BBVA Research

Mexico Economic Outlook

March 2024

Creating Opportunities

BBVA Research

01

Global Economic Outlook 1Q24

Creating Opportunities

Main messages

Recent developments	Tight monetary conditions have hit the manufacturing sector, but services remain resilient, mainly in the US. The latter has prevented a faster disinflation, which together with geopolitical risks, have kept central banks cautious. Markets have scaled back aggressive monetary easing expectations, but financial volatility remains limited.
Inflation and rates outlook	Inflation is expected to slow further moving ahead, as service pressures are likely to subside, assuming no new supply shocks emerge. That would set the conditions for the Fed and the ECB to gradually cut rates from the middle of this year onwards.
Growth outlook	Growth is likely to lose steam, although not as much as expected, in the US, and to remain relatively weak in the Eurozone and China over the next few quarters. Some recovery is forecast from the second half of the year, driven by lower inflation and lower interest rates, but not in China, where structural deceleration factors are expected to prevail. Still, the Eurozone recovery will likely be weaker than anticipated.
Structural factors	Geopolitics will significantly influence future economic dynamics, molding policies and global conflicts. It will potentially increase uncertainty and trigger supply shocks. Combined with other factors, such as demographics and fiscal policy, these shocks will pressure inflation, compelling central banks to keep policy interest rates above pre-COVID levels.

Supply normalization and (surprisingly slow) demand weakening amid high interest rates have triggered an (incomplete) easing of growth and inflation

Main scenario drivers

Waning supply shocks: easing of commodity prices and bottlenecks, despite geopolitical tensions

Demand moderation, on monetary tightness, but backed by fiscal policy and labor markets

Recent macro trends

Declining inflation, which is still above targets, mostly on service pressures

Growth soft-landing: manufacturing weakness, but resilience services

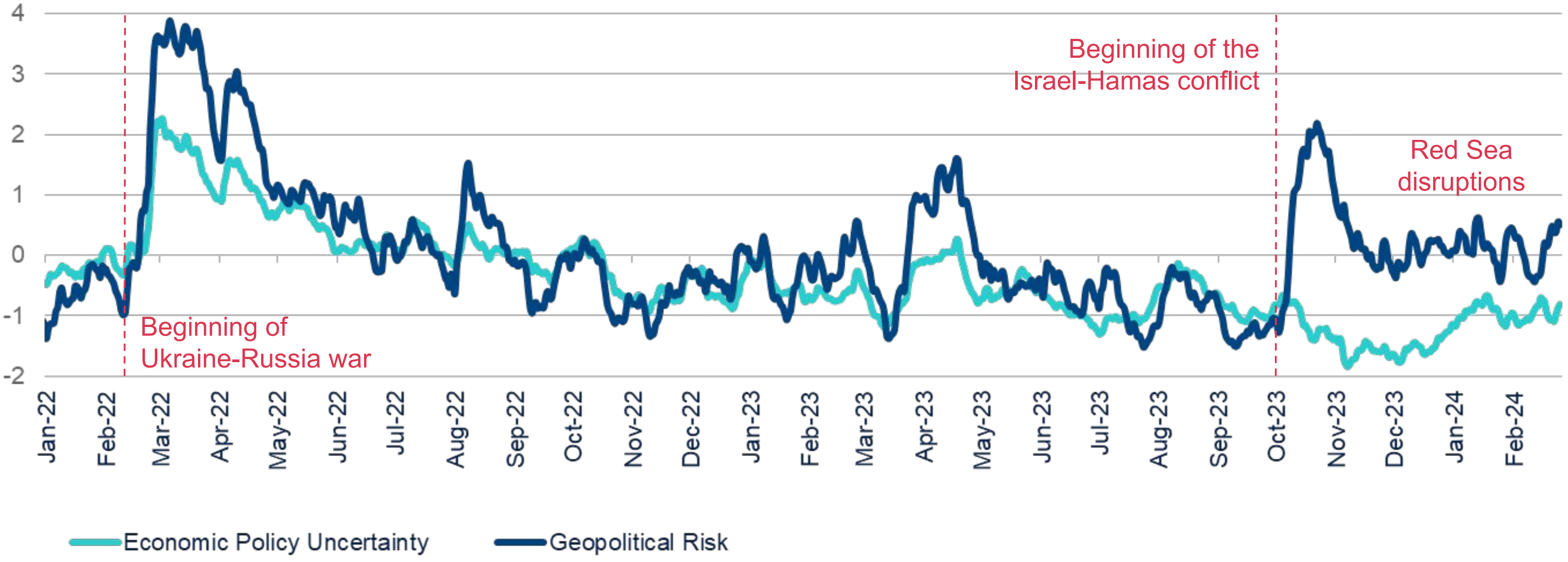
Central banks and financial markets

Rate-hiking cycles seem over; focus on timing and speed of coming easing cycles

Limited financial volatility, despite the scaling back of sharp monetary easing expectations

The geopolitical context continues to be a source of concern; the conflict in the Middle-East has escalated somewhat, with limited economic effects so far

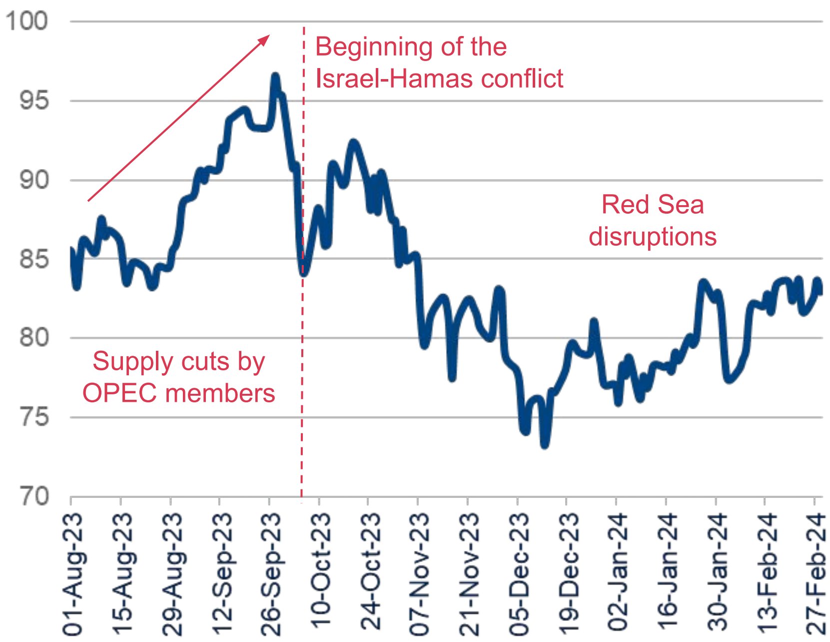
GEOPOLITICAL RISK AND ECONOMIC POLICY UNCERTAINTY IN G3 REGIONS (*)
(INDEXES: AVERAGE SINCE 2019 EQUALS TO 0, 28-DAY MOVING AVERAGE)



(*): G3 regions: U.S., Eurozone and China.
Source: BBVA Research Geopolitics Monitor.

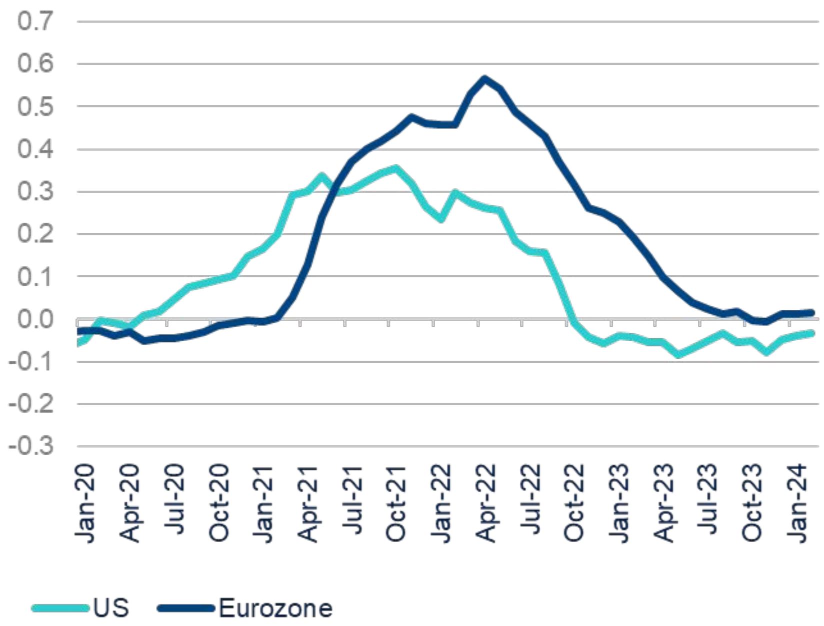
Despite geopolitical tensions, including the maritime disturbances in the Red Sea, commodity prices and bottleneck disruptions remain relatively low

BRENT PRICES
(USD PER BARREL)



Source: BBVA Research based on data from Haver.

BBVA RESEARCH BOTTLENECKS INDICATOR
(INDEX)

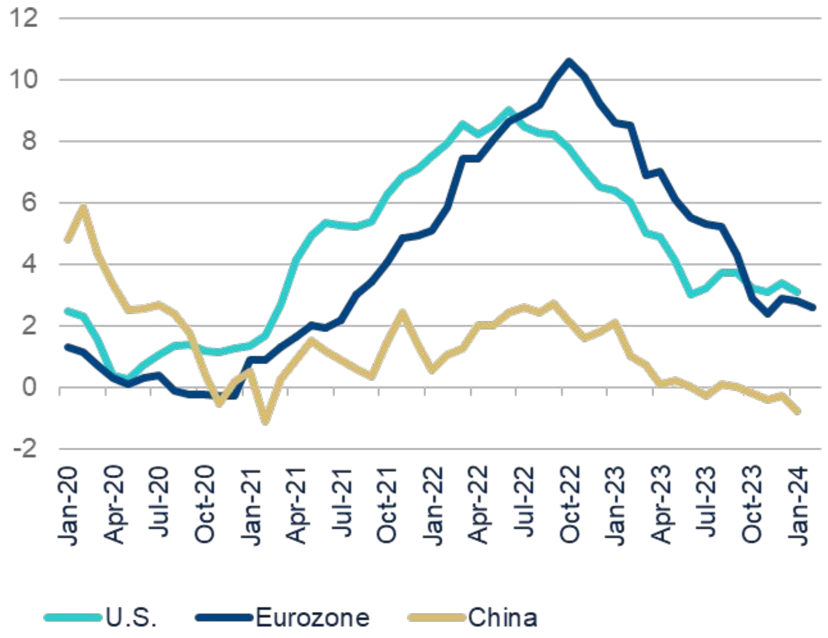


Source: BBVA Research based on data from Haver Analytics.

The disinflationary trend has lost some steam in the last few months, amid resilient service inflation; in China, deflation fears remain alive

CPI INFLATION: HEADLINE

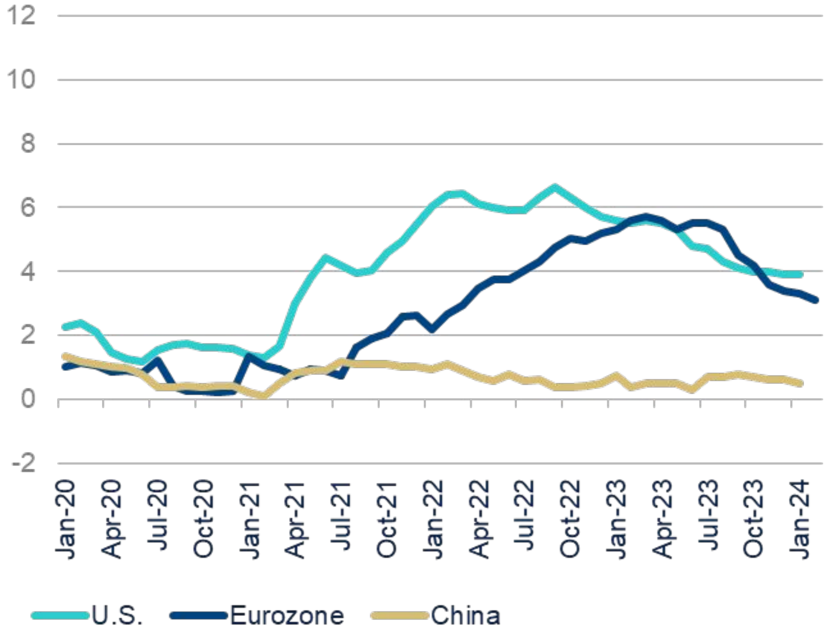
(Y/Y %)



Source: BBVA Research based on data from Haver.

CPI INFLATION: CORE

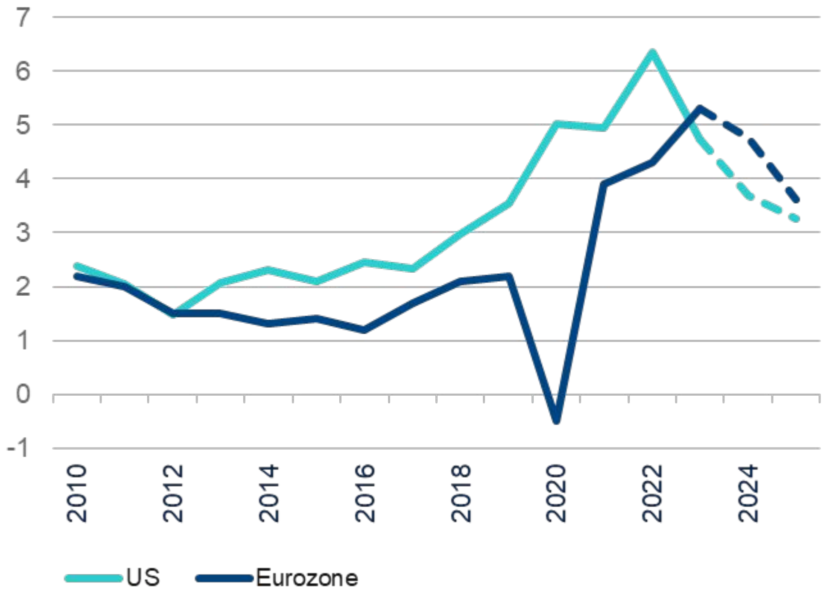
(Y/Y %)



Source: BBVA Research based on data from Haver.

Tight labor markets, fiscal policy and excess savings are still supporting growth, partially offsetting the contractionary impact of monetary policy

NOMINAL WAGES: ANNUAL GROWTH (*)
(%)



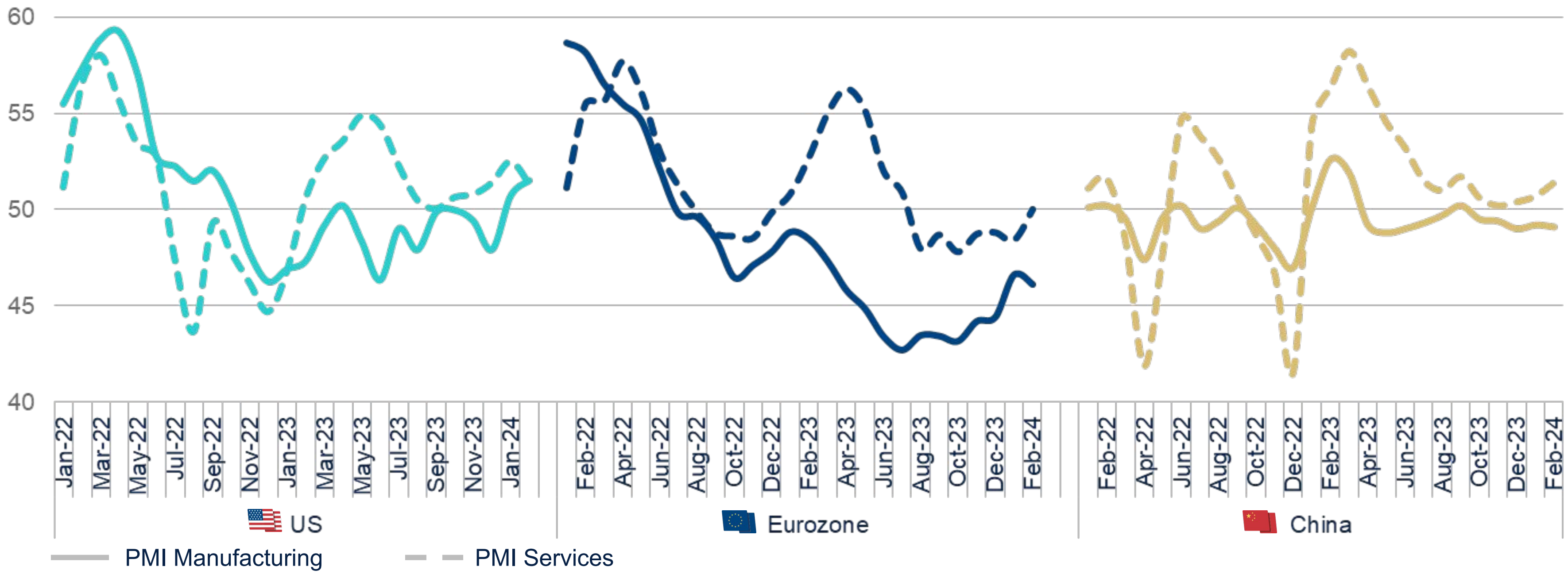
(*) 2024 and 2025 figures: simulated paths consistent with BBVA Research activity and inflation forecasts. US data: average hourly earnings of production and nonsupervisory employees, total private. Eurozone data: compensation per employee
Source: BBVA Research based on data from the BLS and Eurostat.

- Some factors continue backing activity, mainly the services sector, but less than before:
  - labor markets: low unemployment and robust wage growth;
  - fiscal policy: robust spending;
  - excess savings: still supportive.
- Anyway, monetary tightening has favored a gradual growth slowdown:
  - borrowing costs have increased;
  - bank lending has sharply eased;
  - exchange rate has appreciated (at least in US)
  - inflation expectations have remained broadly anchored (slightly above 2%).

Growth remains more positive in the US and in the services sector, but after a previous slowdown there are now preliminary recovery signs in other markets

PMI INDICATORS

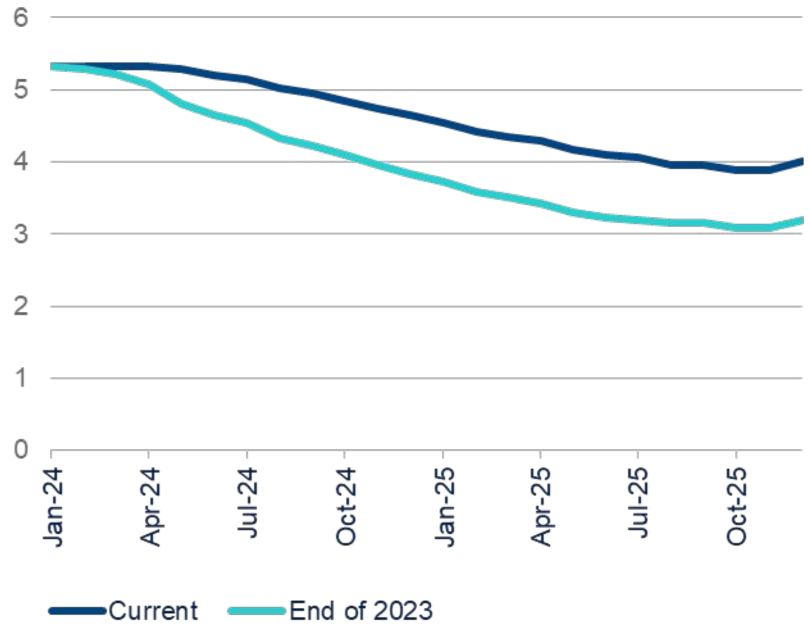
(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)



Source: BBVA Research based on data from Haver.

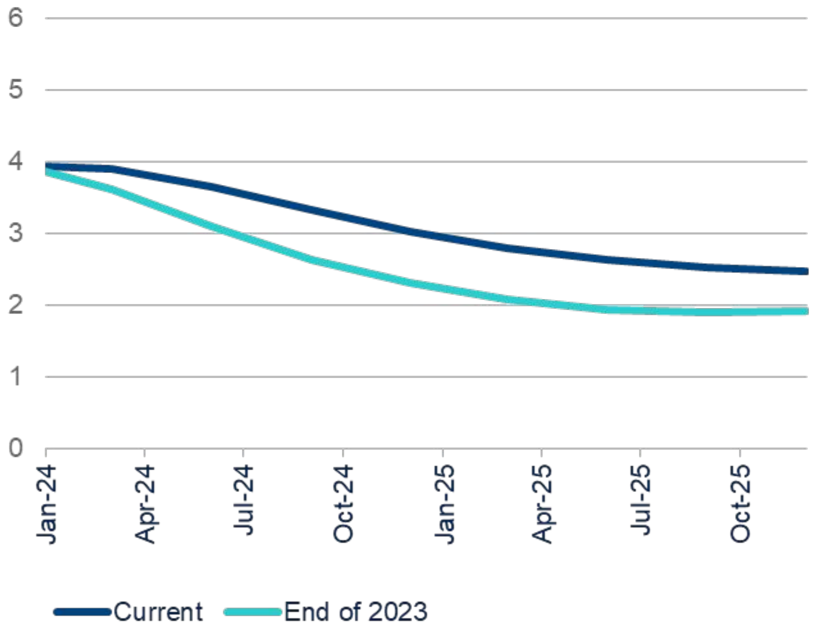
Markets have scaled back their expectations for aggressive easing following the latest macro data and signs of caution from central banks

US: IMPLICIT RATE IN FED FUND FUTURES (%)



Source: BBVA Research based on Bloomberg.

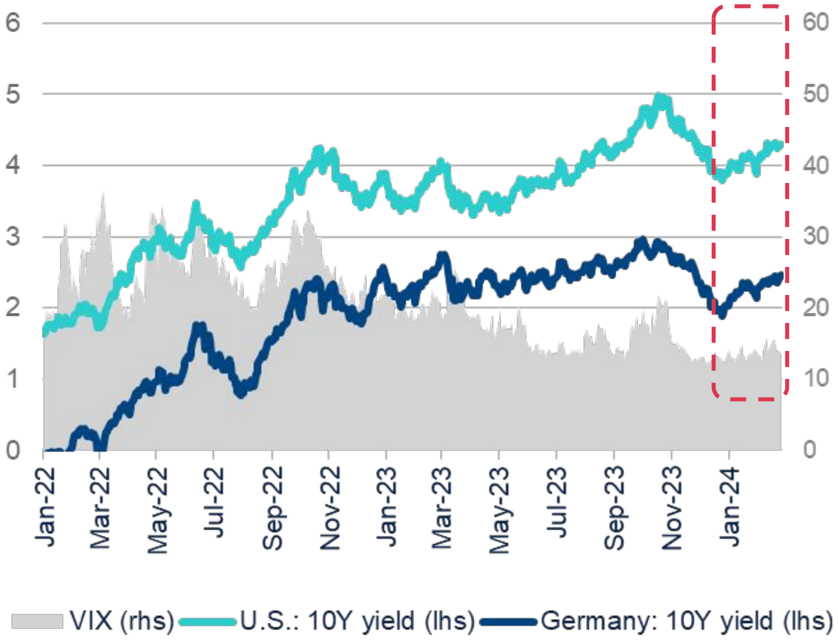
EZ: IMPLICIT RATE IN 3-MONTH EURIBOR FUTURES (*) (%)



(*) Depo interest rates.
Source: BBVA Research based on Bloomberg.

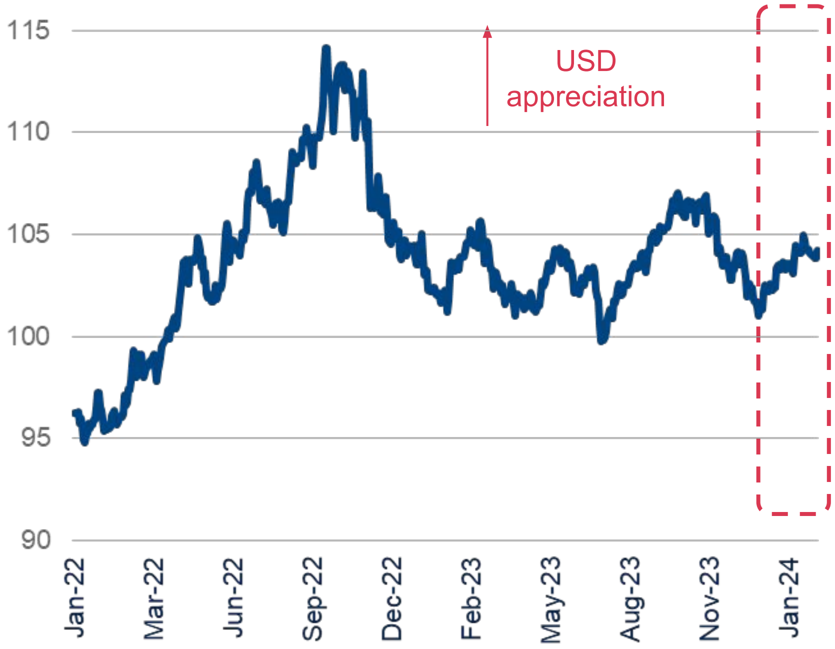
Despite the recent increase in sovereign yields, the USD strength and fears on bank's CRE exposition, volatility remains limited on markets soft-landing view

SOVEREIGN YIELDS AND VOLATILITY
(%, INDEX)



Source: BBVA Research based on Bloomberg.

US DOLLAR: DXY
(INDEX)

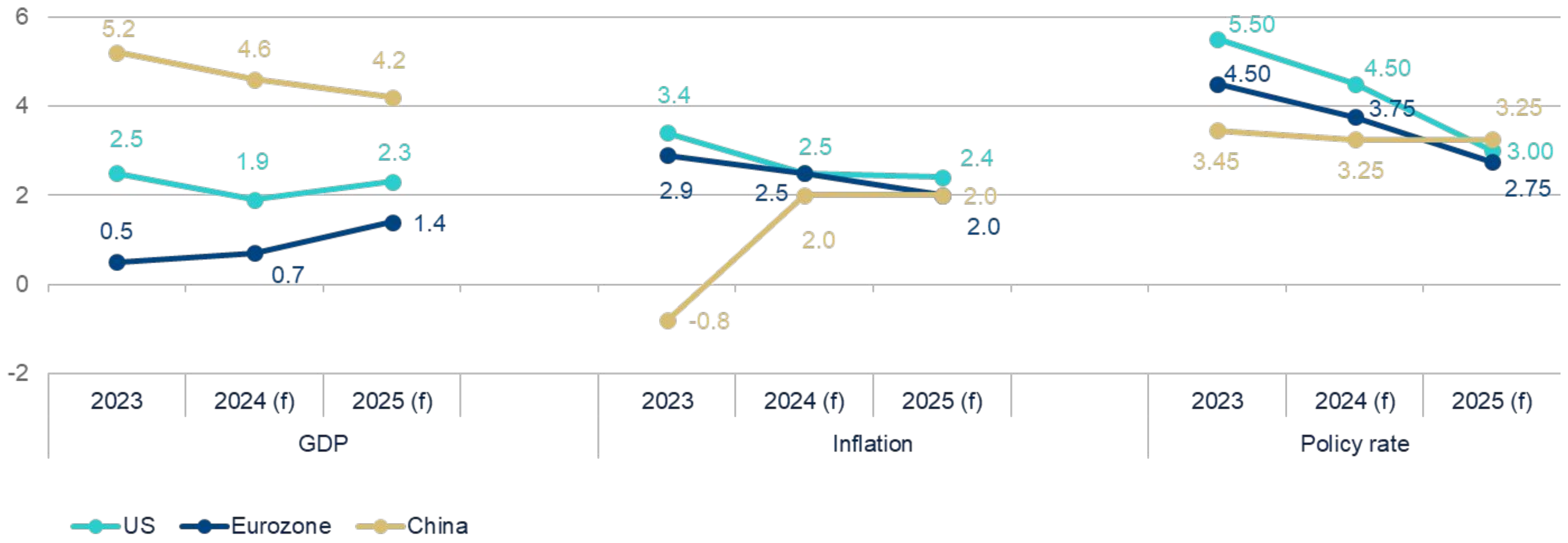


Source: BBVA Research based on Bloomberg.

Global outlook: weak growth will lead to an extra easing of inflation and rate cuts from mid-2024; still, price pressures and interest rates will remain relatively high

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

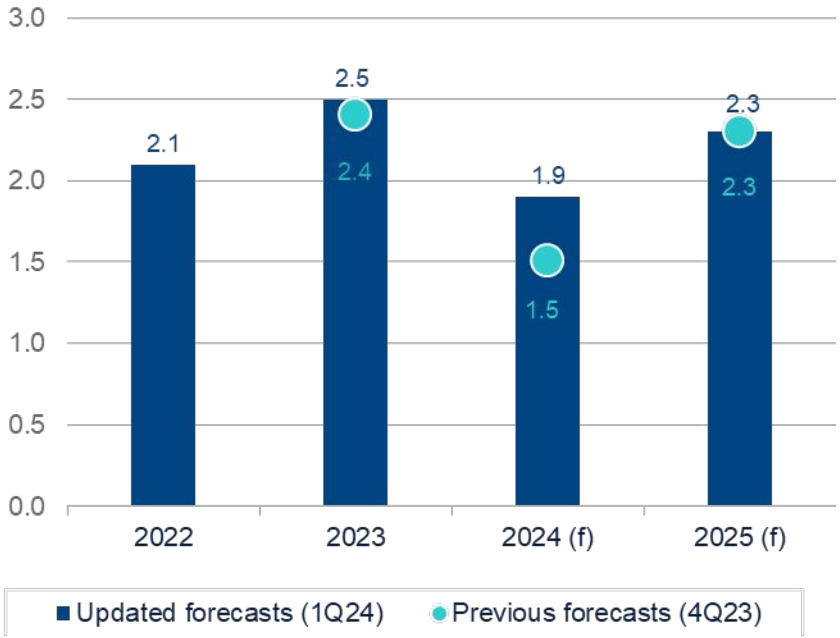
(GDP GROWTH: %, INFLATION: YOY %, EOP, POLICY INTEREST RATES: %, EOP)



(*) Global GDP growth: 3.1% (+0.1pp in comparison to previous estimation), 3.1% (+0.1pp) in 2024 in 2024 and 3.3% (+0.0) in 2025.
(**) In the case of the Eurozone, interest rates on refinancing operations.
Source: BBVA Research.

U.S.: demand strength supports a higher growth in 2024, but a moderation is still likely ahead, which would allow a cautious Fed to cut rates from mid-year

U.S.: GDP GROWTH
(%)



(f): forecast.
Source: BBVA Research.

- Internal demand and service inflation remains resilient, but further easing is likely on excess savings depletion and tight monetary conditions.
- Extra inflation moderation (forecasts remain broadly unchanged) would pave the way for a monetary easing from May/24, supporting a growth recovery from late this year.
- The risks are balanced: there could be a greater decline in growth and inflation, although it is possible, but not very likely, that strong growth prevents inflation from converging to 2% and an early decline in rates.
- Risks: presidential elections, recession or financial stress on high rates, expansive fiscal stance.

Research

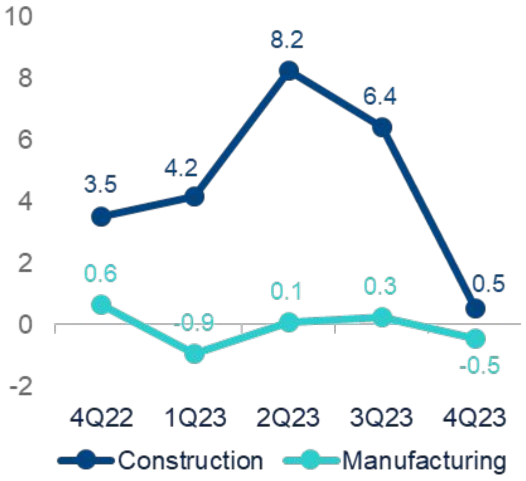
02

We anticipate a moderation in GDP growth and in the pace of job creation in 2024

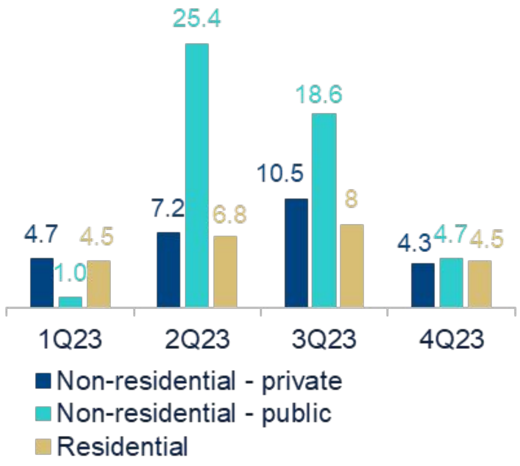
Strong deceleration in 4Q23 (0.1% Q/Q), with contraction in industry (-0.1%) and modest performance in the tertiary sector (0.3%)

GDP
(Q/Q%, REAL, SA)

GDP: SELECTED SECTORS
(Q/Q%, REAL, SA)



VALUE OF CONSTRUCTION: NATIONAL SURVEY OF CONSTRUCTION COMPANIES
(Q/Q%, REAL, SA)

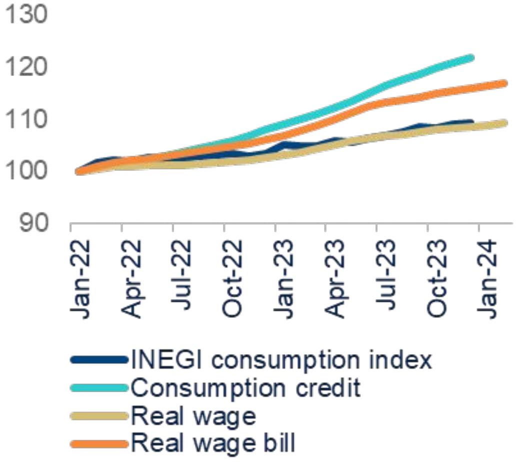


Source: BBVA Research, INEGI and Banxico.

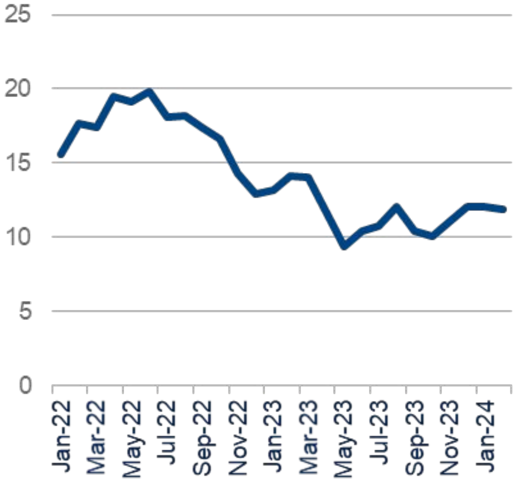
Nonresidential construction slowed significantly in 4Q23; manufacturing is losing ground due to deceleration in external demand. The wholesale sector and related services are losing momentum within the tertiary sector.

Gains in real wages and the trend toward lower savings would prevent a contraction in private consumption

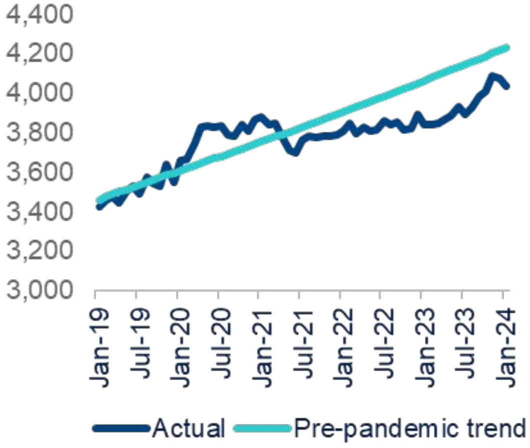
PRIVATE CONSUMPTION AND ITS DETERMINING FACTORS
(MOVING 3-MONTH AVERAGE, INDEX JAN/2022=100, REAL, SA)



BBVA RESEARCH BIG DATA CONSUMPTION INDICATOR
(Y/Y%, MOVING AVG. 3 MONTHS, REAL)



DEPOSITS IN THE FINANCIAL SYSTEM: HOUSEHOLD BALANCES
(BILLIONS OF PESOS, REAL, SA)

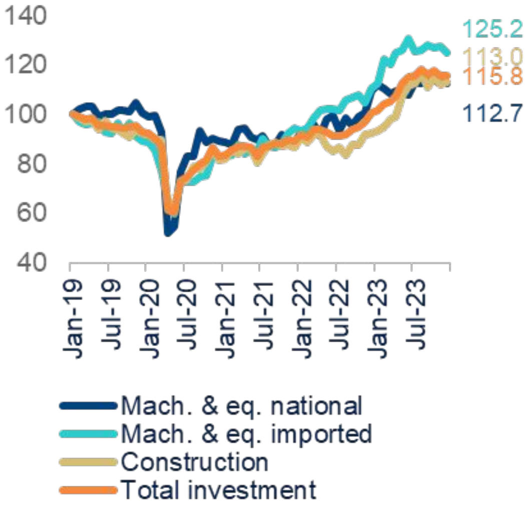


Source: BBVA Research, INEGI and Banxico.

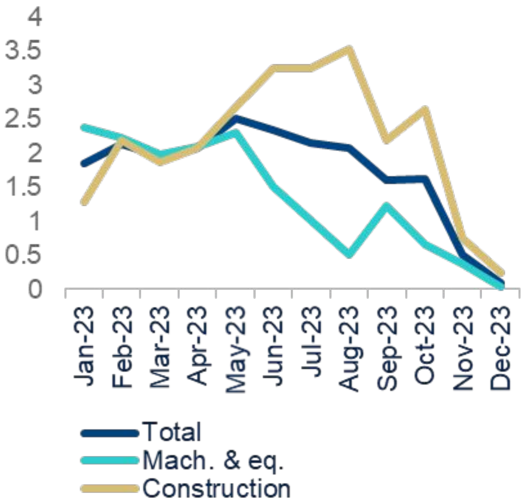
The balance of household deposits held by the financial system is 4.5% below its pre-pandemic trend, indicating a lower trend in savings; the advance of pensions for the elderly should have a positive effect on private spending in 1Q24.

Investment: strong slowdown in construction with loss of momentum in the machinery and equipment segment

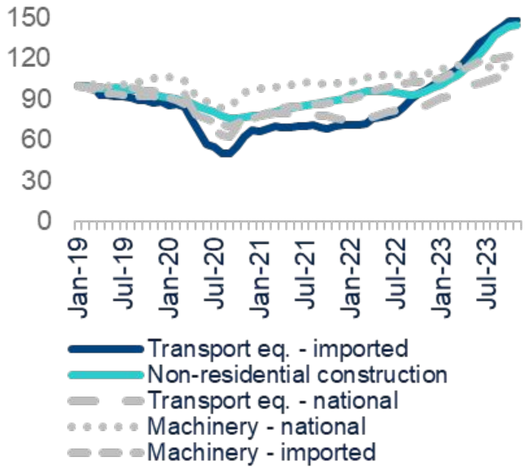
GROSS FIXED INVESTMENT
(INDEX JAN/2019=100)



GROSS FIXED INVESTMENT
(M/M%, 6-MONTH MOVING AVERAGE)



NON-RESIDENTIAL CONSTRUCTION VS. INVESTMENT COMPONENTS (6-MONTH MOVING AVERAGE, INDEX JAN/19=100)

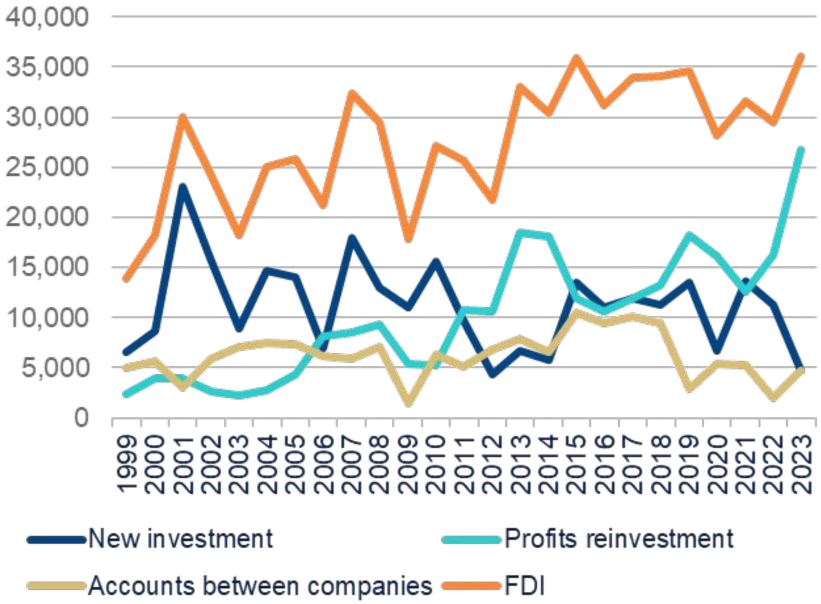


Source: BBVA Research and INEGI.

The momentum in investment of transportation equipment in 2023 coincided with the dynamism of non-residential construction; slowdown in both segments since 4Q23 due to lower public investment.

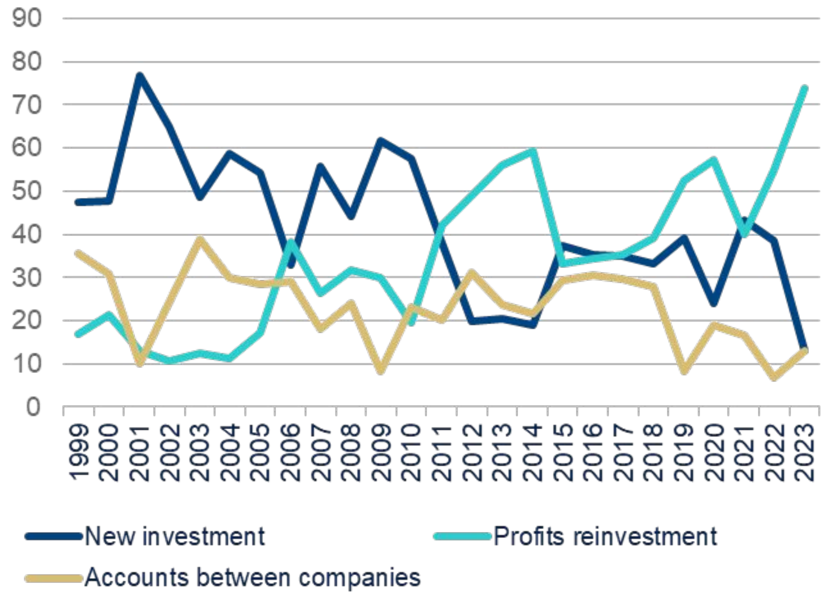
New investment only represents 13% of total FDI flows to Mexico in 2023

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



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

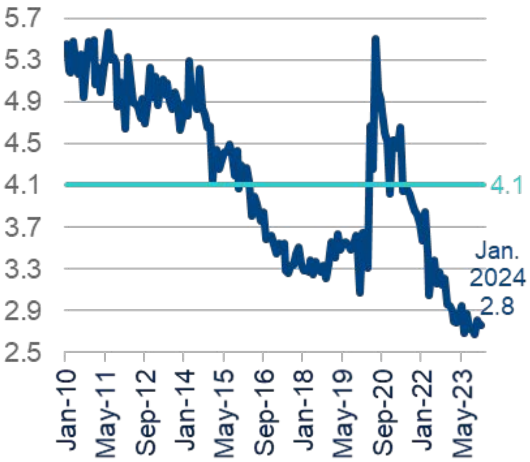
FDI FLOWS TO MEXICO AND MAIN COMPONENTS*
(% OF TOTAL)



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

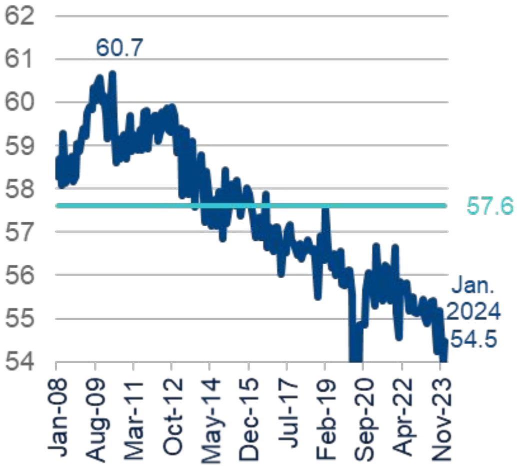
Labor market still shows mixed signals: below-average unemployment and labor informality and a slowdown in formal employment ...

UNEMPLOYMENT RATE
(% OF EAP, SA)



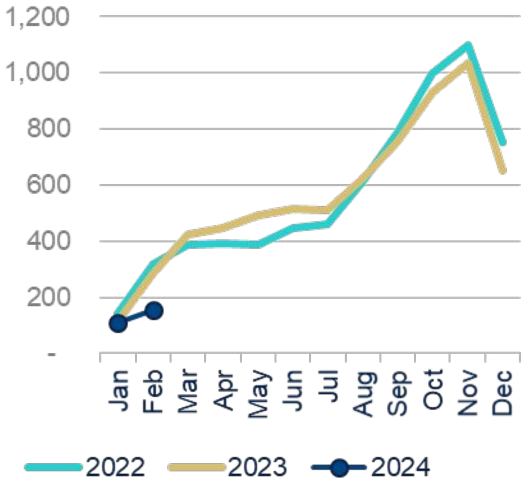
Average from 2005 to 2023.

LABOR INFORMALITY RATE (% EMPLOYED, SA)



Average from 2005 to 2023.

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

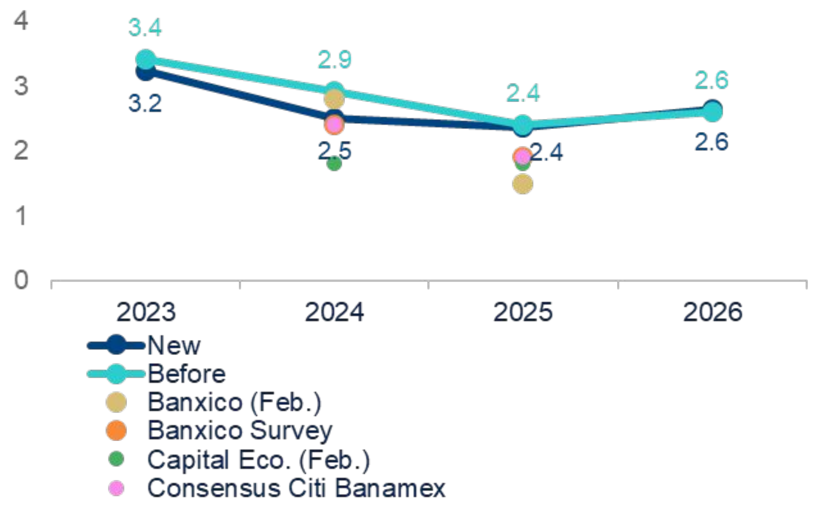


Source: BBVA Research based on data from INEGI and IMSS.

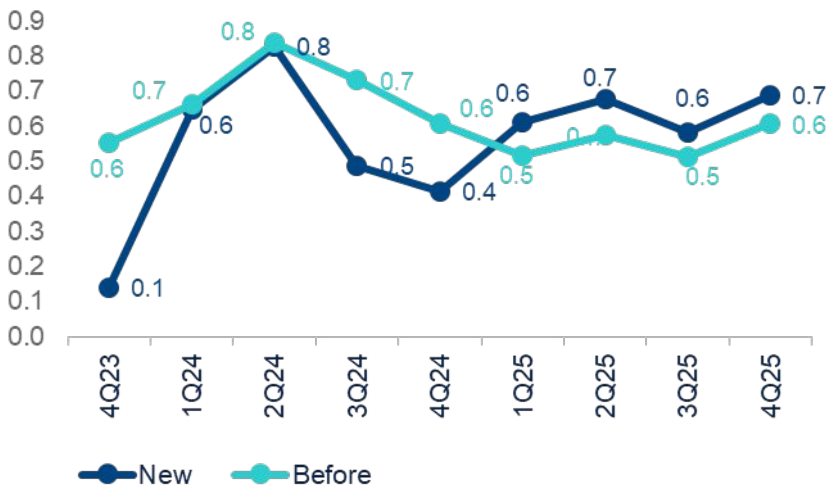
Formal employment in February showed year-on-year growth of 2.9%, a rate 2.5 and 0.5 percentage points lower than February 2022 and 2023, respectively.

We revised our growth estimate for 2024 downward to 2.5% (previously 2.9%) in light of the lower-than-anticipated figure in 4Q23

GDP
(% ANNUAL CHANGE, REAL, SA)



GDP
(Q/Q%, REAL, SA)

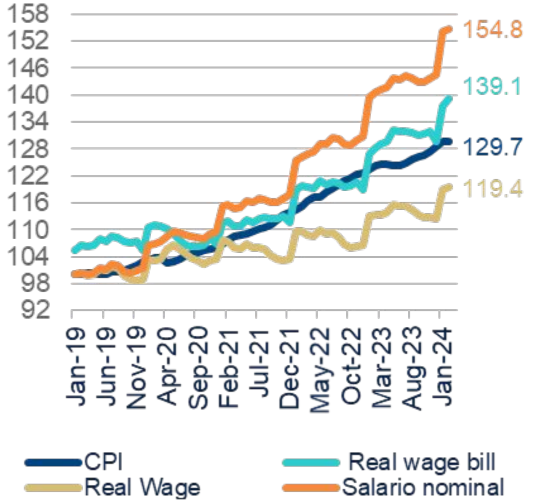


Source: BBVA Research and INEGI.

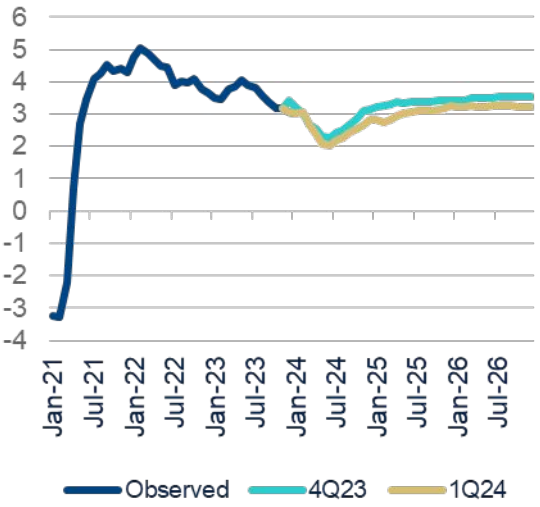
The relative resilience of private consumption and higher public spending should prevent a further slowdown this year.

Based on our GDP growth scenario, we expect the gradual slowdown in formal job creation to continue

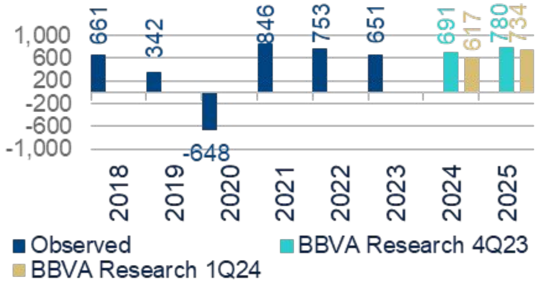
REAL WAGES AND REAL TOTAL WAGE BILL, IMSS (INDEX JAN.-2019 = 100)[1]



JOBS AFFILIATED WITH THE IMSS (ANNUAL CHANGE, %)



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



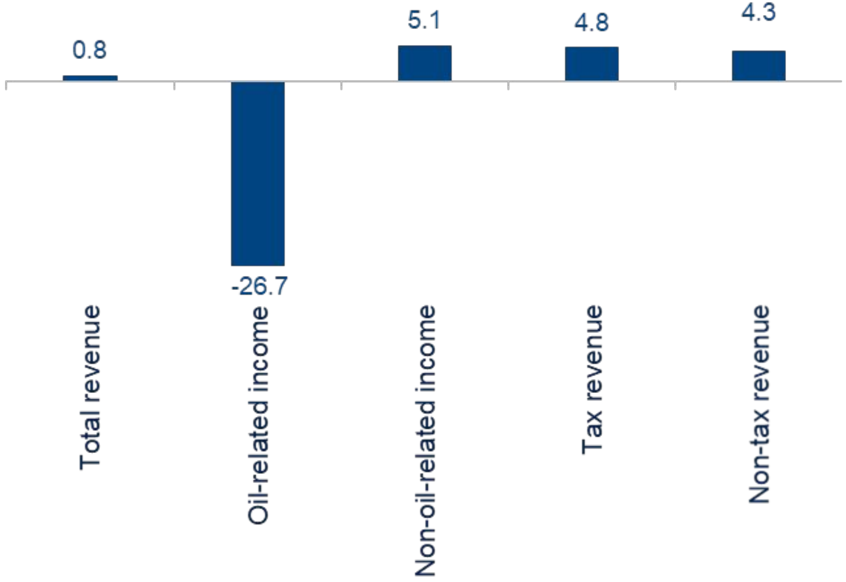
Forecast	2024	2025	2026	2027
Thousands, Eop				
BBVA Research 1Q24	**617**	**734**	**754**	**780**
BBVA Research 4Q23	691	780	835	865
Annual Var., % Eop				
BBVA Research 1Q24	**2.8**	**3.2**	**3.2**	**3.2**
BBVA Research 4Q23	3.1	3.4	3.5	3.5

1) Figures as of February 2024.
Source: BBVA Research based on IMSS data.

The total wage bill will show resilience but a slower pace of growth given the expected slowdown in employment

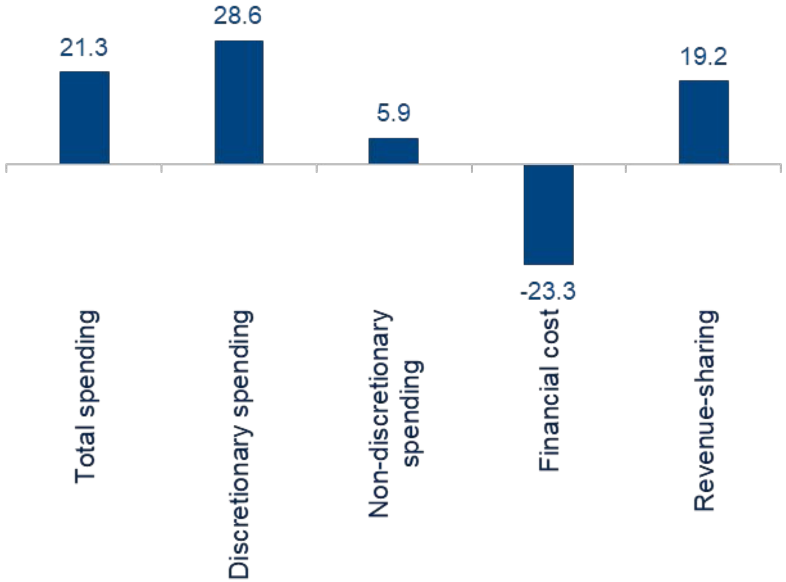
Tax revenue offset the annual fall in oil-related revenue. Public expenditure was driven by subsidies, transfers and contributions

GOVERNMENT REVENUES AND MAIN COMPONENTS IN JANUARY 2024
(% Y/Y REAL)



Source: BBVA Research and SHCP.

PUBLIC EXPENDITURE AND MAIN COMPONENTS IN JANUARY 2024
(% Y/Y REAL)

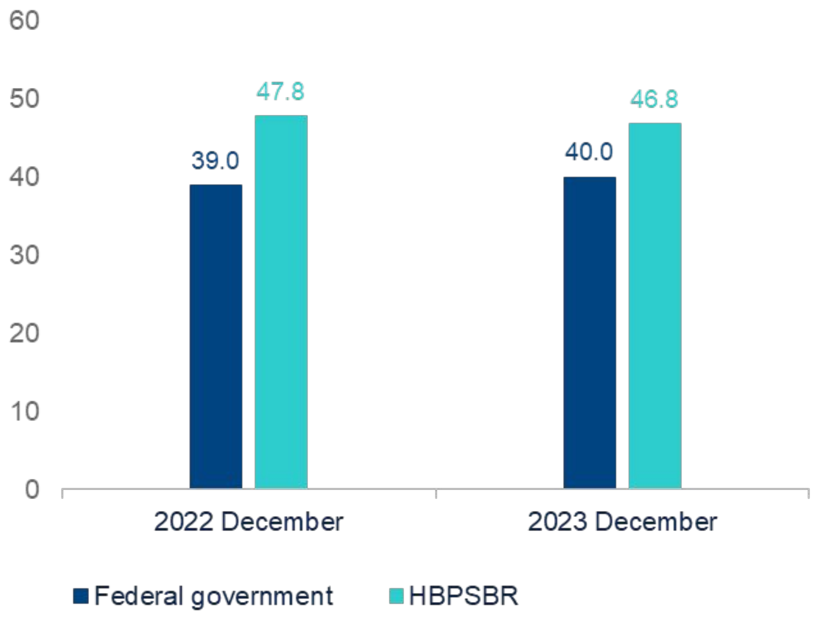


Source: BBVA Research and SHCP.

The external component of the Historical Balance of Public Sector Borrowing Requirements (% of GDP) contributed to the reduction of this ratio between 2022 and 2023

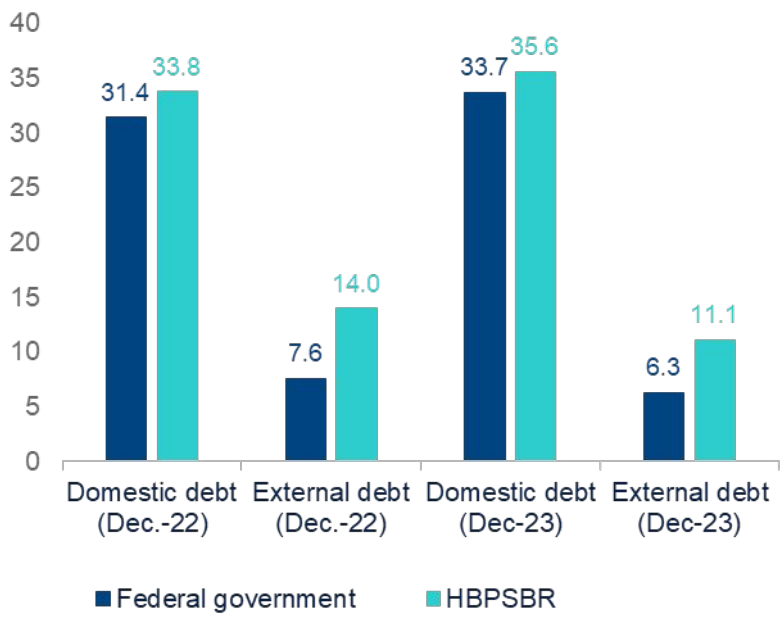
PUBLIC DEBT

(% of GDP)



DOMESTIC AND FOREIGN PUBLIC DEBT

(% of GDP)

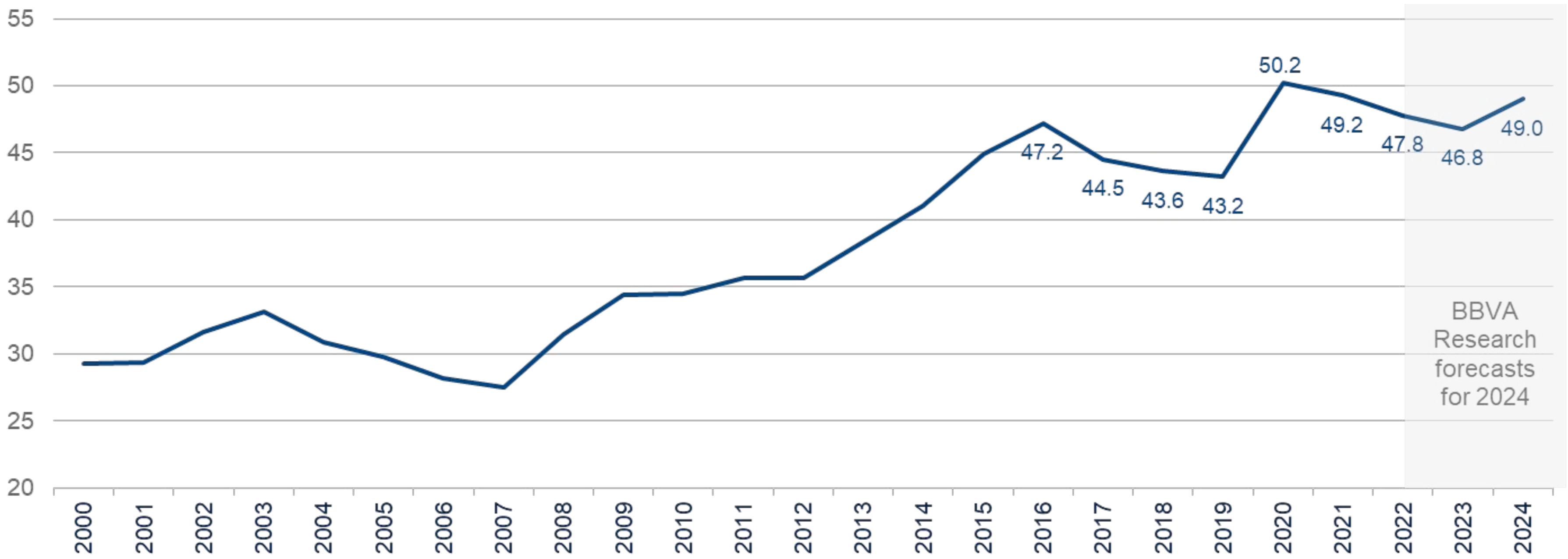


Source: BBVA Research with SHCP. data

Public debt will increase by more than 2 pp in AMLO's last year. Public deficits of around 2.0% of GDP to keep this debt ratio stable

HISTORICAL BALANCE OF THE PUBLIC SECTOR BORROWING REQUIREMENTS

(% OF GDP)



Source: BBVA Research and SHCP.

Research

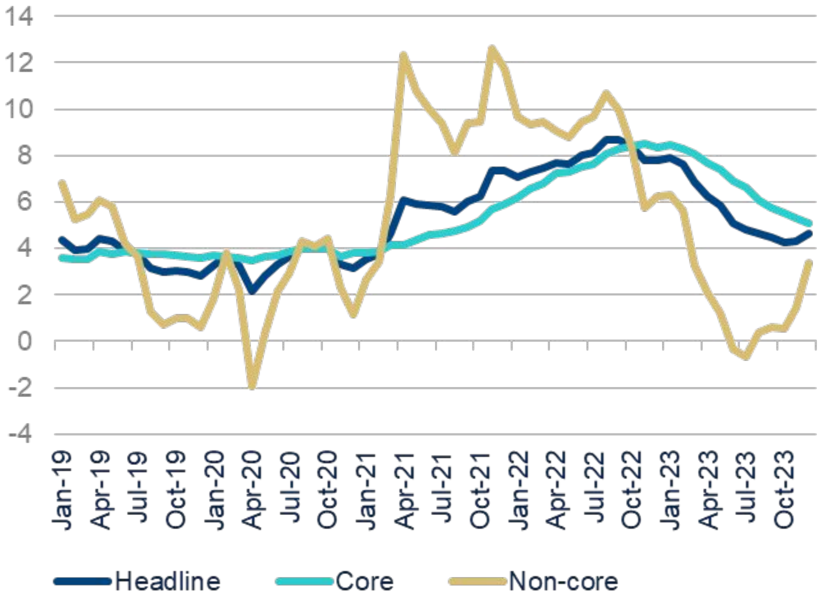
03

We expect lower inflation and lower interest rates in 2024-2025

Inflation continues to cool, but its slowdown is still largely due to a lower goods inflation

BREAKDOWN OF HEADLINE INFLATION

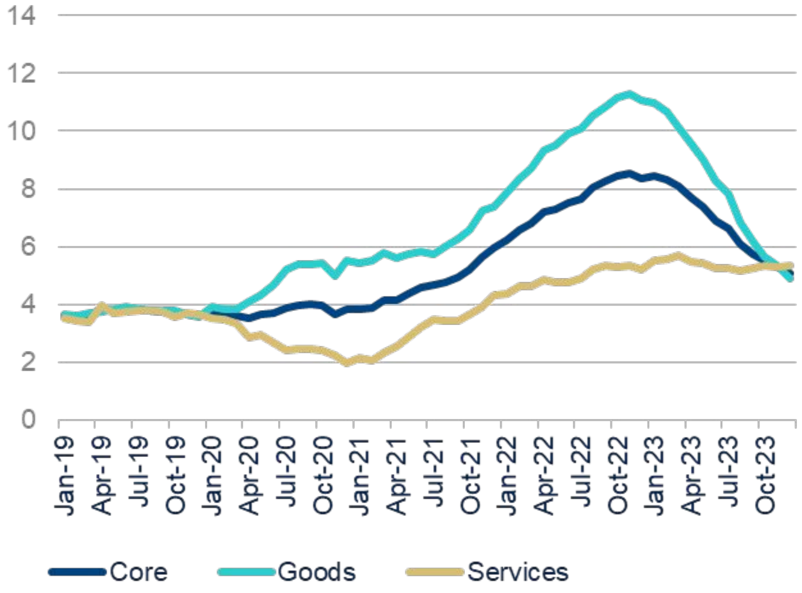
(% RATE OF ANNUAL CHANGE)



Source: BBVA Research and INEGI.

BREAKDOWN OF CORE INFLATION

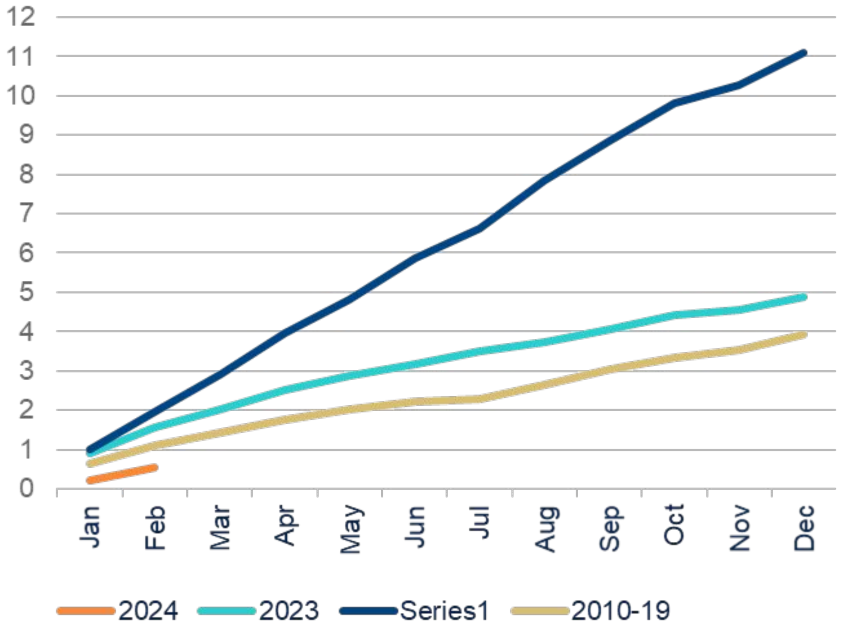
(% RATE OF ANNUAL CHANGE)



Source: BBVA Research and INEGI.

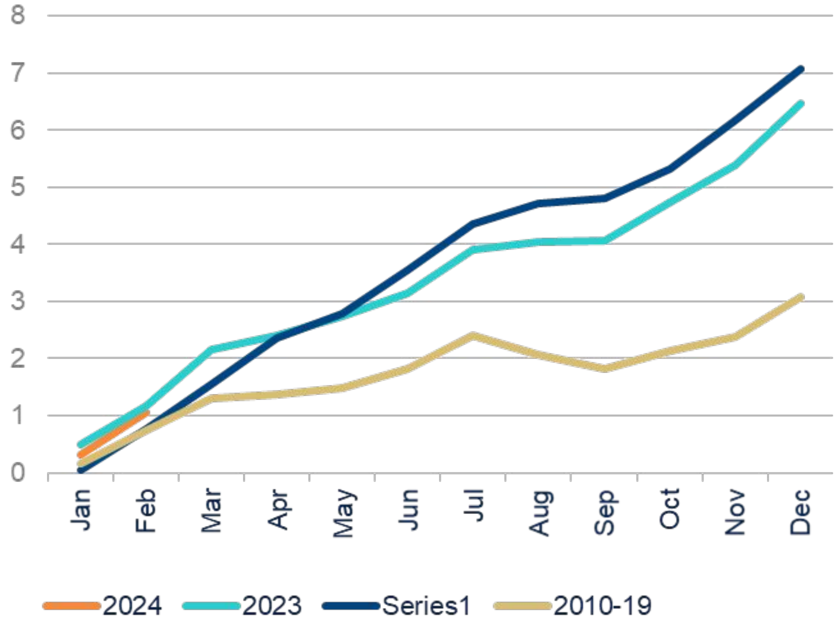
Core services inflations remains sticky to the downside

CUMULATIVE CORE GOODS INFLATION (%)



Source: BBVA Research based on INEGI data.

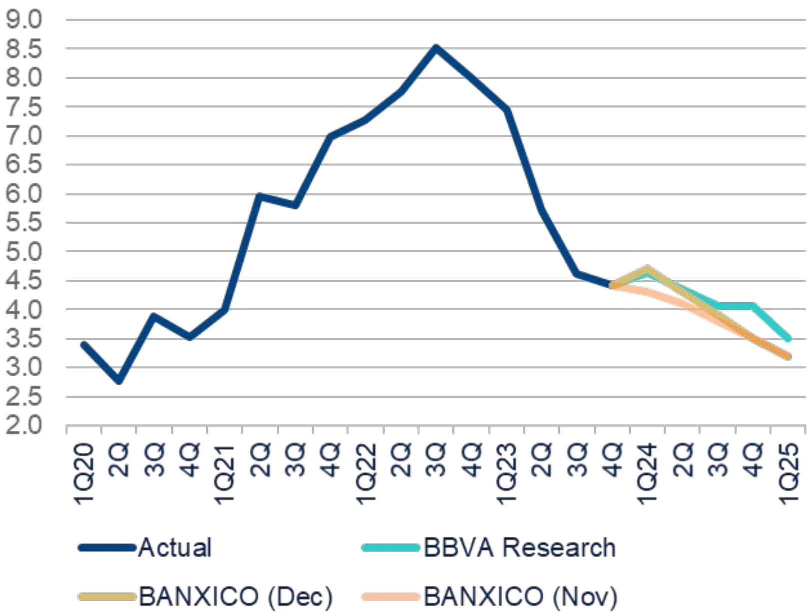
CUMULATIVE CORE SERVICES INFLATION EX-HOUSING AND EDUCATION (%)



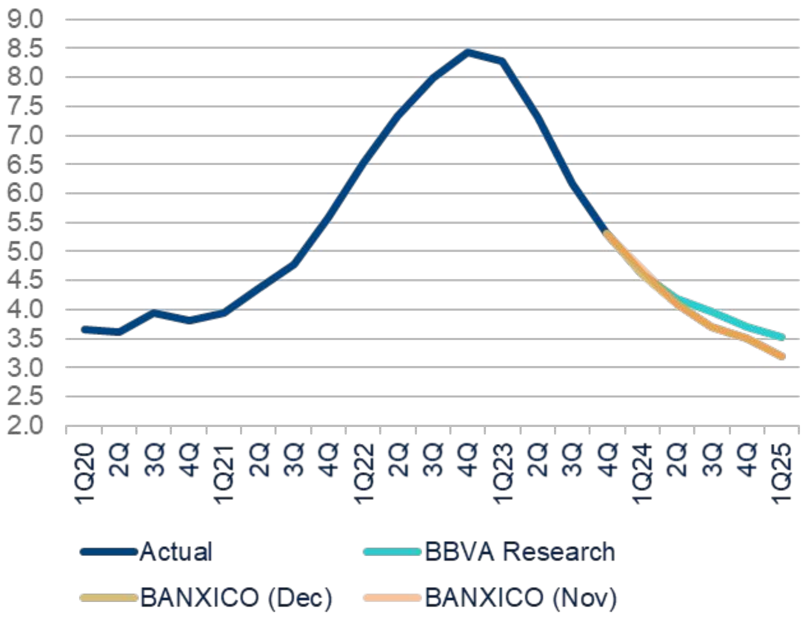
Source: BBVA Research based on INEGI data.

After a transitory rebound in 1Q24, headline inflation will resume a downward path; the core rate could be below 4.0% from 3Q24 onward

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



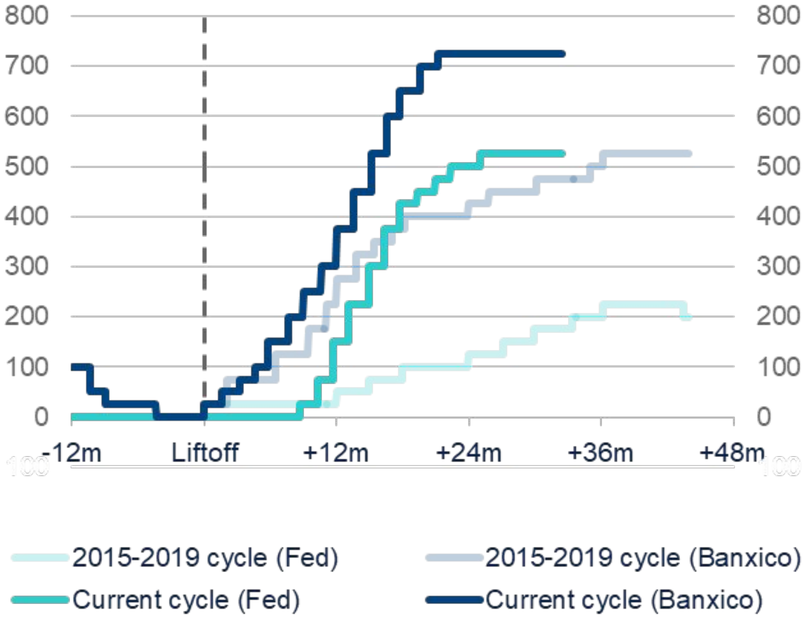
CORE INFLATION FORECASTS
(Y/Y, % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research, INEGI and Banxico.

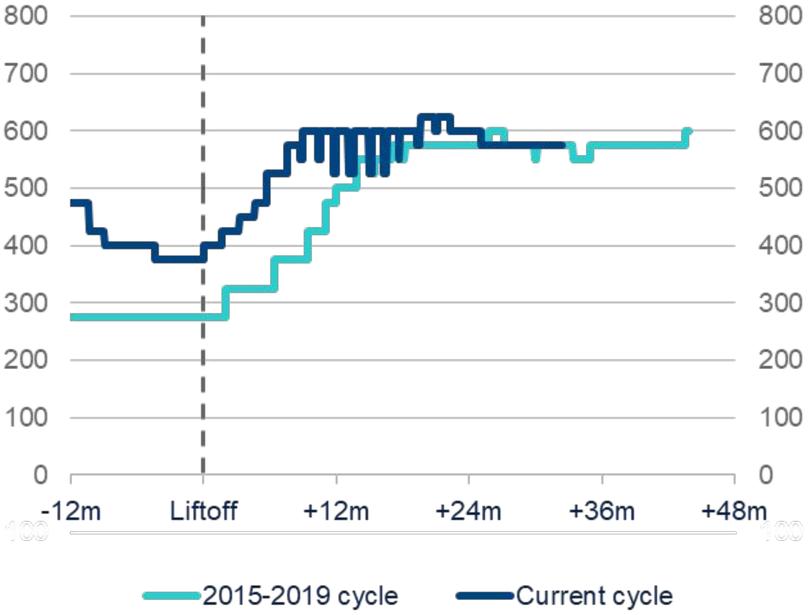
Banxico has kept the policy rate at 11.25% for eleven consecutive months since the last hike in late-March 2023

BANXICO TARGET RATE IN MONETARY TIGHTENING CYCLES
(BPS VS RATE AT LIFTOFF)



The vertical line indicates Banxico's liftoff in each cycle.
Source: BBVA Research and Haver.

MEXICO-US TARGET RATE SPREAD IN MONETARY TIGHTENING CYCLES
(BPS)

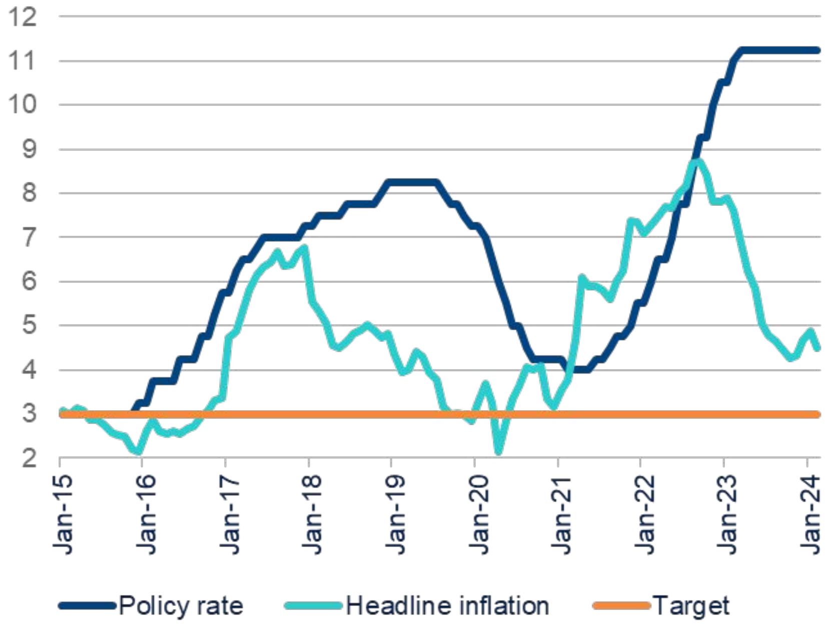


The vertical line indicates Banxico's liftoff in each cycle.
Source: BBVA Research and Haver.

During that period, headline inflation decreased by 2.4 pp and 12-month inflation expectations by 1 pp, which means that…

MONETARY RATE, BANXICO'S INFLATION TARGET AND HEADLINE INFLATION

(% & ANNUAL %)



Source: BBVA Research, Banxico and INEGI.

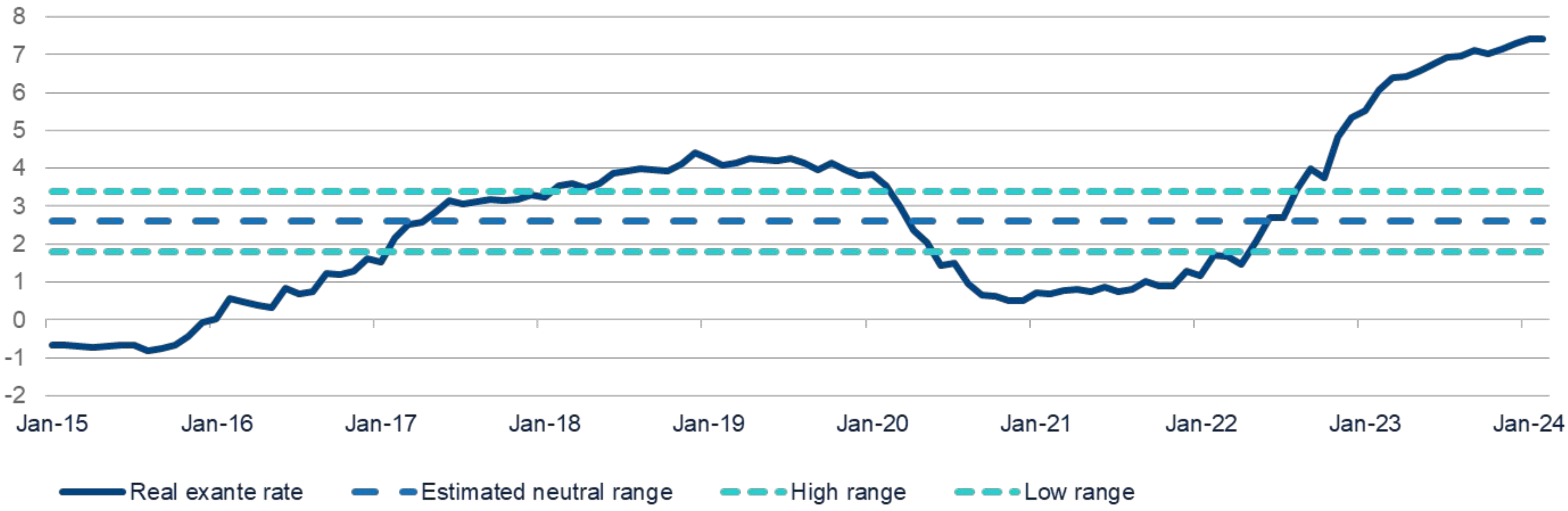
AVERAGE 12-MONTH INFLATION EXPECTATIONS AND INFLATION TARGET

(% ANNUAL)

Source: BBVA Research and Banxico.

... the ex-ante real interest rate has risen from 6.4% to 7.4% and is now 4 pp above the upper limit of the estimated neutral range

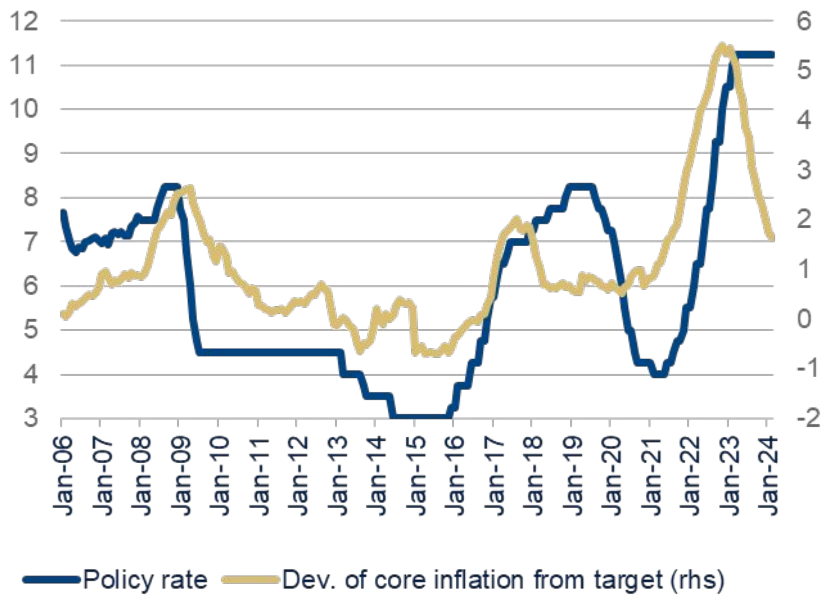
EX-ANTE REAL MONETARY RATE AND ESTIMATED INTERVAL FOR THE LONG-TERM NEUTRAL RATE
(%)



The dotted line corresponds to the midpoint of the interval estimated by Banxico for the neutral rate in the long term in real terms, which is between 1.8 and 3.4%. The shaded area corresponds to the estimated interval in the long term.
Source: BBVA Research, Banxico and INEGI.

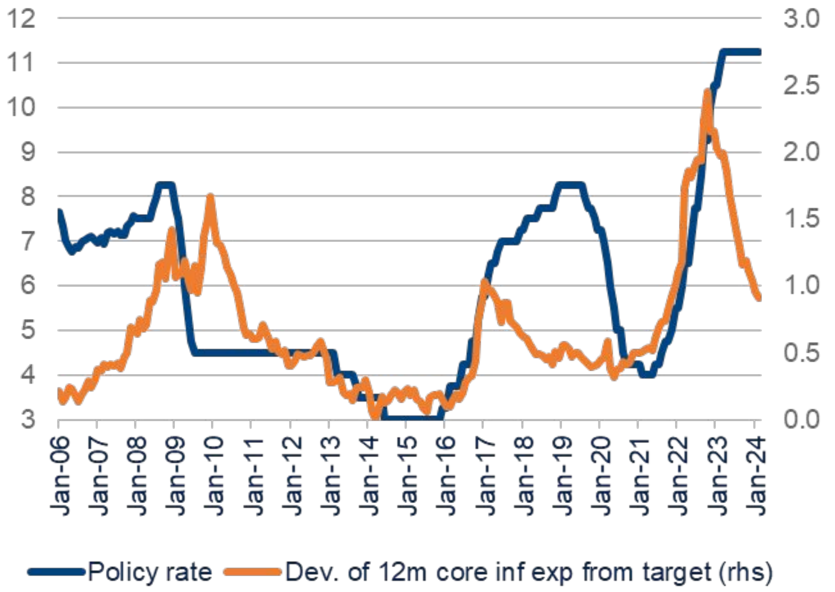
The favorable trend in core inflation and expectations suggest that there is room to start lowering the monetary policy rate...

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



Source: BBVA Research and Banxico.

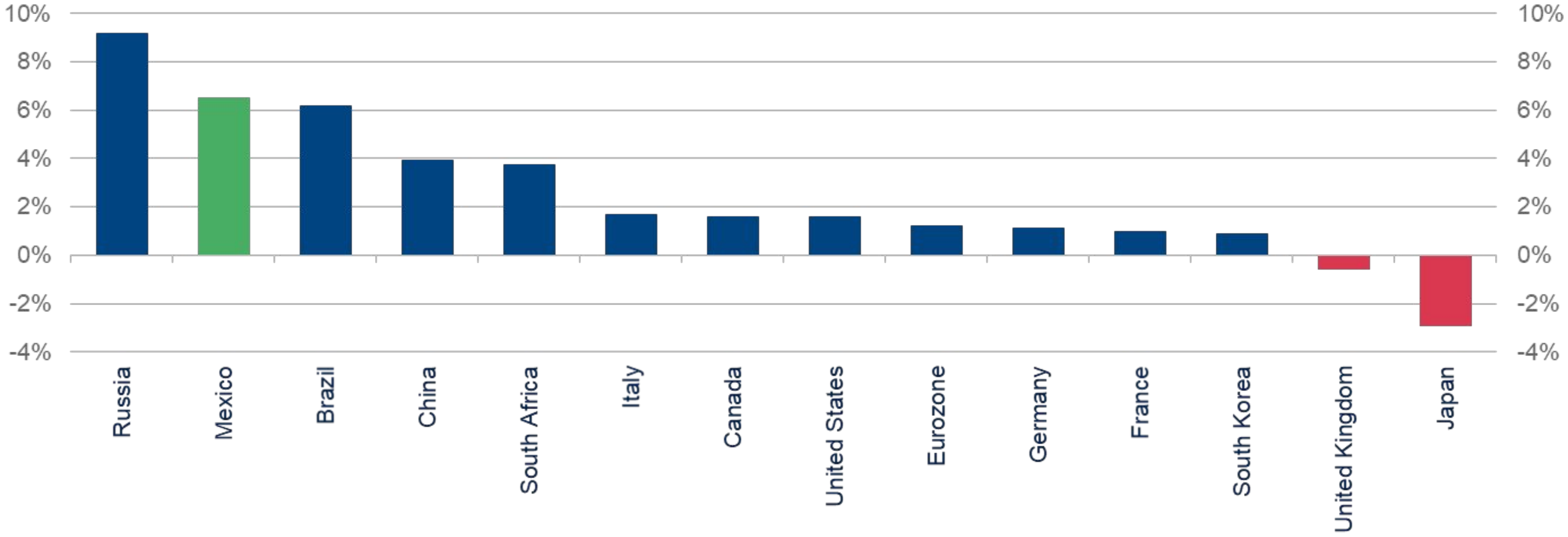
MONETARY RATE AND DEVIATION OF 12-MONTH CORE INFLATION EXPECTATIONS FROM THE TARGET
(% and PP)



Source: BBVA Research and Banxico.

... and we think that well-anchored inflation expectations point to an ample room to begin to gradually normalize the monetary policy stance, ...

POLICY RATE MINUS CORE CONSUMER INFLATION FOR SELECTED G20 COUNTRIES (%)

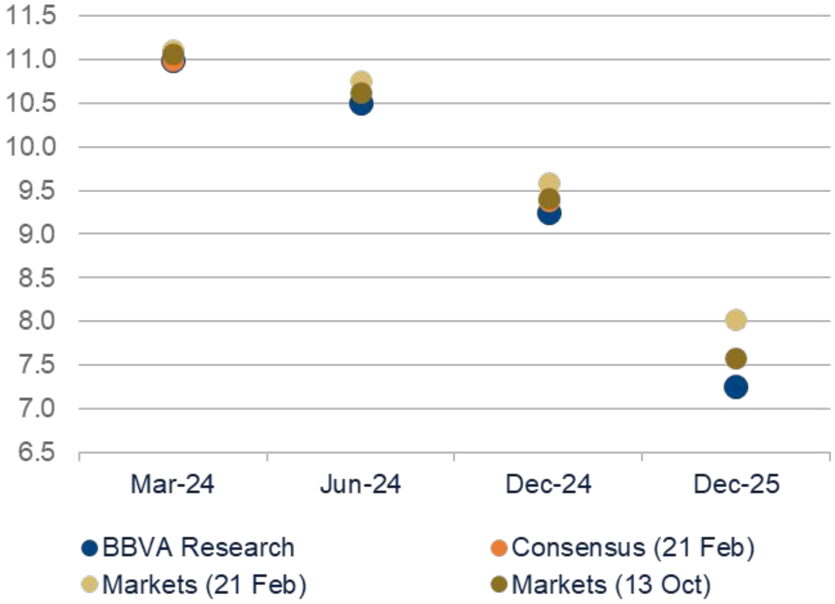


Source: BBVA Research and Bloomberg.

... which we anticipate will remain restrictive for 2024-25 despite the gradual rate cut cycle we expect

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

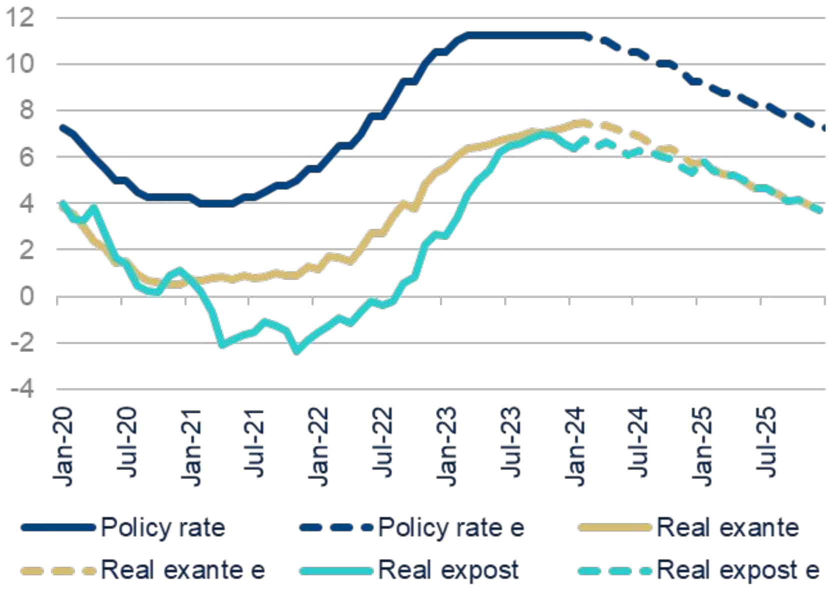
(%)



Source: BBVA Research; Banamex and Bloomberg surveys.

OUTLOOK FOR MONETARY POLICY RATES

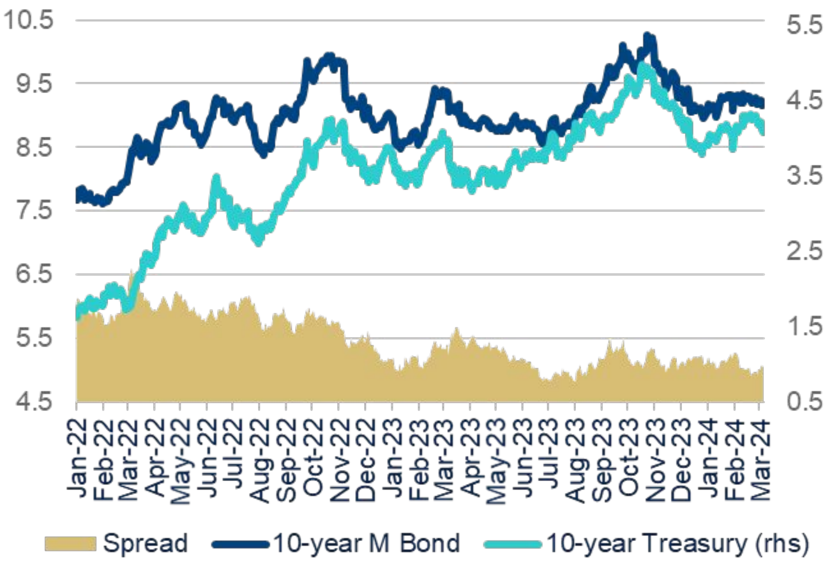
(%)



Source: BBVA Research, Banxico and INEGI.

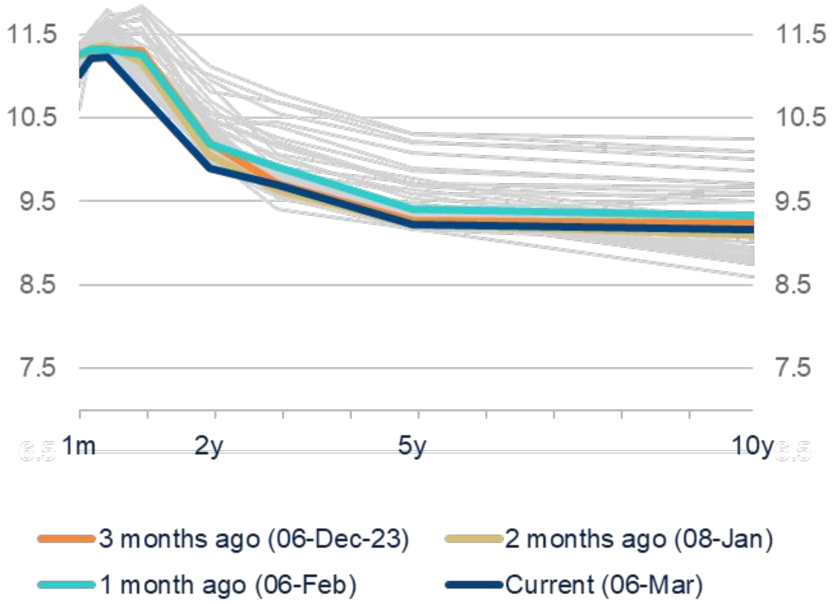
US interest rates rebounded on stronger-than-expected employment and inflation data; in Mexico, they rose to a lesser extent

MEXICO AND US 10-YEAR YIELDS
(%)



Source: BBVA Research, Bloomberg and Haver.

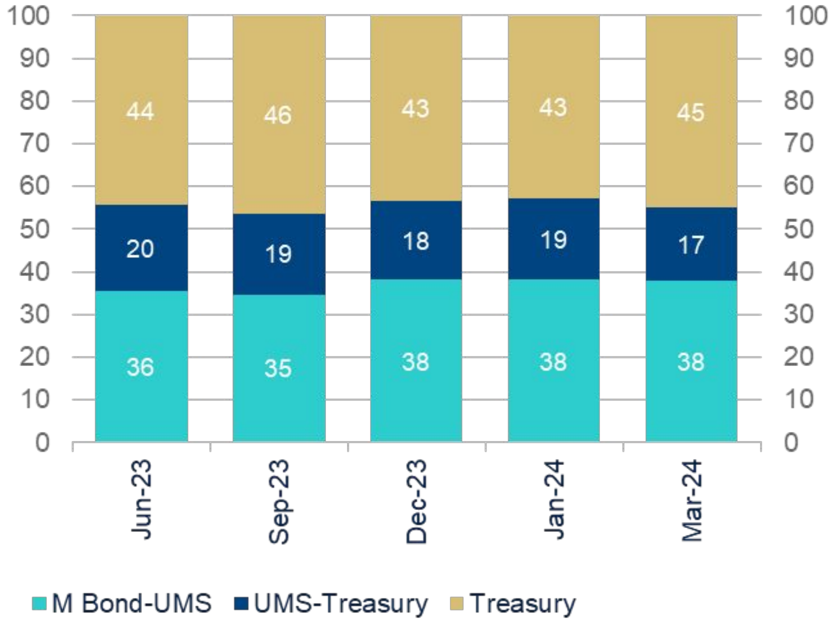
MEXICO SOVEREIGN YIELD CURVE
(%)



Source: BBVA Research and Bloomberg.

Strong growth in 2023 coupled with the “nearshoring” narrative has favored stability in the perception of sovereign risk

MEXICO 10-YEAR YIELD BREAKDOWN (%)



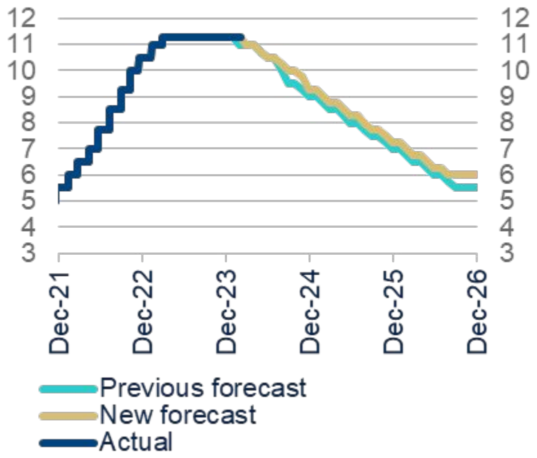
Source: BBVA Research and Bloomberg.

IMPLIED RISKS IN THE GOVERNMENT BOND MARKET (31-DEC-18=100)

Implied risks in the government bond market, calculated as the difference between the 10-year M Bond denominated in pesos and in dollars (exchange rate), and the difference between the 10-year bonds denominated in dollars of Mexico and the US (sovereign).
Source: BBVA Research and Bloomberg.

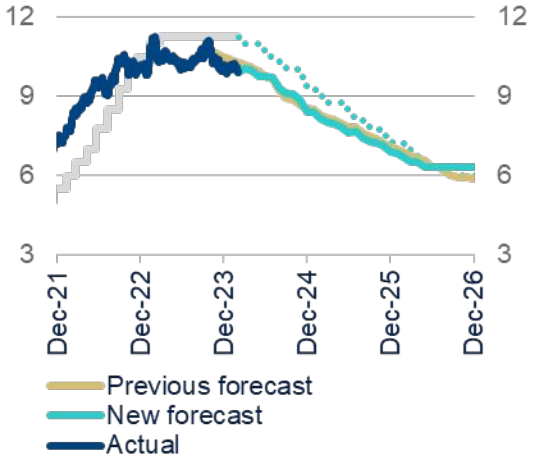
We adjust our expectation for Banxico's easing cycle, which would take the policy rate to 9.25% by the end of the year

MONETARY POLICY RATE
(%)



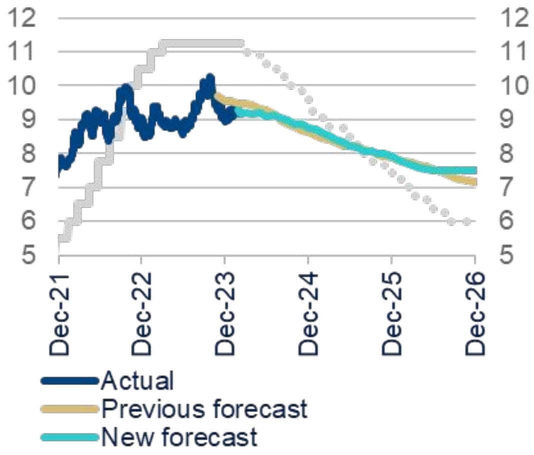
Monetary policy rate	24	25	26
Forecast (eop)	**9.25**	**7.25**	**6.00**
Previous	9.00	7.00	5.50

MEXICO 2-YEAR BOND
(%)



Mexico 2-year M Bond yield	24	25	26
Forecast (eop)	**8.4**	**6.9**	**6.3**
Previous	8.6	7.1	5.9

MEXICO 10-YEAR BOND
(%)



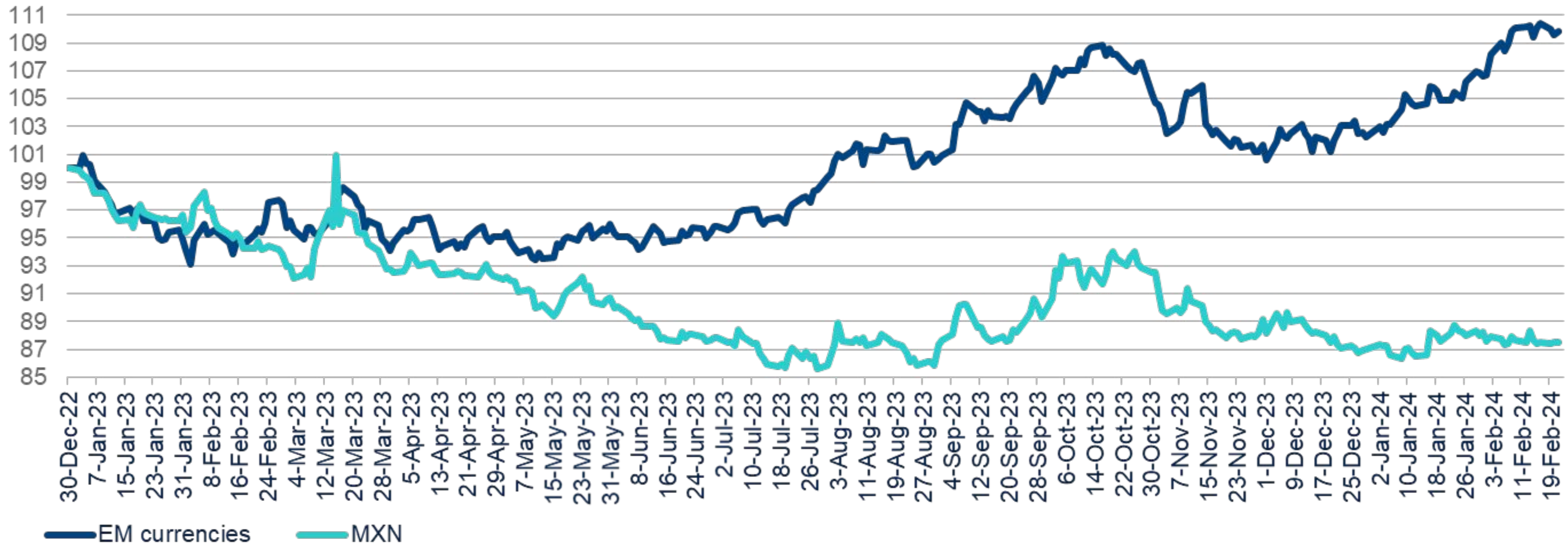
Mexico 10-year M Bond yield	24	25	26
Forecast (eop)	**8.7**	**7.9**	**7.5**
Previous	8.6	7.9	7.2

The gray solid (actual) and dotted (forecast) line indicates Banxico's overnight target rate.
Source: BBVA Research, Bloomberg and Haver.

It is likely that the best moment of the exchange rate has passed, but the peso continues to show absolute and relative strength

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 the MXN.
Source: BBVA Research and 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 2024 growth estimate downward to 2.5% (2.9% previously) and we anticipate growth of 2.4% in 2025 (2.4% previously).

- **Consumption growth moderates** as expenditure normalizes; real wage gains and the trend toward lower savings should prevent a contraction.
- **Strong slowdown in construction**, with loss of momentum in the machinery and equipment segment; lower growth going forward due to lower public investment.
- Low dynamism of domestic demand in 4Q23 with **a negative carry-over effect on 2024**, given the moderation of consumption and the slowdown in public and private investment.

Labor market with mixed signals. The slowdown in formal job creation will continue during 2024; despite this, an annual growth of 2.8% in employment is expected. Together with the expected slowdown in inflation, this will make the total wage bill resilient.

Key points

Inflation and monetary policy

We expect **inflation to end the year at 3.9% and to fall to levels below 4.0% from 2H24**; core inflation will remain on a steady downward path, and will soon be below headline inflation.

- We expect core inflation to stand at 3.6% at the end of this year and at 3.5% at the end of 2025.

We think there is ample scope to gradually normalize the monetary stance in light of the favorable trend in core inflation and expectations.

- We now expect the monetary policy rate to close 2024 at a level of 9.25%.
- Strong growth in 2023 coupled with the “nearshoring” narrative has favored stability in the perception of sovereign risk

Exchange rate and public finances

We forecast the exchange rate to close 2024 and 2025 at 18.2 and 18.6 pesos per dollar, respectively.

Public debt will be around 49.0% of GDP in 2024 vs. 46.8% in 2023. To keep this ratio constant as of 2025 it will be necessary to reduce the public deficit to around 2.0% of GDP.

Forecast summary

		2020	2021	2022	2023	2024	2025	2026
GDP (Annual chg. %)	new	-8.8	6.0	3.9	3.2	**2.5**	**2.4**	**2.6**
	previous					2.9	2.4	2.6
Employment (%, at close)	new	-3.2	4.3	3.7	3.0	**2.8**	**3.2**	**3.2**
	previous					3.1	3.4	3.5
Inflation (%, at close)	new	3.2	7.4	7.8	4.7	**3.9**	**3.5**	**3.5**
	previous					3.7	3.6	3.7
Monetary policy rate (%, at close)	new	4.25	5.50	10.50	11.25	**9.25**	**7.25**	**6.00**
	previous					9.00	7.00	5.50
Exchange rate (ppd, at close)	new	20.0	20.9	19.6	17.2	**18.2**	**18.6**	**18.9**
	previous					18.5	19.1	19.3
M10 (%, at close)	new	5.5	7.6	9.0	9.0	**8.7**	**7.9**	**7.5**
	previous					8.6	7.9	7.2
Fiscal balance (% of GDP)	new	-2.8	-2.8	-3.2	-3.3	**-4.9**	**-3.0**	**-3.0**
	previous					-3.1	-2.5	-2.5
Current account (% of GDP)	new	1.9	-0.7	-1.3	-0.5	**-0.7**	**-0.7**	**-0.8**
	previous					-1.0	-1.4	-1.3

Source: BBVA Research.

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BBVA Research

Mexico Economic Outlook

March 2024

Creating Opportunities