RESEARCH

Mexico Economic Outlook

Second Quarter 2015
Economic Analysis

- Growth should pick up from the second quarter of the year
- Implementation of reforms should continue, so as to speed up growth in the coming years
- Domestic demand should be strengthened to provide balance for the drivers of growth
- Inflation has reached its historical low and should hold at levels of under 3.0% for the rest of the year

BBVA Bancomer

Índex

Closing Date: June 19, 2015

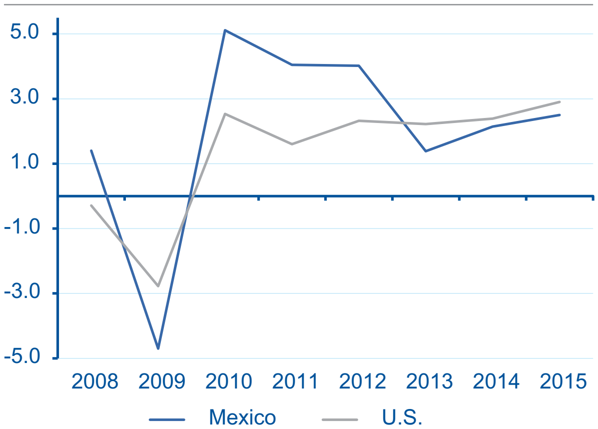
1. Summary

On a global level, a weaker and more uneven economic recovery is observable. On the one hand, the improvement is gathering pace in Europe, whereas in Latin America and Asia growth is easing up. In the United States the slowdown is expected to be only passing, as rising employment and low inflation are propping up household income and consumption, which should offset the effect of the stronger dollar and dwindling external demand. Chief among the risks looming over the world economy are the lack of agreement in Greece and the impact on the emerging economies of the commencement of the cycle of policy rate (MPR) hikes in the United States.

Looking ahead, in Mexico's case, even though economic activity is expected to show more vigour than in 2013-14 (1.8% on average), we are revising our growth forecast for 2015 down from 3.5% to 2.5%. The key driver of growth will continue to be the boost to external demand arising from the quickening pick-up in economic activity in the United States. There are essentially three factors lying behind the downward revision of our growth forecast: i) the declining trend in oil production; ii) the lower-than-expected level of dynamism in manufacturing exports, given the relative weakness of the US manufacturing sector, in spite of the peso's depreciation, and iii) the lower-than-expected contribution to growth of public sector consumption and investment. This has partly been due to the delay and cancellation of various infrastructure projects. For 2H15 public expenditure is expected to be brought down in line with the announced budget cuts (0.7% of GDP). These same factors will continue to be a burden in 2016, for which reason we estimate that growth will be 2.7% that year, which is short of our previously predicted level of 3.4%.

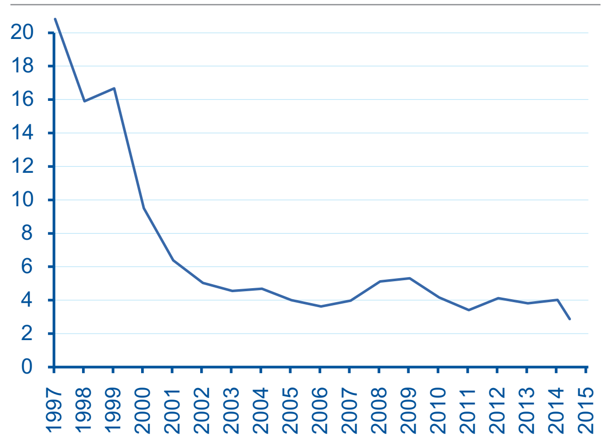
Within the Mexican employment sector, a job formalisation programme has been implemented by the authorities which has proved highly successful. Testament to this is a very substantial rise in the number of workers registered with the Mexican Social Security Agency (the IMSS). On the other hand, it should be added that the low levels of unemployment that are being observed in the economy have been accompanied by a spike in the number of people who have decided to remain outside the labour market, which is something that should potentially be brought under the spotlight because being outside the labour market for any length of time means that the chances diminish of breaking back in, quite apart from the fact that this has the effect of diluting Mexico's demographic bonus that has arisen from a cohort coming of working age.

Figure 1
Annual GDP growth: Mexico and the United States (Percent)



Source: BBVA Research using INEGI and BEA data.

Figure 2
Annual inflation (Percent)



Source: BBVA Research using INEGI data.

The outlook for economic growth in the medium term is unchanged. The reforms could help to take growth to around 4.0% in the medium term, given that the oil price is expected to recover. This would allow Mexico's energy reforms to continue on track and the public sector to press ahead with its major infrastructure plan.

Headline inflation has cooled to its historical low of 2.88%, which is in line with the central bank's target of 3.0% (+/-1.0%), while core inflation is clearly below this level (2.3%). Contributing to the low level of inflation have been the slack in the economy, the reform of the telecommunications sector, the dilution of the effect of the taxation hike and an encouraging performance by agricultural products. Within this situation, a very low level of exchange rate transmission through to prices is observable, so we expect inflation to stay below 3.0% for the rest of the year.

Statements by the central bank suggest a synchronisation of its monetary policy with the process of rate hikes by the Federal Reserve, although the large amount of slack and low inflation in the country imply that the Mexican central bank's cycle of hikes should be slower than in the Fed's case. Banxico is thus expected to lift its reference rate to 3.25% and 4.00% at the end of 2015 and 2016 respectively.

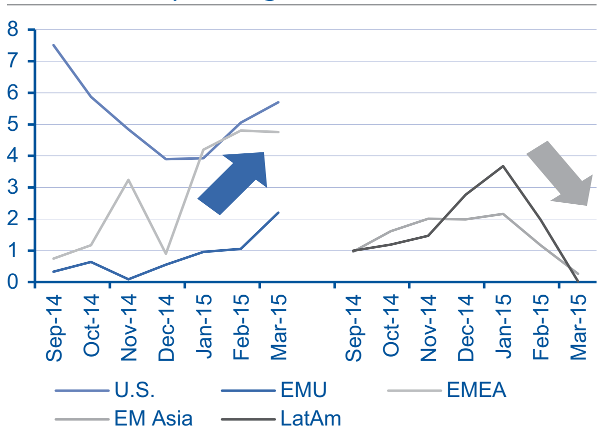
Financial markets in Mexico are still being mainly swayed by those variables which have a direct bearing on any future decision about raising the policy rate in the United States (i.e. employment and inflation figures and statements by the Federal Reserve). Turning to the Mexican peso, although it is thought to be undervalued at its current dollar level of MXN15.4, its staying power around this value and the circumstance of future hikes of the federal funds rate in the United States lead us to predict that a peso appreciation which might be expected towards the year-end, as a result of a better international situation and less uncertainty, could bring down the dollar exchange rate to levels close to MXN14.8 by the close of 2015. This is to the extent that the Fed is clear in its message and manages to persuade the markets that the monetary policy hike process will be gradual. As regards interest rates on long-term Mexican government bonds, the most likely scenario is of an upward trend in harmony with long-term rates in the United States and monetary policy in Mexico.

2. World growth is suffering from the slowdown in the emerging economies

The available economic indicators point to a gradual slowdown in world growth in the first quarter of 2015 towards a 3% annualised rate,[1] a few tenths below the figure in 2H14 (between 3.3% and 3.6%). The slowdown in the US economy, the lower dynamism of China, and the decline in activity in certain key emerging economies (such as Russia and Brazil, though not India) account for the bulk of the slowdown worldwide, which have not been offset by the relatively better performance of the eurozone and the United Kingdom.

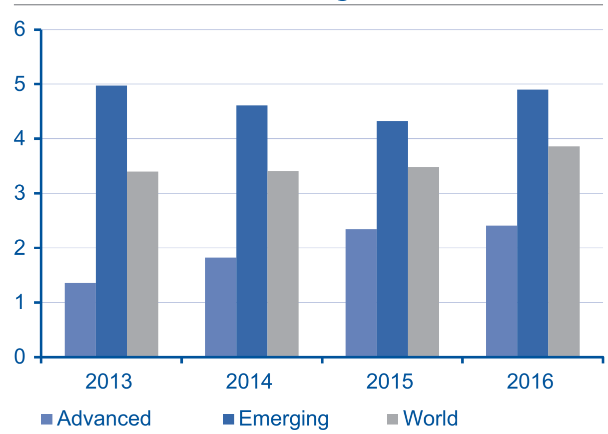
The differentiation among geographical areas and sectors of activity remains in the pattern of world growth at the start of 2015. On the one hand, consolidation of growth among the developed countries contrasts with the almost general loss of steam among the emerging countries, which is more intense in Asia and Latin America than in Eastern Europe, according to the business confidence, industrial production and foreign trade indicators. On the other hand, the improvement in private consumption, as gauged by the recovery in household disposable income within a context of lower energy prices, job-creation and increased financial wealth, is giving support to the services sector in the major developed economies (mainly in the eurozone), while the gains in industrial production and investment are more tepid. These developments could be due to the doubts about the sustainability of the recovery in private consumption, which is delaying industry's decisions on investment and production.

Figure 2.1
Manufacturing PMI (deviation from the 50 point mark — activity holding)



Source: BBVA Research and Haver

Figure 2.2
World GDP: forecast annual growth 2015-16 (%)



Source: BBVA Research

The fact that global activity has performed slightly worse than expected in 1Q15 and the impact of the weakness of the domestic demand, the stabilisation of commodity prices at low levels and the Fed rate hike on key emerging economies lead us to revise our world growth forecast for 2015 to 3.5%, 0.1pp less than forecast in January and only 0.1pp more than the 2014 figure.[2] In 2016, world GDP should record an average growth of 3.9%, partly as a result of the expansive monetary policies in the developed countries, which ought to achieve their best registered figure since 2010. The emerging economies should, within a scenario of a trend of gradual slowdown in China, manage to reverse the current decline thanks to the positive spill-overs from the developed economies, the steady increase of commodity prices and a cycle of interest rate hikes by the Fed that will be more gradual than in previous episodes.

1 Estimate based on BBVA Research's global activity indicator (GAIN). Details of the methodology can be found at: http://bit.ly/1nl5RIn
2 The impact on the world GDP estimate of the revision of India's National Accounts should be particularly noted. Indian economic growth moved from 5.0% to 7.2% in 2013-14, which raises world GDP growth by between 0.1 and 0.2pp, an upward change which is also included in the forecasts.

The progressive rise in commodity prices, in line with BBVA Research forecasts, and the reinforcement of loose monetary policies have been two of the most remarkable elements in the economic global picture in recent months. The base effect of the former has helped to contain the fall in inflation rates in certain geographical regions, mainly in developed countries, which, together with the change in the tone of monetary policies, has anchored the inflation expectations discounted by markets. Both of these, however, have failed to inhibit financial volatility indicators from continuing to tick upwards, although from very low levels and only gradually. This appears consistent with a context of uncertainty about the strength of economic recovery, the timing and the intensity of Fed rate normalisation and the distortions caused by ECB balance-sheet expansion on the price levels of those financial assets with the greatest weight in the portfolios of economic agents.

Having built up a fall of over 45% between September 2014 and January 2015, the price of oil has since climbed by about 15%, with Brent crude standing at c.USD60/bbl. The result has been an easing of downward pressure on headline inflation rates (the average level recorded among the United States, China, Japan and the eurozone remained at under 1% in February), which, however, has not been mirrored in other representative price indicators such as core inflation (stable at 1.5% on average for the group mentioned) or production costs (the fall in industrial or import prices is particularly substantial in China).

The absence of short-term inflationary pressures (even though the oil price is converging to USD70/bbl at the end of the financial year) and long-term inflation expectations being contained at levels below those targeted by the central banks have served to justify a greater degree of proactive moves by central banks, both in developed and emerging economies. In the former case, by continuing at length with asset purchase programmes (ECB and in Japan) or by giving consideration to delaying reference rate hikes (the Fed and the Bank of England); in the latter case, taking further measures aimed at monetary loosening by cutting rates (although Brazil is the main exception here). There is no doubt that this latter aspect represents one of the distinguishing factors of the present economic cycle. Even if the Fed might have decided on a strategy of gradual monetary tightening, the beginning of which could come about in 2H15, the emerging economies have chosen to give priority to kick-starting their domestic demand by trying to cut real interest rates, in some cases at the cost of accepting greater exchange-rate volatility and running the risk of reduced incentives for foreign capital inflows. A sign of this is the slowdown of the short-term nominal interest rate for the world's major economies (excluding the United States), which stands at 3.2%, which is 20bp below the level a year ago.

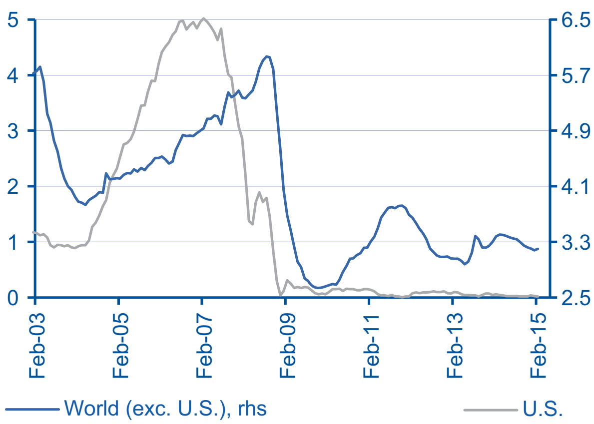
The other side of the coin is the strengthening of the dollar at a global level and the almost across-the-board depreciation of emerging economy currencies, which is more pronounced in those countries that have a greater reliance on foreign funding, a larger share of revenue from commodity exports or a higher reaction to the global liquidity scenario. Moreover, those which decided to implement expansive monetary policies given such "fundamentals" have come off the worse for it. In the short term, the depreciation of emerging currencies can promote the external competitiveness of those countries and kick-start economic growth. That said, this can end up giving rise to adverse effects which are uneven among economies and institutional segments, by making it harder to refinance the debt taken on in foreign currency (in most cases dollars), thereby making the servicing of this more costly.

The contrast in the monetary strategies of the ECB and the Fed will continue to shape the direction taken by capital flows and, by extension, the behaviour of financial variables. The ECB's liquidity injection from buying-up government bonds has reinforced the correction in long-term interest rates among the developed nations and, to a greater extent, in the eurozone, and has magnified the euro's depreciation relative to its main exchange currencies (it stands at close to parity against the dollar).

This trend is likely to remain until the Fed implements the first increase in fed funds. Thus it will be its communication strategy regarding the pace of the forthcoming hikes which shapes the rally for yields in the bond market and the degree of financial volatility. The scale of any capital outflows from the emerging countries will therefore hinge on Fed monetary policy, though also on local factors associated with the point in the cycle and the vulnerabilities of each country, especially when the volatility from the first or first few hikes wears off. Thus, as in terms of growth, major divergences in the course taken by exchange and interest rates among the emerging countries are to be expected.

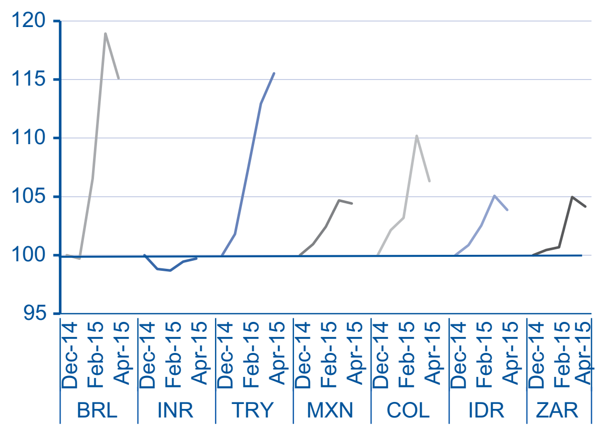
On balance, and although economic policies will continue to be accommodative, the risks to the downside persist for world growth. The most significant of these rest with the extent of the slowdown in China and the spill-overs coming from the beginning of the Fed's rate normalisation process. The deflationary pressures associated with the oil price, geopolitical tensions and any failure of the ECB to reactivate inflation expectations in the eurozone are risks that, despite appearing less likely and less significant in terms of expected impact than some months ago, cannot be ruled out. Finally, a risk which still lurks in the wings is that of a failure to reach agreement between the Greek government and the European institutions and the IMF on how to refinance its debt servicing obligations.

Figure 2.3
Short-term nominal interest rates (%)



Source: BBVA Research and Bloomberg

Figure 2.4
Exchange rates against the dollar, Dec 14=100
A rise in the index denotes dollar appreciation



Source: BBVA Research and Bloomberg

With regard to the details for the major economies, the United States has begun 2015 with a substantial slowdown in its growth rate, which could translate into GDP moving ahead by barely 0.2% QoQ, which compares with an average increase in the previous three quarters of 1%. The unusually harsh weather conditions account for a portion of the slowdown, though this is not the sole cause. The impact of lower oil prices on energy sector activity and the early effects of the dollar appreciation on exports are also having a bearing.

The strength still shown by the labour market, with employment gains at a rate of close to 2% YoY since October 2014, should continue to support household income and private consumption in a scenario of low energy prices, a steady improvement in nominal wages and inflation holding at low levels (in 2015 the average headline rate could be around 0.6% and rise to 1.9% in 2016). The strength of domestic demand, and especially consumer spending, is essential to offset likely export weakness and allow GDP to grow at rates of between 0.7 and 0.8% QoQ for the remainder of the year. Only thus can US growth reach 2.9% and hold at rates approaching 3% as well in 2016.

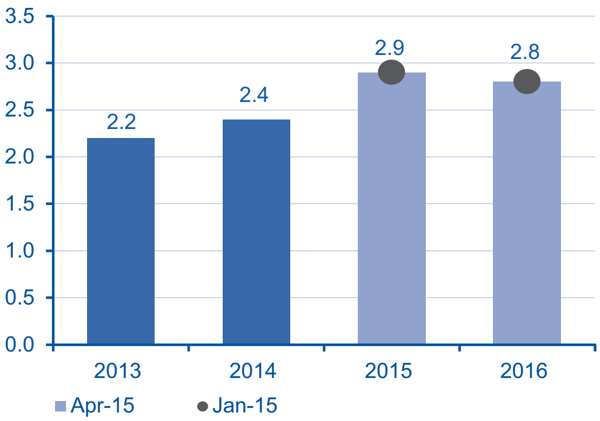
The interpretation which the Fed makes of whether the lower first-quarter growth is transitory or permanent will define how it reacts from now on. Equally significant will be the changes that arise in the international context, which will be shaped by growth among the emerging nations and currency market volatility. At the March meeting of the FOMC, the Fed changed its communication strategy and laid down the reasons for tackling the initial Fed funds rate rise, although it did reiterate that the course taken by monetary tightening will be gradual and conditional upon how the domestic cycle evolves. This, together with the downward revision of its forecasts for growth and inflation, has led the FOMC itself to lower expectations regarding the level for reference rates in the medium term.

As a result, the most likely scenario is that the first rise in the Fed funds rate will occur before or in September 2015, but could be put off if the recovery is not as strong as desired. Unlike with other rounds of Fed monetary normalisation (the last of which began in mid-2004), US core inflation and price expectations for the longer term are at significantly lower levels and well below the central bank's target, and there is greater doubt over world growth. For these reasons the rate hike process is likely to be gradual, with a target level of no more than 1.5% at the end of 2016.

In China, the economic slowdown has accelerated in the last few months, with GDP moving ahead by 7% YoY in 1Q15. Balance of activity indicators place the adjustment focus on the industrial sector (production is growing at under 7% YoY, a historical low) and fixed asset investment (almost 14% ahead YoY, two points below the 2014 average), while it reveals a better relative performance from private consumption, buoyed by the vigour of the labour market and the fall in inflation (1.3% in March).

Figure 2.5

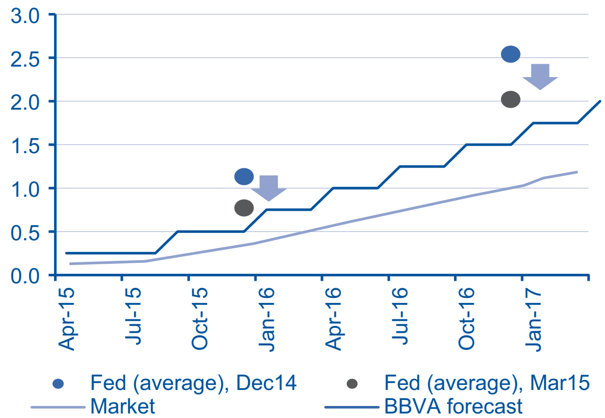
US economic growth, % annual



Source: BBVA Research

Figure 2.6

US Fed Funds expectations (%)

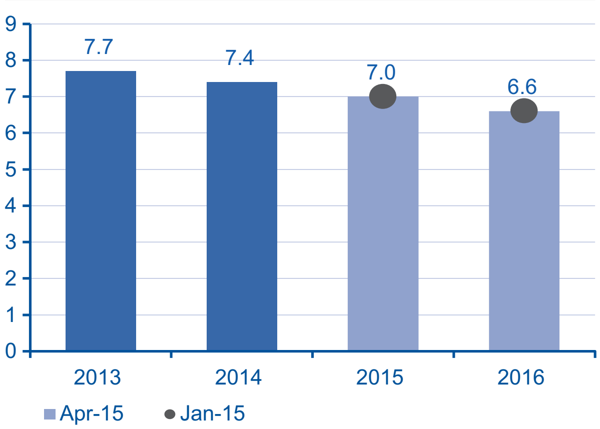


Source: BBVA Research and Bloomberg

There are several factors behind the slowdown in the Chinese economy. Firstly, there is a correction underway in the real estate market, with an impact on construction investment and activity in auxiliary sectors. Secondly, the political uncertainty ahead of the National People's Congress in March, which has left decisions by companies about expanding productive capacity or making new contracts on hold. Thirdly, the decline in competitiveness abroad implied by the worldwide appreciation of the yuan (in terms of the real effective exchange rate). Last but not least, the effects of fiscal consolidation of local authorities which began in 2H14.

Figure 2.7

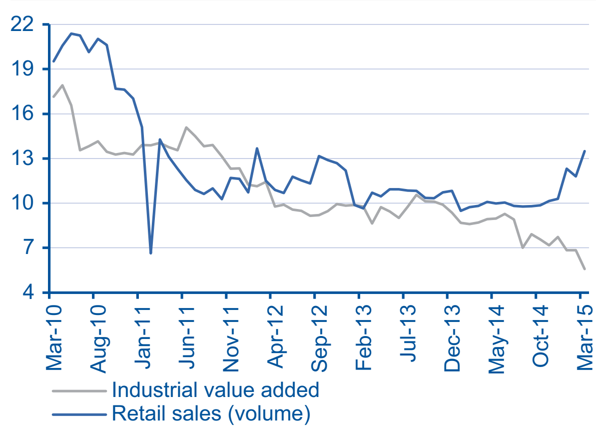
China: economic growth (% annual)



Source: BBVA Research

Figure 2.8

China: Industrial production and retail sales (% YoY)



Source: BBVA Research and BIS

The structural nature of the factors mentioned above supports our assessment that China should grow more slowly in the medium term and with greater volatility. The target annual growth rate of 7% for 2015 which was set by the Chinese authorities relies on implementation of new stimulus measures, both monetary and fiscal, to allow a soft landing for the economy without compromising the process of internal adjustment in progress and the development of structural reforms to raise growth potential. Further cuts to the reference rate (to 5.1% at the end of this year) and the minimum reserves held by banks are likely to be made, and greater fiscal expansion will probably be applied by the central government, which will lead to a certain depreciation of the yuan, which limits the minor impact of external demand on aggregate activity.

Of the developed economies the eurozone is the one which has put in the best relative performance as 2015 gets underway. The GDP could have grown by 0.4-0.5% QoQ in the first three months of the year, which would imply the quickest pace since mid-2011. Private consumption and exports should be offsetting continued substantial investment weakness, with Germany and Spain heading up growth for the area as a whole. The easing of financing conditions and the euro depreciation triggered by the ECB's quantitative easing programme, together with the drop in the oil price, are proving crucial to the recent dynamic of recovery. The less restrictive nature of fiscal policy and containment of falling nominal wages in the countries on the periphery are also helping to promote growth again.

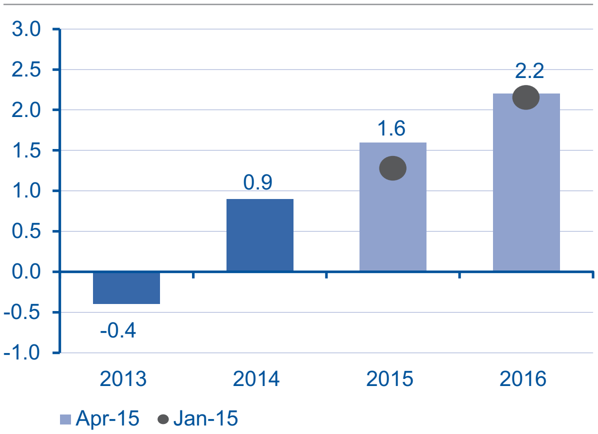
Maintaining these supporting factors over the rest of the year could lead to GDP increasing to 1.6%, 0.3pp above the forecast we made in January. So far the steady improvement in domestic demand is not feeding through into an increase in core inflation, which is stable at 0.6%. This is an element which, together with the rise in the oil price, will keep inflation at close to 0% in 2015 and below 1.5% in 2016.

With respect to the recent ECB asset-purchase programme (the volume of purchases of private and public stock was around EUR134bn in mid-April), the transmission channels that are showing the biggest reaction are euro depreciation (its real effective exchange rate stands at the 2002 low) and the trimming of long term interest rates and risk premiums. How this works through to spreads applying to new banking credit business, as well as to long-term inflation expectations, remains to be seen. The latter have been anchored since the announcement of quantitative easing of government bonds, but they are still under the ECB's 2% reference rate.

A more accentuated slowdown than expected for the Chinese economy and increasingly fraught political and institutional tensions in Greece together comprise the main risks to the eurozone in the short term. In the former case, because it would weigh on export growth, which is vital for sustained improvement in GDP, and in the latter case because it would re-open the debate over the current make-up of the monetary zone and could give rise to a substantial increase in financial volatility. The liquidity restrictions Greece faces in repaying the official financial assistance forthcoming under the different bail-out programmes and the reluctance of the organisations involved to renew or inject flexibility into their terms will add to uncertainty over resolving the Greek crisis until at least the end of 2Q15.

Figure 2.9

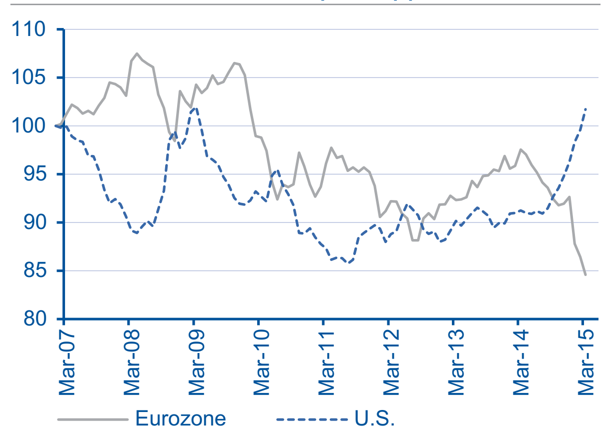
Eurozone: economic growth (% annual)



Source: BBVA Research

Figure 2.10

Real effective exchange rate, Jan 2007=100 An increase in the index implies appreciation



Source: BBVA Research and BIS

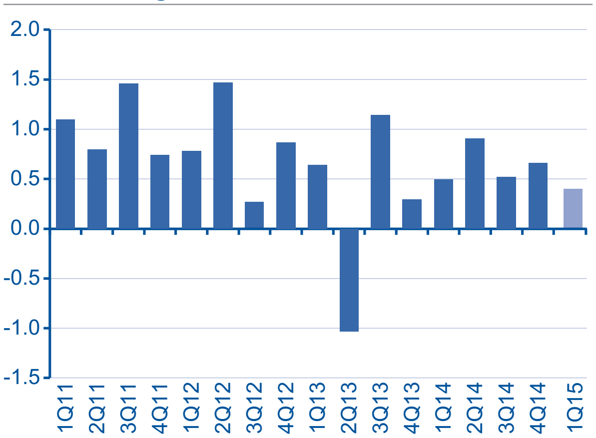
3. Growth is slowing and inflation is at a historical low in 2015

3.1 Moderate growth in 2015, given the languid performance in the United States and the fall-off in oil production

QoQ GDP growth in 1Q15 was 0.40% (see Figure 3.1), in seasonally adjusted terms (sa). After the slow start to the year, we estimate that YoY growth for economic activity in 2015 will be 2.5%. Q1 growth was tied in with a weak showing from the manufacturing and services sectors. Primary activities increased by 3.0% QoQ, which was an encouraging performance compared to the contraction of 2.2% QoQ which they registered in 1Q14. The growth rate in the services sector was only 0.5% QoQ, which was an improvement on the rate of 0.3% QoQ for the sector in the same period in 2014. Manufacturing was the only sector to show a fall relative to the previous quarter, easing back by 0.2% QoQ, while in the same period in 2014 the secondary sector had grown by 0.7%.[1]

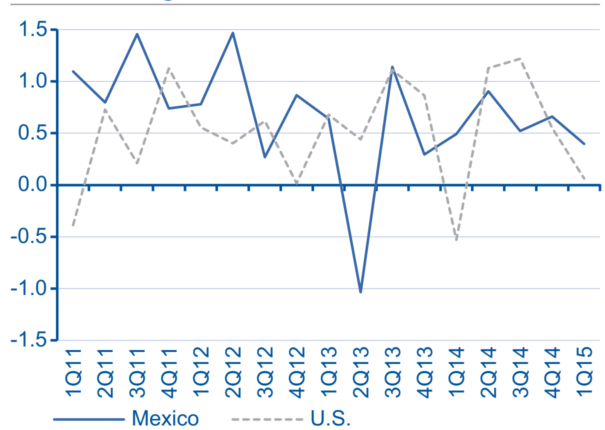
Owing to limited GDP growth in Q1, and even taking into consideration the fact that the economy will grow to some extent in the next few quarters as a result of factors such as greater public spending associated with the elections (though this will be tempered in H2 after the announcement of public spending cuts), as well as the more lively performance expected of the US economy, we are revising our forecast GDP growth rate for this year down to 2.5% from the rate of 3.5% YoY which we had maintained since mid-2014.

Figure 3.1
Gross Domestic Product (QoQ % change, sa)



sa=seasonally adjusted
QoQ=quarter on quarter
Source: BBVA Research with information from INEGI

Figure 3.2
Mexican and US GDP (QoQ % change, sa)



sa=seasonally adjusted
QoQ=quarter on quarter
Source: BBVA Research with information from INEGI and the BEA

There are several significant adverse factors behind the lowering of our estimate for the GDP growth rate. Among these was the weak Q1 performance by the US economy (see Figure 3.2), which was mainly caused by harsh weather and dollar appreciation, and this held back demand for the Mexican manufactures that are exported to the United States. On top of this, there was a fall in oil prices and production in Mexico. Another factor of no less importance is

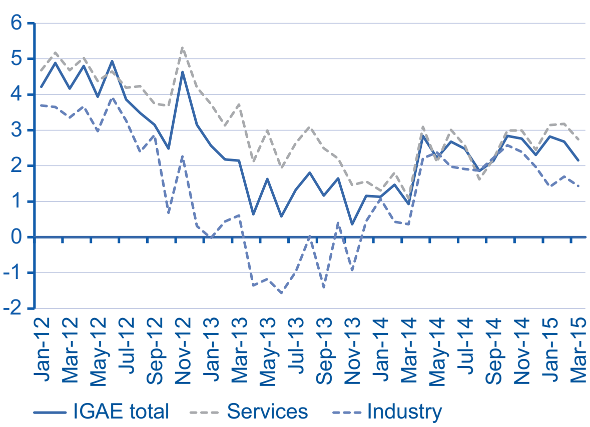
[1] See the Mexico GDP Flash of 21 May 2015. Document available at: https://www.bbvaresearch.com/wp-content/uploads/2015/05/150521_FlashMexico_PIB1T15_esp1.pdf

the lack of strength of domestic demand, which has manifested itself in a modest rate of growth of consumption and low levels of investment. Both factors are influenced by the sluggish recovery of the construction industry and the delays in implementing the energy reform, given the low international prices of energy products. We see these unhelpful factors for growth continuing to be present in 2016, which should be reflected in GDP growth this year of around 2.7% YoY.

3.1.1 Domestic sector: recent increases in employment and consumption, although they are still too limited to drive on domestic demand

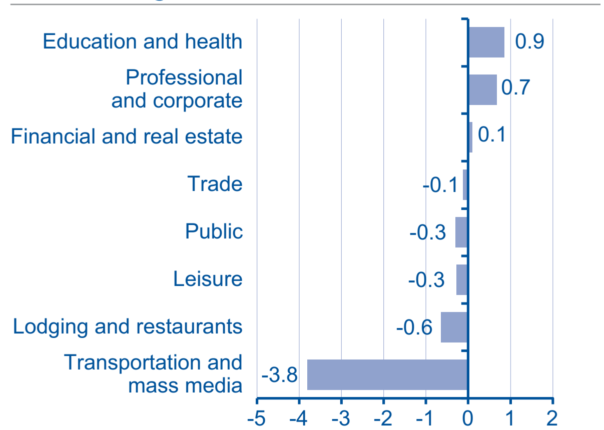
The deceleration in the rate of growth of GDP is reflected in the Global Economic Activity Indicator (IGAE). The monthly growth rates for this indicator in January, February and March were a seasonally-adjusted 0.32%, 0.30%, and -0.64% respectively. The IGAE's retreat in March was due to the fall in agriculture (-4.41% MoM, sa) and the services sector (-0.17% MoM), as well as to negligible growth by industry (-0.02% MoM, sa). Within the services sector, there was a weak showing in March from almost all of its components, which was more pronounced in the transportation and mass media sectors (see Figure 3.4).

Figure 3.3
Global Economic Activity Indicator (IGAE) and its components (YoY % change, sa)



sa=seasonally adjusted. YoY=year on year.
Source: BBVA Research with information from INEGI

Figure 3.4
Services sector: component of IGAE, March 2015 (YoY % change, sa)



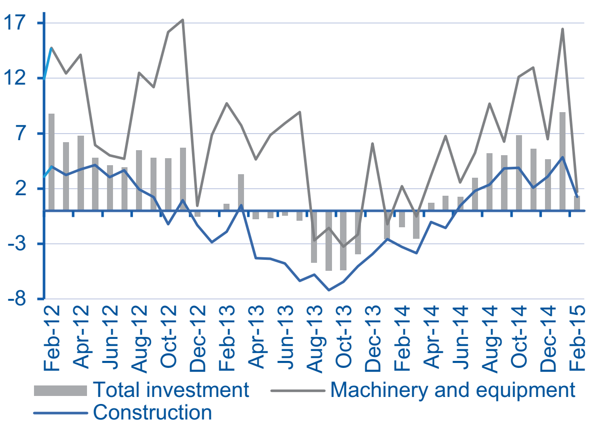
sa=seasonally adjusted. YoY=year on year. *Data estimated by BBVA.
Source: BBVA Research with information from INEGI

On the other hand, over the first four months of 2015 there was some degree of wariness as regards the confidence of economic agents. For example, in January, the producer confidence index (ICP) remained within optimistic territory, meaning that it registered a level above the threshold of 50 points (pt) in the index. From February to April expectations of improved economic activity over the next few months dissipated, which caused the ICP to dip from 50.3pt in January to 49.5pt in February. The indicator continued to come down, and in April it read 48.4pt, sa.

Meanwhile the consumer confidence index (ICC) slipped back from 91.9pt in January to 90.8pt in April. Furthermore, the indicators from the Mexican Institute of Financial Executives (IMEF) of expectations regarding manufacturing and non-manufacturing activity in Mexico also put in a modest performance, with the IMEF manufacturing indicator reading 50.5pt in January, sa, while in April it could only reach 51.8pt, while the IMEF's non-manufacturing indicator edged up from 48.4pt to 49.5pt, sa, (which is below the optimism threshold) over the same time. In other words, if any of these indices have shown any improvement, it is only minor, so it is by no means clear whether the rate at which the IGAE rises will increase substantially in the short term.

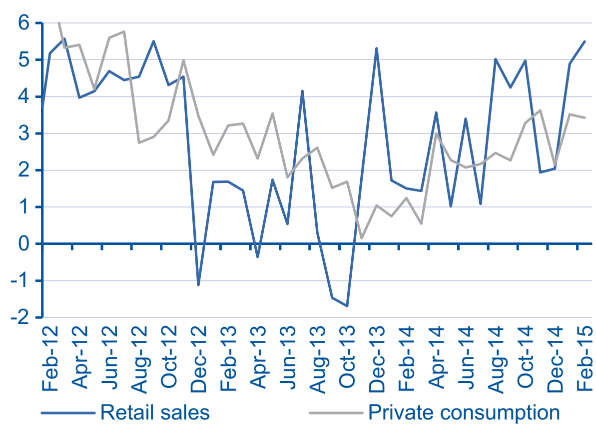
As regards investment, in January 2015 gross fixed investment and its components showed signs of recovery. There was a departure from this improvement in February, when the annual growth rate (AGR) dropped from 8.9% in January to 1.3% for that month (figures sa). This was especially true of the machinery and equipment component, as this only rose in February by 1.7% YoY, sa, while construction remained weak, with annual growth in February of 1.3%, sa (see Figure 3.5). We should add here that, even though we estimate that between Q2 and Q3 this year the public investment component will start to grow, this improvement will be slow.

Figure 3.5
Components of investment (YoY % change, sa)



sa=seasonally adjusted. YoY=year on year.
Source: BBVA Research with information from INEGI

Figure 3.6
Retail sales and private-sector consumption (YoY % change, sa)

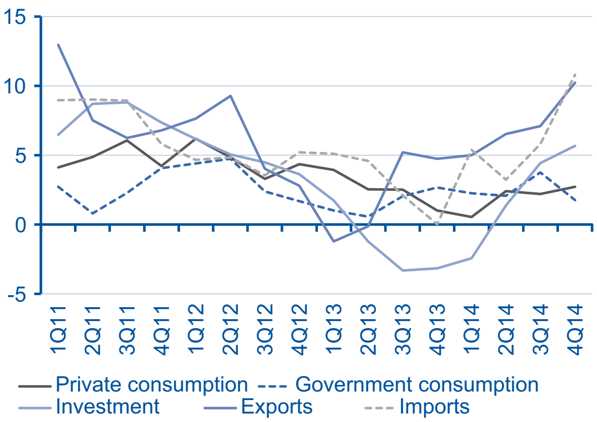


YoY=year on year.
Source: BBVA Research with information from INEGI and STPS

On the other hand, retail sales in the first few months of the year displayed positive growth rates, which suggest that the country's domestic sector will see something of a recovery in 2015. It should be mentioned that in February this indicator's AGR was 5.6%, sa, and this was the highest since December 2013 (see Figure 3.6).

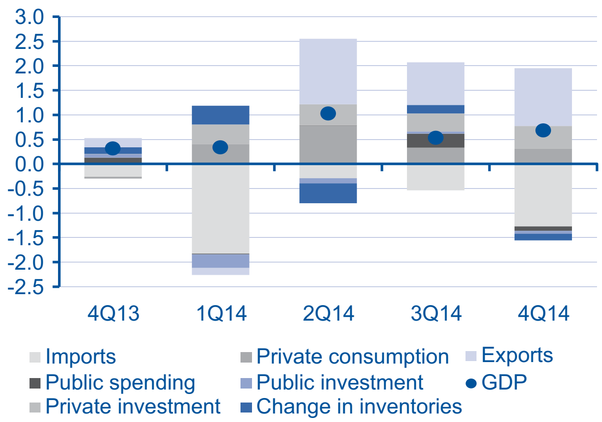
The source of the boost for GDP can be traced to the components of aggregate demand. Exports rose in 4Q14 (10.2% YoY, sa), as did imports (10.8% YoY, sa). Total gross fixed capital formation (GFCF) grew by 5.7% YoY and within this private investment played a prominent role (9.9% YoY), whereas public sector investment experienced a substantial setback (-9.1% YoY). Thus the component that made the biggest contribution to the economic growth of GDP in 4Q14 was the export sector, which was followed by private investment and then by private consumption. Investment and expenditure by the public sector contributed negatively, as did the variation in inventories. Imports made a negative impact on GDP growth which was more severe than in the previous two quarters (see Figure 3.8). The contribution of public expenditure and investment to GDP in recent years has been marginal, which points to problems in allocating and executing funds that should be avoided via greater transparency and accountability. We estimate that in 1Q15 the demand components which relate more to the external sector will experience an acceleration.

Figure 3.7
Aggregate demand: components (YoY % change, sa)



sa=seasonally adjusted. YoY=year on year.
Source: BBVA Research with information from INEGI

Figure 3.8
Contribution to GDP growth, 4Q13-4Q14 (Percentage points, QoQ, sa)

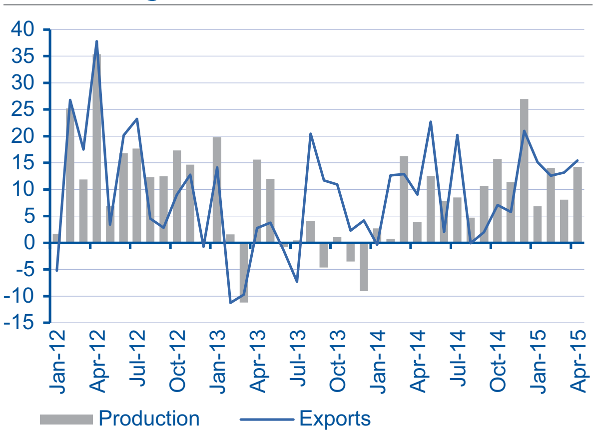


sa=seasonally adjusted. QoQ=quarter on quarter.
Source: BBVA Research with information from INEGI

3.1.2 External sector: continued vigour

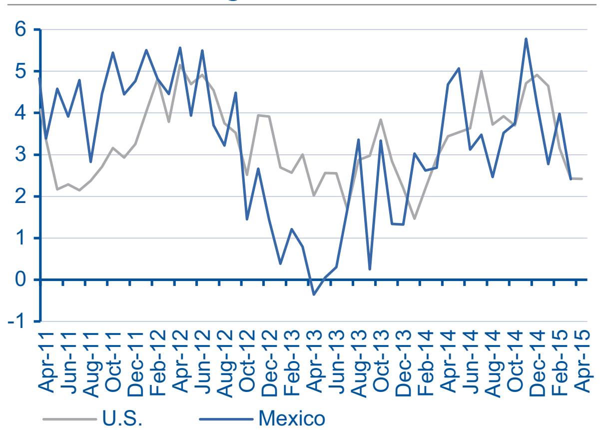
As was said previously, external demand has become established as the key driver for Mexico's economic growth. The sector which has benefited the most from this demand, particularly from the United States, is the automotive sector (see Figure 3.9).

Figure 3.9
Automotive production and exports (YoY % change)



YoY=year on year.
Source: BBVA Research with information from AMIA

Figure 3.10
Manufacturing output of Mexico and the United States (YoY % change, sa)



sa=seasonally adjusted. YoY=year on year.
Source: BBVA Research with information from INEGI and BEA

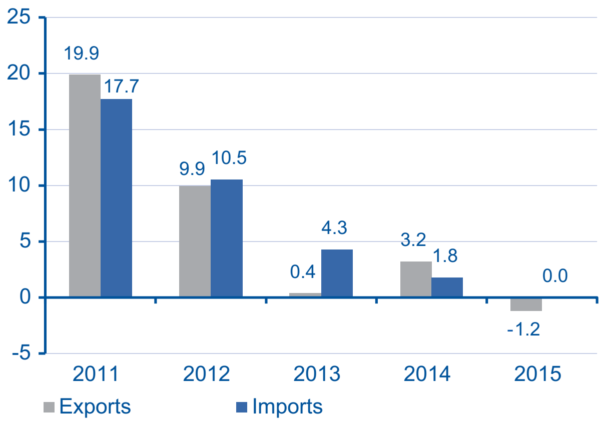
According to the Mexican Automotive Industry Association (AMIA), from January to April 2015 cumulative vehicle production rose 10.7% with respect to the same period in 2014 and vehicle exports grew 14.0% (see Figure 3.9). Despite this, the rest of Mexico's manufacturing sector has been hit by the lower manufacturing output in the United States, which in turn relates to the weather problems which afflicted the United States early on in the year, as well as dollar appreciation (see Figure 3.10). Irrespective of this, auto exports have stood out due to their high growth rate.

3.1.2.1 Goods exports and imports

The AGRs for cumulative goods exports and imports from January to April 2015 were -1.2% and 0.0% respectively (Figure 3.11). The negative growth in exports over the period illustrates the major shrinkage in the value of oil exports in recent months, besides which the performance by non-oil exports has been modest. On the other side of the equation, the lack of growth of imports is reflective of a low level of domestic demand.

Figure 3.11

Annual exports and imports of goods. January-April (Annual % change)



Source: BBVA Research with information from INEGI.

Figure 3.12

Monthly exports and imports of goods (Annual % change)

Source: BBVA Research with information from INEGI.

Going into Q2, in April the AGRs for both exports and imports were negative (Figure 3.12), and in recent months a less spirited performance has been observed (Figure 3.13). Oil exports have come off worst, building up a YoY fall of 46.7% over the first four months of 2015, while the best-performing exports over this time were in the automotive sector, with an annual rate of 11.1% (Figure 3.14).

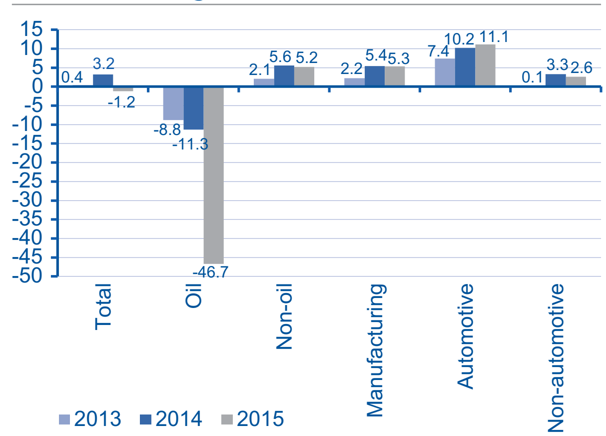
Figure 3.13

Exports and imports of goods (Annual % change of three-month moving average)

Source: BBVA Research with information from INEGI.

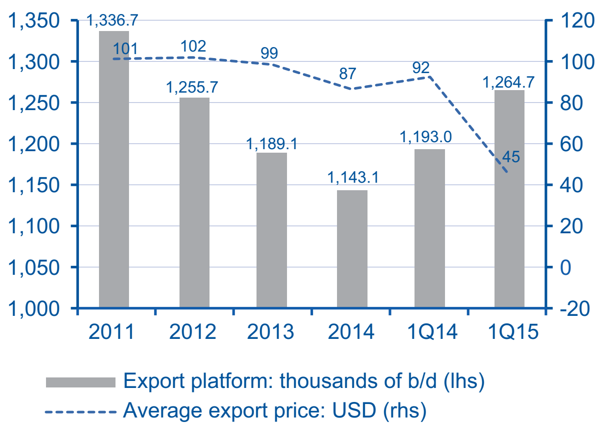
Figure 3.14

Exports of goods by kind of good. January-April (Annual % change)



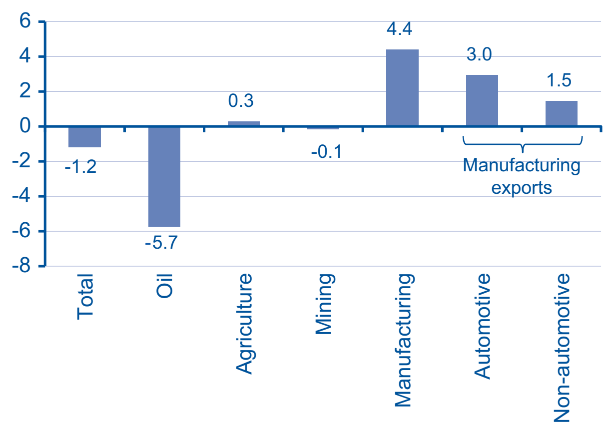
Source: BBVA Research with information from INEGI.

Figure 3.15
Crude oil exports: annual average of the platform and export price (000s b/d and USD/bbl)



1Q = average figures of the first quarter 2015.
Source: BBVA Research with information from INEGI

Figure 3.16
Exports of goods January-April 2015 (Contribution to growth, percentage points)



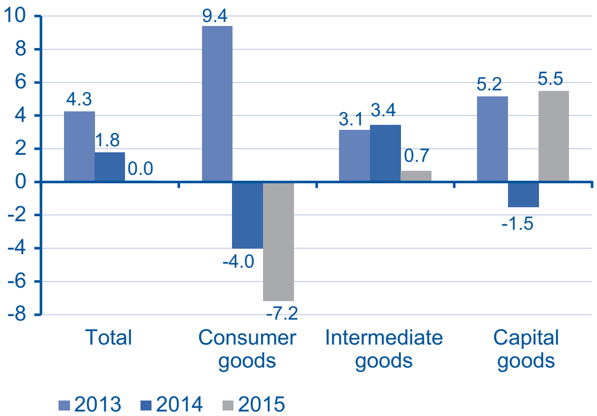
Manufactured goods include automotive and non-automotive goods.
Source: BBVA Research with information from INEGI

Within the drop in value of oil exports, the factor which has made the biggest impact is the fall in the average price per barrel of oil. For example, in 1Q14 the average price per barrel of Mexico's export crude was USD92.40, while for the same quarter in 2015 the average price per barrel had plunged by 51.5%, reaching USD44.80 (Figure 3.15).

The 1.2% fall in export growth from January to April 2015 came from a negative contribution by oil exports of 5.7 percentage points (pp), with -0.1pp for the other extractive industries, while there were positive contributions of 3.0pp for automotive exports, 1.5pp for exports of other manufactures, and 0.3pp for those in the agriculture and livestock sector. This indicates that the fall in oil exports was on such a scale that it was not possible to offset it with exports of automotive products and other manufactures.

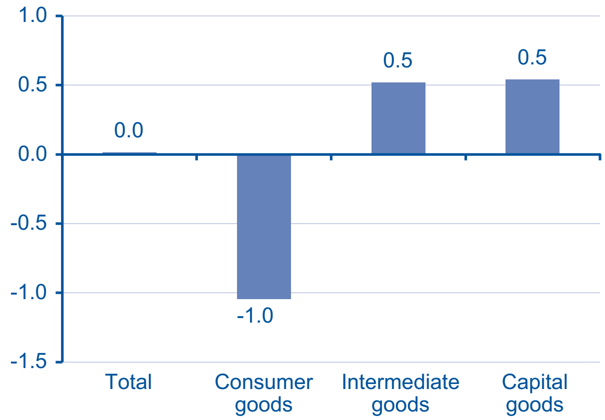
In the case of imports, their negligible annual growth from January to April (Figure 3.17) was brought about by a heavy fall in consumer goods imports (-7.2%) which was not altogether offset by imports of intermediate goods (0.7%) or capital goods (5.5%). Consumer goods imports can be split out into oil and non-oil imports, where oil imports plummeted by 25.6% YoY, while their non-oil counterpart grew by a meagre 0.9%. In terms of contribution to growth, intermediate and capital goods each put in 0.5pp, yet these positive contributions were counteracted by the negative figures for consumer goods imports (Figure 3.18).

Figure 3.17
Imports of goods by type. January-April
(Annual % change)



Source: BBVA Research with information from INEGI

Figure 3.18
Imports of goods. January-April 2015
(Contribution to growth, percentage points)

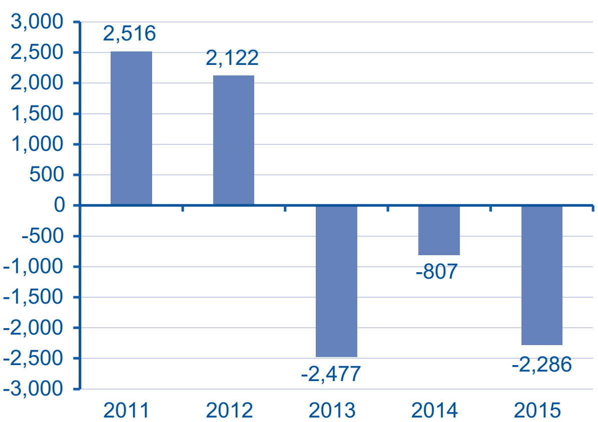


Source: BBVA Research with information from INEGI

3.1.2.2 Balance of trade deficit

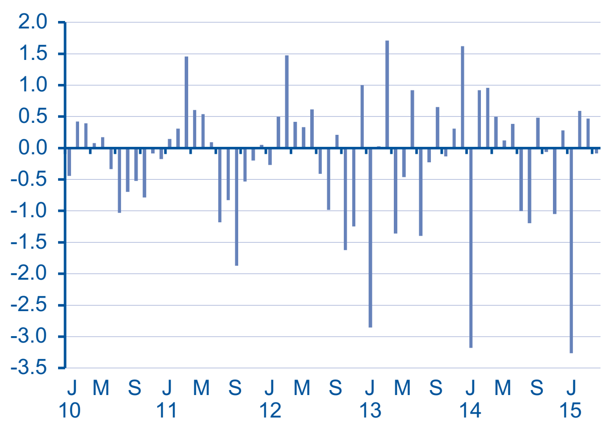
From January to April 2015, the balance of trade built up a cumulative deficit of almost USD2.3bn (Figure 3.19). It is important to note that this deficit was primarily attributable to the oil sector. For example, if all oil sector trade is excluded from overall total exports and imports, the balance of trade shows a surplus of USD371mn for the period referred to. On the other hand, if the balance of trade deficit persists over 2015 as a result of the falling value of oil exports, Mexico's external sector might not make a positive contribution to growth for the year.

Figure 3.19
Balance of trade. January-April
(USD million)



Source: BBVA Research with information from INEGI

Figure 3.20
Monthly balance of trade
(USD billion)



Source: BBVA Research with information from INEGI

3.1.3 positive performance by private sector workers registered with the social security system

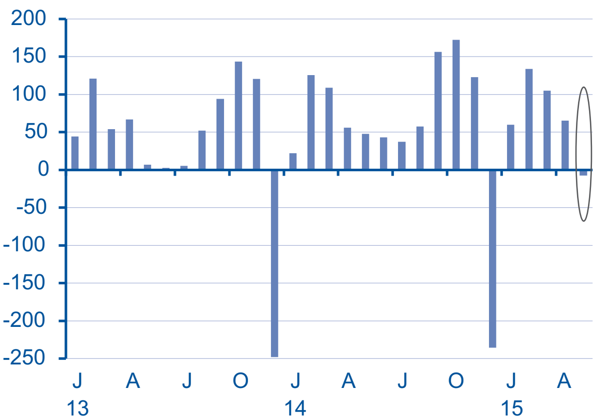
Every month from August 2013 to April 2015 saw a rise in the total number of workers registered with Mexico's Social Security Agency (IMSS), with the exception of December in both 2013 and 2014, due to seasonal factors such as staff reductions after the end of the Christmas holiday (Figure 3.21).

Here we make the point that this has coincided with the job formalisation programme that has been implemented by the labour authorities since 2H13, which consists of encouraging people who are in work, but without social security cover, to become eligible for the latter. The labour authorities have indicated that the job formalisation programme benefited some 300,000 workers in 2013[2] and between 300,000 and 350,000 in 2014[3]. The programme is continuing in 2015.

The job formalisation programme appears to have made a major contribution to the substantial rise that has been observed in the number of IMSS-registered workers in spite of the marginal pace of growth in economic activity. By way of illustration, in 2014 GDP growth was 2.1%, while the number of IMSS-registered workers rose by almost 715,000. The job formalisation which has taken place since 2H13 has thus made significant inroads into the proliferation of formal employment in Mexico.

Figure 3.21

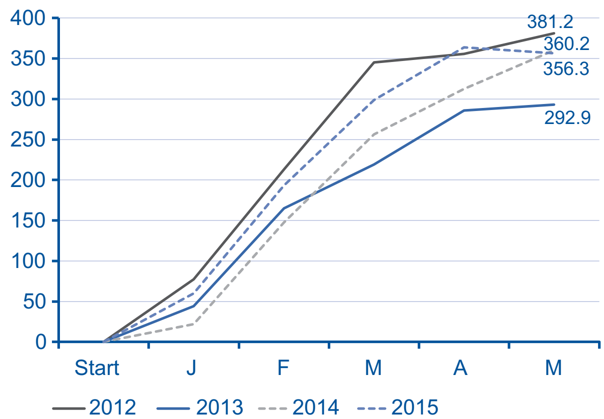
Monthly increase in the total number of workers registered with the IMSS (Thousands of persons)



Source: BBVA Research with information from INEGI.

Figure 3.22

Accumulated monthly increase in the total number of workers registered with the IMSS (Thousands of persons)



Source: BBVA Research with information from INEGI.

On the other hand, for the first five months of 2015 the number of new workers registered with the IMSS was a little over 356,000, which is down slightly if we compare this with the same five months in 2014, when this figure was roughly 360,200 people (see Figure 3.22). This was mainly because of a drop of almost 7,500 IMSS-registered workers in May (see Figure 3.22), which could be indicative of a slowdown in the labour market.

3.1.4 Public finances: greater buoyancy in expenditure than in revenues

Cumulative public sector revenues from January to April 2015 showed a real AGR of 4.9%, which was attributable to non-oil revenues. These registered a real AGR of 26.5% over this time, while oil revenues suffered a YoY fall of 43.7% (Table 3.1). The auspicious performance by public sector revenues came mainly from income tax (ISR), collections of which recorded a real AGR of 25.2% for the period. This significant increase appears to be largely due to the new tax

[2] See article "Se formalizan 40 mil empleos en el Estado de México", published in El Financiero 7 February 2014.
[3] See article "Formalizan 350 mil trabajos en 2014" published in El Financiero 11 January 2015.

rules which arose from the 2014 tax reform and which came in with the annual tax return for individuals and legal entities in March and April 2015. On the other hand, collections of value added tax (IVA) in the same period registered a negative real growth rate of 0.5%.

It should be noted that public sector budget revenues from oil came down as a result of the lower price per barrel of Mexican export crude in the months examined here.

Table 3.1

Public-sector budget revenues. January-April 2015 (Accumulated figures in MXN bn)

	Sum total	Real % change	Struc. %
Total	**1,417.3**	**4.9**	**100.0**
Federal government	1,110.2	9.1	78.3
Tax	873.0	29.2	61.6
ISR	488.8	25.2	34.5
IVA	231.8	-0.5	16.4
Non-tax	237.2	-30.7	16.7
Agencies & Co.	99.2	6.4	7.0
Gvnmt. productive co.	208.0	-13.3	14.7
Pemex	107.7	-19.3	7.6
CFE	100.3	-5.9	7.1
Total	**1,417.30**	**4.9**	**100.0**
Oil income	233.6	-43.7	16.5
Non-oil income	1,183.7	26.5	83.5

Source: BBVA Research with information from SHCP.

Table 3.2

Public-sector budget expenditure. January-April 2015 (Accumulated figures in MXN bn)

	Sum total	Real % change	Struc. %
Total	**1,544.9**	**9.9**	**100.0**
Projected Expenditure	1,214.7	9.1	78.6
Current Expenditure	913.2	7.7	59.1
Capital Expenditure	301.5	13.9	19.5
Non-Projected Expenditure	330.3	12.8	21.4
Investmnts. in States	218.7	1.4	14.2
Borrowing Cost	74.5	32.1	4.8
Adefas* and other	37.1	77.7	2.4

* Adefas: Debits carried over from previous years
Source: BBVA Research with information from SHCP.

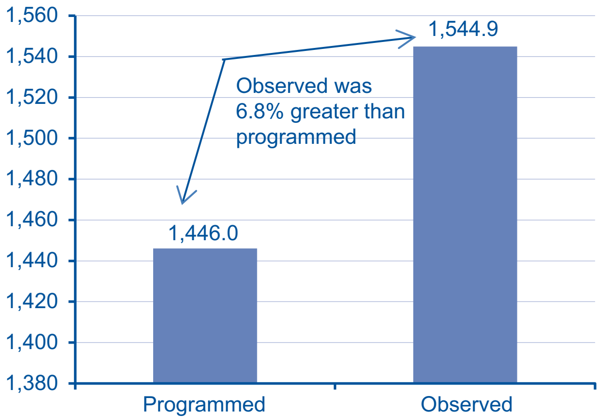
On the other hand, total public sector budget expenditure accumulated from January to April 2015 registered a real growth rate of 9.9%, which outstripped the growth rate for public sector revenues for the same period (Table 3.2). The main item of expenditure was that described as *projected expenditure* (59.1% in current expenditure and 19.5% in capital expenditure), followed by non-projected expenditure (the remaining 21.4%).

Within the two components in projected expenditure, the most active was capital expenditure, which grew by a real 13.9% YoY in the period described here, while current expenditure did so by 7.7%.

Within non-projected expenditure, the public sector borrowing cost shows a significant rise of a real 32.1% YoY. This could have arisen from the rapid increase in public sector borrowing which has been taking place over recent years. On the other hand, it can be seen that investments in the States rose by only a real 1.4% YoY over the months in question. This could be largely influenced by the lower tax revenues coming in from oil exports, a sizeable percentage of which used to be funnelled into the States prior to the drop in the price of export oil.

On the other hand, the cumulative amount from January to April 2015 in total public sector expenditure represented a 6.8% overshoot on the figure authorised in the budget for this period (Figure 3.23). As this situation is corrected in subsequent months there will be less dynamic growth in 2H15 with attempts to come into line with the projected fiscal deficit, which could have negative implications for economic activity.

Figure 3.23
Public sector budget expenditure January-April 2015: programmed and observed (MXN bn)



Source: BBVA Research with data from SHCP

Table 3.3
Public sector finances. January-April 2015 (MXN bn)

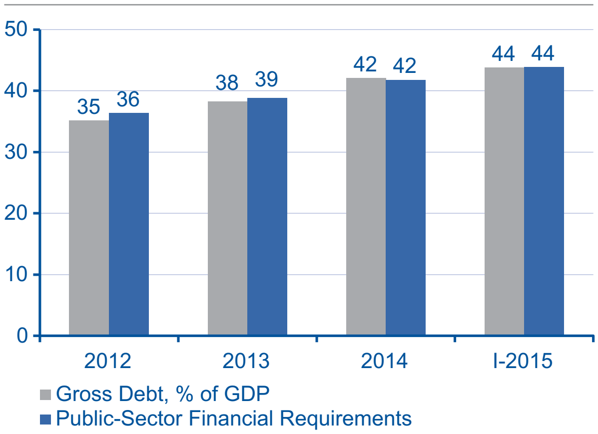
	2014	2015	Real % chge.
Public balance	-37.2	-121.6	ns
Public bal. w/o productive inv.	85.8	54.5	-38.4
Budget balance	-53.1	-127.6	ns
Budget revenue	1,310.8	1,417.3	4.9
Net budget expenditure	1,363.9	1,544.9	9.9
Federal government	-36.1	-55.4	ns
Agencies and companies	-17.0	-72.2	ns
Pemex	-66.8	-121.9	ns
Other companies	49.8	49.7	-3.2
Indirectly-controlled institutions	15.9	6.0	-63.3
Primary balance	15.9	-47.3	ns
Budget balance	1.6	-201.2	ns
Federal government	3.6	-13.0	ns
Agencies and companies	-2.0	-40.1	ns
Pemex	-55.3	-92.8	ns
Other institutions	53.3	52.7	-4.2
Indirectly-controlled institutions	14.3	5.9	-60.4

ns=not significant
Source: BBVA Research with data from SHCP

In absolute value terms, the cumulative public sector deficit from January to April 2015 was almost 3.3 times bigger than it had been over the same months in 2014 (Table 3.3). As is to be expected, given the low oil price and the heavy levels of investment, the item relating to Pemex is particularly notable due to the high deficit it shows.

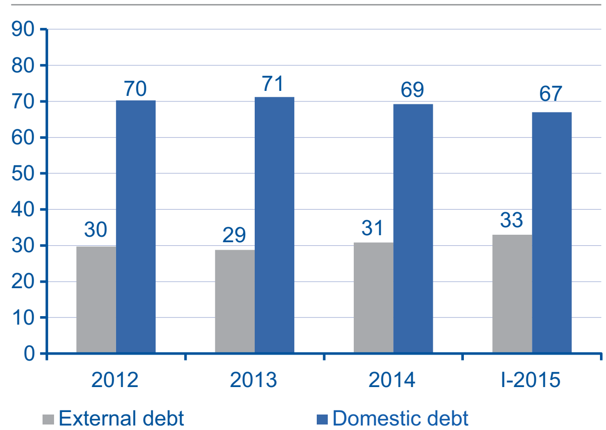
The public sector deficit has led to a higher level of total public sector debt. Looking at this more closely, total gross public sector debt climbed from 35% of GDP in 2012 to 44% of GDP at the end of 1Q15 (Figure 3.24). Even though total gross debt as a proportion of GDP is relatively low by international standards, a solid macro-economic framework has to be maintained within a scenario of rate hikes in the United States.

Figure 3.24
Total gross debt and Public-Sector Financial Requirements (% of GDP)



Source: BBVA Research with information from SHCP.

Figure 3.25
Percentage structure of total public-sector debt: Domestic and external (% of total debt)



Source: BBVA Research with information from INEGI.

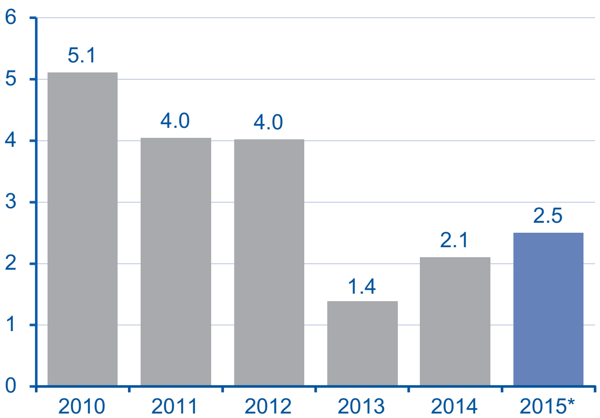
On the other hand, a considerable proportion of the increase in total public sector debt has arisen from external borrowing. This can be seen from the percentage of external debt out of the total, which escalated from 30% in 2012 to 33% in 1Q15. This debt's exposure to a peso depreciation such as that which has occurred in recent quarters represents a greater fiscal cost, which could be having a bearing on rising public sector borrowing costs (Table 3.2).

3.1.5 Outlook for the Mexican economy

Economic growth is expected to have accelerated in Q2, boosted by greater public spending associated with the elections while in the second half of the year external demand should improve with help coming from the United States labour market. This should mean that GDP grows at 2.5% for the year (Figure 3.26).

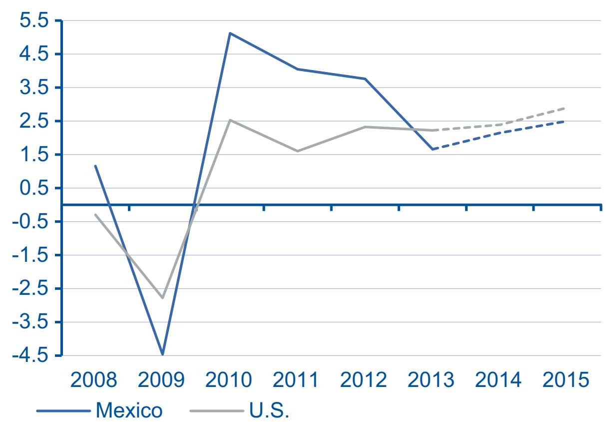
The fall in oil prices and output, along with the repercussions this has on both the industry itself and the amounts of public expenditure and investment, means that growth in economic activity has to rely even more heavily on the export sector. A balance therefore has to be found without delay for the drivers of growth, by strengthening domestic demand. To do this requires, among other factors, the implementation of economic policies which encourage the creation of well-paid formal jobs, conducting a more efficient campaign aimed at lowering the crime rates which lead to the obstruction of investment, and enhancing the transparency of all action taken within the public sector to head off the diversion of funds and to help to bring down levels of corruption and legal impunity, as these are factors which have the effect of lowering investment and increasing economic uncertainty in Mexico. Applying these measures described would contribute to gradually overcoming the lags and limitations which hinder Mexico from achieving a higher growth rate of economic activity.

Figure 3.26
Annual growth of Mexican GDP (YoY % change)



YoY=year on year.
Source: BBVA Research with information from INEGI

Figure 3.27
GDP of Mexico and the United States (YoY % change, sa)



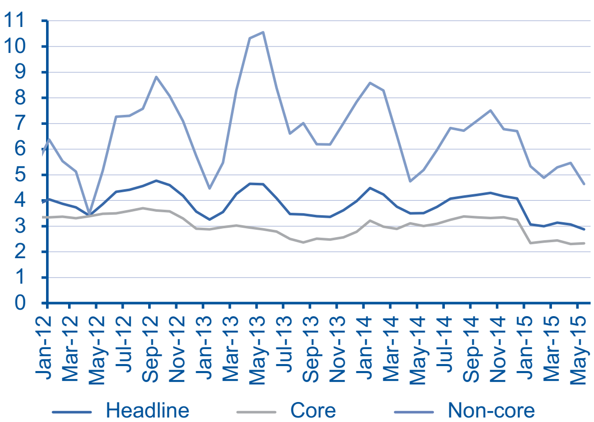
sa=seasonally adjusted. YoY=year on year.
Source: BBVA Research with information from INEGI and BEA

3.2 Positive performance by annual inflation in 2015, reaching an historical low in May

As expected, annual headline inflation dropped back in January 2015. YoY inflation came down from 4.08% in December to 3.07% in January, whereas annual core inflation dipped from 3.24% in December to 2.34% in January. This decrease mainly reflects the wearing off of the impact of the 2014 tax hikes on the inflation of various goods, as well as the sharp fall in the services sub-index, which arose from lower prices for telecoms services after the charge for long-distance domestic calls was removed. This was nonetheless also due to the initial positive effects for consumers of stiffer competition after approval was given for subscribers to change their phone operator within 24 hours while keeping the same number, within the context of the telecommunications reform. On top of this, the smaller-than-expected rise in the petrol price and the lowering of the electricity price have contributed to the recent drop in inflation.

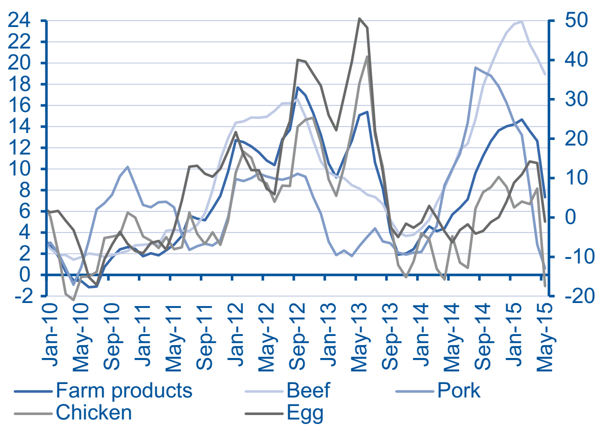
In spite of the heavy depreciation of the peso over the past eight months, annual headline inflation averaged 3.07% in 1Q15 (compared to 4.18% in 4Q14), meaning that it reached its historical low for a quarter within the recent records of the National Consumer Price Index (INPC) and now stands very close to the central bank's target of 3.0%. In April, annual headline inflation was 3.06% and then in May it recorded a further decrease, arriving at a historical low of 2.88% (see Figure 3.28). This implies that there is a very high probability that the average rate for annual headline inflation in Q2 this year will have been slightly under 3.0%.

Figure 3.28
Inflation and components
Annual % change



Source: BBVA Research with data from INEGI

Figure 3.29
Inflation of farm products
Annual % change



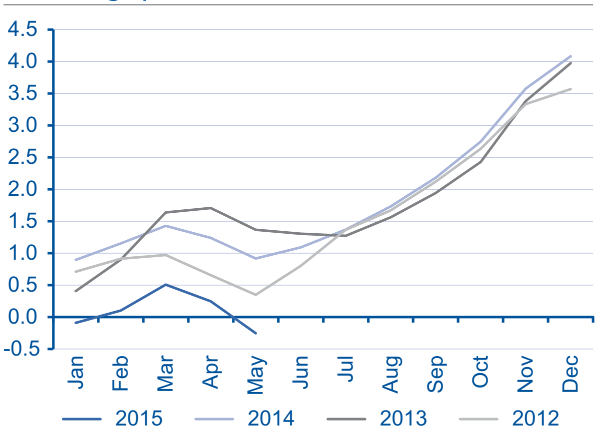
Source: BBVA Research with data from Economy Ministry

Meanwhile, annual core inflation averaged 2.39% in 1Q15, which was also an historical low for a quarter for the price index. This average compares with 3.30% for 4Q14. Annual core inflation has, in fact, remained at close to 3.0% since 1Q11, showing a quarterly average of 3.09% between 2011 and 1Q15. Even though annual core inflation has stayed low for several quarters and has shown no sign of demand pressure on prices, it rose from an average of 3.05% in 1H14 to 3.31% in 2H14, standing at 3.24% at the close of the year. This performance was mainly associated with the rise in the goods sub-index, with an annual rate of inflation that flipped up from 3.00% in 1H14 to 3.52% in 2H14, primarily due to the increase in food products as the increase in meat prices was passed on to certain processed foods such as sausage-meat products. Annual core inflation fell back noticeably in 1Q15, as the supply shock from tax rises which had been observed in January 2014 wore off, and it has remained very low in spite of the heavy depreciation of the peso in the last two months. Specifically, in April and May core inflation slipped back further, its annualised rate reaching 2.31% and 2.33% respectively.

The annual variations in the components that make up core inflation (goods and services) came down in 1Q15. This downward trend continued into the second quarter of the year. The average rate of annual inflation for the goods price sub-index descended from 3.57% to 2.56% over 4Q14 and 1Q15, while throughout April and May it averaged 2.55%. This encouraging progress was mainly accounted for by a major fall in the average annual rate of variation within the processed foods component, which shrank back from 5.35% to 3.15% between 4Q14 and 1Q15. In April and May further retreats were recorded, to an average of 2.67%. It should be noted that the reassuring performance by the goods sub-index was also made possible by a positive showing from the other goods component, thanks to the limited pass-through of an exchange rate effect to prices, which has so far manifested itself principally in durable goods prices and has not given rise to second-round effects in price formation, as we had anticipated. Thus, annual inflation of non-food goods shows a very gradual rising pattern, which has allowed it to hold at a low level, climbing from 2.04% at the close of 2014 to 2.44% in May 2015. On the other hand, the average annual variation in the services sub-index came down significantly between 4Q14 and 1Q15, from 3.08% to 2.26%, and was 2.03% and 2.23% in April and May respectively. Two factors principally lie behind this fall: i) the fall in the price of telecoms services, and ii) the slack existing in the economy.

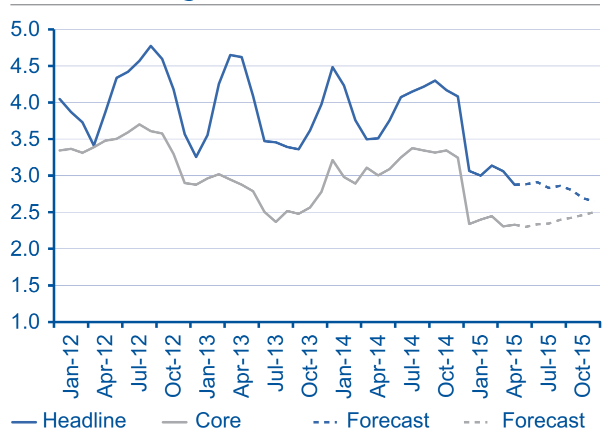
There has been a notable fall in core inflation over the past six quarters. Although it has faced three separate shocks, in the form of: i) tax rises; ii) the sharp increase in meat prices at the end of last year, which fed through to certain processed foods, and iii) the heavy depreciation of the peso, core inflation has stayed low and even fallen back further on occasion. Contributing to this were stability in inflation expectations and domestic demand weakness in a context of slack within the economy. At any rate, these shocks have not had any visible effect on the price formation process and the various changes in relative prices have not led to second-round effects.

Figure 3.30
Accumulated inflation by year
Percentage points



Source: BBVA Research with INEGI data

Figure 3.31
Inflation outlook
Annual % change



Source: BBVA Research

Annual inflation for the non-core sub-index, which includes more volatile products such as those in the agriculture and livestock segment, energy and public tariffs, dropped from 6.99% to 5.17% on average between 4Q14 and 1Q15. This also registered additional decreases in Q2, with a reading of 4.64% in May. The fall was primarily linked to the drop in the annual inflation of energy prices, which came down from a rate of annual variation of 6.36% in 4Q14 to one of 3.30% in 1Q15, and they recorded additional decreases in Q2, showing 2.90%. This is essentially due to the lower rate of increase in petrol prices and reductions in electricity rates, registering 2.0% in January 2015, helped by the movements in the prices of the fuels used in generating electricity, mainly fuel oil and natural gas. On the other hand, even though the overall annual variation rate for the agriculture and livestock sub-index has not shown any obvious change of trend (an average of 8.39% in 1Q15, compared to 8.04% in 4Q14 and 8.68% in April and May), the strong pressure on livestock prices in 2H14, which as a whole had not lost ground in 1Q15, seems to be finally beginning to ease off (averaging 13.43% in 4Q14 and 14.15% in 1Q15, compared to 9.99% in April and May, and 7.64% in May), As can be seen in Figure 3.29, the annual rate of variation for the key livestock products is now showing a downward trend.

To summarise, inflation's performance has been very encouraging over the first five months of the year. Factors contributing to this were: i) the dissipation of the effects of the fiscal reforms in 2014; ii) the positive effect of the telecoms reform, lower electricity prices and smaller petrol price rises; iii) the slack present in the economy, and iv) the credibility of the central bank, which has allowed inflation expectations to remain anchored in spite of several changes in relative prices. As can be seen in Figure 3.30, for the first time in recorded history cumulative inflation as of May is negative, at -0.26 percentage points.

Going forward, we estimate that headline inflation will hold at under 3.0% over the whole year and we are revising our year-end forecast down to 2.65%

Bearing in mind that the factors which explained inflation's upward trend to October 2014 were supply shocks (i.e. the 2014 fiscal changes and movements in relative prices, mainly among livestock products) which have had no second-round effects on price formation, and that feed-though of the exchange rate effect has remained limited, our outlook for inflation in 2015 is still favourable, within a context of a high level of slack in the economy. At the same time, the effects of the telecoms reform have been evident and developments in inflation have also been assisted by the impact on electricity rates of lower prices for those fuels used in generating energy of this kind.

Given the prospects of a gradual recovery of the economy, we do not foresee pressure on prices. Trends in core inflation (the measure which is the best indicator of how inflation will behave in the medium term) are still being helped by the weakness in the economic cycle, as well as the resulting slack that has led to an absence of demand pressure on prices. Besides this, as we explain in the chapter on economic activity, we have revised our growth forecasts for 2015 and 2016 downwards, assuming a further increase in the already high level of slack in the economy. This will continue to allow the feed-through effect of the peso depreciation on inflation to be only limited and means that no second-round effects will appear, as has been the case thus far.

In qualitative terms, our inflation scenario is unchanged. In quantitative terms, though, we are revising our forecasts down for headline inflation at the close of 2015 from 2.9% in our previous Outlook to 2.65%, and from 2.8% to 2.5% for core inflation. We also now predict that annual headline inflation will average 2.9% in 2015, compared to 4.0% in 2014, and that annual core inflation will average 2.4% this year, 0.8 percentage points below the 2014 figure (3.2%).

If the smaller rise in energy prices is maintained (i.e. if there is no return to the substantial increases in petrol prices and no reversal of the sound performance by those fuels used in the electricity generation process), this will not only help to bring about lower inflation in 2015 due to its direct effects on the INPC basket, but should also facilitate inflation's convergence towards the 3.0% target on a permanent basis, to the extent that it has indirect effects on other prices. Moreover, when economic agents perceive that this slower annual rate of increase is going to be long-lasting, this could also contribute to anchoring medium- and long-term inflation expectations at lower levels. In short, the non-core sub-index should perform better from 2015 compared to previous years and help to achieve lower inflation rates.

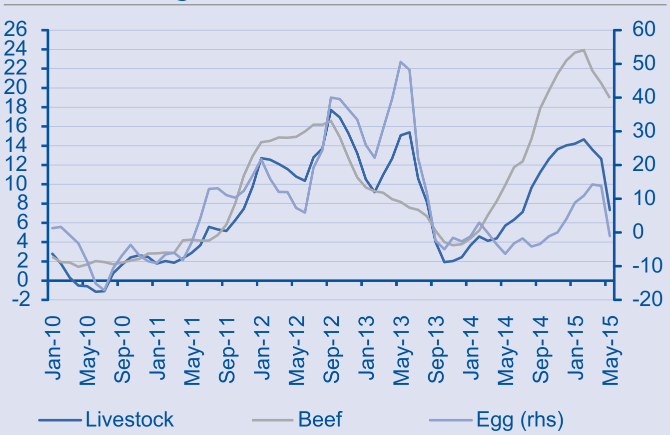
Our forecasts are subject to both downside and upside risk. The main downside risks are from a less vigorous than expected economy which gives rise to a widening of the output gap, the possibility of further decreases within mobile phone services if the changes under the telecoms reform spur greater competition in the sector, and sharper-than-expected falls in livestock prices. On the other hand, the upside risks could come from the exchange rate if it settles at its current level or if there is further peso depreciation (although the level of feed-through which we estimate is low), and the chance of a rise in the minimum wage. The effect of this would be fleeting, though, and similar to that of another supply shock in the mould of last year's tax changes. This is assuming that the increase is confined to all workers earning the minimum wage, that it is a one-off policy, and that economic agents see this as such.

Box 1: Recent movements in livestock product prices

At the end of last year, non-core inflation came under upward pressure, mainly from surges in beef and egg prices, among other livestock products (see Figure 3.32). For example, with respect to the meat price, this had an impact on cumulative headline inflation for 4Q14 of 0.139 percentage points (pp), which means that, if the price had not risen at such high monthly rates over that period, inflation would have closed 2014 within the band around the central bank target at 3.9%, rather than at 4.08% as was finally the case. With regard to the price of eggs, its cumulative impact on headline inflation over the final two months of 2014 was 0.59pp. The livestock prices sub-index has a weight of 4.87% in the national consumer price index. Within the basket for this sub-index, the price with the greatest relative significance is that of beef, with a weight of 1.78% in the general index, which means that it accounts for 36% of the livestock price sub-index. On the other hand, although the relative significance of the egg price is less, at 0.61% of the index, the strong volatility in its price gives rise to very sizable monthly swings (see Figure 3.33) and this means that in recent years its impact on headline inflation has been very considerable.

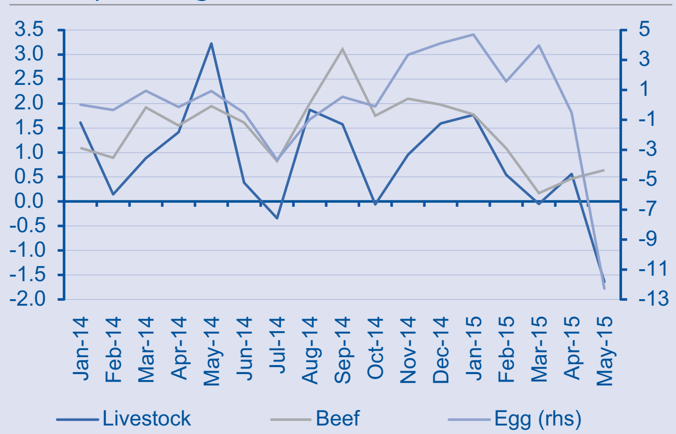
Even though there is monthly monitoring of livestock prices, which can give us a fair estimate of these prices in monthly consumer inflation, anticipating turnarounds in them is a major challenge and provides an element of uncertainty as regards predicting monthly inflation for the next few months, as well as, by extension, with respect to the annual inflation forecast. In this sense it is important to recognise that, given the substantial integration of trade between Mexico and the United States, changes in the relative prices of these products in the United States appear to anticipate movements, in the same direction and with similar strengths, of the same products in Mexico. As can be seen in Figure 3.34, on the last two occasions when beef prices rose significantly and persistently in Mexico (i.e. from the end of 2011 to 2012, as well as during 2H14), the increases had arisen beforehand in the United States. It thus seems that supply shocks for this product in the United States are passed on to Mexico with a lag of just a few months; in other words, falls in supply in the United States influence the supply in Mexico. This could be because, if production falls off in the United States, after a subsequent rise in prices there, Mexican producers might respond by stepping up the amount which they allocate to exports, which ultimately has the effect of choking off the supply for the domestic market and bringing about a rise in the beef price. On the other hand, as Figure 3.34 shows, even though egg prices in Mexico follow a sharper pattern of movements and on occasions there have been supply-side problems (e.g. an outbreak of avian flu in the summer of 2012), these seem to owe themselves more to global factors. This can be observed in the high correlation with the price of eggs in the United States, and more recently (4Q14 and the first five months of this year) the price in the United States appears to have exhibited turnarounds in trend a little before these have affected the price in Mexico. As well as these, the prices of pork and chicken also to some extent shadow those in the United States, and with a lag too.

Figure 3.32
Farm products prices
Annual % change



Fuente: BBVA Research con datos de INEGI

Figure 3.33
Farm products prices
Monthly % change



Fuente: BBVA Research con datos de INEGI

If we bear in mind that the combined weights for meat, pork, egg and chicken account for 90% of the overall livestock product sub-index, anticipating shifts in the price trend for these some months before the event allows us in turn to foresee changes in trend for headline inflation that are brought about by these items.

Looking ahead, the recent change in the slope for the livestock product index leads us to suppose that the sharp increases observed from the second half of the previous year could have reached their conclusion. Stabilisation of this index would produce very encouraging annual comparison effects in H2, which would give a downward bias to our year-end headline inflation forecast of 2.65%. An upside risk remains with the beef price, which still does not seem to have topped out after showing a further substantial increase in May.

Figure 3.34

Índice de precios de la carne de res en EE.UU. y México*

* Índice de EE.UU. dic97 = 100; índice de México 2a. quincena dic10 = 100
Fuente: BBVA Research con datos de INEGI y Bloomberg

Figure 3.35

Índice de precios del huevo en EE.UU. y México*

* Índice de EE.UU. dic97 = 100; índice de México 2a. quincena dic10 = 100
Fuente: BBVA Research con datos de INEGI y Bloomberg

3.3 Communication by the central bank suggests synchronisation of its monetary policy with the Federal Reserve's rate hike process

The weak economic growth and the low level of inflation during H1 gave rise to uncertainty over whether it was appropriate to embark on a cycle of monetary tightening. Nonetheless, the central bank has stuck to its message of monetary restriction, given the risk of inflation taking a firmer grip with the forthcoming hiking of the US federal funds rate. Specifically, after announcing the lowering of the forecast range for GDP growth in 2015 to 2.0-3.0% from 2.5-3.5%, the governor of the central bank repeated that the prospects of monetary policy rate (MPR) hikes remain intact, even though this might entail a cost in terms of economic activity in the short term.

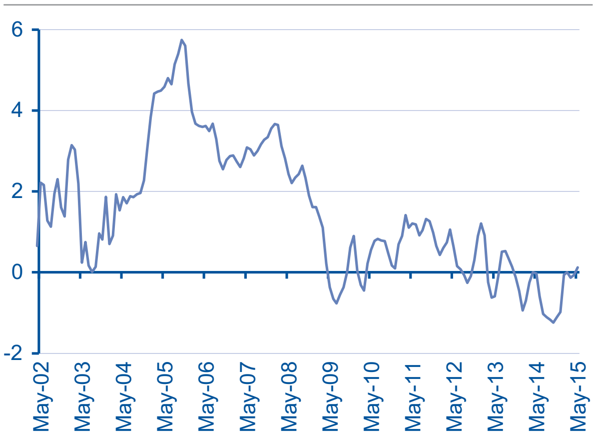
This comes as the central bank has focussed its attention on the inflation risk represented by the potential depreciation of the peso with the start of the cycle of monetary normalisation by the Federal Reserve (Fed). Even though the passing on of peso depreciation to price and inflation expectations has thus far been limited, the central bank remains wary, as it says that Fed monetary policy action could have a knock-on effect on inflation in Mexico via the volatility that this creates in the currency and fixed income markets.

This begs the question of whether, in an environment in which inflation is at a historic low (marking 2.88% in May), the risk is of such a magnitude that it could compromise or delay convergence towards target inflation. As regards the rest of the year, the answer is probably no. Nonetheless, given the time which it takes for monetary policy to work through, the central bank is likely to be weighing up the balance of risk for 2016, for which we estimate that inflation will average 3.4% if no major shocks are forthcoming. This means that if the risks for inflation become more significant halfway through next year, then inflation in annual terms will be around 3.5%, given the effect of annual comparison of the national price index that will occur.

Here we should bear in mind that the central bank's message does not merely refer to convergence towards the target, but it states the need for this to be consolidated (where this is understood to mean not only managing to steer inflation to 3.0% for a few months, but keeping it there or thereabouts for some length of time). Unlike in previous years where "efficient convergence" (i.e. convergence towards the target while keeping the costs to economic activity at a minimum) was the watchword in any change in monetary policy position, in the coming months consolidating inflation's convergence towards the target is likely to be the mantra behind any action by the central bank.

Figure 3.36

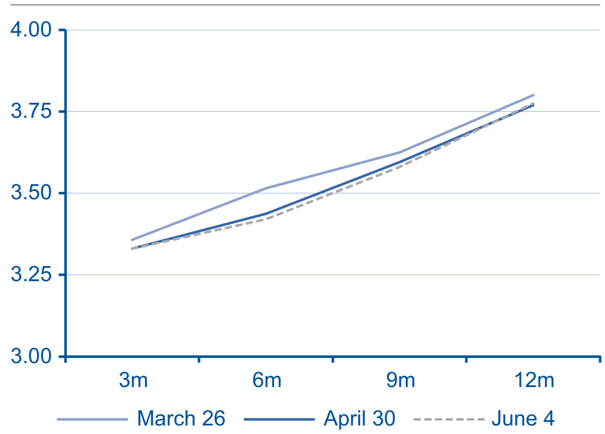
Real short-term interest rate (%)



Source: BBVA Research with data from Banxico and INEGI.

Figure 3.37

Swap rate curve in the last monetary policy statements (%)



Source: BBVA Research with data from Bloomberg

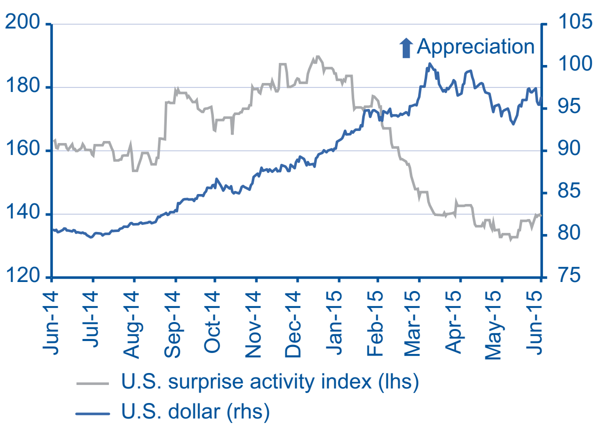
Thus, given the clarity and emphasis in the central bank's communication regarding its future monetary decision-making, we will have to watch out for action by the Fed and the feed-through of the exchange rate effect to prices and inflation expectations, as these will spur monetary policy decisions in Mexico.

In keeping with the above points, we are standing by our forecast of a 25 basis point hike in the reference rate towards Q4, in harmony with the hike in the federal funds rate in the United States. We think that while the economy's flatness appears to have little bearing on the start of tightening, it will have considerable influence on the speed of the hiking cycle.

3.4 With a federal funds rate hike imminent, the greater appeal of dollar-denominated assets is driving the peso to historic lows

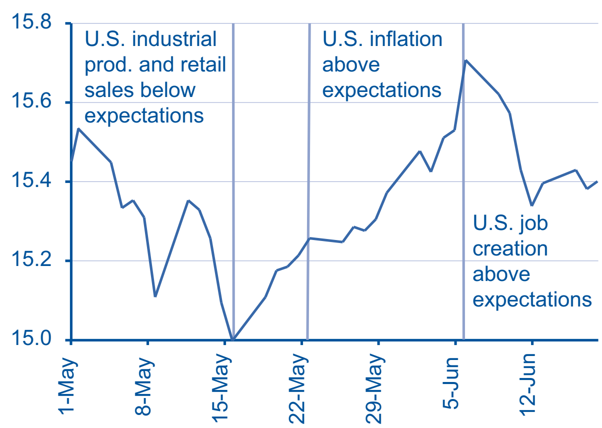
The divergence between the United States and the rest of the world with regard to economic prospects and monetary policy continues to be the key factor guiding movements in financial markets. In particular, uncertainty over the timing of the start and the pace of monetary normalisation by the Federal Reserve (Fed) has given rise to a reallocation of funds among the various asset classes by investors. One of the most salient manifestations of this reallocation is the rise in the demand for dollar-denominated assets since 4Q14. The USD has appreciated by around 18% against the key currencies worldwide in the past year. This dollar demand has been kept at a high level even though in 1Q15 the US economy registered quarterly growth of -0.7% YoY and despite the fact that industrial production strung together six months of negative monthly growth rates. How should we interpret such behaviour? The explanation could be found in the fact that the US economy is the only region in the developed world with above-potential growth prospects, which in turn feeds expectations that the Fed will begin to raise its reference rate after almost seven years of unconventional monetary policy measures that have held the federal funds rate at levels between 0 and 0.25%. These circumstances are reflected in a higher expected yield on US assets, which also benefit from the presence of high liquidity levels and low levels of credit risk relative to other markets.

Figure 3.38
U.S. surprise activity index and U.S. dollar vs. main currencies (indices)



Source: BBVA Research with Bloomberg data

Figure 3.39
Exchange rate (pesos per dollar)



Source: BBVA Research with Bloomberg data

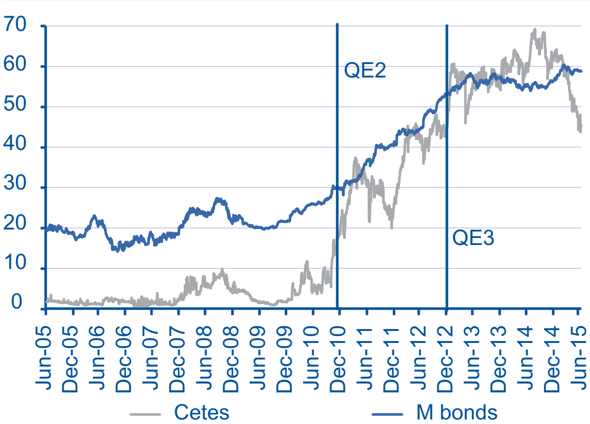
This situation has highlighted the strength of the US dollar with respect to the Mexican peso. After the 11.3% depreciation during 4Q14 deriving from the oil price collapse, the uncertainty surrounding future action by the Fed after each item of data on economic activity in the United States has taken the dollar to a market value of as much as MXN15.71, which is an all-time high. To illustrate the uncertainty affecting the peso, the first week of June ended with the release of the May employment report, which revealed that job creation had exceeded the market consensus, whereupon the peso depreciated by 2.12%. Yet in the past few months the negative correlation between the positive figures on the US economy and the peso's exchange rate has become even more pronounced, to such an extent that a better-than-expected set of figures on employment and wage growth in the United States has translated, in average terms, into a daily depreciation of 1.0% for the peso. Furthermore, it has also been noted that, despite this negative correlation, the peso has not managed to hold onto the ground gained on those days when lower-than-expected figures on US activity have been reported. In other words, although the worse-than-expected data on industrial production, retail sales or GDP growth did result in gains for the peso where the dollar even stood below 15 pesos, these turned out to be short-lived and evaporated in the days that followed. This behaviour could be a sign of the high demand for dollars and the high liquidity of the Mexican peso in international markets. In spite of all these movements described here, the peso is among the 11 emerging market currencies to have depreciated the least against the dollar in 2015, with a fall of 4.38%. This figure is a long way off the falls of over 14.0% for countries such as Brazil and Turkey, and even the levels of depreciation experienced by the euro and the Canadian dollar, which have lost 7.19% and 5.79% respectively.

A second illustration of this switching of funds among the different asset classes has been the reduction in short-term Mexican bond holdings by foreigners. May was the sixth month in a row where there was a fall in holdings of Cetes (federal treasury certificates) by investors from abroad, which was a hitherto unseen phenomenon that caused the percentage interest of holders in this category out of the total to fall by almost 70%, to a little over 45%. This can partly be explained by the lower returns to be gained from short-term investment (carry trade) strategies funded in foreign currency, given the depreciation and high volatility of the Mexican peso. By way of contrast with this trend, foreign holdings of bonds along the medium and long sections of the curve have remained stable. In fact, over April and May these rose again following two months of mild falls, with the net result that the interest of non-resident investors as a percentage of the total held remains at a fraction under 60%. This stability might have something to do with the inclusion of several M-bond issues within the global bond indexes that are typically part of allocations of assets of institutional investors such as pension funds. Unlike in the case of Cetes, some of the investors in M-bonds seem to have longer-term investment horizons, which makes for greater stability in holdings of them, even within the current climate of uncertainty.

Despite the currency depreciation and the reduction in holdings of short-term bonds by foreigners, there are certain indicators of risk that lend weight to the contention that what we are witnessing is more a case of a reallocation of funds among different asset classes given monetary normalisation in the United States than a deterioration per se in the Mexican economy. The level of credit risk attaching to dollar-denominated Mexican debt if we gauge this from five-year credit default swaps (CDSs) stands at 127 basis points (bp), a level far below that observed at the time of the Lehman Brothers bankruptcy filing (601bp) and that seen during the September 2011 euro crisis (216bp). Another of the indicators is currency risk when estimated by the implied volatility of currency options, which is currently 11.0%, whereas during episodes of volatility such as those mentioned before it stood as high as 71%. Finally, while it is true that the Currency Commission set in train a programme of dollar auctions with no minimum price, these are of a preventative nature, as no shortages of liquidity have been reported in the currency market.

Figure 3.40

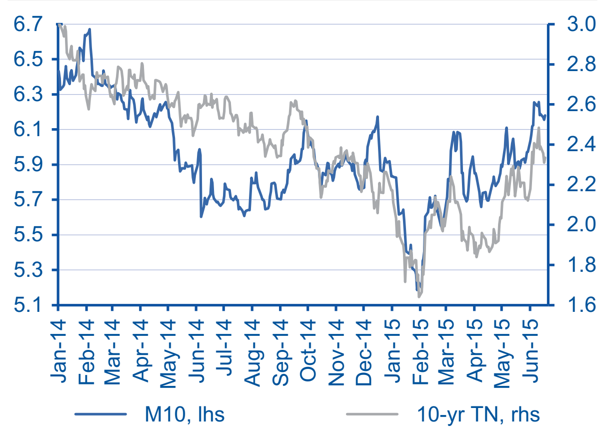
Holdings of cetes and M bonds by foreigners (% of total holdings by instrument)



Source: BBVA Research with Banxico data

Figure 3.41

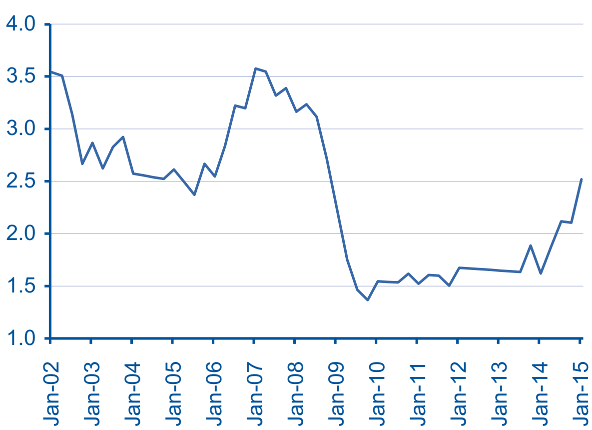
Yield on 10-year Mexican and US government bonds (%)



Source: BBVA Research with Bloomberg data

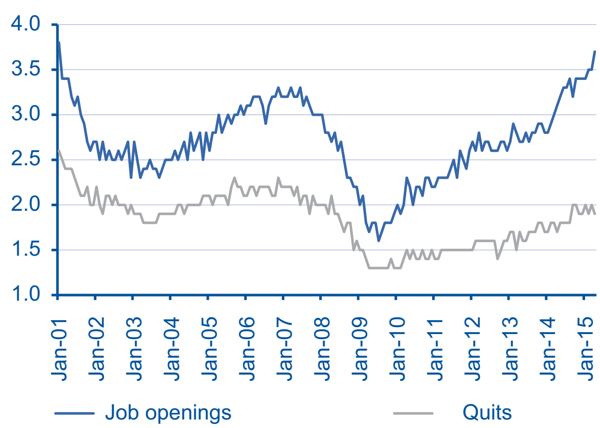
Another of the variables which has behaved differently from previous occasions when there was volatility has been the interest rate curve. Despite the context of global risk aversion on account of the forthcoming cycle of monetary policy normalisation in the United States, long-term interest rates on Mexican bonds have moved in harmony with those on US T-Notes. The yield on the 10-year M-bond (M10) stands at 6.18%, which is some way below the level reached in the times of major financial upheaval following the Lehman Brothers failure (it averaged 9.82% in November 2008) and 100 basis points below the average registered during 1H11 when concern was mounting over the euro crisis. Thus, in 2015 to date, movements in the M10 bond rate have shadowed those of the 10-year T-Note. At those times when the data on job creation and wage growth in the United States have been positive and influenced expectations over the timing of the initial hiking of the federal funds rate, long-term bond yields in both countries have trended higher, whereas when the data has been worse than expected, long-term rates have halted on their upward course and briefly drifted back down to lower levels. Overall though, after trending downwards in 2014, rates have tended gradually upwards in 2015 (see Figure 3.41). In fact, after sinking to their recent lows at the beginning of the year (1.64% for the 10-year T-Note and 5.19% for the M10 bond) the yields on both government bonds have climbed by 69bp and 99bp respectively, arriving at levels of 2.33% and 6.18%.

Figure 3.42
Labor cost index*
(Annual % change)



*Workers of all industries and occupations
Source: Bloomberg & BBVA Research

Figure 3.43
Job openings and quits
(% of employment)



Source: Bloomberg & BBVA Research

Going forward, we expect the switching of funds among the different asset classes to continue and even to escalate, given the imminence of the monetary normalisation process. Moreover, we should not rule out more volatility over events such as the negotiations between Greece and the European authorities, or some other occurrence involving geo-political risk. Specifically, as regards the exchange rate, we think that there is scope for a limited appreciation from current levels to a dollar rate of between 14.8 and 15.0 pesos towards the end of the year, on the basis of the following factors: i) some dissipation of uncertainty regarding the course taken by US interest rates, once normalisation gets under way in September and when the markets price in the gradual nature of the cycle of hikes proposed by the Fed; ii) the lift-off of the US economy during H2 such that an annual growth rate (AGR) of no less than 2.5% is achieved in 2015, and iii) a continuation of the oil price recovery. With respect to long-term interest rates on government bonds, the decisive factor will also be the impending start to the Fed's rate hike cycle. Here we should ask ourselves whether the net balance of negative surprises as regards activity figures in the United States so far this year could mean a delay to the Fed's decision over when to make a start on monetary policy normalisation. As expected, the Fed did not take any decision to move the Monetary Policy Rate (MPR) at its June meeting, being influenced by the bad patch the US economy went through in Q1 and swayed by the fact that the low inflation rates preclude any pressing need to take such action. Instead, the Fed chose to sit it out and see whether the figures that come out are still moving in the right direction. In September, however, the Fed's patience could either run out or, more likely, come close to such a point, so we therefore still expect it to commence its hike cycle in September. Should this not be the case, the delay is unlikely to drag on beyond the December meeting this year.

Why are we drawing near to the end of exceptionally low interest rates in the United States? Although there was a fall-off in production in the United States in Q1 and the figures on the economy did not brighten up as swiftly as expected in Q2, which allows the Fed to remain patient, the fact is that temporary circumstances which had kept inflation in check, such as the plunging oil price and the substantial appreciation of the dollar, are now beginning to fade away and even starting to morph into a steady swell in market inflation expectations, which is something that will contribute to the annual inflation rate gradually shifting towards the Fed's target level. And this is one of the key factors that will decide when the rate hikes start, as we should recall that the Fed has made it clear that it will not begin this process until the labour market rallies and it is "reasonably confident" that annual inflation will rise to around 2.0% in the medium term.

It is important to underline how much the labour market matters to the Fed, because its recovery has remained intact despite the slowdown which other economic activity figures have pointed to so far this year. Not only does job creation continue apace, but wages are also hardening (which will be crucial if inflation is to approach the levels which the Fed hankers after). Wages grew by 0.3% MoM in May (compared to an expected 0.2%) and the employment cost index for all employees showed a YoY variation of 2.5% in 1Q15 (2.8% for private sector workers). The most important aspect here is that after several years of very modest growth rates, employment costs seem to have started on an upward cycle (see Figure 3.42), which is a key factor towards inflation rising in the future. On top of this, labour market strength, which is increasingly evident if we bear in mind that job offers are growing at the fastest rate since 2001, and the fact that more and more workers are leaving their current jobs given the livelier outlook for the labour market (see Figure 3.43), mean that wages are likely to continue to recover over the coming quarters.

To summarise, we think that the most significant figures when it comes to Fed decisions are moving in the right direction, which should mean an MPR hike this year. To the extent that the first hike in the forthcoming cycle comes sooner rather than later (i.e. in September and not December) the bias to our current forecasts for 10-year government bond interest rates in Mexico (6.1%) and the United States (2.4%) would be to the upside and around 30-40bp for the M10 bond, whereas if the Fed decides to put off the hike to December, the bias would be more limited.

4. Recent developments in employment in Mexico

Introduction

Given the importance of the labour market as a source of domestic demand, and bearing in mind the major job formalisation programme initiated in 3Q13,[1] this article looks at recent labour market trends in Mexico.

According to the figures from the National Occupation and Employment Survey (ENOE) published by INEGI, in 1Q05 there was an economically active population (EAP) of almost 43.1 million and by 1Q15 this figure had grown to a little over 52 million. Thus, in the space of 10 years, the EAP grew by 8.9 million people, meaning that, on average, 890,000 people a year had joined the labour market.

The EAP divides into employed and unemployed people. In 1Q15 there were 49.8 million employed people (95.8% of the EAP) and 2.2 million who were unemployed (4.2% of the EAP). Employed people can be subdivided according to their employment situation (subordinate workers, employers, self-employed workers and others) or according to whether or not they have access to social security cover.

A nationwide job formalisation programme has been implemented, which is notable for having lifted the total number of workers registered with the Mexican Social Security Agency (IMSS) significantly within the context of low growth in the economy. For example, in 2013 GDP grew by 1.7% and the annual growth in the total number of workers registered with the IMSS at the end of that year was 2.9%, while in 2014 GDP grew by 2.1% and the total number of IMSS-registered workers did so by 4.3%. These figures do not make a distinction between the number of jobs created purely due to the expansion of economic activity and the formal jobs which have been registered as a result of the job formalisation programme.

It should be noted that a new formal job registration that arises from the growth of economic activity implies an additional flow of income within the economy, which in turn increases the demand for goods and services. Conversely, a new registration due to formalisation of an existing job does not imply any additional flow of income, since the person already received this. Nevertheless, formalisation gives rise to greater security for the worker, both in the ambit of their employment and as regards the health and welfare of their family. In the medium term this could encourage greater consumption, although how much this amounts to will also depend on the net income received by the worker before and after formalisation. The problem of identifying the origin of formal job creation has implications for forecasting certain key variables, such as private consumption or the demand for consumer and housing loans, which to a large extent depend on new employment that purely arises from economic activity.

Job creation, with and without access to Social Security cover

Employed people can be divided into those who have Social Security and those who do not. This is a classification which is often used to denote job informality, where a formal worker is one who has Social Security cover, while an informal worker is one who does not. According to this classification, out of the 49.8 million people who were employed in 1Q15, only 18.3 million, or 36.7% of the total, had access to social security. This means that employed people who did not have social security numbered 31.3 million, which is 62.5% of the employed population (see Table 4.1).

[1] The issue of job formalisation has appeared in the press on certain occasions such as, for example, in the articles published on 7 February 2014 and 11 January 2015 in El Financiero. Besides this, the press releases issued by the Ministry of Labour and Social Welfare (STPS) make reference to the matter of formalisation or job migration to formality (e.g. STPS Newsletter 165 of 7 February 2014). This process consists of getting someone who has been in employment but has not had Social Security cover (i.e. is not registered with the IMSS) to formalise their situation, so that the worker now has social security cover having registered with the IMSS).

According to the ENOE, from the end of 2Q13, when the job formalisation programme was begun, to the end of 1Q15, the rise in the overall employed population was 509,835 people. This figure comprises an increase of 579,661 people with access to social security and a drop of 24,497 in those who did not, as well as a fall of 45,329 people for whom no specification was provided regarding whether or not they had access (see Table 4.1).

Table 4.1
Economically Active Population in work according to access to social security

	Figures in numbers of people					Increase in the number of people employed in the period under review			
	1	2	3	4		5	6	7	8
	Total EAP in work	EAP with social security access	EAP with-out social security access	EAP with unspecified access		Total EAP in work	EAP with social security access	EAP with-out social security access	EAP with unspecified access
IV-2010	45,911,934	16,500,567	29,133,888	277,479	2010-2009	(431,770)	460,544	(870,450)	(21,864)
IV-2011	48,307,467	16,925,874	31,075,371	306,222	2011-2010	2,395,533	425,307	1,941,483	28,743
IV-2012	49,945,599	18,056,654	31,597,517	291,428	2012-2011	1,123,328	383,255	762,293	(22,220)
IV-2013	49,945,599	18,056,654	31,597,517	291,428	2013-2012	1,123,328	383,255	762,293	(22,220)
IV-2014	49,823,798	18,267,966	31,299,257	256,575	2014-2013	(121,801)	211,312	(298,260)	(34,853)
II-2013	49,296,229	17,716,433	31,302,185	277,611					
I-2015	49,806,064	18,296,094	31,277,688	232,282	I-15-II-13	509,835	579,661	(24,497)	(45,329)

Source: INEGI, ENOE

From these figures we can see that, from the end of 2Q13 to 1Q15, progress was made in terms of greater coverage of the working population who have access to social security, as this segment increased by a greater amount than overall employment. This situation illustrates the headway made in the job formalisation programme which the labour authorities set in train from the beginning of 3Q13.

Formal subordinate and waged job creation

The total number of people in work can also be broken down into the following categories: i) subordinate and remunerated workers; ii) waged subordinate and remunerated workers; iii) workers with non-waged earnings[2]; iv) employers; v) self-employed workers, and vi) non-remunerated workers (see Table 4.2)

From the end of 2Q13 to 1Q15 the number of people with non-waged earnings fell off (-119,436: Table 4.2, column 11), as did the number of employers (-39,100: Table 4.2, column 12), self-employed workers (-26,251: Table 4.2, column 13), and non-remunerated workers (-288,884: Table 4.2, column 14). Overall employment over the period within these four categories dropped by 473,671 people.

[2] One example of non-wage earnings is income that a person might earn by way of fees.

Table 4.2

Economically Active Population according to employment situation

	Figures in numbers of people								Increase in the number of people employed in the period under review						
	1	2	3	4	5	6	7		8	9	10	11	12	13	14
	Total EAP in work	Total Subordinate and Remunerated Workers	Waged Subordinate and Remunerated Workers	Workers with non-waged earnings	Employers	Self-employed Workers	Non-remunerated Workers		Total EAP in work	Total Subordinate and Remunerated Workers	Waged Subordinate and Remunerated Workers	Workers with non-waged earnings	Employers	Self-employed Workers	Non-remunerated Workers
IV-2010	45,911,934	31,926,649	29,771,088	2,155,561	1,764,154	9,287,728	2,933,403	2010-2009	(431,770)	1,736,017	1,728,674	7,343	(324,078)	(1,603,674)	(240,035)
IV-2011	48,307,467	31,973,036	29,858,562	2,114,474	2,325,825	10,915,950	3,092,656	2011-2010	2,395,533	46,387	87,474	(41,087)	561,671	1,628,222	159,253
IV-2012	48,822,271	33,962,012	31,747,737	2,214,275	1,903,568	9,968,460	2,988,231	2012-2011	514,804	1,988,976	1,889,175	99,801	(422,257)	(947,490)	(104,425)
IV-2013	49,945,599	33,614,596	31,535,684	2,078,912	2,292,799	11,096,188	2,942,016	2013-2012	1,123,328	(347,416)	(212,053)	(135,363)	389,231	1,127,728	(46,215)
IV-2014	49,823,798	33,836,470	31,787,571	2,048,899	2,072,609	11,178,627	2,736,092	2014-2013	(121,801)	221,874	251,887	(30,013)	(220,190)	82,439	(205,924)
II-2013	49,296,229	33,033,213	30,886,624	2,146,589	2,205,208	11,261,033	2,796,775	-							
I-2015	49,806,064	33,897,283	31,870,130	2,027,153	2,166,108	11,234,782	2,507,891	I-15-II-13	**509,835**	864,070	983,506	(119,436)	(39,100)	(26,251)	(288,884)

Source: INEGI, ENOE

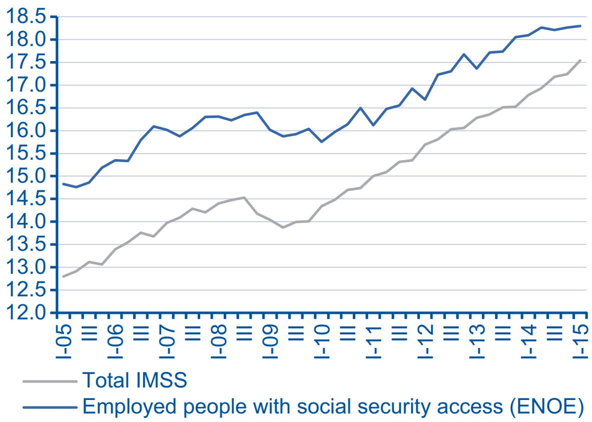
In contrast with the previous figures, the number of waged subordinate and remunerated workers rose by 983,506 people (Table 4.2, column 10). If, from this figure of nearly one million people, we subtract the almost 474,000 by which employment fell within the four categories of employed workers mentioned previously, we find that employment only rose by 509,835 people (Table 4.2, column 8). This implies that in the last seven quarters an average of almost 73,000 jobs have been created per quarter.

In the period under review, total employment was almost 510,000 people (Table 4.2, column 8) and at the same time there was an increase of almost 984,000 people who are subordinate and waged workers (Table 2, column 10). This last figure points to a major supervisory effort by the authorities in a bid to bring about the registration as subordinate and waged workers of personnel registered under different employment categories. It is also important to bear in mind that only a portion of the 510,000 jobs by which employment rose in the period described was as a result of the expansion in economic activity that transpired over this time.

Comparison of ENOE and IMSS figures

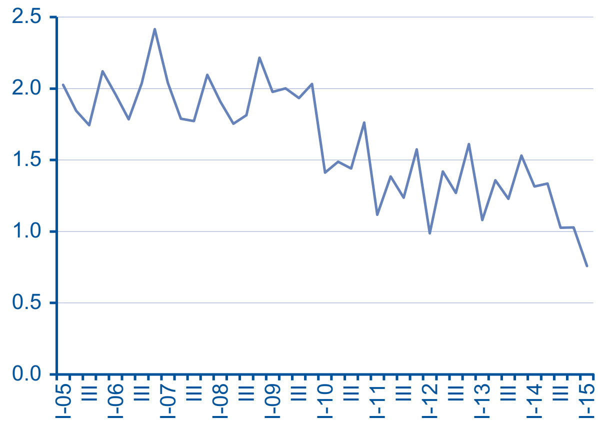
According to the figures from the IMSS, the total number of workers registered with the agency has risen steadily since 3Q09, which is not the case with the total number of employed people with access to social security. Specifically, from 2Q09 to 1Q15 the rise in the total number of people registered with the IMSS was 3.7 million, whereas the increase in employed people with social security access was only 2.4 million. These figures indicate that the progress in job formalisation has been mainly observed in IMSS registrations. This can also be observed in the reduction in the difference between the total number of employed people with social security access and the total number of workers registered with the IMSS, which shrank from two million in 1Q05 to 0.8 million people in 1Q15 (see Figures 4.1 and 4.2).

Figure 4.1
Total number of IMSS-registered workers and number of employed people with social security access according to the ENOE
Figures in millions of people



Source: INEGI, ENOE

Figure 4.2
Difference between the number of employed people with social security access and the total number of IMSS-registered people
Figures in millions of people



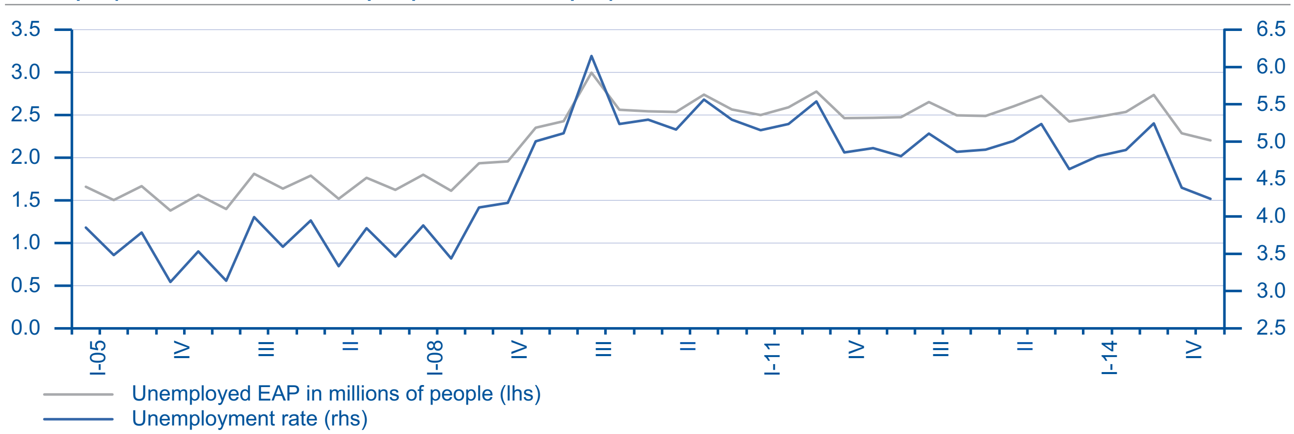
Source: INEGI, ENOE

Population of working age

Given that from 2Q13 to 1Q15 the population of working age (15 and over) rose by 2.1 million (Table 4.3, column 8) and that the number of those in jobs taken was only 510,000, the outcome could be a rise in the number of unemployed people or in the number of people deciding to remain outside the labour market. The latter are classified as the Economically Inactive Population (EIP) and are those who are not looking for work as they are engaged in other activities, such as housewives, students, the independently wealthy, pensioners or retirees. Obviously all of these are people who are 15 or over.

With respect to unemployment, no increase is noticeable in the period examined, and there is even a fall in the unemployed EAP of almost 398,000 people (Table 4.3, column 11), while in the last quarter the decrease in terms of both numbers of people and the unemployment rate becomes accentuated (see Figure 4.3). The latter is also appreciable in connection with the unemployment rate, since, in 1Q15, instead of rising relative to the unemployment rate in the previous quarter, as has occurred in the every first quarter of the year since 2006 with the sole exception of 2011, it fell.

Figure 4.3
Unemployed EAP in millions of people and unemployment rate



Source: INEGI, ENOE

Table 4.3

Population aged 15 and over, and split into the Economically Active Population (EAP) and Economically Inactive Population (EIP)

	Figures in people								Increase in number of people in the period reviewed						
	1	2	3	4	5	6	7		8	9	10	11	12	13	14
	Population aged 15 and over	EAP	EAP in work	EAP out of work	Total EIP	Available EIP	Unavailable EIP		Population aged 15 and over	EAP	EAP in work	EAP out of work	Total EIP	Available EIP	Unavailable EIP
IV-2010	82,226,208	48,478,718	45,911,934	2,566,784	33,747,490	6,204,965	27,542,525	2010-2009	1,435,959	(425,074)	(431,770)	6,696	1,861,033	250,750	1,610,283
IV-2011	83,741,134	50,772,496	48,307,467	2,465,029	32,968,638	6,144,202	26,824,436	2011-2010	1,514,926	2,293,778	2,395,533	(101,755)	(778,852)	(60,763)	(718,089)
IV-2012	85,346,680	51,317,999	48,822,271	2,495,728	34,028,681	6,135,101	27,893,580	2012-2011	1,605,546	545,503	514,804	30,699	1,060,043	(9,101)	1,069,144
IV-2013	86,128,981	52,370,886	49,945,599	2,425,287	33,758,095	6,112,965	27,645,130	2013-2012	782,301	1,052,887	1,123,328	(70,441)	(270,586)	(22,136)	(248,450)
IV-2014	87,520,286	52,108,400	49,823,798	2,284,602	35,411,886	5,834,585	29,577,301	2014-2013	1,391,305	(262,486)	(121,801)	(140,685)	1,653,791	(278,380)	1,932,171
II-2013	85,764,390	51,895,865	49,296,229	2,599,636	33,868,525	6,193,113	27,675,412								
I-2015	87,883,549	52,007,842	49,806,064	2,201,778	35,875,707	6,031,098	29,844,609	I-15-II-13	2,119,159	111,977	509,835	(397,858)	2,007,182	(162,015)	2,169,197

Source: INEGI, ENOE

By way of contrast, the Economically Inactive Population (EIP) rose by 2 million (Table 4.3, column 12) over the time examined, while the EAP only increased by 111,000 people over the same period (Table 4.3, column 9). These figures show that a major portion of the population of working age has decided to stay outside the labour market. Among the reasons for this could be the difficulty encountered by these people in finding a job with employment and wage conditions suitable for them.

The fact that a significant proportion of the population of working age chooses to stay outside the labour market could contribute to both the unemployed population and the unemployment rate not rising, as seems to have been the case from 2H13 to 1H15. Notwithstanding this, it is unlikely to be a permanent condition since the level of dependency of the Economically Inactive Population (EIP) with respect to the EAP can only rise to a certain level before families begin to be overstretched and demand for work by the population rises. It is also important to bear in mind that being outside the labour market for a long time means that the chances of getting back in diminish, and that the demographic bonus for the country caused by people reaching working age also wears thin.

To summarise, the ENOE figures suggest that the job formalisation process implemented by the authorities has been successful. On the other hand, while modest, the data on new job creation has not been accompanied by a higher level of unemployment, although it has been by a higher number of people who have decided to stay outside the labour market.

5. Indicators and forecasts

Table 5.1

Macroeconomic forecasts: Gross Domestic Product

(YoY growth rate)	2012	2013	2014	2015	2016
United States	2.3	2.2	2.4	**2.9**	**2.8**
EMU	-0.8	-0.4	0.9	**1.6**	**2.2**
Germany	0.6	0.2	1.6	**1.9**	**2.2**
France	0.4	0.4	0.4	**1.1**	**1.8**
Italy	-2.8	-1.7	-0.4	**0.7**	**1.3**
Spain	-2.1	-1.2	1.4	**3.0**	**2.7**
UK	0.7	1.7	2.8	**2.5**	**2.3**
Latin America *	2.8	2.5	0.8	**0.6**	**2.1**
Mexico	3.8	1.7	2.1	**2.5**	**2.7**
Brazil	1.0	2.7	0.1	**-0.7**	**1.8**
EAGLES **	5.8	5.6	5.3	**4.9**	**5.3**
Asia-Pacific	5.7	5.9	5.7	**5.8**	**5.8**
Japón	1.8	1.5	0.0	**1.3**	**1.2**
China	7.8	7.7	7.4	**7.0**	**6.6**
Asia (exc. China)	4.1	4.5	4.3	**4.9**	**5.0**
World	3.4	3.4	3.4	**3.5**	**3.9**

* Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela
** Brazil, Korea, China, India, Indonesia, Mexico, Russia, Taiwan, Turkey
Closing date: April 30, 2015
Source: BBVA Research

Table 5.2

Macroeconomic Forecasts: inflation (Average)

(YoY growth rate)	2012	2013	2014	2015	2016
United States	2.1	1.5	1.6	**0.5**	**1.9**
EMU	2.5	1.4	0.4	**0.1**	**1.3**
Germany	2.1	1.6	0.8	**0.3**	**1.4**
France	2.2	1.0	0.6	**0.1**	**1.1**
Italy	3.3	1.3	0.2	**0.0**	**0.9**
Spain	2.4	1.4	-0.2	**-0.2**	**1.4**
UK	2.8	2.6	1.5	**0.3**	**1.7**
Latin America *	7.8	9.2	12.6	**13.5**	**13.5**
Mexico	4.2	3.8	4.0	**2.9**	**3.4**
Brazil	5.4	6.2	6.3	**6.7**	**5.7**
EAGLES **	5.2	5.2	4.6	**4.8**	**4.5**
Turkey	8.9	7.6	8.9	**7.3**	**7.2**
Asia-Pacific	3.9	4.1	3.3	**2.7**	**3.3**
Japón	0.0	1.6	2.7	**1.0**	**1.6**
China	2.6	2.6	2.0	**1.7**	**2.5**
Asia (exc. China)	4.8	5.2	4.4	**3.5**	**3.9**
World	4.5	4.2	3.9	**3.8**	**4.1**

* Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela
** Brazil, Korea, China, India, Indonesia, Mexico, Russia, Taiwan, Turkey
Closing date: April 30, 2015
Source: BBVA Research

Table 5.3

United States indicators and forecasts

	2013	2014	2015	2016	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15
Macroeconomic Indicators												
GDP (real % change)	2.2	2.4	**2.9**	**2.8**	-2.1	4.6	5.0	2.2	-0.7	**3.9**	**5.9**	**4.5**
Personal consumption (real % change)	2.4	2.5	**3.0**	**1.9**	1.2	2.5	3.2	4.4	1.8	**2.8**	**3.4**	**3.7**
Gov. consumption (real % change)	-2.0	-0.2	**0.8**	**0.4**	-0.8	1.7	4.4	-1.9	-1.1	**2.1**	**3.9**	**-0.8**
Gross fixed investment (real % change)	4.7	5.3	**7.2**	**7.1**	0.2	9.5	7.7	4.5	-1.3	**13.9**	**15.9**	**11.0**
Construction	3.4	4.8	**7.7**	**5.3**	4.7	5.5	8.8	10.3	3.6	**8.7**	**10.4**	**8.2**
Industrial prod. (real annual % change)	2.9	4.2	**1.9**	**3.4**	3.3	4.2	4.6	4.6	3.5	**1.6**	**1.3**	**1.1**
Current account balance (% of GDP)	-2.5	-2.7	**-3.8**	**-3.2**	-2.4	-2.3	-2.3	-2.6	**-3.3**	**-3.6**	**-3.4**	**-3.0**
Final annual inflation	1.5	0.8	**1.9**	**1.7**	1.5	2.1	1.7	0.8	-0.1	**0.2**	**0.9**	**1.9**
Average annual inflation	1.5	1.6	**0.5**	**1.9**	1.4	2.1	1.8	1.2	-0.1	**0.0**	**0.7**	**1.4**
Primary fiscal balance (% of GDP)	-4.1	-2.8	**-2.8**	**-2.5**				-2.8				**-2.8**

Note: **Bold** figures are forecast
Source: BBVA Research

Table 5.4

Mexico Indicators and Forecasts

	2013	2014	2015	2016	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15
Economic Activity												
GDP (seasonally-adjusted series)												
Real annual % change	1.7	2.1	**2.5**	**2.7**	0.9	2.8	2.2	2.6	2.6	**2.4**	**2.6**	**2.3**
Per inhabitant (US dollars)	10,630	10,627	**10,720**	**11,009**	10,506	10,939	10,830	10,414	9,646	**9,814**	**9,863**	**10,288**
US$ billions	1,256	1,272	**1,297**	**1,467**	1,258	1,310	1,296	1,247	1,167	**1,188**	**1,194**	**1,245**
Inflation (average, %)												
Headline	3.81	4.02	**2.90**	**3.36**	4.16	3.59	4.15	4.18	3.07	**2.94**	**2.87**	**2.72**
Core	2.72	3.18	**2.37**	**3.07**	3.03	3.07	3.32	3.30	2.39	**2.31**	**2.35**	**2.45**
Financial Markets (eop, %)												
Interest rates												
Bank funding	3.50	3.00	**3.25**	**4.00**	3.50	3.33	3.0	3.0	3.00	**3.00**	**3.25**	**3.25**
28-day Cetes	3.16	3.00	**3.25**	**4.00**	3.23	3.14	2.79	2.86	2.94	**2.99**	**3.13**	**3.25**
28-day TIIE	3.80	3.35	**3.85**	**4.85**	3.79	3.63	3.29	3.30	3.30	**3.33**	**3.53**	**3.68**
10-year Bond (%, average)	5.68	6.10	**5.78**	**6.38**	6.34	5.87	5.9	5.8	5.60	**5.90**	**5.93**	**6.07**
Exchange rate (average)												
Pesos per dollar	13.0	13.29	**15.1**	**14.5**	13.2	13.0	13.2	14.1	15.1	**15.3**	**15.2**	**14.8**
Public Finances												
*FRPS (% of GDP)	-3.0	-4.0	**-4.0**	**-3.5**	-	-	-	-4.0				**-4.0**
External Sector[3]												
Trade balance (US$ billions)	-1.2	-2.4	**-4.6**	**-0.8**	-1.3	1.1	-1.5	-0.7	-3.1	**-0.2**	**-2.1**	**0.7**
Current account (US$ billions)	-29.7	**-26.5**	**-23.7**	**-25.7**	-10.6	-7.9	-2.8	-5.3	-6.5	**-6.1**	**-5.5**	**-5.6**
Current account (% of GDP)	-2.4	**-2.1**	**-2.0**	**-1.9**	-3.4	-2.4	-0.9	-1.7	-2.2	**-2.1**	**-1.8**	**-1.8**
Employment												
Formal Private (annual % change)	3.5	**3.5**	**4.3**	**3.6**	2.8	3.3	3.8	4.2	4.6	**4.5**	**4.2**	**4.0**
Open Unemployment Rate (% active pop.)	4.91	**4.83**	**4.68**	**4.69**	4.97	4.93	4.88	4.52	4.56	**4.66**	**4.76**	**4.74**

Continues on next page

Mexico Indicators and Forecasts

	2013	2014	2015	2016	1Q14	2Q14	3Q14	4Q14	1Q15	2Q15	3Q15	4Q15
Aggregate Demand [4] (annual % change, seasonally-adjusted)												
Total	2.0	3.1	**2.5**	**4.2**	2.0	2.9	3.1	4.6	**2.4**	**2.6**	**2.7**	**2.5**
Domestic Demand	1.9	1.8	**1.0**	**2.5**	1.0	1.8	1.8	2.7	**-0.3**	**1.0**	**1.8**	**1.6**
Consumption	2.4	2.0	**2.4**	**2.5**	0.8	2.4	2.4	2.6	**2.6**	**2.3**	**2.2**	**2.5**
Private	2.5	2.0	**2.5**	**2.8**	0.5	2.4	2.2	2.7	**2.7**	**2.2**	**2.4**	**2.6**
Public	1.6	2.5	**1.8**	**1.0**	2.2	2.1	3.8	1.8	**2.3**	**2.7**	**0.6**	**1.8**
Investment	-1.0	2.3	**3.4**	**3.6**	-2.1	0.9	4.5	6.0	**5.6**	**4.0**	**2.7**	**1.5**
Private	-0.7	4.7	**5.3**	**5.5**	-1.6	3.4	7.2	9.9	**7.6**	**5.4**	**4.6**	**3.5**
Public	-1.9	-7.2	**-4.7**	**-5.9**	-4.2	-9.0	-6.2	-9.1	**-2.8**	**-2.1**	**-6.0**	**-7.9**
External Demand	2.1	7.3	**7.2**	**9.2**	5.0	6.5	7.1	10.2	**11.0**	**7.4**	**5.6**	**5.0**
Imports	2.9	6.3	**2.8**	**8.7**	5.4	3.2	5.8	10.8	**1.9**	**3.1**	**3.2**	**2.9**
GDP by sectors (annual % change, seasonally-adjusted)												
Primary	0.8	3.5	**5.8**	**2.7**	2.6	3.1	6.8	1.4	6.8	**5.5**	**6.4**	**4.6**
Secondary	-0.6	1.9	**1.5**	**2.8**	0.4	2.7	2.0	2.3	1.5	**1.9**	**1.6**	**1.2**
Mining	-0.5	-2.2	**-3.8**	**-1.5**	-0.3	-0.2	-2.8	-5.6	-4.7	**-4.7**	**-3.6**	**-2.2**
Electricity	0.5	1.8	**3.2**	**3.9**	2.2	1.7	1.5	1.7	3.2	**2.6**	**4.0**	**2.8**
Construction	-4.7	1.8	**2.5**	**3.7**	-3.2	1.3	3.8	5.6	4.4	**5.3**	**1.8**	**-1.2**
Manufacturing	1.5	3.7	**3.5**	**3.8**	2.9	4.1	3.3	4.6	3.8	**3.2**	**3.5**	**3.5**
Tertiary	2.7	2.2	**2.8**	**2.7**	1.2	2.9	2.1	2.8	2.9	**2.5**	**2.9**	**2.8**
Retail	2.9	3.3	**3.4**	**3.4**	0.6	3.4	3.9	5.4	5.7	**3.1**	**2.7**	**2.1**
Transportation, mail and warehouse	2.7	1.9	**2.9**	**3.3**	1.6	2.9	0.8	2.3	3.1	**2.5**	**2.8**	**3.0**
Massive media information	5.1	2.2	**7.3**	**6.5**	2.1	4.6	-0.2	2.4	5.7	**5.6**	**9.5**	**8.6**
Financial and insurance	10.5	2.0	**2.9**	**6.8**	4.2	1.4	1.0	1.7	1.5	**2.5**	**3.0**	**4.6**
Real-estate and rent	1.0	2.1	**2.2**	**2.0**	1.8	2.2	2.3	2.2	1.5	**1.9**	**2.6**	**2.9**
Prof., scientific and technical servs.	0.9	1.2	**2.6**	**1.9**	-0.5	0.2	1.3	3.7	2.5	**3.3**	**2.8**	**1.9**
Company and corporate management	-1.4	6.4	**0.0**	**1.8**	6.5	3.9	3.4	12.5	-2.8	**-2.0**	**2.9**	**1.9**
Business support services	4.3	0.0	**2.2**	**1.2**	0.0	1.8	-0.1	-1.7	2.6	**1.3**	**2.5**	**2.4**
Education	0.8	1.5	**1.0**	**0.8**	1.1	1.8	2.3	0.9	0.6	**0.7**	**1.2**	**1.6**
Health and social security	2.5	0.7	**1.2**	**0.8**	0.3	0.9	0.8	0.6	1.3	**1.1**	**1.5**	**1.1**
Cultural and sport	4.0	-0.8	**3.4**	**2.6**	-2.2	-0.9	2.0	-2.0	3.7	**3.9**	**3.1**	**2.9**
Temporary stay	1.9	2.9	**3.3**	**2.0**	1.9	4.2	2.1	3.3	3.6	**3.0**	**3.8**	**2.8**
Other services, except government activities	2.2	1.4	**1.8**	**1.6**	0.4	1.4	1.9	1.9	2.8	**1.4**	**1.2**	**1.7**
Government activities	-0.5	2.5	**3.0**	**-2.3**	3.0	2.6	2.3	2.0	5.2	**2.9**	**2.1**	**1.9**

1: Residential investment
2: Fiscal balance (% GDP)
3: Accumulated, last 12 months
4: Base 1993=100; GDP by sector base 2003=100. The observed data of the primary sector, secondary and tertiary seasonally-adjusted by INEGI, the rest own seasonally-adjusted
bd: billions of dollars
dpb: dollars per barrel
*FRPS: Financial Requirements of the Public Sector
na: not available
Note: **Bold** figures are forecast
Source: BBVA Research with Federal Reserve, Bureau of Labor Statistics, Banco de Mexico, INEGI and SHCP data

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