Mexico Economic Outlook

2nd QUARTER 2016 | MEXICO UNIT

01
Complex external climate with concerns about global economic growth and the slowdown in international trade

02
We have upgraded our forecast for economic growth for this year to 2.6%, based on expectations that private consumption in Mexico will continue driving aggregate demand

03
General annual inflation has been below the 3.0% target for 13 consecutive months, despite the significant exchange-rate depreciation since late 2014

Index

Closing date: June 10, 2016

1. In summary

The figures available to date confirm we are still seeing a slowdown in global growth. Global GDP growth during the first quarter was well below the average for 2010 to 2015. This growth rate may edge upwards in the second quarter if the signals of slower deterioration in the available indicators for output, trade and business confidence are maintained. Even so, this will not be sufficient to boost global economic growth to around 3.2% (our forecast for 2016 as a whole).

Considering the continued slowdown in China and the weakness of the activity cycle in the main emerging economies, substantial economic growth is required in the USA and Japan to achieve our global growth forecast. However, industrial output and exports of goods have been falling year-on-year in these two developed nations, as a result of adjustments in the energy sector and the accumulated appreciation of the dollar, in the case of the USA, and lower demand in Asia and the revaluation of the Yen, in Japan. Continuing resistance by the services sector in the developed world is another prerequisite, although this has been losing steam over recent months due to the adjustment in manufacturing.

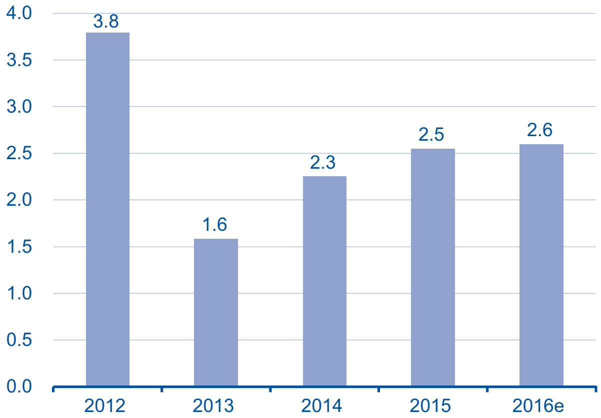
Against this backdrop of global growth rates stabilising at moderate levels, domestic demand in Mexico has remained robust. This is the main reason why we have revised our growth forecast for the year upwards. In particular, we have increased our forecast for 2016 GDP growth from 2.2% to 2.6% for two reasons: i) the positive surprise in GDP, with quarter-on-quarter growth of 0.8%, on a seasonally-adjusted basis; and ii) the expectation that private consumption will remain the main driver of aggregate demand in economic growth in 2016. Figures for private consumption in the first quarter confirm that this component of aggregate demand is continuing to support economic growth.

As in 2015, private consumption this year is underpinned by increases in real salaries, remittances in the domestic currency and continuation of programmes to formalise employment. However, there are a number of risks to our revised growth forecast, particularly from external demand, productive investment and the public finances. This is because the weak performance of manufacturing exports and the balance of trade in oil could continue over the coming months. Moreover, creation of new jobs will be stymied by productive investment growing at annual rates of around 2.5%.

Although we have recently witnessed a pick up in the economy, inflation remains favourable, undershooting the 3.0% target continuously over the last 13 months. This is mainly due to continuing slack in the economy, some prices falling creating a pass-through effect of the exchange rate on inflation and the anchoring of inflation expectations. We are continuing to see a change in relative prices and a slow pass-through to general inflation, with no knock-on effects. We continue to expect inflation to end 2016 at around 2.9%. However, the likely increase in petrol prices in the second half of the year gives certain upside bias to our forecast.

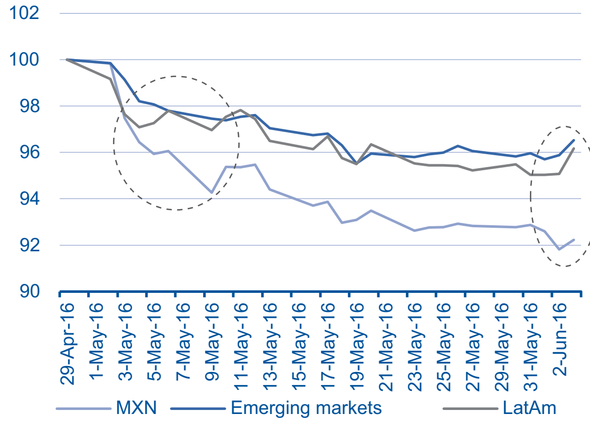
Turning to the financial markets, the greater frequency and persistence of risk episodes has been reflected in the exchange rate, which at the moment remains the main shock absorber. Concerns about the global cycle and expectations about the pace of normalisation of monetary policy in the USA have combined with some clear negative differentiation of the Mexican peso against the dollar, taking the exchange rate back over 18.2 pesos per dollar - the peso is the second most depreciated emerging-economy currency. Irrespective of the causes of this differentiation, the fact is that this has exacerbated the depreciation of the peso. Against a backdrop of increasing potential risks for the remainder of the year, this leads us to think that the appreciation from the current level is likely to be more limited than we previously expected.

Figure 1
Gross domestic product (YoY % change)



e = estimate
Source: BBVA Research with INEGI data

Figure 2
Emerging-economy currencies, LatAm and MXN (index 29 April = 100)



Information for LatAm and emerging markets, based on JP Morgan indices.
Source: BBVA Research with Bloomberg data

Exchange-rate uncertainty has reignited expectations of upward rate movements outside the calendar for the benchmark rate. Although the central bank communiqué played down this scenario, the weakness of the peso and the diminished likelihood of any change by the Fed in June encourages expectations of divergence between Mexican and US monetary policy. Thus, even if synchronisation with the Fed is maintained in the central scenario, the probability of an increase by Banxico - unrelated to a US rate hike - has increased significantly. These expectations of an increase in the benchmark rate. together with reduced foreign holdings of government bonds, are reflected in a rebound in long-term interest rates. Therefore, we continue to expect returns on the 10-year Mexican government bond to remain slightly below 6.5% at the end of the year.

In summary, Mexico's economy has been affected by a weak recovery in external demand, particularly in the USA, and by lower oil prices. This has fed through into a slowdown in growth of Mexican exports and cuts to the federal government's budget. However, the economy has proved resistant to a more pronounced slowdown, and the strong performance of private consumption has, to date, offset the weakness of external demand and the volatility of the FX market. As external conditions and oil prices improve, and structural reforms kick in, the GDP growth rate may return to around 3% over the medium term.

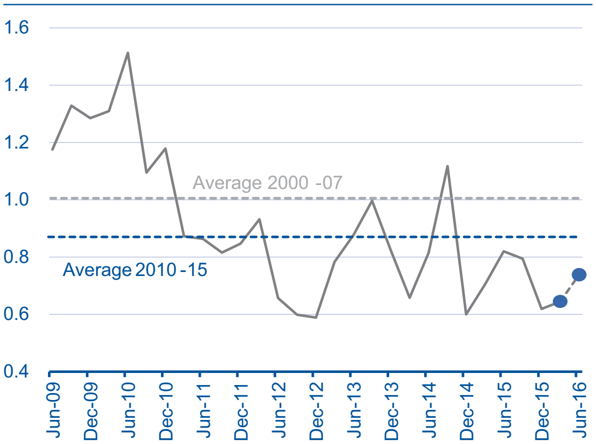
2. Low and fragile economic growth, dependent on developments in China

Available data for the first quarter of 2016 confirm our forecasts of stabilisation of world GDP growth still at reduced rates but slightly higher than at the end of 2015. Our BBVA-GAIN[1] index puts the quarterly increase of world GDP at 0.6% (2.9% annualised rate), considerably lower than the average recorded between 2010 and 2015. A pace of growth that could accelerate slightly in the second quarter if the signs of lower deterioration anticipated by the available indicators of production, trade and business confidence are consolidated, but still not sufficient for the annual increase to reach around 3.2% (our forecast for 2016 as a whole).

For our forecast to be correct, bearing in mind the progressive slow-down in China and the weakness in the activity cycle in the major emerging countries, it will be necessary to witness a substantial improvement in economic growth in the US and Japan, two developed economies where industrial production and export of goods have seen year-on-year falls as a result of the adjustment in the energy sector and the accumulated appreciation of the dollar, on the one hand, and lower Asian demand and the revaluation of the yen on the other. Resilience in the production of services in the developed block, which in recent months has lost steam due to the manufacturing adjustment, is also a necessary condition.

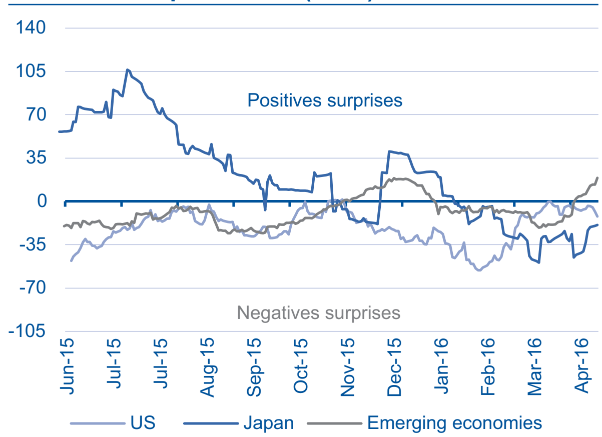
The sharp increase in financial volatility observed between December 2015 and February 2016, as well as responding to the actual deceleration of global activity, threatened to accentuate it if it continued at the same intensity and translated into a contraction of demand decisions. Since then, financial tensions, as well as the probability of the occurrence of a stress scenario on a global scale, have subsided. The better than expected balance of economic indicators from China, lower downward pressure on the value of the yuan, the recovery of raw material prices and the moderation of expectations on interest rate rises by the Fed have been determining factors.

Figure 2.1
World GDP, % q/q. Q1 and Q2 forecasts 2016 based on BBVA-GAIN



Source: BBVA Research

Figure 2.2
Economic Surprise Index (CESI)



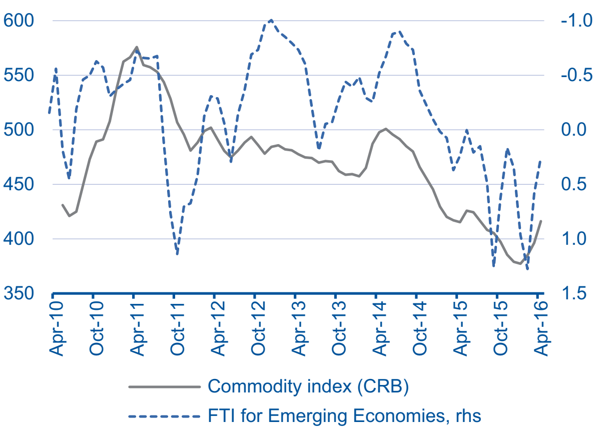
Source: BBVA Research & Haver

1: See https://www.bbvaresearch.com/en/publicaciones/global-gdp-growth-to-benefit-from-a-less-stressed-financial-outlook/

The strengthening of stimulus policies, both monetary and fiscal, by the Chinese authorities has contributed to ease the effects of the readjustment in the manufacturing sector on aggregate production and, consequently on the country's trade flows with the rest of the world. In the short term, the implementation of counter-cyclical measures may facilitate a more gradual slow-down of the economy than expected; nevertheless if it is accompanied by a delay in the correction of fundamental imbalances such as high leverage in the corporate sector or excess installed capacity in some industries and construction, the financial vulnerability of China in the face of shocks like the one seen in the summer of 2015 would increase and, with it, its destabilising potential on the rest of the world.

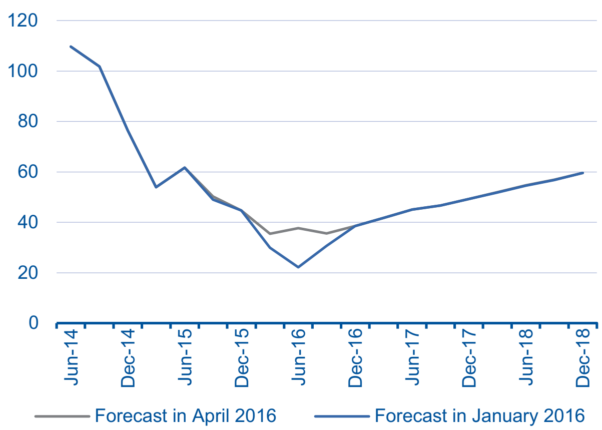
The stabilisation of activity in China partly explains the recovery of prices of the major raw materials from the minimum levels reached in January. In the particular case of oil (the WTI barrel price increased by 10 dollars to achieve levels of 43), the increase was due, to a large degree, to greater supply restriction than forecast (reduction in US production, supply cuts in countries such as Iraq and Nigeria, and expectation of an agreement between the OPEC countries to freeze their production)[2] and to the depreciation of the dollar.

Figure 2.3
Synthetic index of raw materials and BBVA index of financial tensions for Emerging Economies



Source: BBVA Research, Bloomberg & Haver

Figure 2.4
Oil price, dollars per barrel. Forecasts



Source: BBVA Research

The relative weight given by financial agents to the deterioration of the international environment in the reaction of the Fed explains the delay and moderation in expectations about the next interest rate rise. In the face of the two increases forecast by the members of the FOMC for 2016, the market has put off the second increase until early 2017. The response of the dollar, depreciating despite the relatively good performance still shown by US domestic demand, and the drop of the US long term sovereign yields have contributed to alleviating financing restrictions on the emerging world, as reflected in: (i) the BBVA index of financial tensions for this region, which has corrected all the rise seen in the first few months of 2016 (the improvement has been more gradual in LatAm, conditioned by the idiosyncratic behaviour of Brazil), and (ii) the reactivation of the inflows of foreign capital (emerging assets have received net capital inflows since mid-February due, in part, to the search of yield and the capital reallocation towards more profitable financial instruments).

2: Oil price forecasts have been adjusted upwards for the middle quarters of 2016 in relation to the January scenario but reproduce the same dynamics as then for the future.

Furthermore, in so far as the developed central banks maintain the monetary policy direction of recent months (strengthening or maintaining stimuli in the case of BCE and the Bank of Japan; caution in normalisation of interest rates on the part of the Fed), the authorities of emerging economies will have more flexibility to prioritise, among their objectives, the economic recovery, without ignoring the possible accumulation of imbalances. The gradualness expected by the Fed (a factor that supports flows of capital into the region) and the recent recovery of currencies (a restraint on the potential increase in inflation through price rises for imported goods) reduce the need to tackle aggressive interest rate rises.

Given all this, the relative improvement in the world economic outlook in the last quarter continues to be fragile and dependent on how the Chinese economy evolves, the resolution of hot spots of instability around Europe (geopolitics, "Brexit", payment of the Greek debt) and a possible slow-down in the US. In any case, it is not ruled out that episodes of financial volatility can repeat like those at the beginning of this year (of greater or lesser intensity) in a context of heightened uncertainty over the ability of the emerging world to avoid a downturn and of the central banks of developed economies to promote growth.

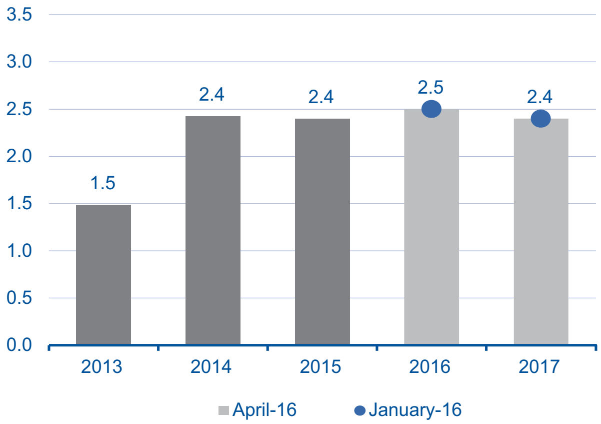
US: moderate growth and downwards risks condition the Fed's response

The US economy has suffered again at the beginning of 2016, as in the two previous years. According to the first official estimate, GDP would have risen barely 0.5% (annualised quarterly rate) in the first quarter, a similar figure to the same period in 2015 which gives continuity to the road to moderate growth seen in the US since then. The dynamism of private consumption, which has also begun to moderate, and the support of the public expenditure are not sufficient to compensate for the fall in exports of goods and the weakness of private capital investment (despite the improvement in the residential sector, total investment in fixed capital could register in the first quarter of 2016 the first annual correction since 2011). The adjustment of activity in the energy sector and its impact on other dependent industries continue to affect domestic spending on investment.

Leading signals offered by sentiment indicators for the second quarter reinforce the divergence between the evolution of industry (the manufacturing PMI for April shows the lowest figure since 2011, slightly above 50 points) and services, in favour of the latter (business confidence continues to point towards expansion of activity in this sector). The expectations of economic recovery for next quarters are based on the support of consumption (the job market is keeping the strength of the past few months, with the pace of job creation stabilising at 200,000 people per month) and the possible relief brought about by the recent depreciation of the dollar for exports. To realise our expectation of 2.5% annual GDP growth in 2016 (in line with that of 2015 and the January estimate), we will need to witness annualised quarterly advances of the same order in the future.

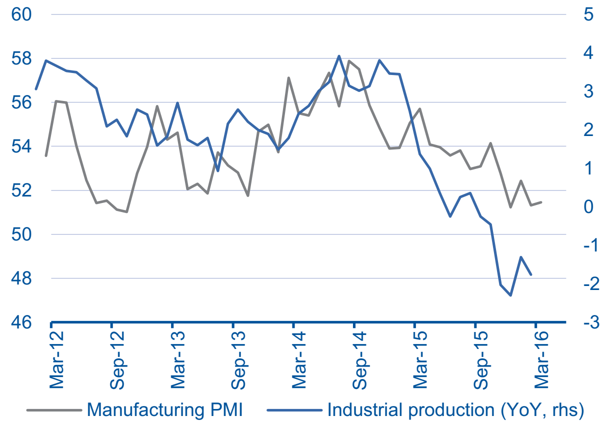
This forecast shows a downwards bias bearing in mind the risks mentioned for the global economy and the behaviour of domestic investment. Likewise for the reduction in forecasts for reference interest rates during 2016 and 2017 by the members of the FOMC. As in the central scenario of BBVA Research, they are now expecting two new rate rises this year and four next years; a path of more aggressive hikes than that discounted by the market and whose bias is also downside in so far as general inflation is progressively converging towards 1.5%, and the core rate hovers around 2%.

Figure 2.5
U.S.: GDP (annual change, %)



Source: BBVA Research & Haver

Figure 2.6
U.S. industrial production (%) and business confidence



Source: BBVA Research & Haver

China: stabilisation of activity in the short term and greater risks in the medium term

The increase in financial tensions since mid-2015 due to uncertainty over the future evolution of the yuan and the acceleration of capital outflows, have pushed the Chinese authorities into prioritising the stabilisation of economic activity, trying to avoid a sharp downturn of GDP that would compromise the achievement of economic growth targets.

The strengthening of measures of fiscal support (the public deficit could reach 3% of GDP in 2016), the keeping of the scheme of liquidity injections into the banking system and the relaxation of some regulatory standards applied to the central bank and local governments make up the package of stimuli which, up to now, and according to official figures, are facilitating a very gradual moderation of Chinese activity. GDP grew by a year-on-year 6.7% in the first quarter of 2016 and our forecasts improve on the expected annual growth for 2016 by 0.2 points to 6.4%, settling at 5.8% for 2017. Inflation could be somewhat higher than the forecasts made in January, reaching 2.3% in 2016 and 2.7% in 2017.

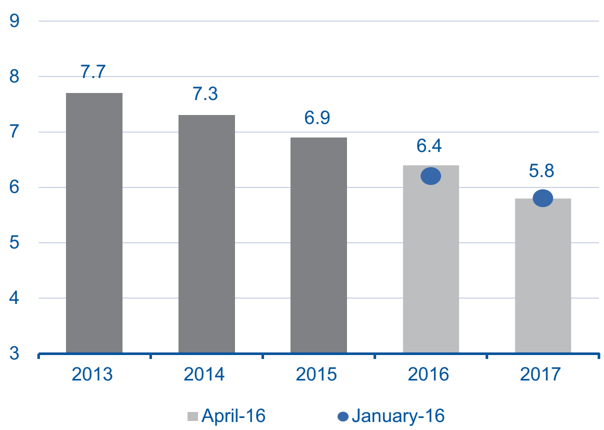
Nevertheless, and independently of this improvement forecast for the short-term growth figures, the risks lie in the impact that the delay in the programme of structural reforms could have in terms of financial stability and capacity for economic growth in the medium term. Despite the process of reorientation of production in which the country finds itself (manufacturing sector confidence continues to be in the contracting zone in April, industrial production is growing at rates close to 6% year-on-year, well below those recorded for 2014-2015, and prices of production, though not so pronounced, have continued to fall relentlessly since 2012), debt has not stopped growing. According to BIS data, non-financial private sector debt exceeded 205% of GDP in the third quarter of 2015; a tendency for increase which has foreseeably been maintained until now bearing in mind the volume of new debt operations (in particular those arising from bank loans).

The longer the restructuring of semi-public companies linked to high-overcapacity areas of activity is postponed (in the Five-year Plan presented last March there was no a concrete plan heading in this direction), the greater the negative impact will be on the profitability and quality of bank assets and, therefore, on the economy as a whole in the medium term. Among the options under consideration to address the management of corporate debt with the greatest risk of default, are a programme of debt conversion to capital (*Debt to Equity Swap*)[3] and

3: See https://www.bbvaresearch.com/wp-content/uploads/2016/04/April-2016_China-Equity-for-Debt-Swap.pdf the securitization of outstanding debts as marketable securities. For these initiatives to be successful, as well as overcoming the associated implementation restrictions, they need to be accompanied by a comprehensive action plan, focus on the restructuring of viable firms and benefiting from the participation of the banks to speed up the identification of non-performing loans; a strategy that, for the moment, does not seem to be in place.

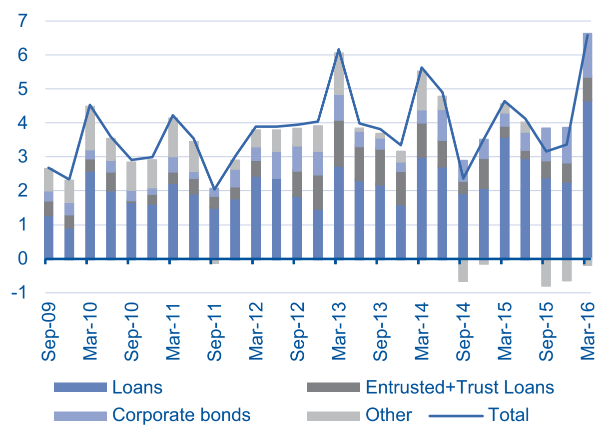
As regards the management of monetary policy, the central bank may carry out new cuts in reference interest rates, though more restrained than those foreseen at the beginning of the year (4.1% and 3.6% are the estimated levels to be reached this year and next, as against 4.35% at the close of 2015), given the other current stimulus schemes. The yuan, after the recent appreciation, may possibly lose value again to levels of 6.8CNY/USD towards the end of 2016

Figure 2.7
China: GDP (annual change, %)



Source: BBVA Research & Haver

Figure 2.8
China: debt, new operations by instrument (trillions of yuan)



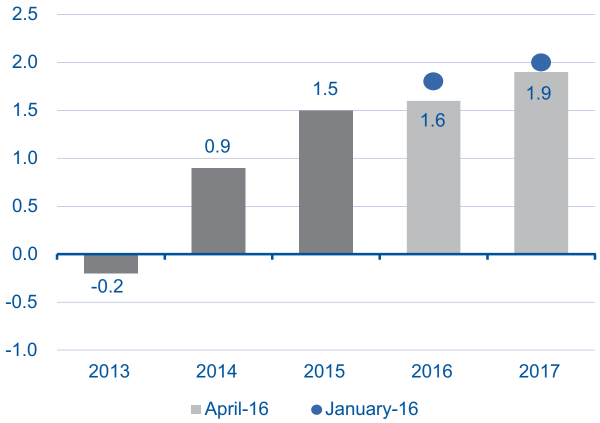
Source: BBVA Research & Haver

Eurozone: downwards revision of growth forecasts. Political events are the main risk in the short term

After a second quarter 2015 of moderate growth (quarterly GDP rates of 0.3%), the Eurozone economy would have accelerated its pace of growth in the first quarter of 2016, with an increase in GDP, according to the preliminary indicator, of 0.6%. The best relative performance expected for France and Germany (with growth rates in the order of 0.5-0.6%) and the dynamism of Spain (increase of 0.8% for the third quarter in a row) would be behind the improvement for the whole area at the start of this year. The strength of private consumption, which has recovered to pre-crisis levels, continues to be the key to the pattern of growth of the Eurozone, although the recent fall in agent confidence and the level of household debt of some peripheral countries limit the scope of additional support to the aggregate activity.

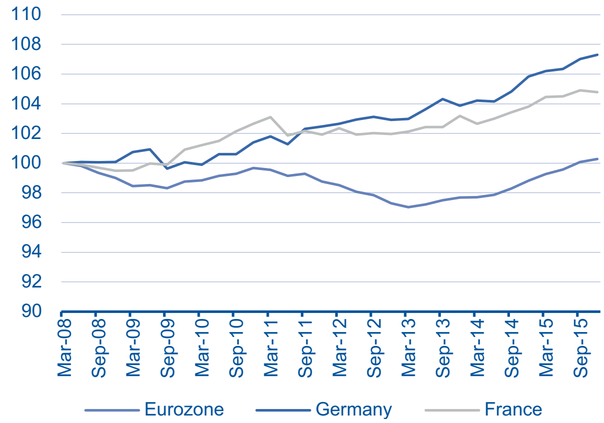
This, combined with the modest recovery shown by the capital investment (in a context of raised external and political uncertainty, and downward pressures on business profits) and the weakness of external trade (the effect of the depreciation accumulated by the euro since mid-2014 has begun to diminish, especially in latter months with the currency recovering to levels of 1.15 against the USD), justify the downward revision of our growth forecasts for 2016 and 2017. Eurozone GDP could grow this year by 1.6% (0.2pp lower than forecast in January) and by 1.9% in 2017 (-0.1pp).

Figure 2.9
Eurozone: GDP (annual change, %)



Source: BBVA Research & Haver

Figure 2.10
Eurozone: private consumption (base 100=2008)



Source: BBVA Research & Eurostat

In our opinion, the support for activity that the new stimulus measures by the BCE[4] may produce and the slightly expansive nature of fiscal policy in the main countries of the zone will not be enough to compensate for the negative impact of the aforementioned factors and of the political uncertainty (referendum on the UK remaining in the EU, electoral processes open or foreseen for 2017, etc.) on private sector confidence and spending decisions. Additionally, it is not ruled out for the proximity of important debt payments on the part of Greece to create tensions in the markets if the agreement being negotiated with public creditors is not reached beforehand.

As regards inflation, we maintain practically unchanged the January forecasts which put the average general rate for 2016 at 0.2% and at 1.3% for 2017. The increase observed in oil prices may alleviate downward pressure on the energy component of the CPI in the shorter term, but in the absence of a sustained increase in the prices of the core items (stable at rates of 1%) general inflation will not meet the ECB's price stability target until 2018.

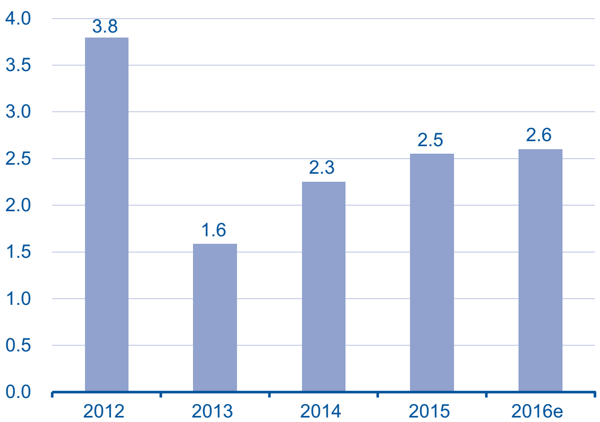
4: See https://www.bbvaresearch.com/wp-content/uploads/2016/04/ECB-Watch-Minutes-April162.pdf

3. 2016 growth slightly outperforms 2015

3.1 2016 growth driven mainly by consumption

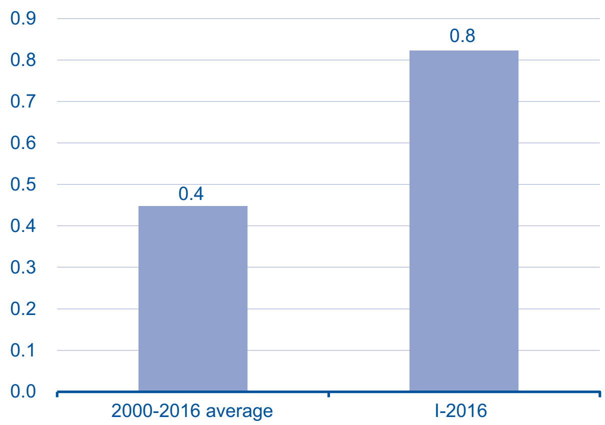
GDP grew at a rate of 2.5% in 2015. We expect to see a slight improvement, to 2.6%, in 2016. However, there is little difference between these numbers. Both can be considered to represent satisfactory performance by the Mexican economy, given the difficult international conditions, and particularly as they are in line with GDP growth from 2005 to 2015, which averaged 2.5%.

Figure 3.1
Gross domestic product (YoY % change)



e = estimate
Source: BBVA Research with INEGI data

Figure 3.2
GDP in the first quarter (QoQ % change, sa)

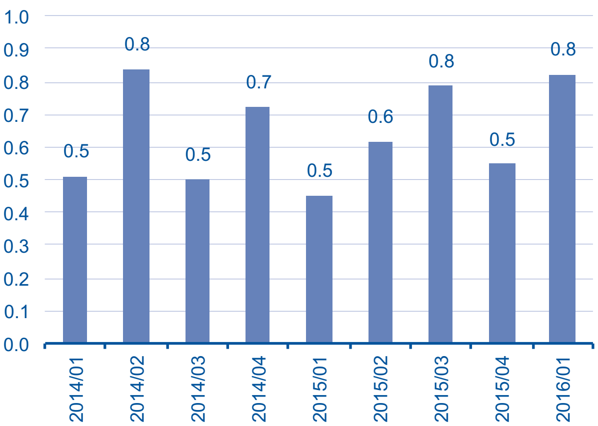


sa = seasonally-adjusted; QoQ = quarter-on-quarter
Source: BBVA Research with INEGI data

GDP grew by 0.8% in the first quarter of 2016 (1Q2016), outperforming expectations, and significantly higher than the 0.4% average QoQ growth rate for the first quarter from 2000 to 2016. Moreover, the growth rate in the first quarter of the year has a significant influence on the annual growth rate, given the characteristics of the seasonally-adjusted data series and their multiplicative quarterly structure.

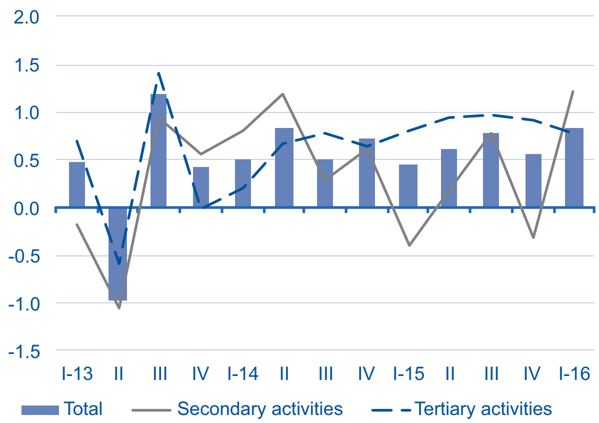
We can illustrate this point with some examples of the impact of different quarterly growth rates on annual GDP growth. For example, if quarterly GDP growth rates for 2016 were 0.4% for 1Q16, 0.5% for 2Q16, 0.6% for 3Q16, and 0.5% for 4Q16, the annual GDP growth rate would be 2.2%. But if we use the figure observed for 1Q16, 0.8%, and the other quarterly rates remain the same at 0.5% for 2Q16, 0.6% for 3Q16, and 0.5% for 4Q16, GDP growth in 2016 would be 2.6%. And if we consider the same quarterly GDP growth rates in a different order, such as 0.5% for 1Q16, 0.5% for 2Q16, 0.6% for 3Q16, and 0.8% for 4Q16, the annual GDP growth rate would fall to 2.4%. In other words, the fact that we have seen a higher quarterly growth rate in 1Q16 will have an impact on GDP growth for 2016 as a whole, which we expect to be 2.6%.

Figure 3.3
Quarterly GDP
(QoQ % change, sa)



sa = seasonally-adjusted; QoQ = quarter-on-quarter
Source: BBVA Research with INEGI data

Figure 3.4
GDP by components
(QoQ % change, sa)



sa = seasonally-adjusted; QoQ = quarter-on-quarter
Source: BBVA Research with INEGI data

The services or tertiary sector, which accounts for 61% of GDP, has been the main driver of growth in the country since 2014. The average quarterly growth rate for the services sector in 2015 was 0.9%. This came in slightly lower in 1Q16, at 0.8%. The secondary or industrial sector accounts for 33% of GDP, and made less of a contribution in 2015. The quarterly growth rate for this sector over the year scraped in at 0.1%. The performance of this sector improved notably in 1Q16, with quarterly growth of 1.2%. Finally, the primary sector accounts for only 3% of GDP. As a result, despite strong growth in 1Q16 of 3.5%, its impact on overall GDP growth was necessarily limited.

The favourable performance by the industrial sector in 1Q16 was due to the strong growth by the construction sector in January. However, this is not expected to be repeated. Likewise, as we will see in the following sections, it is possible that the dynamism in the industrial sector may dissipate in the remaining quarters of 2016, if manufacturing exports over the rest of the year do not grow dynamically. This would pose a risk to our 2016 growth forecast of 2.6%. This would also mean that most of the boost to economic activity in the country will come from the strong performance by the services sector, as in 2014 and 2015.

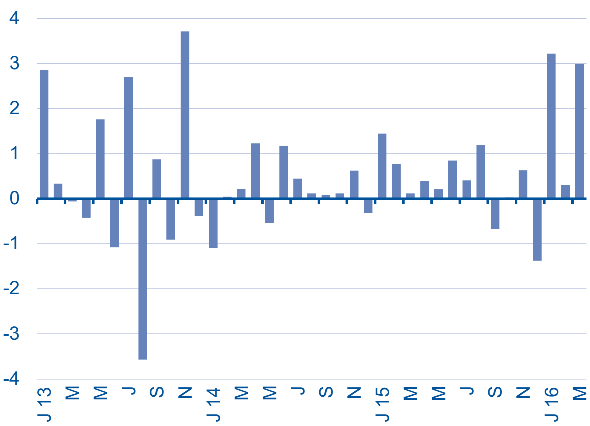
3.1.1 Domestic demand indicators: strong private sector consumption but limited growth in gross fixed investment

Whilst GDP figures for the first quarter of 2016 (1Q2016), have been released, figures for the components of aggregate demand are not yet available. Therefore, the performance of private consumption has to be visualised through the available monthly information for the main variables in aggregate demand, such as retail sales and the monthly private consumption indicator. Retail sales grew strongly in two of the first three months of 2016. This means we can expect a favourable performance by private consumption in these months.

The private consumption index performed favourably in the first quarter of the year. For example, the annual average growth rate for private consumption for the first three months of 2016 was 4.2%, slightly higher that the last three months of 2015 (4.0%), and the first three months of 2015 (3.1%).

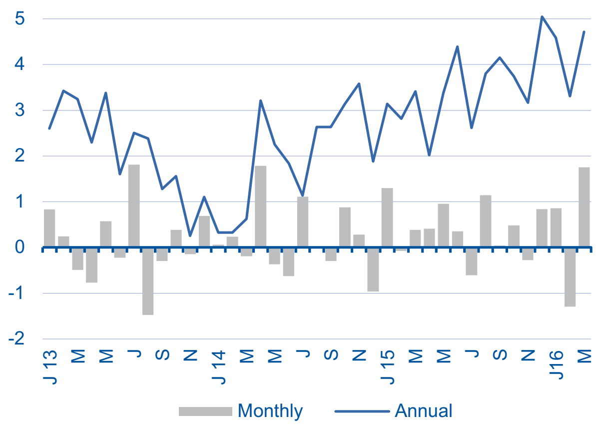
These figures point to a significant growth in private consumption in the first quarter of the year, making this component the main driver of expansion in economic activity in 1Q2016, as in 2015. And, to the extent that private consumption maintains high rates of growth over the remainder of the year, this component will again be the main driver of the country's GDP growth in 2016.

Figure 3.5
Retail sales index (Monthly % change, sa)



sa = seasonally-adjusted
Source: BBVA Research with INEGI data

Figure 3.6
Private sector consumption index (Monthly and annual % change, sa)



sa = seasonally-adjusted
Source: BBVA Research with INEGI data

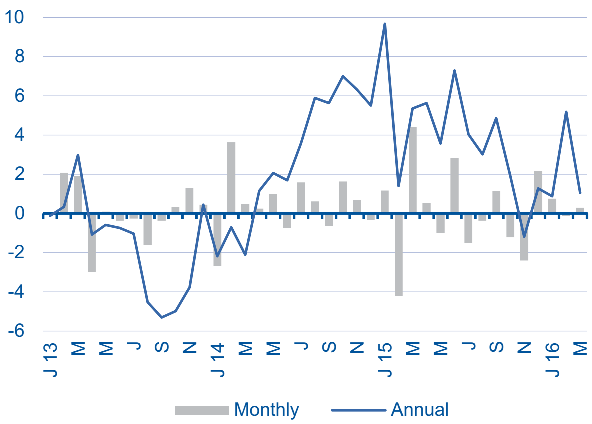
However, the favourable performance of private consumption in 1Q2016, was not matched by the performance of gross fixed investment (or gross fixed capital formation). For example, the average annual growth in gross fixed investment in January to March 2016 was 2.4%. Whilst this was higher than in the last quarter of 2015 (0.7%), it fell short of the average rate in the first quarter of 2015 (5.5%). In other words, the dynamism of gross fixed investment in 1Q2016 was limited, and needs to be much higher if it is to have a significant impact on the country's economic growth. There are two reasons for this. Firstly, if gross fixed investment is to be a significant factor or component in driving GDP growth in the country, it needs to make a bigger contribution to the growth of output, and this will only be achieved if investment also increases more rapidly. Secondly, investment increases the country's productive capacity, and this in turn creates new jobs and has the capacity to increase consumption in future. Moreover, without sustained expansion in productive capacity, there can be no sustained increase in employment or the well-being of the population.

From the previous point, we can anticipate that if investment is limited or low, for example 2.5%, then the expansion in productive capacity will likewise be limited, and thus the creation of new jobs. As a result, the improvement in the well-being of the population could be affected or could be much more limited.

Exports of goods are another component of GDP that has recorded limited - and in some months negative - growth. As we will see in more detail in the next section, the recent performance of the country's balance of trade has not been favourable. This could be a significant risk that 2016 GDP could undershoot our expectations. This point can be appreciated if we consider non-automotive manufacturing exports (almost 60% of total exports), which have more frequently recorded negative rather than positive monthly growth rates since the second half of 2015.

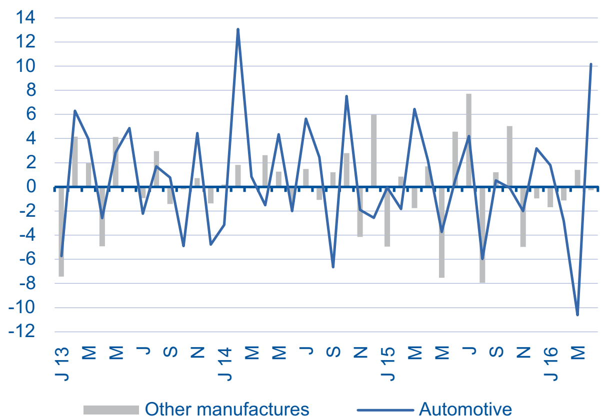
In other words, the recent performance of the balance of trade is a risk factor that may undermine the expected GDP growth rate for 2016, as may the progress of the country's public finances in 2016 to date (as we will see in the relevant sections). Both of these variables have been affected by the lower price per barrel of Mexican Mix oil, which has increased the trade deficit and reduced public-sector revenues.

Figure 3.7
Gross fixed capital formation index (Monthly and annual % change, sa)



sa = seasonally-adjusted
Source: BBVA Research with INEGI data

Figure 3.8
Non-automotive manufacturing exports (Monthly % change, sa)



sa = seasonally-adjusted
Source: BBVA Research with INEGI data

3.1.2 External sector: increased trade deficit as a result of the deficit in the balance of trade in oil

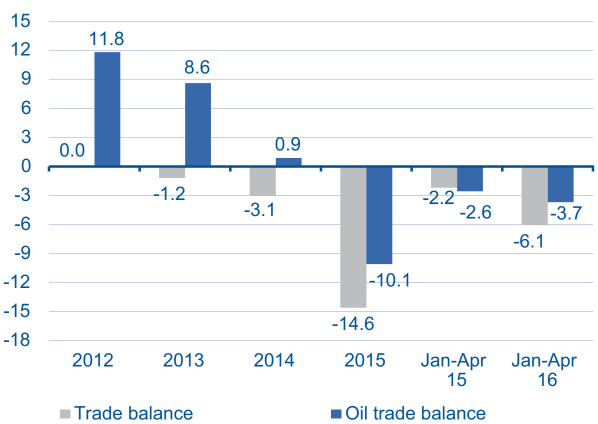
Mexico's economy has faced two major challenges so far this year. As already discussed, one of these is the external sector, particularly the performance of manufacturing exports. These account for around 88% of total exports (31% automotive and 57% non-automotive manufacturing exports). The average annual growth rate for manufacturing exports in the first half of 2015 was 3.8%, which fell to -1.7% in the second half of the year: this fell further, to -4.1% in the first four months of 2016.

This poor performance by manufacturing exports, taken together with oil exports in the first four months of 2016, is reflected in the accumulated balance of trade from January to April 2016. The deficit in this period stood at $6.1 bn, 64% higher than the same period in 2015. In annualised terms, this deficit in the first four months of the year equates to $18.3 bn for 2016 as a whole. This $18.3 bn deficit is 25.3% higher than the $14.6 bn deficit in 2015.

The other challenge relates to the deterioration in the balance of trade, including the deterioration in the balance of trade in oil. In 2013, when the average oil price for Mexican Mix exports stood at USD 99 per barrel, there was a surplus in the balance of trade in oil of $8.6 bn. The deterioration in the balance of trade in oil over the subsequent years is largely explained by the ongoing and considerable fall in the average price per barrel of oil exports. In 2014, the average price of crude exports stood at USD 86 per barrel, falling to USD 43 in 2015. This fell even further - to an average of USD 27 per barrel - over the first four months of 2016.

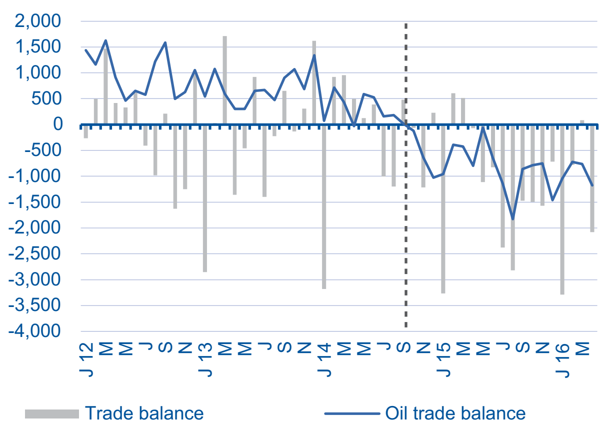
The fall in the price of oil exports has resulted in significant deficits in oil. In 2015, this deficit stood at $10.1 bn, whilst the balance of trade deficit was larger, at $14.6 bn. The deficit in the balance of trade in oil in the first four months of 2016 was $3.7 bn, with a balance of trade deficit of $6.1 bn. In other words, these figures indicate that the main cause of the significant deterioration in the balance of trade was a large deficit in the balance of trade in oil.

Figure 3.9
Balance of trade and balance of trade in oil (US$ billions)



Source: BBVA Research with INEGI data

Figure 3.10
Monthly balance of trade and balance of trade in oil (US$ billions)



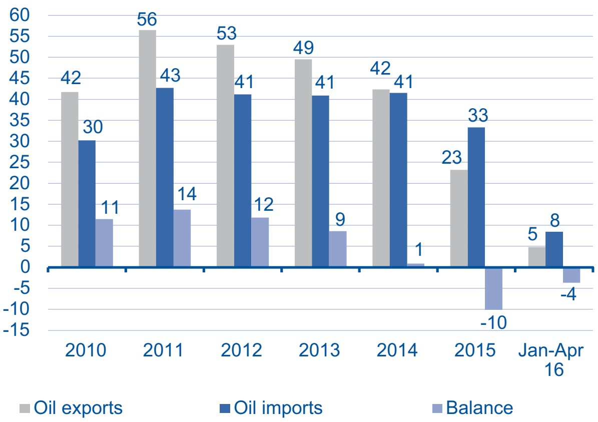
Source: BBVA Research with INEGI data

Having been falling gradually, the price of a barrel of crude exported from Mexico stood at USD 94.7 in July 2014, and then fell rapidly over the following months. It fell to USD 75.2 in October 2014 and USD 51 in December 2014.

The balance of trade in oil went into deficit in October 2014, where it has remained ever since, as the price of oil exports continued on its downward path. The price bottomed out at USD 23.9 in January 2016, recovering to average almost USD 32 in April 2016.

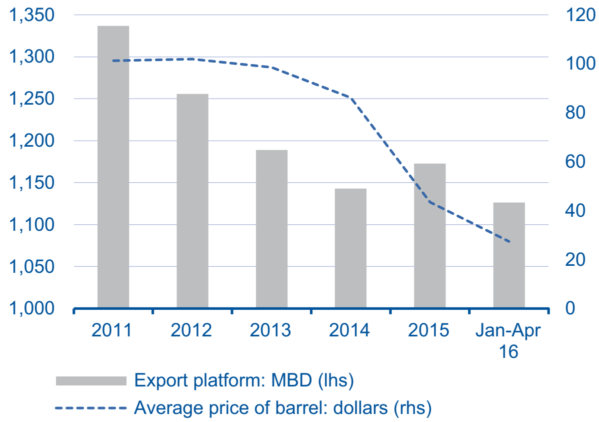
The other factor responsible for the deficit in the balance of trade in oil is the scale of oil imports. Such imports grew from $30 bn in 2010 to $41 bn in 2014. However, in 2015, the value of imports fell to $33 bn, reflecting the fall in oil prices in international markets. In other words, the need to import petrol, at the same time as falls in the price of a barrel of crude oil and in oil exports, are all factors in the generation of the deficit on the balance of trade in oil. This situation will persist until the price of a barrel of crude oil returns to levels similar to those in September 2014 (USD 86), or until the country increases its crude oil output and internal petrol production. Thus, the deficit in the balance of trade in oil will continue, contributing to the weakness of the country's external sector.

Figure 3.11
Mexico's balance of trade in oil: oil exports - oil imports (US$ billion)



Source: BBVA Research with INEGI data

Figure 3.12
Oil exports (figures in US$ billion and thousands of barrels per day, MBD)

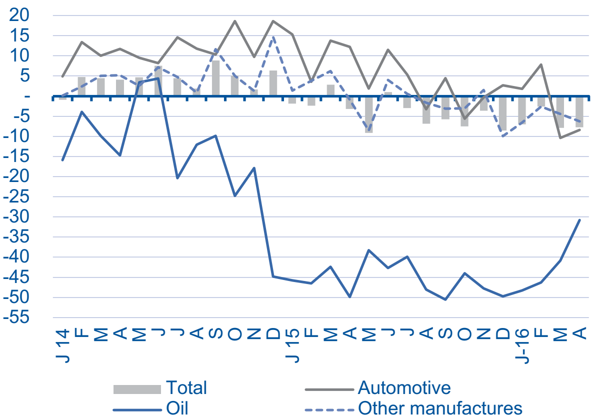


Source: BBVA Research with INEGI data

3.1.2.1 Exports of goods by type: weak performance in the first four months of 2016

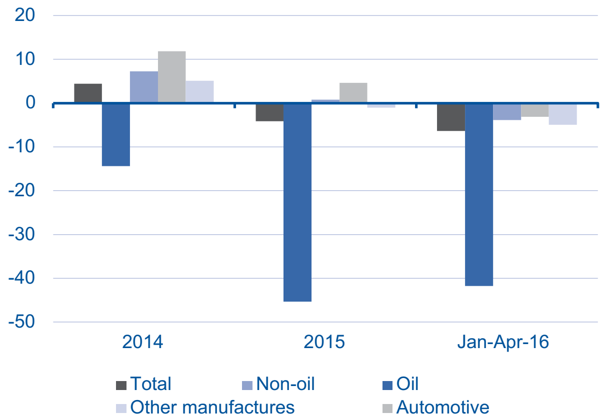
The most important category of goods exported is non-automotive manufacturing exports (representing 58% of the total), followed by automotive goods (31% of the total), oil (6%), farm produce (3%) and, finally, non-oil minerals (1%). Non-automotive manufacturing exports have returned persistent negative annual growth rates since August 2015. Automotive exports performed well in 2015, but growth returned to negative territory in March and April 2016. Thus, the weak performance of automotive and non-automotive manufacturing exports in the first four months of 2016, together with the contraction in oil exports, resulted in accumulated export sales from January to April 2016 contracting at an annual rate of 6.4%.

Figure 3.13
Monthly exports of goods by type (YoY % change)



Source: BBVA Research with INEGI data

Figure 3.14
Goods exports by type of goods (YoY % change)



Source: BBVA Research with INEGI data

The negative growth in both types of manufacturing exports in the first four months of the year suggests that the external sector may not be one of the drivers of the country's economic growth. Moreover, should the poor performance of the export sector continue throughout 2016, particularly for manufacturing exports, then rather than fostering expansion, the external sector may become a risk factor that could hamstring GDP growth.

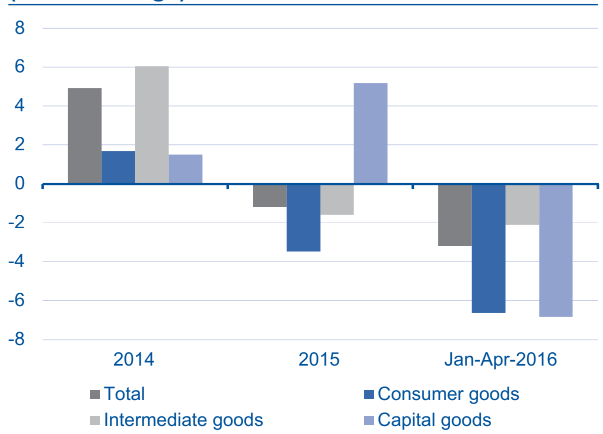
3.1.2.2 Imports based on type of goods: slow growth limits momentum in economic activity

The annual growth rate in total imports of goods reflects the performance of exports. The previous point is illustrated when we consider the correlation between the annual growth rates for imports and exports of goods. For example, from January 2010 to April 2016, there was a strong correlation between these two variables, with a ratio of 0.965. This should not really be a surprise, if we consider that a significant portion of the country's exports of finished goods is directly associated with the import of intermediary goods.

Figure 3.15
Monthly imports of goods by type (YoY % change)

Source: BBVA Research with INEGI data

Figure 3.16
Imports of goods by type (YoY % change)



Source: BBVA Research with INEGI data

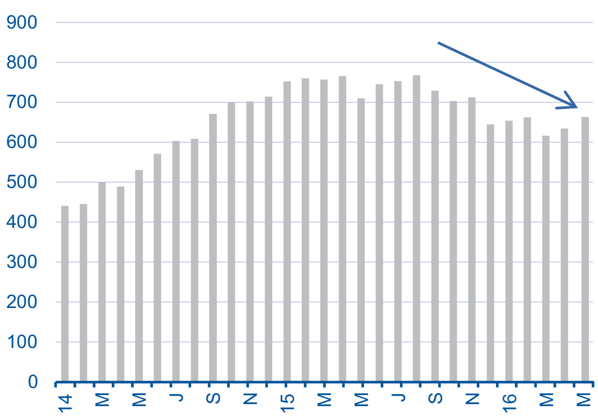
Based on the previous point, we also find that, as with total exports of goods, accumulated goods imports from January to April 2016 fell at an annual rate of 3.2%. It is worth noting that the largest contraction in this period was in capital goods (-6.8%). This indicates that one of the main components of aggregate demand - gross fixed investment - could be affected in the coming months by the decline in gross fixed investment in imported machinery and equipment.

Imports of intermediary consumer goods fell at an annual rate of 2.1%, according to the accumulated figures for January to April 2016. This could be a reflection of the decreased economic activity in the country, as there is no need for imports of supplies to increase when growth in economic activity is weak.

3.1.3 Recent evolution of formal employment in the private sector (Mexican Institute of Social Security - IMSS)

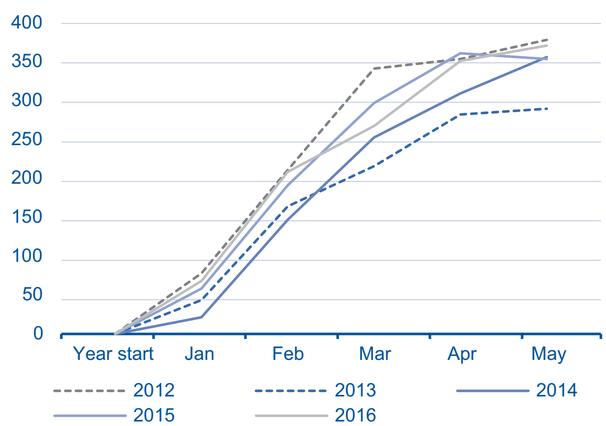
Mexico's employment authorities implemented a programme to formalise employment in July 2013. This programme involved people who had jobs but no social security coverage receiving this at the moment they registered with Mexico's Social Security (Instituto Mexicano del Seguro Social - IMSS). This programme resulted in a significant boost in the number of registered workers, with an increase of 463,000 in the number of workers registered with the IMSS in December 2013 compared to 12 months earlier. By December 2014, this had further increased to 715,000, as result of the jobs generated by increased economic activity and the programme to formalise employment. The increase in the number of workers registered with the IMSS fell to 644,000 at the end of 2015.

Figure 3.17
Increase in total workers registered with the Mexican Institute of Social Security over 12 months (Thousands of people)



Source: BBVA Research with INEGI data

Figure 3.18
Accumulated monthly increase in the total number of workers registered with the Mexican Institute of Social Security from January to May (Thousands of people)



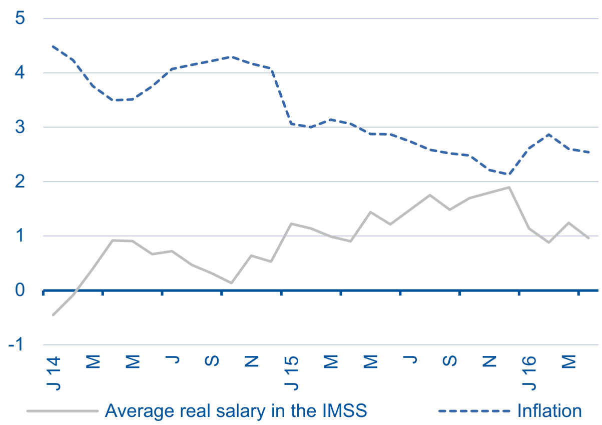
Source: BBVA Research with INEGI data

The lower annual increase in formal employment over 12 months kicked in from September 2015 to March 2016. This decrease in the annual increase in employment may be due to the effectiveness of the programme to formalise employment wearing off somewhat. At the end of February 2016, the head of the Work and Social Welfare Secretariat (Secretaría del Trabajo y Previsión Social - STPS) mentioned at a governors' meeting the need to relaunch his department's employment formalisation programme. Irrespective of this, the annual increase in workers registered with the IMSS improved in April and May 2016. For example, the annual increase in the number of workers registered with the IMSS increased to 662,000 in May 2016.

Figure 3.19
Total workers registered with the IMSS (YoY % change)

Source: BBVA Research with INEGI data

Figure 3.20
Real salary and annual inflation (YoY % change)



Source: BBVA Research with INEGI data

On 23 May 2016, the head of the STPS established an agreement with all of the country's governors and the IMSS to relaunch the employment formalisation programme. This relaunch included 110,000 inspection visits to workplaces to formalise the jobs of at least 250,000 workers under the new programme. The fact that STPS decided to relaunch the programme leads us to believe that its effectiveness had been in decline possibly since September 2015. With the relaunch, the increase in the number of workers registered with the IMSS could return to levels seen in the first half of 2015.

Average real salaries for workers registered with the IMSS increased in 2015, as a result of lower inflation in the year. Real salaries continued to increase in the first four months of 2016 at a similar pace to the same period in 2015, although the increase was slightly slower due to higher inflation.

This increase in real salaries has been one of the factors behind the increase in private consumption and, therefore, the increase in GDP. It is therefore desirable that this increase in real salaries should continue, further boosting the spending power of households. In this regard, the head of the STPS recently announced an intention to make the minimum wage rise, through concerted action between the authorities, workers and businesses.

The intention is that the increase in the minimum wage should be applied concertedly, and in such a way that it has no inflationary impact. Furthermore, against an unfavourable external backdrop for the country, with low oil prices and a flagging export sector, the increase in real wages could be a relevant factor in 2016 in enabling consumption to continue growing rapidly, with GDP growing by 2.6%.

3.1.4 Public finance: the Bank of Mexico operating surplus means that there could be a positive real annual variation in budget revenues, whilst public spending contracted during the first four months of the year

Total public-sector budget revenues grew at a real annual rate of 16.2% from January to April 2016, compared to the same period last year. It should be noted that this positive YoY comparison was enabled by the 239.1 billion peso operating surplus the Bank of Mexico transferred to the Secretariat of the Treasury and Public Borrowing (Secretaría de Hacienda y Crédito Público - SHCP). By excluding this component, budget revenues fell by 0.2% on a real annual basis during the first four months of the year.

There was a 66.3% real annual increase in non-tax revenues from January to April 2016, due to the transfer of the Bank of Mexico operating surplus to the SHCP. There was a 7.5% real annual increase in tax revenues in this period. This included a 9.7% real annual increase in income tax (ISR) in the period. With this annual increase in ISR, and given ISR's 56% share of taxes from January to April 2015, ISR contributed around 72% to the real annual growth in tax revenues.

VAT is another major component of tax revenues, accounting for 26% from January to April 2016. In the first four months of this year, VAT grew at a real annual rate of 4.0%, comparing favourably to the 3.2% annual growth in 2015. VAT revenues are closely linked to economic activity in the country, which grew at a real annual rate of 2.8% in the first quarter of 2016 (GDP grew by 2.5% in real annual terms in 2015).

Public sector oil revenues only accounted for 13.3% of total budget revenues from January to April 2016 (19.8% during the same period in 2015). These revenues continued to fall in real annual terms, at a rate of 6.6%. Box 1 shows an estimate of the impact of the average price of Mexican Mix oil and lower oil output on revenues from the barrels of oil produced in 2016 and 2017.

Table 3.1

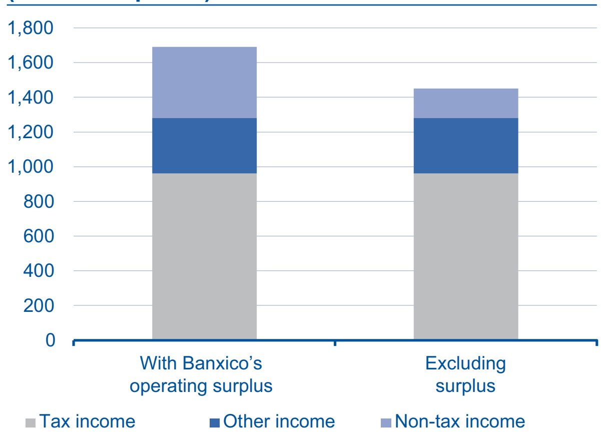
Total public sector budget revenue from January to April (billions of pesos)

	2015	2016	Real % chge.	% struc.
Total	**1,416.7**	**1,689.8**	**16.2**	**100.0**
Federal Government	1,109.6	1,368.9	20.1	81.0
Tax	870.4	960.6	7.5	56.8
Income Tax	486.8	548.4	9.7	32.5
VAT	232.0	247.6	4.0	14.7
Non-tax	239.1	408.3	66.3	24.2
Agencies & companies	98.1	106.2	5.4	6.3
Gvmnt. productive co.	209.0	214.7	0.1	12.7
Pemex	108.6	123.8	11.1	7.3
CFE	100.3	90.9	-11.8	5.4
Total	**1,416.67**	**1,689.82**	**16.2**	**100.0**
Ingresos petroleros	234.5	225.0	-6.6	13.3
Ingresos no petroleros	1,182.1	1,464.8	20.7	86.7

Source: BBVA Research Finance Ministry data

Figure 3.21

Main public sector budget revenues (billions of pesos)



Source: BBVA Research Finance Ministry data

Net public spending fell at an annual rate of 3.3% in real terms from January to April 2016, compared to the same period in the previous year. This was mainly due to the negative performance of programmable spending (accounting for 79% of total net public sector spending from January to April 2015), with a real annual growth rate of -5.0% in the first four months of the current year. Breaking this down, capital spending accounted for 67% of the percentage fall in programmable spending in January to April 2016. The remaining 33% of the fall was accounted for by current spending, with a moderate real annual contraction of 2.2%.

Table 3.2
Net public sector spending in January to April (billions of pesos)

	2014	2015	Real % chge.	% struc.
Total	**1,539.1**	**1,527.1**	**-3.3**	**100.0**
Projected expenditure	1,214.3	1,183.9	-5.0	77.5
Current expenditure	914.2	917.5	-2.2	60.1
Capital expenditure	300.1	266.4	-13.5	17.4
Non-projected expen.	324.8	343.2	2.9	22.5
Investments in states	218.7	232.4	3.5	15.2
Borrowing cost	74.6	89.1	16.3	5.8
Adefas* and other	31.5	21.8	-32.6	1.4

Adefas: Liabilities carried over from previous years.
Source: BBVA Research Finance Ministry data

Table 3.3
Public sector financial situation in January to April (billions of pesos)

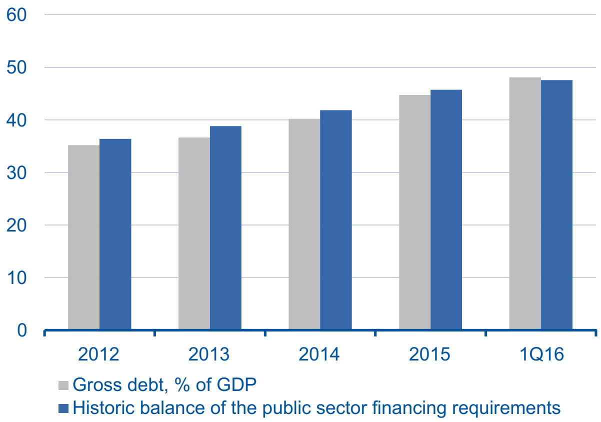
	2014	2015	Real % chge.
Public Balance	-116.3	177.1	n.s.
Pub. Bal. w/o Prod. invstmnt.	60.1	313.3	407.5
Budget Balance	-122.4	162.7	n.s.
Budget Revenue	1,416.7	1,689.8	16.2
Net Budget Expenditure	1,539.1	1,527.1	-3.3
Federal Govnmt. Balance	-50.2	161.4	n.s.
Agencies & Co. Balance	-72.2	1.3	n.s.
Primary Balance	-42.2	264.6	n.s.
Budget Balance	-47.9	251.7	n.s.
Federal Government	-7.9	218.9	n.s.
Agencies & Companies	-40.0	32.8	n.s.
Pemex	-92.6	-31.6	-66.8
Other institutions	52.6	64.4	22.3
Indirectly-controlled institut.	5.6	12.9	123.5

ns = not significant
Source: BBVA Research Finance Ministry data

The performance of programmable spending observed in the first four months of 2016 seems to be a reflection, in part, of the 132 billion peso cut in public spending, announced on 17 February this year (including a 100 billion pesos cut to Pemex spending). This was a result of the fall in public sector oil revenues, but was also an economic policy measure to meet the annual public sector budget balance target, among other objectives.

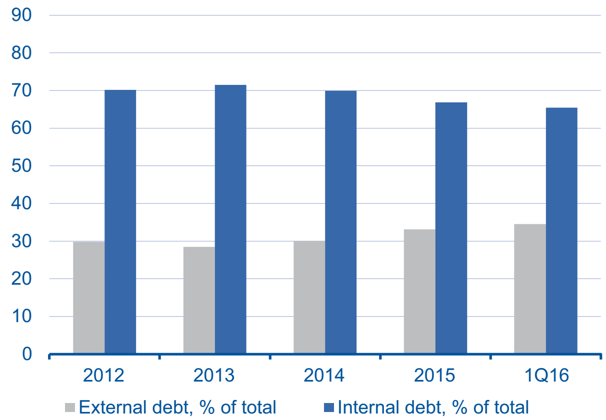
Unlike January to April 2015, the public sector primary balance was positive in the first four months of the current year. Much of the primary balance is reflected in the federal government balance. This balance reflects both higher budget revenues and the reductions in annual public spending in the first four months of 2016. Continuing positive primary balances in the public sector will be key over coming quarters to putting a brake on the pace of public-sector indebtedness seen over recent years, creating some fiscal slack through which the federal government could deal with any future adverse economic shocks.

Figure 3.22
Public sector gross debt and financing requirements (% of GDP)



Source: BBVA Research Finance Ministry data

Figure 3.23
Percentage structure of internal and external public sector debt (% of the total debt)



Source: BBVA Research Finance Ministry data

Gross public debt stood at 48% of GDP at the end of the first quarter of 2016. This is 3.5 percentage points higher than the ratio of public debt to GDP at year-end 2015 (the difference between the first quarter 2015 and year-end 2014 was 3.2 percentage points). The relatively strong depreciation of the exchange rate in the first quarter of the year is one of the main factors explaining this increase in the level of public debt as a share of GDP. This situation is also reflected in the larger share of external public debt in total public debt, which rose from 33% at year-end 2015 to 35% in the first quarter of 2016.

In the first quarter of 2016, national debt was 11 percentage points of GDP higher than its level in 2012. In order to initiate a downward trend in national debt as a share of GDP, growth in the public sector net cash requirement (PSNCR) must be lower than GDP growth. In this regard, it is important to mention the SHCP's intention to reduce the annual PSNCR deficit to 3.5% of GDP in 2016 (from 4.1% of GDP in 2015), 3.0% in 2017 and 2.5% from 2018.

Even assuming that both the SHCP's central forecast for medium-term economic growth and its public deficit targets are met, national debt as a proportion of GDP will not start to decline until 2017. This is because the SHCP forecasts medium-term GDP growth of 2.7% and 3.1% for 2016 and 2017, respectively. However, we forecast that GDP will grow by 2.6% in 2017, which will not be sufficient to reverse the upward trend in national debt as a proportion of GDP.

Irrespective of actual GDP growth in 2016 and 2017, very tight fiscal discipline will be required to avoid total public sector debt continuing to grow, overall and as a proportion of GDP: any deterioration in the public finances would throw up new obstacles to growth in economic activity in the near future.

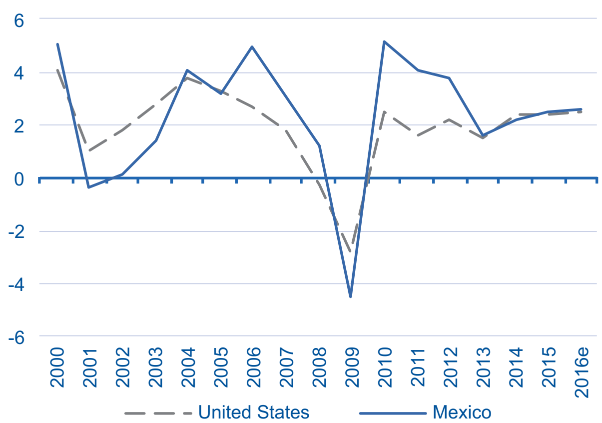
3.1.5 Forecasts for the Mexican economy in 2016

As already mentioned in this section, we expect GDP growth of 2.6% in 2016, with private consumption being the main driver of total demand. Given the recent relaunch of the Work and Social Welfare Secretariat (STPS) programme to formalise employment, expectations that real wages will continue to grow and the possibility of a concerted increase in the minimum wage through the actions of the STPS, we can expect consumption to be the main driver of GDP in 2016.

Figure 3.24
Annual growth in quarterly GDP in Mexico and the U.S. (YoY % change)

YoY = year-on-year
Source: BBVA Research with INEGI data

Figure 3.25
Annual GDP in Mexico and USA (YoY % change, sa)



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

The close trade relations between Mexico and the United States means there is a strong correlation between GDP growth in the two countries. The importance of this trade relationship for Mexico is illustrated by 81% of its goods exports going to the USA. Therefore, high and sustained growth rates in the USA are a prerequisite for Mexico's economy also growing at relatively high and sustained rates. This is important: if the US economy grows by less than the 2.5% expected in 2016, then it is also likely that Mexico's economy will grow by less than the 2.6% we expect.

Recuadro 1. Forecast public sector oil revenues, 2016 and 2017

We used forecasts of the average price for a barrel of Mexican Mix oil over 2016 and 2017, with average production capacity of 2.1 and 2.0 million barrels of oil per day in 2016 and 2017, respectively[1], to analyse the impact of a higher price per barrel of Mexican Mix on public sector oil revenues in these two years.

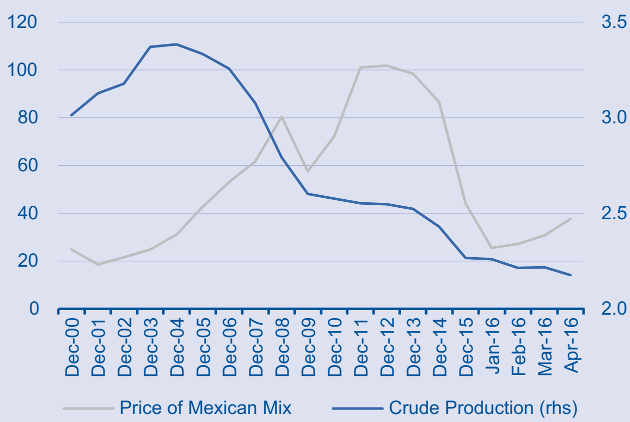
Public sector oil revenues this year will mainly depend on the average annual price for a barrel of Mexican Mix oil, which will condition the oil hedging exercise. Whilst the price of a barrel of oil is the most relevant factor in determining public sector oil revenues, due to the sharp fall that began in October 2014, oil production has also had a negative impact on such revenues, as this has been declining for several years (Chart 3.26).

It should be noted that oil hedging for 2016 will only be exercised when the annual average price of a barrel of Mexican Mix oil is below USD 49. Even so, the volume of production hedged is only 212 million barrels (approximately 28% of total annual production). Even if this hedging is exercised (given our forecast of USD 37.3 for a barrel of Mexican Mix oil in 2016) and oil production capacity is 2.1 million barrels per day in 2016, public sector oil revenues will fall by around 29.3% compared to 2015.[2] This is mainly due to the 2015 oil hedge being more favourable, as it guaranteed a minimum price of USD 76.4 per barrel for 228 million barrels.

Turning to public sector oil revenues for 2017, we forecast that these will increase by 10.7% (given our forecast of USD 47.1 per barrel of Mexican Mix oil), even without oil hedging and assuming production capacity of 2.0 million barrels per day. Even so, such oil revenues would only represent 36.3% of revenues from this source in 2012 (Chart 3.27).

Figure 3.26

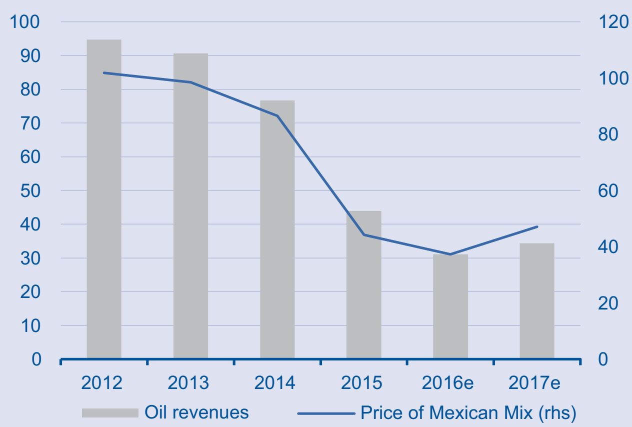
Oil production and the price of Mexican Mix crude (million barrels per day and USD per barrel)



Source: BBVA Research with & Bloomberg data

Figure 3.27

Public sector oil revenues and the price of Mexican Mix (billions of USD and USD per barrel)



e = own estimates
Source: BBVA Research with SIE & Bloomberg data

1: Unlike the public sector oil revenue data reported by the SHCP, the oil revenues we analysed in this exercise only consider revenues from sales of barrels of oil.
2: If oil production capacity remains around 2.3 million barrels per day, as in 2015, the annual contraction in oil revenues will be just 24.3%.

It should be noted that this exercise used information and estimates from the US Energy Information Administration (EIA) for the global oil market in the second half of 2016 and the whole of 2017. The main forecasts include: i) oil prices will gradually recover over the second half of 2016 and the coming year, in line with the trend to reduce global oil stockpiling over the coming months (Chart 3.28); ii) global demand and supply for oil and other liquids will return to equilibrium in late 2017; and iii) OPEC countries will account for a larger share of oil production, given the forecast of reduced oil production in other countries (Chart 3.29).

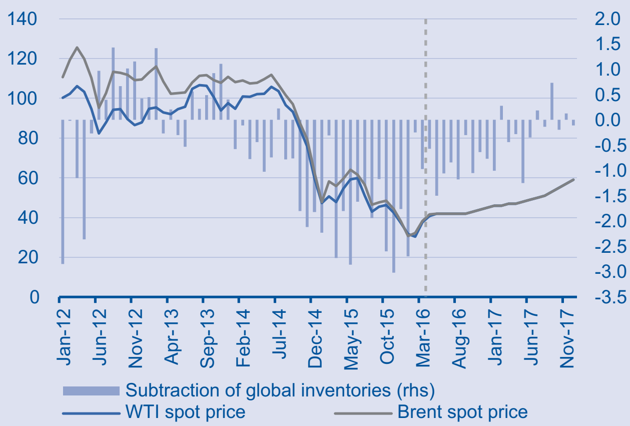
The price of a barrel of West Texas Intermediate (WTI) oil increased from USD 30.6 in February to USD 46.8 in May. The main factors that have recently influenced oil prices favourably include: a) an acceleration in global oil demand; b) a negative trend in production and oil platforms operating in the USA; and c) some disruption to global oil supplies.

The higher consumption in the non-OECD part of Asia explains the acceleration in the growth of global oil demand. The EIA estimates that oil consumption will be 200,000 barrels per day higher than previously estimated for 2016.

Oil production in the USA averaged 9.0 million barrels per day in April. The EIA forecasts a decrease to an average of 8.6 million barrels per day in 2016 and 8.2 million barrels per day in 2017. Oil prices are forecast to continue to rise as the number of platforms in operation continues to decrease, as this is an indicator of future oil supply in the USA (Chart 3.30).

Figure 3.28

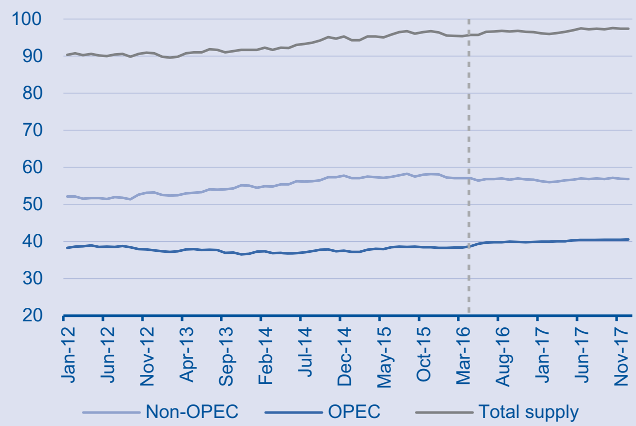
Global oil inventories and price
(millions of barrels per day, MBD, USD per barrel)



Source: BBVA Research with US EIA data

Figure 3.29

Global oil production
(millions of barrels/day)



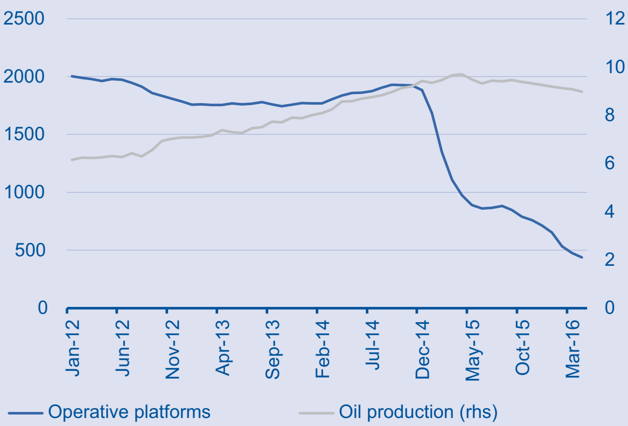
Source: BBVA Research with US EIA data

Disruptions to global supply in Nigeria, Canada and Venezuela in May this year probably resulted in global consumption exceeding production for the first time in almost two years (the last time was in July 2014).

In the panorama expected by the EIA for the global oil market in the second half of 2016 and the whole of 2017, the price of a barrel of Mexican Mix oil will gradually recover as it is benchmarked against the WTI[3] price. According to our forecasts, the Mexican Mix will average USD 37.3 and USD 47.1 in 2016 and 2017, respectively (Chart 3.31).

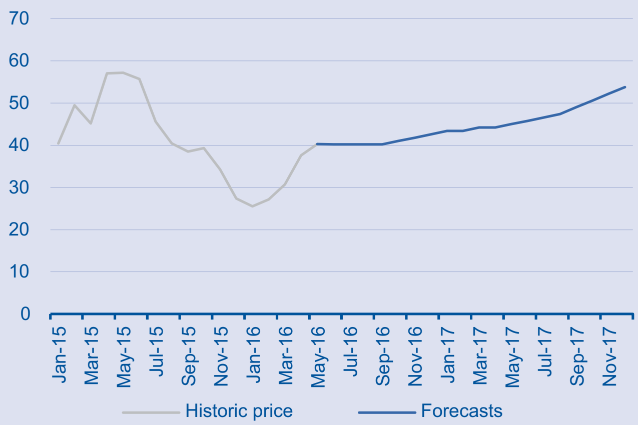
As previously mentioned, our forecasts point to a 29.3% reduction in public sector oil revenues in 2016 and a 10.7% increase in 2017. It should be recognised that this paints a picture of relatively low oil revenues in 2016 and 2017. Oil revenues will fall further if there is any further fall in the price of a barrel of Mexican Mix oil.

Figure 3.30
US oil production and platforms
(million barrels per day and units)



Source: BBVA Research with US EIA data

Figure 3.31
Mexican Mix oil price
(USD per barrel)



Source: BBVA Research with Bloomberg data

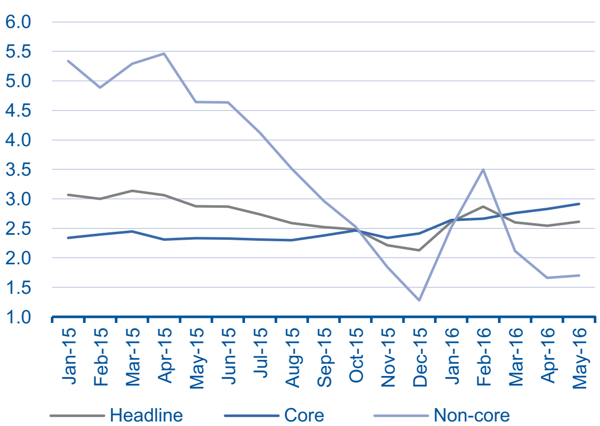
3: Simple econometric analysis, using daily figures from 14 May 2014 to 13 May 2016, shows that the price of a barrel of Mexican Mix oil is equivalent to the price of a WTI barrel, discounted by approximately 20%.

3.2 The favourable inflation figures will be maintained: 13 consecutive months below the 3.0% target

Following general inflation hitting a historic low at year-end 2015, it bounced back slightly at the start of the year. However, this was due to a number of temporary factors, as there was a shock to the supply of agricultural products and a mathematical effect from an unfavourable base for comparison. Even so, inflation has remained below its permanent target of 3.0% for 13 consecutive months, and it is likely that this will continue for at least one quarter (the third) more and probably two, against what continues to be a favourable backdrop.

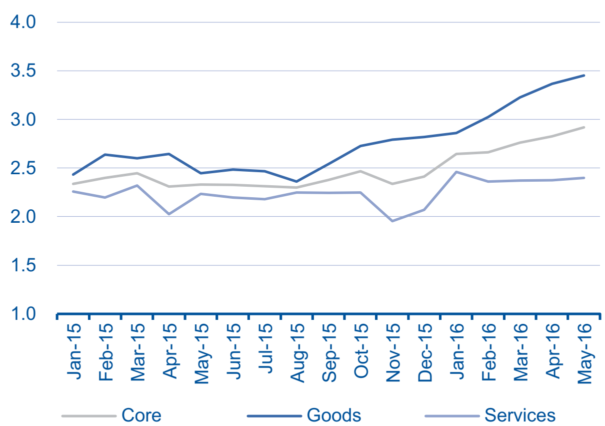
The factors that have enabled this performance include the credibility of the Bank of Mexico (Banxico)'s monetary policy, slack in the economy and falls in some prices that have created a pass-through effect from the exchange rate to inflation. With regard to the latter factor, this was firstly influenced by lower prices for telecommunication services. These were mainly the result of reforms to the sector, which eliminated some charges (e.g. long distance) and fostered competition in the sector, feeding through into lower prices for consumers. Secondly, there was also an effect from lower energy prices resulting from low international prices and energy reforms, leading to lower petrol and electricity prices, which have relatively high weightings in inflation. The first two factors - the credibility of Banxico policies and slack in the economy - have meant, as we expected, that we have seen no knock-on effects on the price-formation process. Thus, what we are continuing to see is a change in relative prices - with an upward trend in the underlying component of goods deriving mainly from increased costs due to the depreciation of the peso (MXN) – and a low pass-through effect to general inflation, deriving mainly from the absence of the aforementioned knock-on effects.

Figure 3.32
Inflation and components
YoY % change



Source: BBVA Research with INEGI data

Figure 3.33
Core inflation and components
YoY % change



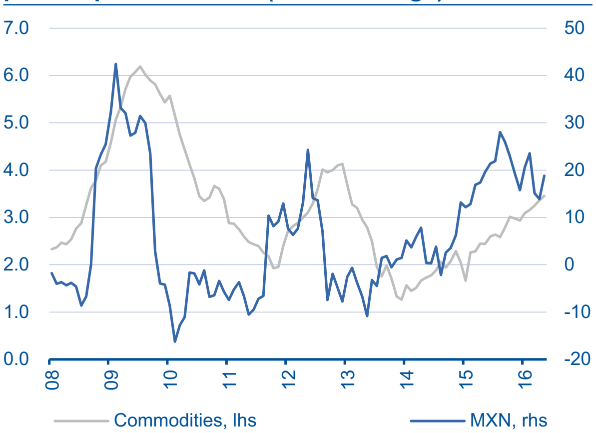
Source: BBVA Research with INEGI data

Against this favourable backdrop, general inflation rebounded slightly in the first two months of the year from the historic low at year-end 2015. Whilst general inflation bounced back by 0.74 percentage points (pp) in the first two months of 2016 to 2.87% (Chart 3.32), this increase was not due to deterioration in the factors that determine inflation nor to increased pass-through effects. Rather, the increase was explained by two factors: i) a mathematical effect caused by the reduction in prices for landline telephone services in January 2015, which was not repeated in January 2016; and ii) a supply-side shock to the fruit and vegetable component in January and February. With regard to the second factor, the increases in this component during the first two months of the year were so marked that they took the annual rate for this component to 27.3% (+21.6 pp compared to the annual rate at year-end 2015). Thus, average general inflation increased from 2.27% in the final quarter of 2015 to 2.69% in the first quarter of 2016.

The two temporary shocks mentioned gradually disappeared over the following three months (March to May). Over this period there were average monthly falls of 3.4% for fruit and vegetables, taking the annual rate back to more moderate levels (13.4%). The above, accompanied by the favourable evolution of energy prices, has enabled the non-core component of inflation as a whole to remain close to the lows recorded in late 2015 (Chart 3.32). The favourable performance of non-core inflation over the last three months explains the decrease in general inflation, from 2.87% in February to 2.60% in May. As a result, average annual general inflation so far in the second quarter (April and May) is slightly lower than the average for the first quarter (2.58% vs. 2.69%).

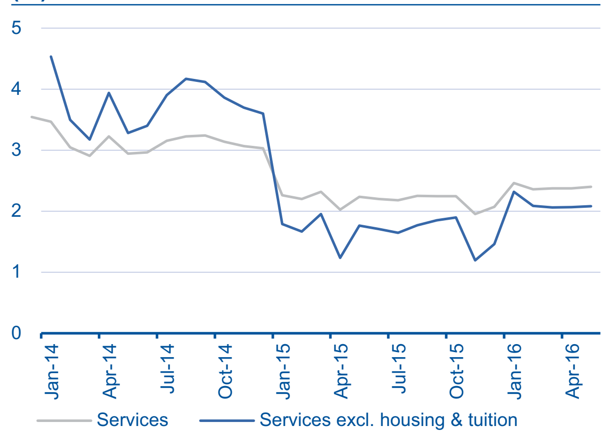
Core inflation has remained on an upward trend in 2016 to date, as a result of an adjustment to relative prices due mainly to pass-through effects. The adjustment to the relative prices of goods compared to services explains the dynamics of core inflation during the year (Chart 3.33). The average annual variation in core inflation increased from 2.40% in the fourth quarter of 2015 to 2.69% in the first quarter of 2016, subsequently further adjusting to 2.88% on average during the first two months of the second quarter. Within core inflation, the sub-index for goods continues to reflect the pass-through effect of the depreciation of the peso. Annual inflation for this sub-index increased from an average of 2.78% in the fourth quarter of 2015 to 3.04% in the first quarter of 2016, with a further increase to 3.46% in the second quarter to date (April and May). The increase in this sub-index is mainly explained by the sustained increase in the non-food goods component, the average annual inflation for which increased from 2.98% in the fourth quarter of 2015 to 3.17% in the first quarter of 2016 and 3.36% in April-May. This upward trend is mainly explained by pass-through effects (Chart 3.34).

Figure 3.34
Inflation of non-food commodities and the annual peso depreciation rate (YoY % change)



Source: BBVA Research with INEGI & Bloomberg data

Figure 3.35
Annual inflation for the core services sub-index (%)



Source: BBVA Research with INEGI data

In contrast, inflation on the services sub-index remains low, benefiting from slack in the economy and increased competition in the telcoms sector leading to lower mobile telephone prices (Chart 3.35). The average annual variation for this sub-index rose from 2.09% in the fourth quarter of 2015 to 2.40% in the first quarter of 2016, standing at 2.39% in April-May (Chart 3.35).

In summary, the favourable performance of the services sub-index, the decrease in energy prices and the credibility of the Bank of Mexico have enabled pass-through effects to be offset and explain the absence of knock-on effects. Thus, despite the adverse shock to inflation from the depreciation of the peso, the feed through of this into general inflation remains limited (Chart 3.36).

We continue to expect annual inflation to remain below 3.0% for most of the year, ending the year at around this level

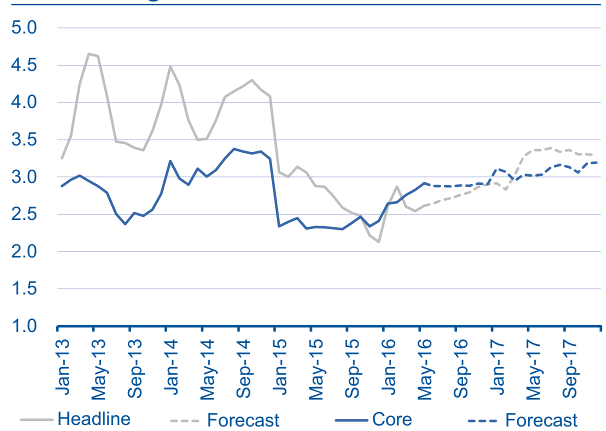
We consider that the context for inflation remains favourable. It is likely that the change in relative prices will continue in the second half of the year without any knock-on effects, and we expect the pass-through effects of the depreciation of the peso to general inflation to remain limited. Thus, we continue to expect annual general inflation to remain below 3.0% in the third quarter, at least, and probably in the fourth quarter too. We maintain our forecast of 2.9% for the year-end, although with a slight upside bias, as the formula for petrol prices suggest that these will increase towards the second half of the year in response to recent increases in international prices.

Our forecasts are subject to both upside and downside risk. The main downside risk is that the economy's lower-than-expected momentum may result in an additional increase in the output gap and the possibility of further reductions in prices for mobile-phone services if competition in the sector continues to increase. Meanwhile, there is upside risk from the exchange rate, should it remain at its current level or see further depreciation against an increasingly complex global backdrop, and from any additional supply shock to more volatile prices.

Figure 3.36
Annual general inflation and depreciation of the peso (%)

Source: BBVA Research with INEGI & Bloomberg data

Figure 3.37
BBVA Bancomer inflation outlook YoY % change



Source: BBVA Research with INEGI data

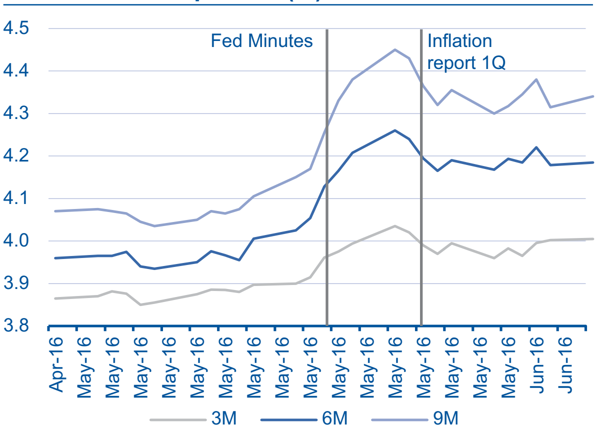
3.3 Banxico waits on the Fed, against a backdrop of exchange-rate volatility

Volatility returned to FX markets in May, with renewed negative impact on the Mexican peso, which depreciated by 7.0% during the month - the second largest fall of any emerging-economy currency. Given this significant depreciation, and a degree of negative differentiation against the peso, particularly during the last 10 days of the month, the market and some analysts expected a national funding rate hike. This would imply that this national rate increase would not be related to whatever may happen to the Fed's rates or to any intervention in the FX market, as occurred in February.

However, Banxico played down this possibility strongly at the presentation of its inflation report for the first quarter. In response to express questions from the press about the possibility of a monetary policy rate hike or intervention in the FX market in response to depreciation of the peso, Banxico's governor said that the markets were working correctly and the depreciation had been orderly, i.e. with no lack of liquidity. He added that Banxico would be paying careful attention to the Fed's monetary-policy decision and that it was highly likely that future changes in the monetary-policy rate would follow the schedule of meetings. He also reiterated that Banxico wanted to see the exchange rate anchored to healthy economic fundamentals and that, while he could not rule out the possibility of intervention, this would only occur in exceptional circumstances.

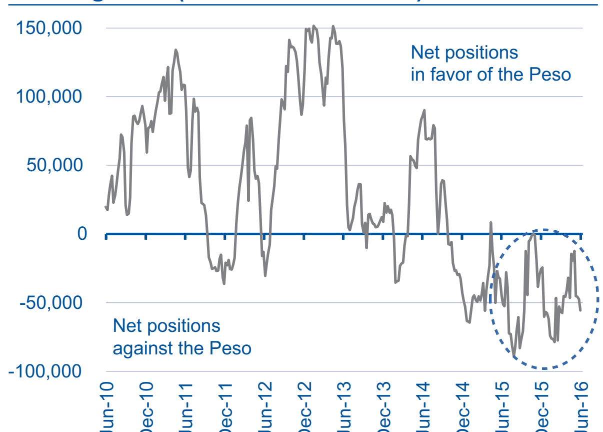
The Exchange Rate Committee subsequently announced that the International Monetary Fund had renewed and increased the Flexible Credit Line (FCL) Mexico has had in place since 2009 to USD 88 billion, to cover against increased risks in the external environment. The FCL complements domestic policies, and is designed to prevent any crisis by providing immediate liquidity in the event of adverse external circumstances. The total of the FCL and international reserves available to deal with any contingency currently amounts to USD 265 billion.

Figure 3.38
Implicit expectations of the funding rate in the interest-rate swap curve (%)



Source: BBVA Research with Bloomberg data

Figure 3.39
Non-commercial contracts net of the peso-dollar exchange rate (number of contracts)



Source: BBVA Research with Bloomberg data

In summary, recent events and the communiqué for the last month indicate that Banxico will try to avoid any surprise changes in the benchmark rate, such as those that occurred in February, to the extent that inflation, and inflationary expectations, remain under control. An additional point in this regard is set out in the box on the monetary policy transmission mechanism that Banxico presented in its most recent inflation report. According to this study, the expectations channel has strengthened, resulting in macroeconomic variables responding more rapidly to unexpected shocks. This means that a less intense response is required from the monetary authorities to any such shocks, and for a shorter time.

Therefore, we expect to see Banxico seek to maintain the federal funds rate spread over the coming months: this is consistent with the idea of synchronization with Federal Reserve movements. However, in the current volatile climate, if the peso suffers further significant depreciation compared to the main emerging-economy currencies, this could lead to intervention through activation of the central bank's mechanism for discretionary dollar sales, and even an increase in the monetary-policy rate.

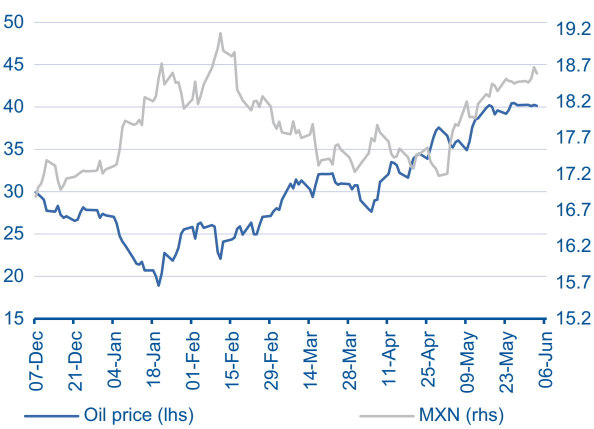
3.4 Negative differentiation of the peso in a volatile climate

Financial markets remain volatile, with concerns about the price of oil, incessant doubts about global growth and expectations of the pace of normalisation of monetary policy in the USA. Domestically, the peso is the variable most affected by this climate.

Unlike the situation in the first few weeks of the year, the oil market has stabilised at significantly higher price levels, influencing higher demand for emerging-economy assets in March and April. And energy prices have been on a clear upward path since some OPEC members hinted at the possibility of freezing their production levels, subsequently supported by an ongoing reduction in US oil production: the price of a barrel of Brent crude rose from USD 30.0 in mid-February to USD 48.0 at the end of April. Taken together with concerns about the global cycle weakening, this has enabled increases of over 13.8% in global (MSCI World Index) and 17.8% in emerging-economy (MSCI EM) stock markets in this period. Within these, the S&P500 and Mexico's IPyC stock-market indices were up by 12.9% and 8.08%, respectively.

In the FX market, most emerging-market currencies bounced back from the depreciations at the start of the year, with an appreciation of 7.8% by the end of April. In particular, the Mexican peso appreciated by 11.5% to 17.17 pesos per dollar (ppd) at the end of April, slightly below the 17.20 ppd at the end of 2015. Whilst this recovery was significant, the peso remains the second most heavily depreciated emerging-economy currency in the year to date, a characteristic of the Mexican currency since a significant negative differentiation against the peso emerged in February.

Figure 3.40
Exchange rate and Mexican Mix oil price (ppd and USD per barrel)



Source: BBVA Research with Bloomberg data

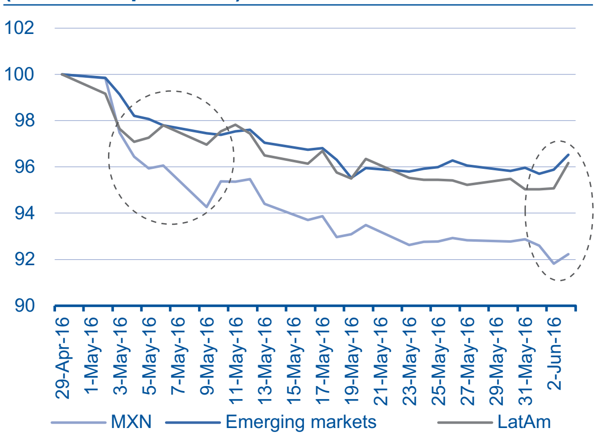
Figure 3.41
Implicit probability in the futures market of a 25 bp movement in the Federal funds rate at the June meeting (%)

Source: BBVA Research with Bloomberg data

Despite the significant appreciation of the peso in March and April, it again displayed its vulnerability to the external climate in May. In a movement similar to that seen at the beginning of the year, albeit of lesser magnitude, worse-than-expected figures for both the Chinese and US economies led to increased concerns about the global cycle and gave rise to a brief bout of risk aversion and flight to quality. Subsequently, the markets focused on shifting expectations about the next movement in the US benchmark rate. Towards the middle of the month, the minutes of the latest Fed meeting were interpreted by the markets as more restrictive, which was reflected on the futures market in an increase in the implied probability of a federal funds rate hike at the next meeting in June: this probability increased from 4.0% to 33.0% following publication of the minutes. However, this was fleeting, as the negative surprise in the US job creation figures for May (37,000 vs. the 160,000 expected by the markets) reduced this probability to 3.0%. In this environment, asset classes responded differently.

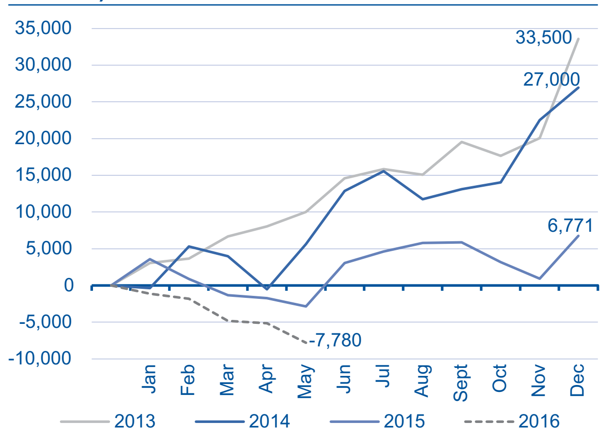
The equity markets ended May with gains, mostly offsetting the losses posted in the first half of the month, underpinned by the perception that a possible rate hike signals that the US economy is continuing to recover. This was put in doubt in the first week of June and there were further losses in response to poor US payroll figures. Even so, many stock markets preserved their gains from 29 April to 3 June: the global benchmark stock index (the MSCI World) gained 0.4%; the S&P500 was up 1.6%; and Mexico's IPyC stock-market index was practically unchanged on the end of April. On the other hand, the increased probability of a rate hike by the Fed in May caused the dollar to appreciate against most other world currencies. In particular, between 29 April and 3 June, the peso fell by 7.6% against the dollar - the largest depreciation of any emerging-market currency - ending the first week of June at around 18.60 ppd. It should be noted that there were episodes during this period when the negative differentiation of the peso was exacerbated and an asymmetrical relationship with oil-price movements was again displayed. One of these episodes was during the first eleven days of May, when the correlation between the peso and the oil price weakened: whilst the oil price fell by 1.1%, the peso depreciated by 4.5%. The second episode was on 4 June when the USA released surprisingly weak payroll figures: the dollar weakened by an average of 1.5% against emerging-market currencies (the South African rand appreciated by 3.2% during the day), but the peso only appreciated by 0.5%, influenced this time by a low oil price. Thus, the peso remained weak, as a result of both the volatile climate and erratic behaviour during certain periods. pointing to the persistence of various idiosyncratic factors by which it might be being affected (e.g. the financial situation of PEMEX, speculative attacks given its high liquidity).

Figure 3.42
Emerging currencies performance, LatAm and MXN (index 29 April = 100)



Information for LatAm and emerging markets, based on JP Morgan indices.
Source: BBVA Research with Bloomberg data

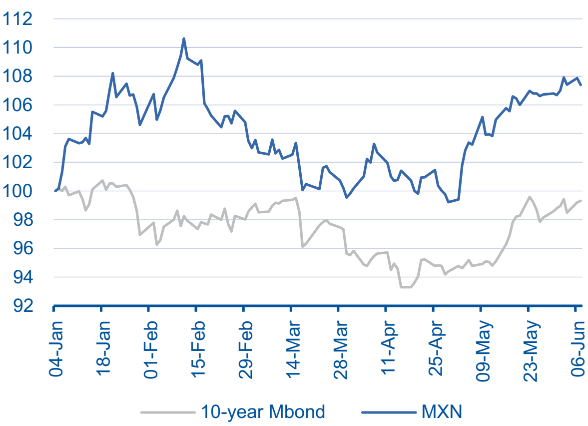
Figure 3.43
Accumulated change in foreign holdings of CETES bills and Mexican government bonds (USD millions)



Information to 19 May 2016.
Source: BBVA Research with Bloomberg data

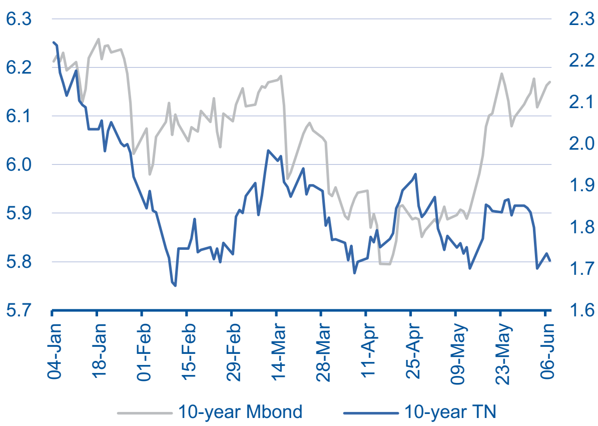
Whilst the exchange rate was the variable most affected by the external climate, there was also a significant fall in foreign holdings of government instruments in May. This reduction in holdings was at its most pronounced during the first 10 days of the month, when the performance of the peso diverged negatively from other emerging-market currencies. In the case of Mexican government bonds, the fall in holdings during the first 20 days of May amounted to USD 1.4 billion (USD 1.163 billion during the first 10 days of the month and USD 238 million during the last 10 days), a drop practically unheard of over the last five years. Meanwhile, Mexican federal government bonds (CETES) fell by USD 1.24 billion (USD 681 million in the first 10 days of the month and USD 560 million during the remainder of the period): this suggests that the fall in the month may be lower than the USD 3.0 billion in the previous month. Foreign holdings of CETES and Mexican government bonds have fallen by USD 7.78 billion so far this year, something not seen over recent years. This is important as, with the larger current account deficit due mainly to the fall in oil prices, equilibrium in foreign-trade accounts is more heavily dependent on capital flows, in the forms of both direct foreign investment and portfolio investment.

Figure 3.44
10-year Mexican government bond and exchange rate (Index: 4 Jan 16 = 100)



Source: BBVA Research with Bloomberg data

Figure 3.45
10-year government bond rates (Maturity, constant, %)



Source: BBVA Research with Bloomberg data

This more adverse climate, with outflows of foreign funds from Mexican government bonds in May (USD 1.401 billion), has been reflected in an uptick in long-term interest rates. Unlike the period of risk aversion at the start of the year in which the Mexican peso (MXN) depreciated significantly and the return on the 10-year Mexican government bond fell, in the current episode, whilst the MXN movement has been sharper, the MXN and the 10-year government interest rate have this time both moved in the same direction (Chart 3.44). In the first episode, the MXN fell by 8.8%, whilst the 10-year Mexican government bond rate fell by 17 bp. In contrast, in the current episode, whilst the depreciation of the MXN was similar between the end of April and 7 June (8.2% vs. 8.8%), the performance of the 10-year Mexican government bond has been completely different. In the current episode, the rate on this bond has increased by 31 bp - equivalent to 5.2% - compared to the 8.2% depreciation of the peso over the same period. In summary, whilst the current (figures for 7 June) 10-year Mexican government bond rate is similar to the rate at the start of the year (6.17% vs. 6.21%), suggesting a degree of stability in long-term interest rates in the face of the two episodes of risk aversion so far this year, there are important differences in behaviour between the two episodes.

However, these differences in the recent performance of the 10-year Mexican government bond rate may be in response to changes in other relevant factors, such as long-term interest rates in the USA, particularly the 10-year treasury note (10-year TN) and expectations about monetary policy in Mexico. Whilst the 10-year interest rate in the USA fell by 49 bp (from 2.24% to 1.75%) during the first episode, influenced mainly by the significant downward adjustment in expectations of an increase in the federal funds rate for 2016, it only fell by 11 bp in the second episode (from 1.83% to 1.72%). Moreover, we have seen upward blips throughout the second period, unlike the first episode, when the trend was uniformly downwards throughout practically the whole period. The increase in the 10-year Mexican government bond rate in the second episode coincided with an increase in the 3-month TIIE SWAP rate: i.e. it is consistent with an increasing belief that the Bank of Mexico may increase its benchmark rate in the near future.

Having said this, the changes in the 10-year Mexican government bond rate have decoupled from the 10-year TN rate. This would appear to suggest that recent fund outflows are being negatively influenced by changes in the 10-year Mexican government bond rate, considering that one of the main reasons for the change in expectations about monetary policy in Mexico has been the weakness of the peso. The average for the 10-year Mexican government bond rate over the second quarter to date (5.97%) has been lower than the rate in the first quarter of 2016 (6.12%). The recent dynamics of these interest rates suggest there has been a qualitative deterioration, which we will have to keep track of over the coming months.

Moving forward, we expect to see the exchange rate show a limited appreciation to levels around 18 pesos per dollar. This is based on a scenario of stabilising oil prices during the second half of the year, improved manufacturing activity in the USA, a reduction from current levels of volatility, and no recurrence of the episodes of negative differentiation of the currency we have seen recently. Nevertheless, it should be noted that there is upside bias to these risks. This will particularly be the case over the next few weeks, with the various events that could provoke uncertainty in the financial markets (e.g. the Fed's June decision and the EU referendum in the UK).

As far as long-term interest rates are concerned, we continue to believe that the margin for increase is limited and that, as risk aversion dissipates, movements will once again come to reflect those of long-term U.S. interest rates. We therefore maintain our forecast that the performance of the 10-year Mexican government bond might settle at slightly below 6.5% at the close of the year. Nevertheless, recent developments in flows and the possibility of an increase in the benchmark interest rate over the coming months give some upside bias to this forecast. As we have mentioned, the increasing dependence on capital flows to finance the current-account deficit makes this of particular relevance. Any adverse development in external factors would negatively impact both the dynamics of long-term interest rates and perceptions of country risk.

4. Indicators and forecasts

Table 4.1
Macroeconomic forecasts: Gross Domestic Product

(YoY growth rate)	2013	2014	2015	2016	2017
United States	1.5	2.4	2.4	**2.5**	**2.4**
EMU	-0.2	0.9	1.5	**1.6**	**1.9**
Germany	0.4	1.6	1.4	**1.7**	**1.8**
France	0.7	0.2	1.2	**1.3**	**1.6**
Italy	-1.8	-0.3	0.6	**1.0**	**1.4**
Spain	-1.7	1.4	3.2	**2.7**	**2.7**
UK	2.2	2.9	2.3	**1.8**	**1.9**
Latin America *	2.6	0.7	-0.5	**-1.0**	**1.7**
Mexico	1.6	2.3	2.5	**2.6**	**2.6**
Brazil	3.0	0.1	-3.9	**-3.0**	**0.9**
EAGLES **	5.5	5.2	4.6	**4.7**	**4.9**
Turkey	4.2	3.0	4.0	**3.9**	**3.9**
Asia-Pacific	5.8	5.6	5.5	**5.3**	**5.1**
Japan	1.5	0.0	0.5	**0.8**	**0.8**
China	7.7	7.3	6.9	**6.4**	**5.8**
Asia (exc. China)	4.3	4.2	4.3	**4.4**	**4.5**
World	3.3	3.4	3.1	**3.2**	**3.4**

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Saudi Arabia, Bangladesh, Brazil, China, Philippines, India, Indonesia, Irak, Mexico, Nigeria, Pakistan, Russia, Thailand and Turkey.
Forecast closing date: 6 May 2016.
Source: BBVA Research & FMI

Table 4.2
Macroeconomic Forecasts: inflation (Average)

(YoY growth rate)	2013	2014	2015	2016	2017
United States	1.5	1.6	0.1	**1.3**	**2.0**
EMU	1.4	0.4	0.0	**0.2**	**1.3**
Germany	1.6	0.8	0.1	**0.0**	**1.2**
France	1.0	0.6	0.1	**0.1**	**1.3**
Italy	1.2	0.2	0.1	**0.1**	**1.3**
Spain	1.4	-0.2	-0.5	**-0.3**	**1.7**
UK	2.6	1.5	0.1	**0.7**	**1.6**
Latin America *	9.2	12.7	17.5	**32.9**	**34.4**
Mexico	3.8	4.0	2.7	**2.7**	**3.2**
Brazil	6.2	6.3	9.0	**8.6**	**5.2**
EAGLES **	5.2	4.5	4.4	**4.2**	**4.1**
Turkey	7.5	8.9	7.7	**8.1**	**7.8**
Asia-Pacific	4.0	3.3	2.2	**2.7**	**3.1**
Japan	1.6	2.7	0.8	**0.7**	**1.5**
China	2.6	2.0	1.4	**2.3**	**2.7**
Asia (exc. China)	5.1	4.4	2.9	**3.0**	**3.5**
World	4.2	3.9	3.8	**5.0**	**5.4**

* Argentina, Brazil, Chile, Colombia, Mexico, Peru and Venezuela.
** Saudi Arabia, Bangladesh, Brazil, China, Philippines, India, Indonesia, Irak, Mexico, Nigeria, Pakistan, Russia, Thailand and Turkey.
Forecast closing date: 6 May 2016.
Source: BBVA Research & FMI

Table 4.3

United States indicators and forecasts

	2014	2015	2016	2017	1T15	2T15	3T15	4T15	1T16	2T16	3T16	4T16
Macroeconomic Indicators												
GDP (real % change)	2.4	2.4	**2.5**	**2.4**	0.6	3.9	2.0	1.4	0.8	**4.5**	**3.8**	**3.3**
Personal consumption (real % change)	2.7	3.1	**3.0**	**2.7**	1.7	3.6	3.0	2.4	1.9	**3.6**	**4.3**	**3.2**
Gov. consumption (real % change)	-0.6	0.7	**1.6**	**0.8**	-0.1	2.6	1.8	0.1	1.2	**2.8**	**1.8**	**1.6**
Gross fixed investment (real % change)	5.3	4.0	**3.4**	**5.8**	3.3	5.1	3.7	0.4	-1.5	**8.1**	**7.6**	**7.6**
Construction	5.2	5.7	**3.8**	**6.6**	7.4	8.3	-0.8	-0.1	-0.1	**10.4**	**8.7**	**7.0**
Industrial prod. (real annual % change)	2.9	0.3	**0.2**	**2.7**	2.4	0.4	0.1	-1.6	-1.6	**-0.6**	**0.6**	**2.2**
Current account balance (% of GDP)	-3.0	-2.6	**-2.7**	**-2.8**	-2.7	-2.5	-2.9	-2.8	-2.7	**-2.8**	**-2.9**	**-2.8**
Final annual inflation	0.8	0.7	**1.9**	**1.9**	-0.1	0.1	0.0	0.7	0.9	**1.1**	**1.7**	**1.9**
Average annual inflation	1.6	0.1	**1.3**	**2.0**	-0.1	0.0	0.1	0.5	1.1	**1.1**	**1.5**	**1.7**
Primary fiscal balance (% of GDP)	-2.8	-2.5	**-3.0**	**-3.0**				-2.5				**-3.0**

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

Table 4.4

Mexico Indicators and Forecasts

	2014	2015	2016	2017	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	3Q16	4Q16
Economic Activity												
GDP (seasonally-adjusted series)												
Real annual % change	2.3	2.5	**2.6**	**2.6**	2.5	2.4	2.7	2.5	2.8	**2.7**	**2.6**	**2.3**
Per inhabitant (US dollars)	10,619	9,350	**8,854**	**9,540**	9,774	9,575	9,005	9,046	8,632	**8,845**	**8,883**	**9,058**
US$ billions	1,271	1,131	**1,083**	**1,178**	1,183	1,159	1,086	1,108	1,055	**1,081**	**1,086**	**1,108**
Inflation (average, %)												
Headline	4.02	2.72	**2.72**	**3.23**	3.07	2.94	2.62	2.27	2.69	**2.60**	**2.73**	**2.86**
Core	3.18	2.36	**2.85**	**3.08**	2.39	2.32	2.33	2.40	2.69	**2.89**	**2.91**	**2.91**
Financial Markets (average, %)												
Interest rates												
Bank funding	3.00	3.02	**3.73**	**4.35**	3.00	3.00	3.00	3.08	3.58	**3.75**	**3.75**	**3.83**
28-day Cetes	3.00	3.25	**3.41**	**4.31**	2.94	3.01	3.05	3.04	3.55	**3.71**	**3.71**	**3.79**
28-day TIIE	3.35	3.44	**3.72**	**4.66**	3.30	3.31	3.32	3.39	3.89	**4.05**	**4.05**	**4.14**
10-year Bond (%, average)	6.01	5.94	**6.10**	**6.65**	5.66	5.96	6.05	6.10	6.12	**5.98**	**6.06**	**6.23**
Exchange rate (average)												
Pesos per dollar	13.4	16.0	**18.2**	**17.8**	15.1	15.5	16.6	16.8	17.8	**17.9**	**18.4**	**18.2**
Public Finances												
*FRPS (% of GDP)	-4.6	-4.1	**-3.5**	**-3.0**	-	-	-	-4.1	-	-	-	**-3.5**
External Sector[3]												
Trade balance (US$ billions)	-2.8	-14.5	**-17.5**	**-21.0**	-2.2	-1.9	-6.5	-3.9	-4.7	**-4.2**	**-6.5**	**-5.2**
Current account (US$ billions)	-24.8	-32.4	**-33.7**	**-37.0**	-8.9	-7.6	-8.2	-7.7	-8.6	**-8.6**	**-7.5**	**-9.0**
Current account (% of GDP)	-2.0	-2.9	**-3.1**	**-3.1**	-3.0	-2.6	-3.0	-2.8	-3.2	**-3.2**	**-2.8**	**-3.3**
Employment												
Formal Private (annual % change)	3.5	4.3	**3.5**	**3.8**	4.5	4.4	4.4	4.0	3.7	**3.4**	**3.8**	**3.1**
Open Unemployment Rate (% active pop.)	4.8	4.4	**4.5**	**4.5**	4.4	4.4	4.3	4.4	4.5	**4.5**	**4.5**	**4.5**

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Mexico Indicators and Forecasts

	2014	2015	2016	2017	1Q15	2Q15	3Q15	4Q15	1Q16	2Q16	3Q16	4Q16
Aggregate Demand[4] (annual % change, seasonally-adjusted)												
Total	3.1	3.2	**2.9**	**3.7**	3.5	3.2	3.5	2.5	3.8	**2.7**	**2.7**	**2.6**
Domestic Demand	1.9	1.2	**2.2**	**2.8**	0.7	1.2	1.4	1.6	3.2	**2.0**	**2.0**	**1.5**
Consumption	1.9	3.0	**3.0**	**2.9**	3.3	2.7	2.8	3.4	3.1	**3.2**	**3.0**	**2.7**
Private	1.8	3.1	**3.3**	**3.1**	3.3	2.6	3.1	3.5	3.3	**3.5**	**3.4**	**3.0**
Public	2.4	2.4	**1.0**	**1.4**	3.3	2.7	1.4	2.2	1.5	**1.0**	**0.8**	**0.7**
Investment	2.8	3.9	**1.7**	**3.5**	5.9	5.0	3.9	0.9	2.2	**1.0**	**1.3**	**2.5**
Private	4.7	6.3	**4.0**	**5.9**	8.0	6.4	7.3	3.6	5.2	**3.8**	**3.1**	**4.0**
Public	-4.5	-6.5	**-9.2**	**-9.3**	-2.8	-1.3	-10.4	-11.3	-11.8	**-11.7**	**-7.8**	**-5.0**
External Demand	7.0	9.1	**5.1**	**6.4**	12.5	9.2	9.9	5.1	5.4	**4.9**	**4.5**	**5.6**
Imports	5.9	5.1	**4.0**	**7.1**	6.6	5.6	5.8	2.4	6.7	**2.9**	**2.9**	**3.6**
GDP by sectors (annual % change, seasonally-adjusted)												
Primary	4.4	0.5	**4.0**	**2.4**	2.7	0.4	-0.5	-0.8	2.7	**5.7**	**4.0**	**3.7**
Secondary	2.7	1.0	**1.0**	**1.7**	1.7	0.7	1.2	0.3	1.9	**0.1**	**0.8**	**1.3**
Mining	-1.5	-5.7	**-2.6**	**-0.4**	-5.4	-7.9	-5.6	-4.0	-3.6	**-3.6**	**-2.6**	**-0.6**
Electricity	8.2	4.1	**3.1**	**2.9**	6.6	2.5	3.6	3.6	1.7	**3.7**	**3.9**	**2.9**
Construction	1.9	2.7	**1.3**	**1.9**	4.7	3.2	3.2	-0.3	3.8	**0.2**	**1.1**	**0.2**
Manufacturing	4.1	2.6	**1.5**	**2.8**	3.7	2.6	2.9	1.3	1.3	**1.0**	**1.6**	**2.3**
Tertiary	1.8	3.3	**3.5**	**2.8**	2.9	3.2	3.4	3.7	3.7	**4.0**	**3.5**	**2.7**
Retail	3.1	4.5	**3.8**	**2.6**	5.9	3.6	4.7	3.9	2.4	**5.7**	**4.1**	**2.9**
Transportation, mail and warehouse	3.1	3.5	**2.2**	**2.8**	3.4	3.1	4.1	3.4	1.7	**2.3**	**2.5**	**2.4**
Massive media information	0.2	10.0	**9.6**	**8.3**	5.3	4.6	11.6	18.7	11.7	**9.2**	**9.0**	**8.8**
Financial and insurance	-0.8	0.9	**4.9**	**3.8**	-0.6	-0.4	1.9	2.8	6.5	**4.9**	**3.8**	**4.3**
Real-estate and rent	2.0	2.3	**3.3**	**2.5**	1.8	3.1	2.3	2.2	2.3	**3.7**	**4.5**	**2.9**
Prof., scientific and technical servs.	1.3	3.8	**5.2**	**2.0**	2.6	5.8	3.0	3.9	7.8	**5.4**	**5.5**	**2.4**
Company and corporate management	7.2	1.9	**3.7**	**1.3**	-1.9	1.0	4.8	3.9	4.7	**4.0**	**3.9**	**2.2**
Business support services	-0.1	1.0	**1.7**	**1.4**	2.2	0.4	0.7	0.8	2.7	**2.3**	**0.7**	**1.1**
Education	0.1	0.7	**0.9**	**0.1**	0.1	0.7	0.3	1.7	1.1	**0.9**	**0.8**	**0.7**
Health and social security	-0.6	1.3	**0.7**	**0.9**	1.1	1.6	1.2	1.4	0.3	**0.9**	**0.7**	**0.9**
Cultural and sport	-1.4	4.7	**3.5**	**2.4**	3.4	6.0	4.5	4.8	3.8	**3.5**	**4.1**	**2.8**
Temporary stay	2.9	5.8	**6.0**	**4.8**	3.7	4.8	7.0	7.8	6.3	**8.0**	**6.8**	**3.0**
Other services, except govnt. activities	1.6	2.4	**2.3**	**2.0**	3.1	1.6	1.3	3.4	6.4	**0.6**	**1.7**	**0.8**
Government activities	1.9	2.6	**-2.0**	**1.9**	5.2	4.0	1.0	0.5	-3.1	**-1.4**	**-2.7**	**-1.0**

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 Census Bureau, Federal Reserve, Bureau of Labor Statistics, Banco de México, INEGI and SHCP data

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Mexico Economic Outlook
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