

## Mexico | Improvement on the economic horizon

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From 8 November when the results of the US presidential election were announced until mid-January, Mexico's economic panorama looked gloomy. President elect Trump was relentless in his protectionist rhetoric towards Mexico - he would leave NAFTA, impose high duties on imports of Mexican cars and tax remittances to finance the construction of the border wall.

Given the importance of the external sector as a growth driver for the Mexican economy, it seemed that the country might enter a prolonged phase of lower growth. The currency depreciated significantly reaching 22 pesos per dollar. Most analysts have started to revise their growth forecasts downwards for this year. At Bancomer, we lowered ours from 1.5% to 1%.

Three months on, the panorama has improved substantially. Analysts, ourselves included, are revising our growth expectations upwards. Just in the past few days various financial institutions have raised their expectations. At Bancomer we are now estimating growth of 1.6%. What is behind this change? In my opinion, two basic factors. The first is the change of tone on the part of the Trump administration, which leads one to think that the chances of NAFTA's being renewed, to the benefit of all three countries that are party to it are now significantly greater. The second is the good performance of the US manufacturing sector. The change of tone is due in my view to the understanding that has gradually evolved in the US to the effect that NAFTA has benefited the US too. As I have commented before in this column, this is due to the fact that Mexico is the second biggest destination for US exports, not far behind Canada, which is the biggest. In fact Mexico buys more goods from the US than Germany, Japan and the UK together. The improved tone had been evident in remarks made by several members of the administration. Yesterday, pPresident Trump himself declared that he would not be withdrawing from NAFTA for now but would seek to renegotiate it in such a way as to make all three countries stronger. During the past few months, the exchange rate has fluctuated with the perceived probability of trade relations between Mexico and the US being permanently affected. The peso's appreciation seen today relative to 20 January is basically due to the markets' now assigning greater probability to the scenario in which NAFTA is renegotiated with positive results for all three countries.

The second aspect is the improved performance of the US manufacturing sector. It is this sector that best explains the volume of exports of Mexican manufactured goods to the US. It had shown very low rates of growth in the past two years, which explains why Mexican exports did not perform well in that period. I forecast that this year, US manufacturing will grow significantly, judging from the manufacturing purchasing managers' indices. This will mean an increase in Mexico's exports, which I estimate will grow by 5% in 2017. It should be borne in mind that, despite Trump's rhetoric, Mexico is currently exporting to the US on exactly the same terms as it was before 8 November.

However we should also not lose sight of the fact that the US election results will have some negative effects on the Mexican economy's performance. In the first place, investment will fall due to uncertainty about what might happen with NAFTA. In fact in January investment fell by an annualised rate of more than 15%.

Secondly, the peso's depreciation since Trump's win will lead to higher inflation due to increased prices of imported goods. We estimate that inflation will end the year somewhere between 5.6% and 5.9%, and that it will cross the 6% threshold during the summer. Higher inflation will translate into lower disposable income for households, leading in turn to lower levels of consumption.

In short, the economic outlook for Mexico is worse than it would have been with a different outcome of the US election, but better than it was three months ago. This will be a year in which growth is driven by exports, with a slowdown in consumption relative to 2015 and 2016.

More important still is that in the baseline scenario the negative impact on growth will be cyclical, not

structural; short term, not long. However, it should also be borne in mind that although the risk of the US government's resuming its protectionist stance has diminished, it is still there, and will continue to be there until renegotiation of NAFTA has been completed.

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