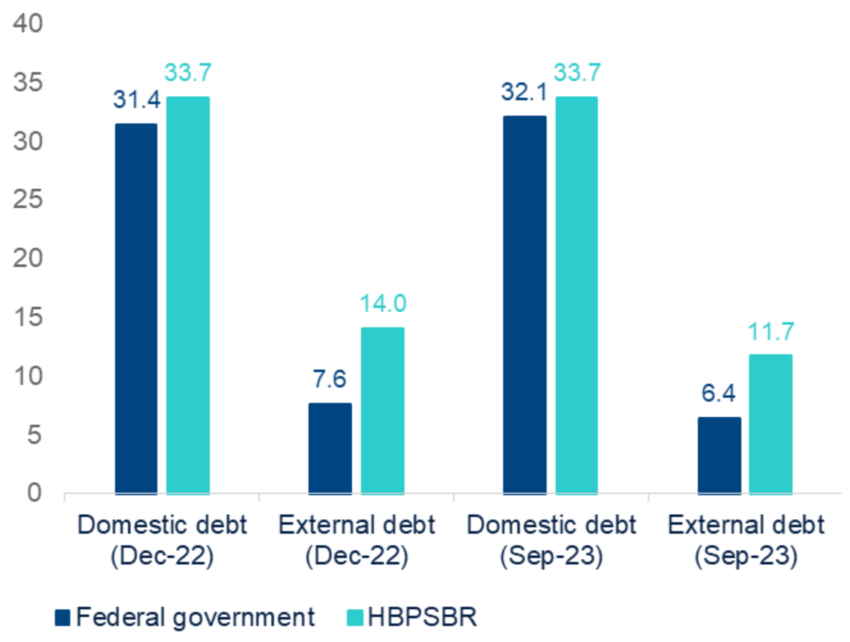
Source: BBVA Research / SHCP.

The external component of the Historical Balance of PSBR (% of GDP) contributed to all of the reduction of this ratio between Dec. 2022 and Sep. 2023

PUBLIC DEBT
(% of GDP)



DOMESTIC AND FOREIGN PUBLIC DEBT
(% of GDP)

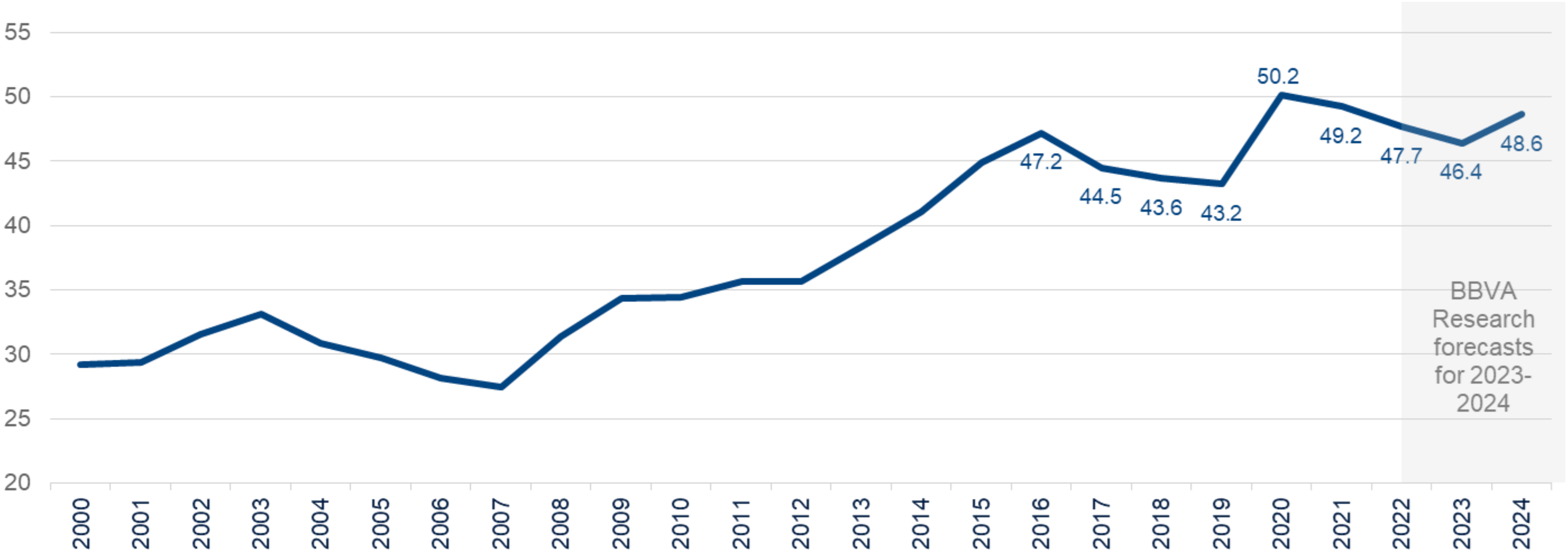


Source: BBVA Research / SHCP

Public debt will increase by more than 2pp in AMLO's last year. Public deficits of around 2% of GDP will be needed to keep this debt stable

HISTORICAL BALANCE OF THE PUBLIC SECTOR'S FINANCIAL REQUIREMENTS

(% OF GDP)



Source: BBVA Research / SHCP

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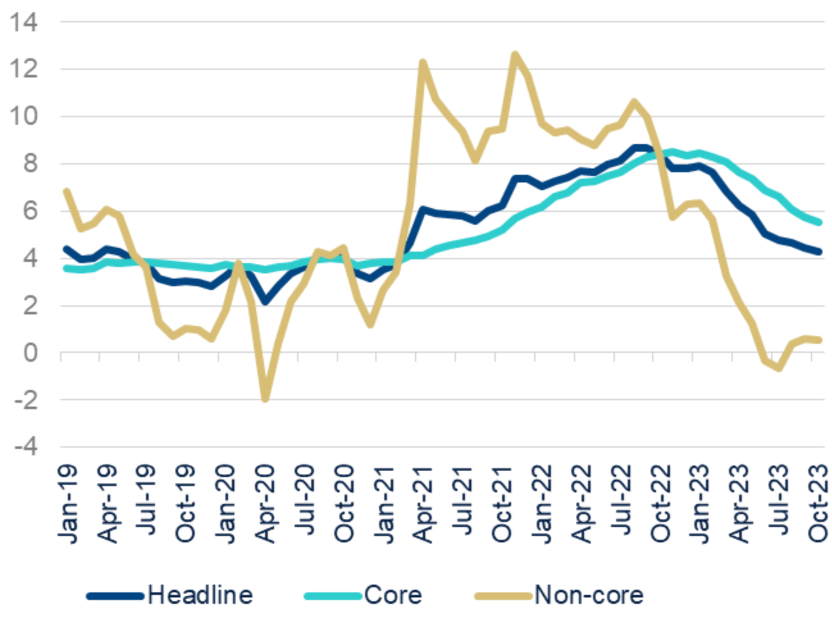
03

We forecast the beginning of a rate cut cycle in 1Q24, but now expect an even more gradual pace

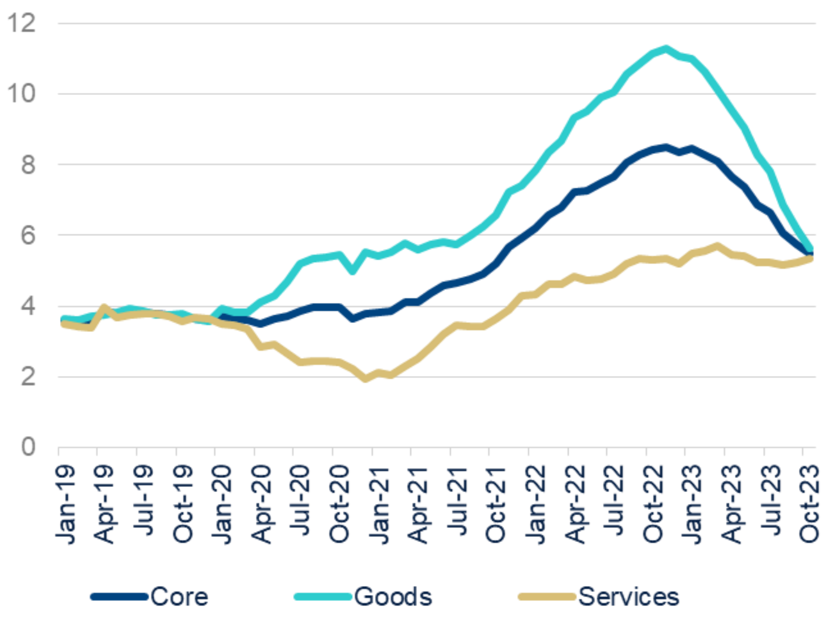
Inflation continues to cool, but its recent slowdown is still due to a large extent to lower core goods inflation

BREAKDOWN OF HEADLINE INFLATION
(% RATE OF ANNUAL CHANGE)



Source: BBVA Research, INEGI.

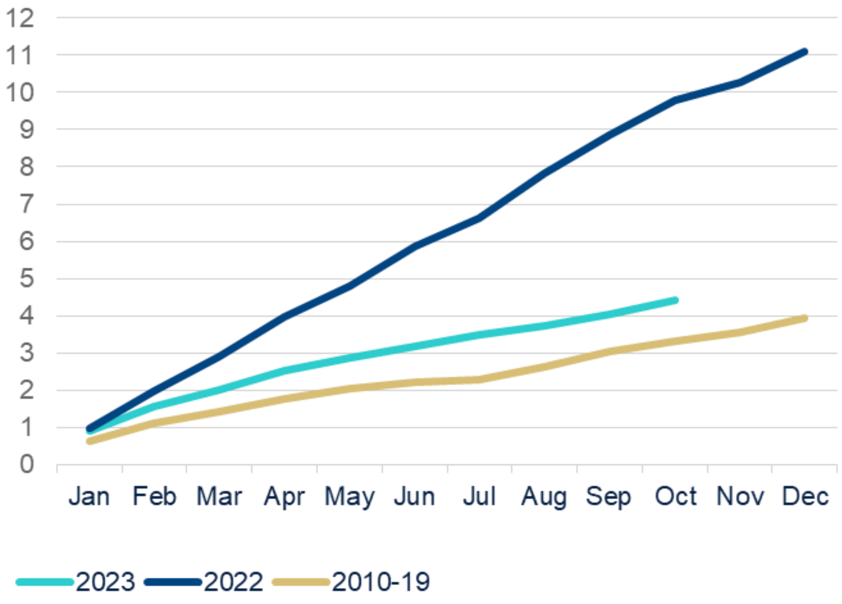
BREAKDOWN OF CORE INFLATION
(% RATE OF ANNUAL CHANGE)



Source: BBVA Research, INEGI.

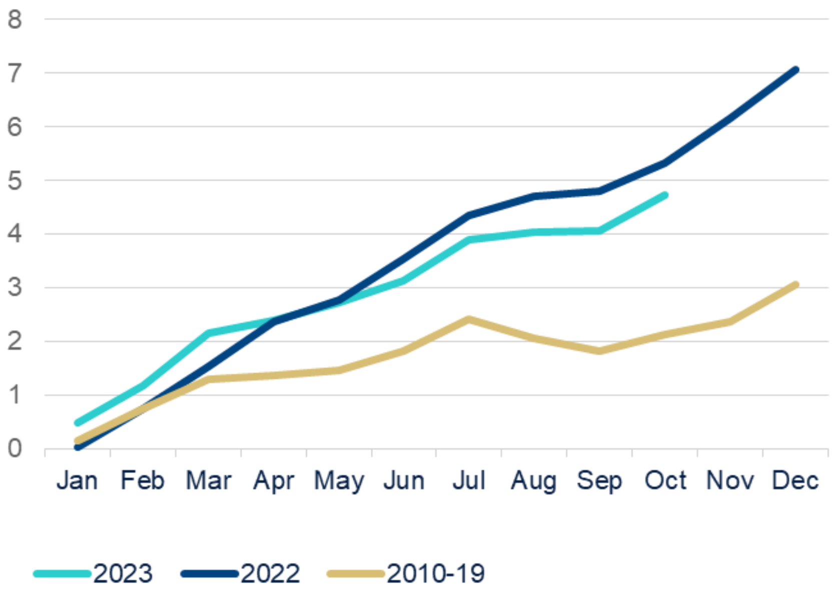
Core services inflation continues to show stickiness

CUMULATIVE CORE GOODS INFLATION IN GOODS (%)



Source: BBVA Research based on INEGI data.

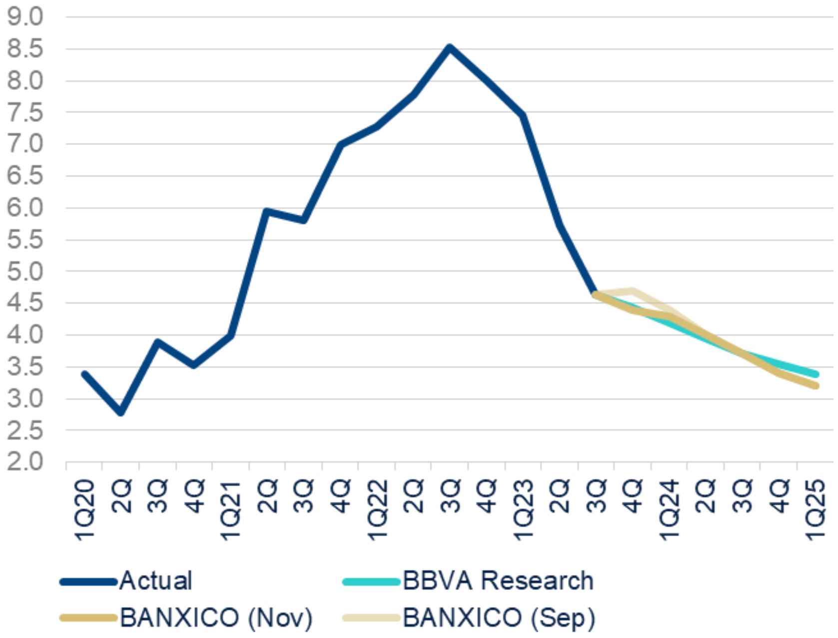
CUMULATIVE CORE SERVICES INFLATION EX-HOUSING AND EDUCATION (%)



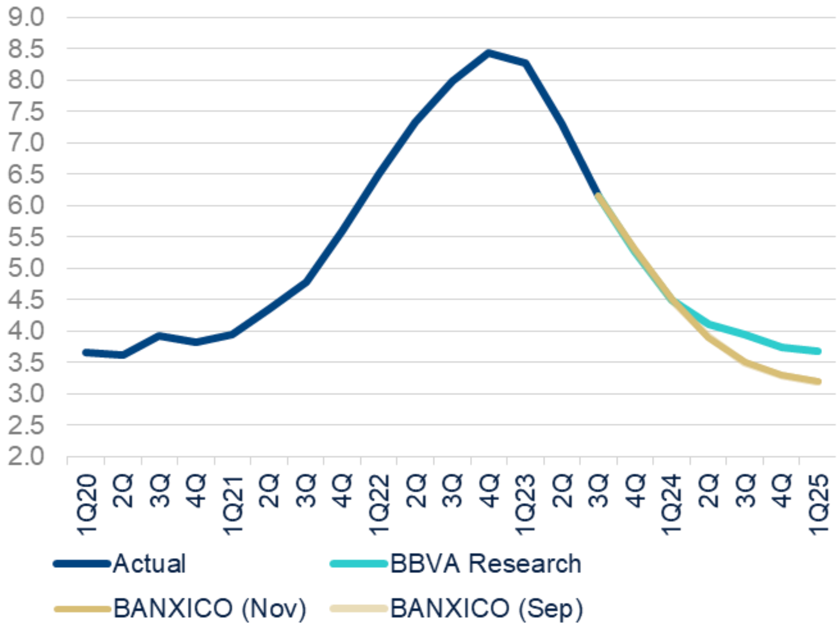
Source: BBVA Research based on INEGI data.

We forecast that the inflation rate will be within the target range from the second quarter of 2024

HEADLINE INFLATION FORECASTS
(Y/Y, % CHANGE, QUARTERLY AVERAGE)



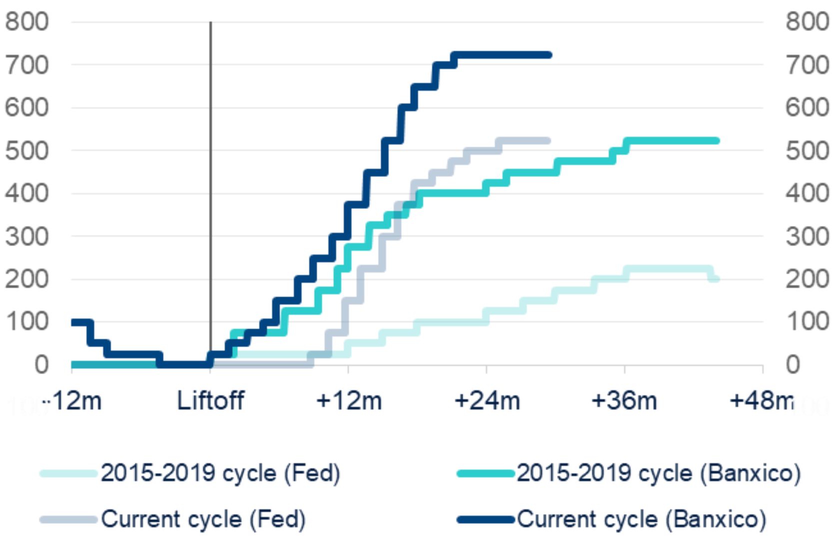
CORE INFLATION FORECASTS
(Y/Y, % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research, INEGI, BANXICO.

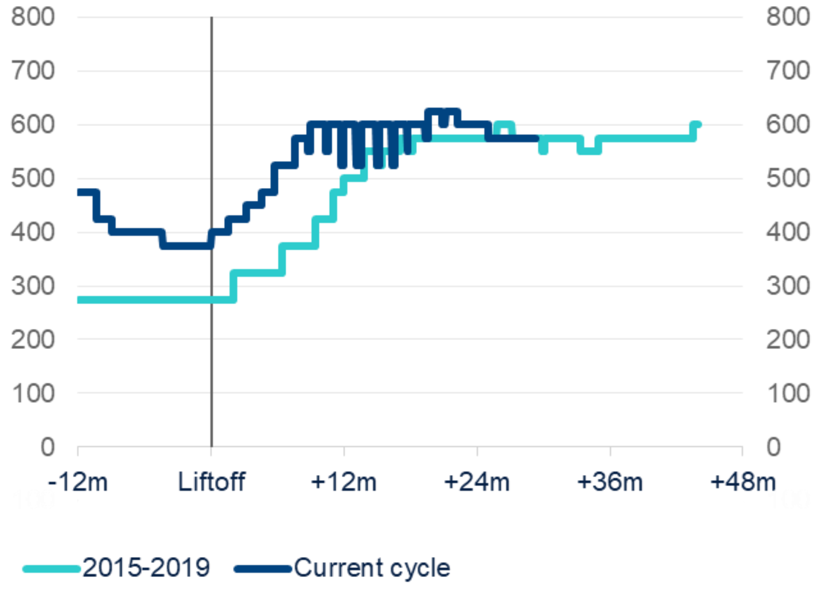
With Banxico on hold for the last five meetings, the rate differential between Mexico and the US has fallen from its peak of 6.25%

BANXICO TARGET RATE IN MONETARY TIGHTENING CYCLES
(BP VS RATE AT TIME OF FIRST RISE)



The faint lines indicate the difference in bp between the upper limit of the target range of the fed funds rate and its level at the time of the first Banxico rise.
Source: BBVA Research / Haver

MEXICO-US TARGET RATE DIFFERENTIAL IN MONETARY TIGHTENING CYCLES
(BP)

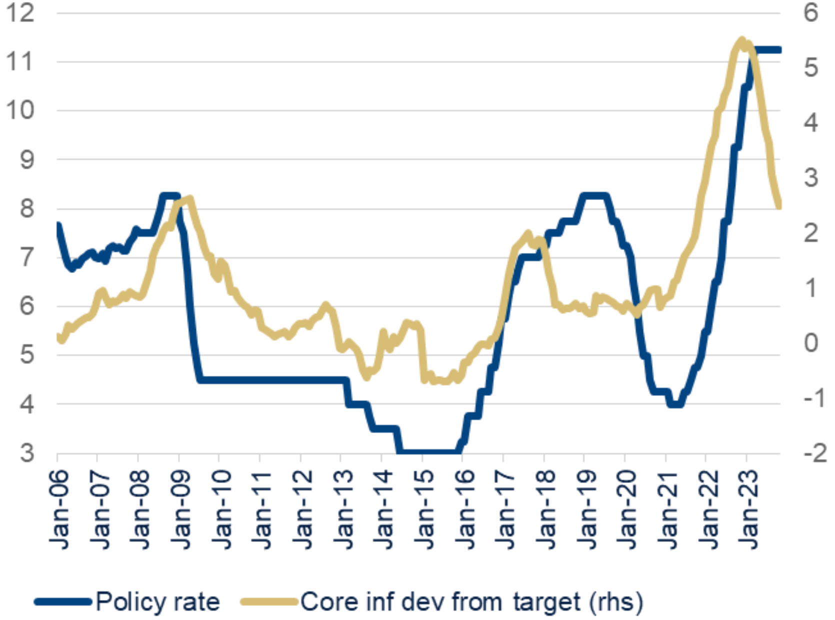


The vertical line indicates the time of the first Banxico rise in each cycle.
Source: BBVA Research / Haver

It is likely that the Board has begun discussions to avoid a more restrictive stance in 2024, which suggests that a rate cut cycle will start soon

MONETARY POLICY RATE AND DEVIATION FROM THE CORE INFLATION TARGET

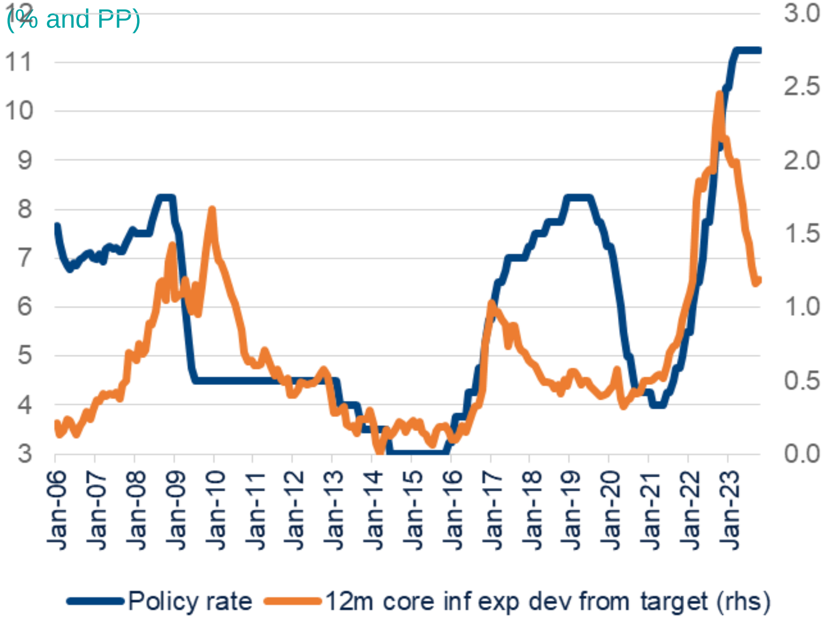
(% and PP)



Source: BBVA Research / Banxico.

MONETARY POLICY RATE AND DEVIATION FROM TARGET OF 12-MONTH CORE INFLATION EXPECTATIONS

(% and PP)

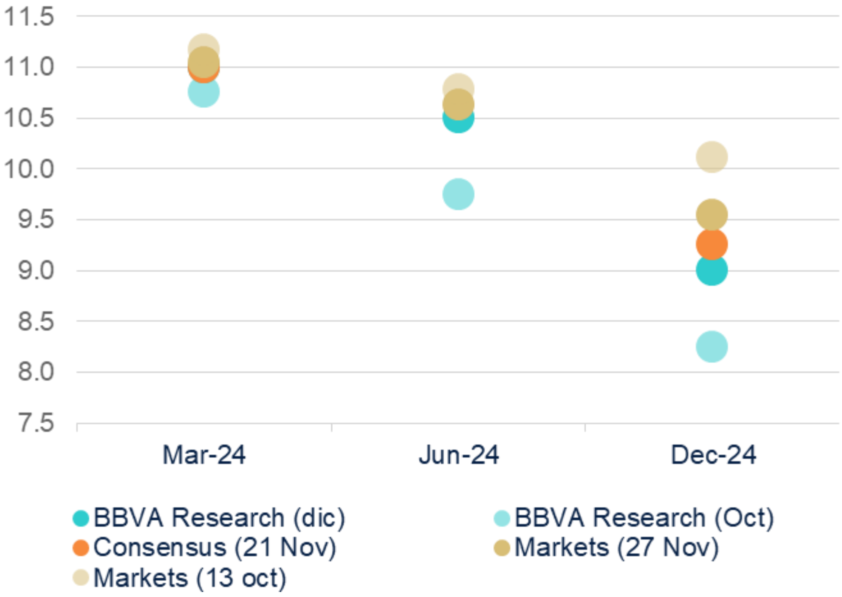


Source: BBVA Research / Banxico.

The monetary policy rate will not remain unchanged "for an extended period", but just "for some time"

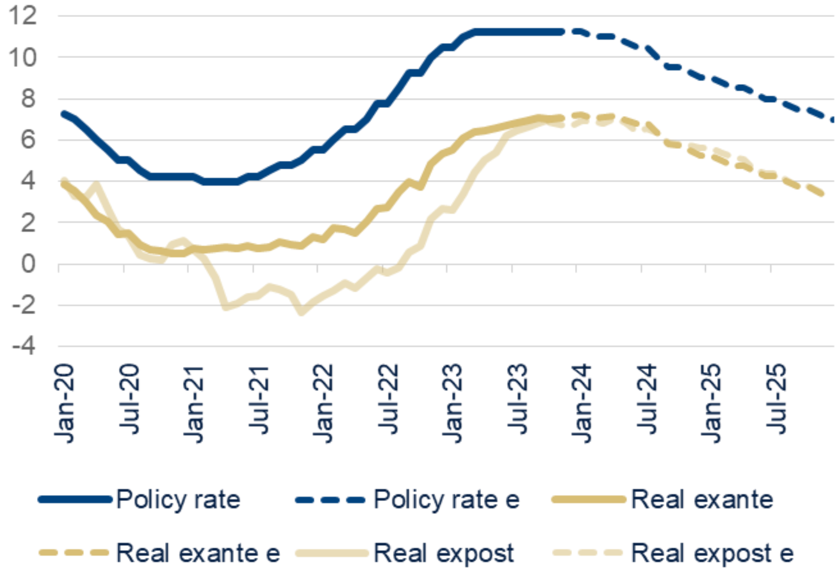
We forecast the beginning of a rate cut cycle in February, but now expect an even more gradual easing cycle due to Banxico's caution

MONETARY POLICY RATE EXPECTATIONS: BBVA RESEARCH VERSUS MARKET AND CONSENSUS (%)



Source: BBVA Research; Banamex and Bloomberg surveys.

OUTLOOK FOR MONETARY POLICY RATES (%)

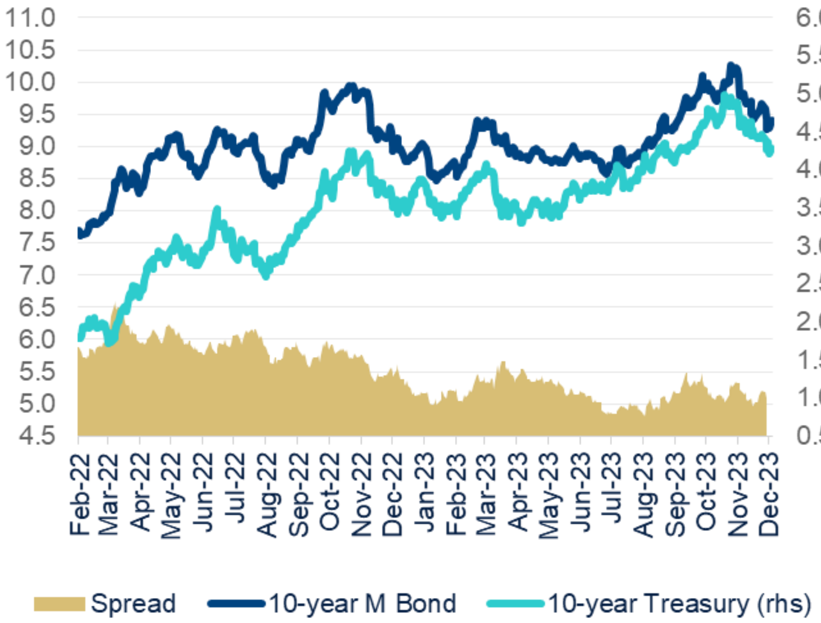


Source: BBVA Research, Banxico and INEGI.

The dynamics of the US 10-year Treasury yield remain the main determinant of the movements of the 10-year M Bond

MEXICO AND US 10-YEAR YIELDS

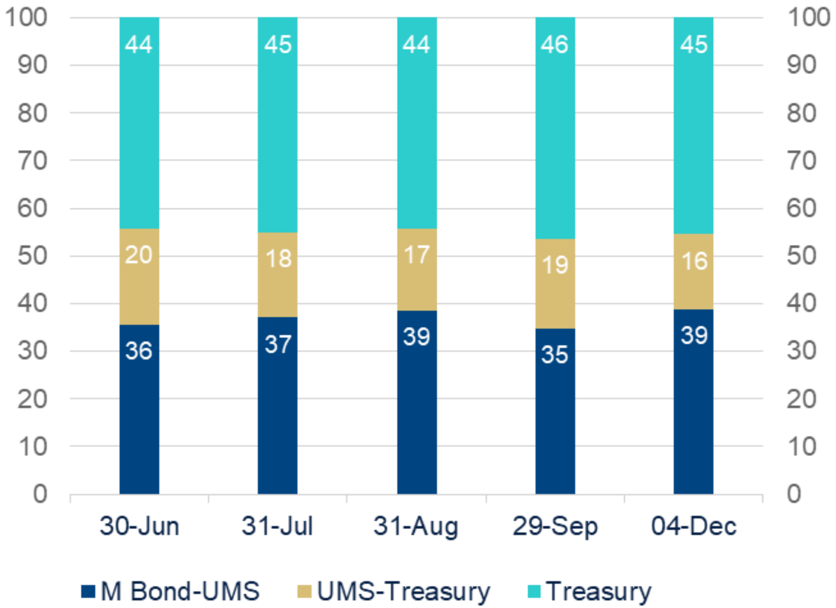
(%)



Source: BBVA Research / Bloomberg / Haver.

10-YEAR M BOND YIELD BREAKDOWN

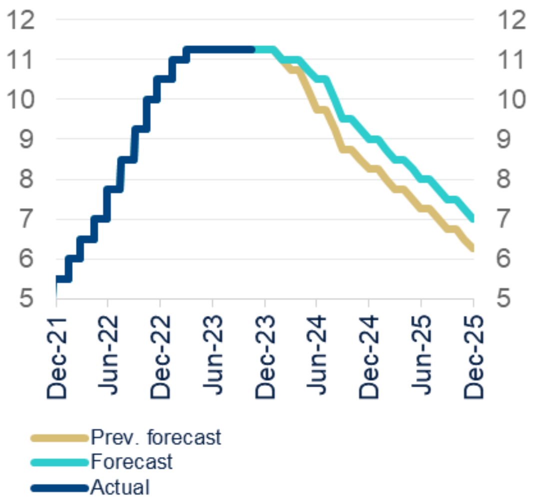
(% CONTRIBUTION TO NOMINAL YIELD)



Source: BBVA Research / Bloomberg / Haver.

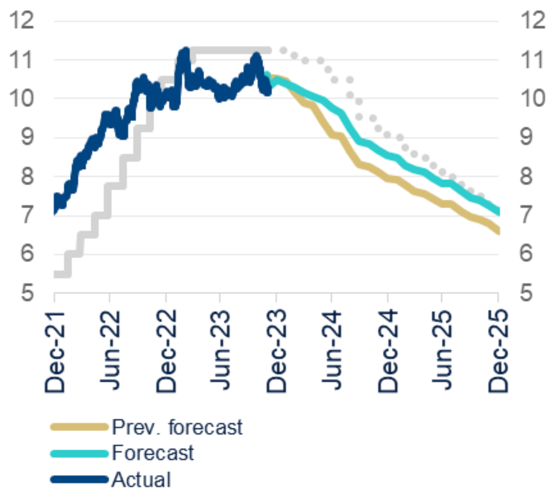
Upward revision of our rate forecasts given a greater probability of a more gradual cycle of rate cuts than previously expected

POLICY RATE OUTLOOK
(%)



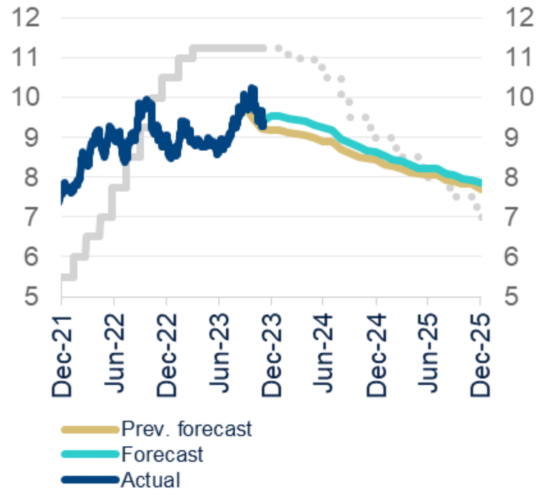
Policy rate	23	24	25
Forecast	**11.25**	**9.00**	**7.00**
Previous	11.25	8.25	6.25

2-YEAR M BOND YIELD OUTLOOK
(%)



2-year M Bond	23	24	25
Forecast	**10.5**	**8.6**	**7.1**
Previous	10.5	8.0	6.6

10-YEAR M BOND YIELD OUTLOOK
(%)



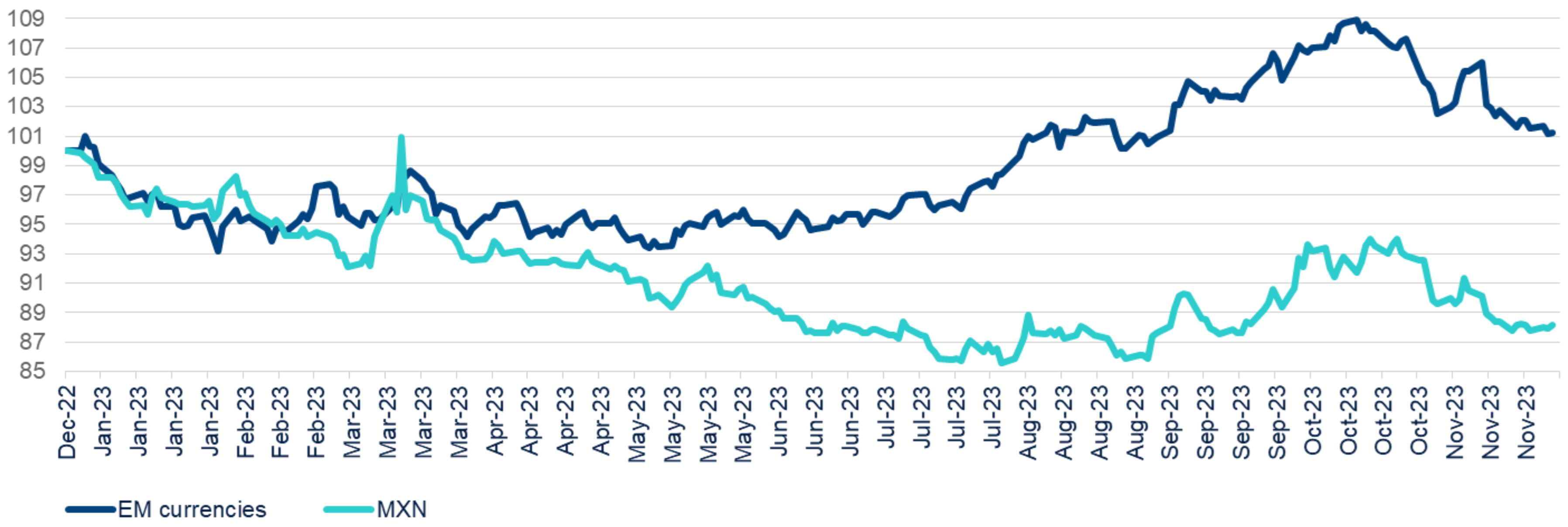
10-year M Bond	23	24	25
Forecast	**9.6**	**8.6**	**7.9**
Previous	9.2	8.4	7.7

The solid (actual) and dotted (forecast) gray lines indicate Banxico's overnight target rate.
Source: BBVA Research / Bloomberg / Haver.

It is likely that the best moment of the exchange rate has passed, but the peso remains relatively strong

RELATIVE PERFORMANCE OF EMERGING MARKET CURRENCIES[1] IN 2023

(INDEX, 31 DEC 2022=100)



1 Based on a re-weighting of the JP Morgan Emerging Market Currency Index after removing MXN.
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. Gradual slowdown in the context of robust labor markets and post-pandemic reopening. Lower inflation due to improvements in energy prices and bottlenecks, but with core inflation persisting. Central banks focused on inflation; rates at (or near) peak levels, but higher for longer.

Growth estimate

We revised our 2023 growth estimate upward to 3.4% (3.2% previously) and we anticipate growth of 2.9% in 2024 (2.6% previously).

- Consumption remains resilient, driven by real wage gains, employment and the lower household saving rate.
- Investment shows a positive performance, boosted by public investment and the rapid growth of the imported machinery and equipment component, which we attribute to nearshoring expectations.
- The higher dynamism of domestic demand in 2023, with a positive carry-over effect on 2024, with resilient private consumption and dynamic private investment.

Labor market ends 2023 strongly. Growth in the real total wage bill and the slowing inflation dynamic will support consumption. Job creation will gradually slow in 2024.

Key points

Inflation and Monetary Policy

We expect **to end the year at 4.5% and to fall to levels below 4% from 2Q24**; core inflation will remain on a steady downward path, but will stay above headline inflation for some time.

- We expect headline inflation to stand at 5.1% at the end of this year and at 3.7% at the end of 2024.

We still forecast **the beginning of a downward cycle in 1Q24, but we now anticipate a slower pace to reach a level of 9% at the end of 2024.**

- We now expect the monetary policy rate to close 2024 at a level of 9%.
- **The dynamics of long-term US Treasury yields remain the main determinant of the movements of the 10-year M Bond**; we still expect rates along the yield curve to gradually decline.

Exchange rate and public finances

We forecast the exchange rate to close 2023 and 2024 at 18.0 and 18.5 pesos, respectively.

Public debt will be around 48.6% of GDP in 2024 vs. 46.4% in 2023. To keep this ratio constant from 2024 onwards it will be necessary to reduce the public deficit to around 2% of GDP.

Forecast summary

		2020	2021	2022	2023	2024	2025
GDP (Annual chg. %)	new	-8.8	6.0	3.9	**3.4**	**2.9**	**2.4**
	previous				1.4	2.2	2.1
Employment (%, eop)	new	-3.2	4.3	3.7	**3.4**	**3.1**	**3.4**
	previous				3.5	3.2	3.5
Inflation (%, eop)	new	3.2	7.4	7.8	**4.5**	**3.4**	**3.6**
	previous				4.6	3.5	3.7
Monetary policy rate (%, eop)	new	4.25	5.50	10.50	**11.25**	**9.00**	**7.00**
	previous				11.25	8.25	6.25
Exchange rate (ppd, eop)	new	20.0	20.9	19.6	**18.0**	**18.5**	**19.1**
	previous				18.5	18.8	18.8
M10 (%, eop)	new	5.5	7.6	9.0	**9.6**	**8.6**	**7.9**
	previous				9.2	8.4	7.7
Fiscal balance (% of GDP)	new	-2.8	-2.8	-3.2	**-3.3**	**-4.9**	**-3.0**
	previous				-3.9	-3.1	-2.5
Current account (% of GDP)	new	1.9	-0.7	-1.3	**-0.9**	**-1.0**	**-1.4**
	previous				-1.3	-1.3	-1.4

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Research

Mexico Economic Outlook

December 2023

Creating Opportunities