Economic Analysis

Economic slowdown

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Yesterday, the INEGI (Instituto Nacional de Estadística y Geografía — Mexican national institute of statistics and geography) published preliminary growth data for the second quarter. As we know, this showed growth of 0.1% compared with the previous quarter. This figure had been eagerly awaited, given that, had it been negative, we would technically be facing a recession, defined as two consecutive quarters of negative growth. This discussion appears to be a moot point. In qualitative terms, we would be in a similar situation if this figure had been -0.1%.

What matters is that the economy is slowing down. Year-on-year variation for the first half of 2019 was +0.3%. This shows very low growth and a significant slowdown if we bear in mind that the economy was growing at a rate of 2% not long ago. The reality is that growth has slowed down in the last 12 months. But why has this happened? This appears to be due to a number of factors that I will expand on below, not necessarily in order of importance. First, there's the slowdown in the manufacturing sector in the United States, which in turn has resulted in less-buoyant Mexican non-oil exports. Second, investment is currently very low. Public investment growth has been negative for seven years.

Some years ago, public investment was around 6% of GDP; now, it is less than 3%. The above is explained by the fact that the previous government, after irresponsibly increasing the debt-to-GDP ratio by almost 15 percentage points and being forced to reduce spending in light of pressure from markets and rating agencies, decided to make this reduction entirely in public investment (without affecting current expenditure). This was unfortunate and compromises capacity for economic growth in the medium term.

In addition to the fall in public investment, private investment has been stagnant since 2016 when it became apparent that Donald Trump was likely to win the United States presidential election, which risked disrupting the trade relationship between North American countries. This has resulted in an uncertain climate that still persists to this day thanks to Trump's tariff threats and it still not being clear whether the United States–Mexico–Canada Agreement will be approved. In addition to this source of foreign uncertainty, domestic uncertainty has also increased due to doubts surrounding the type of economic policies that the new administration can adopt. This uncertainty has increased following decisions to cancel construction of the new Mexico City airport, cancel oil auctions and dispute gas pipeline contracts with foreign companies.

Third, there's the implementation of highly restrictive monetary and fiscal policies. The lending rate is very high: The rate currently stands at around 4.5%, while the neutral rate should stand at around 2%. As such, it would appear that Banco de México is about to initiate a cycle of reductions that should help to eliminate headwinds against the economy. In this regard, and recognizing this government's commitment to fiscal discipline (which has been well-received by markets), taking the economic slowdown into account, it would appear that there is room for fiscal loosening that would not be poorly received by markets. I do not think it is necessary to aim for a fiscal surplus of 1% for next year's budget. A surplus slightly above 0 would be acceptable to markets and could somewhat boost the economy.

The fiscal policy is also contractionary if we consider that spending was lower than the budgeted 6% in the first half of the year. To put this figure into perspective, it is important to remember that spending also came in under budget during the first six months of Enrique Peña Nieto's administration, which affected growth. That financial year it was 2.3%. In order to tackle the slowdown, the government needs to display signs of certainty to investors.

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