BBVA Research

Mexico Economic Outlook

October 2024

Creating Opportunities

BBVA Research

01

Global Economic Outlook. October 2024

Creating Opportunities

Main messages

Recent developments

Monetary easing cycles are now in place in the US and Eurozone as inflation has fallen due to demand moderation and supply gains. Labor markets are slowing, manufacturing remains weak, but services and consumption remain relatively strong. Financial volatility has risen, but markets continue to see a soft-landing ahead.

Growth outlook

Global growth is likely to converge to moderate levels. In the US, growth was revised up again, as incoming data surprised to the upside, but is still expected to gradually weaken ahead. In the Eurozone, forecasts remain unchanged; lower inflation and interest rates will support a cyclical recovery. In China, increasing policy stimulus will help to sustain growth, but a structural deceleration is still likely.

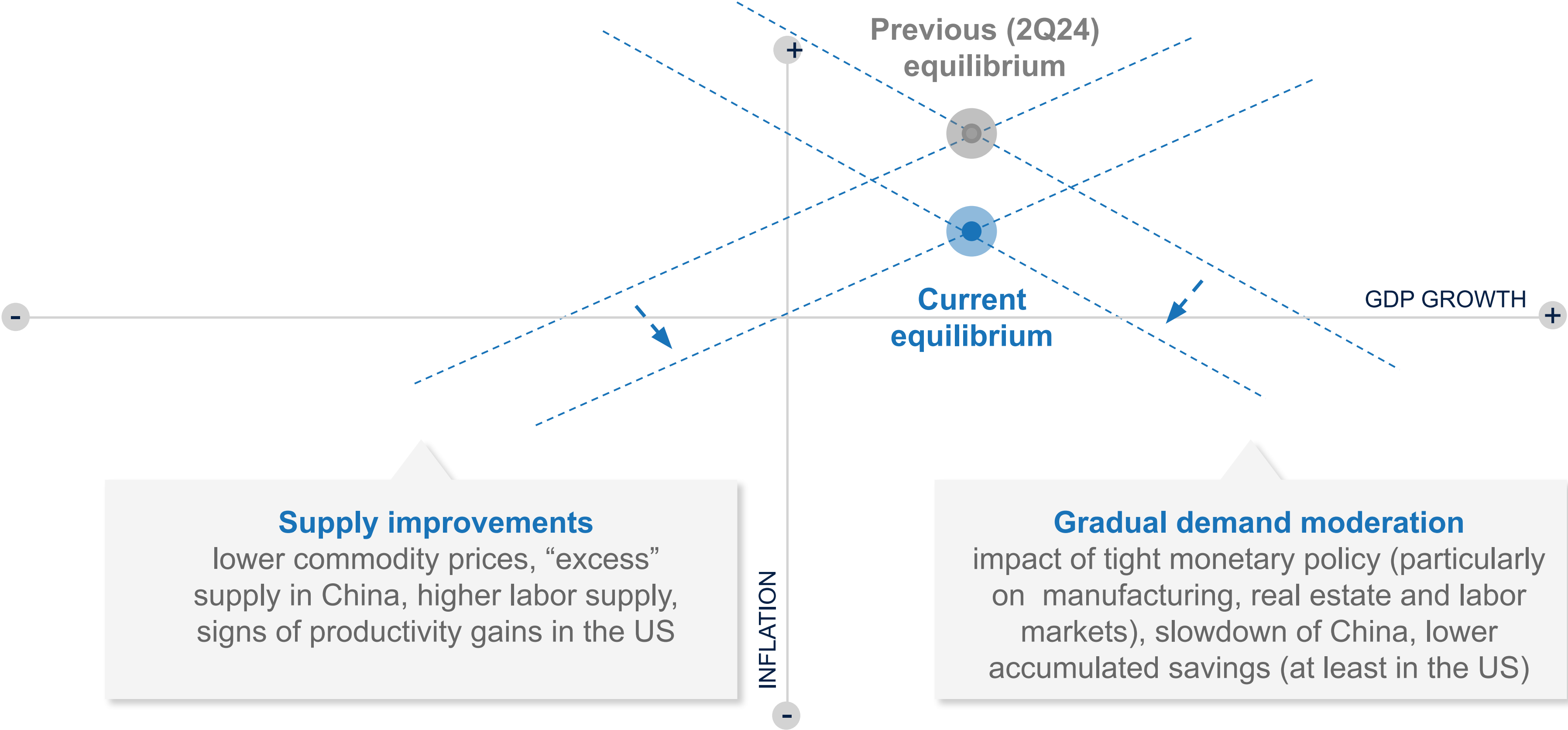
Inflation and rates outlook

Monetary conditions are set to gradually become less restrictive given more controlled inflation and easing labor pressures. The Fed’s rate cuts are likely to be more aggressive than anticipated, but interest rates are forecast to remain relatively high. The monetary easing cycle is also expected to continue in the Eurozone and China.

Risks

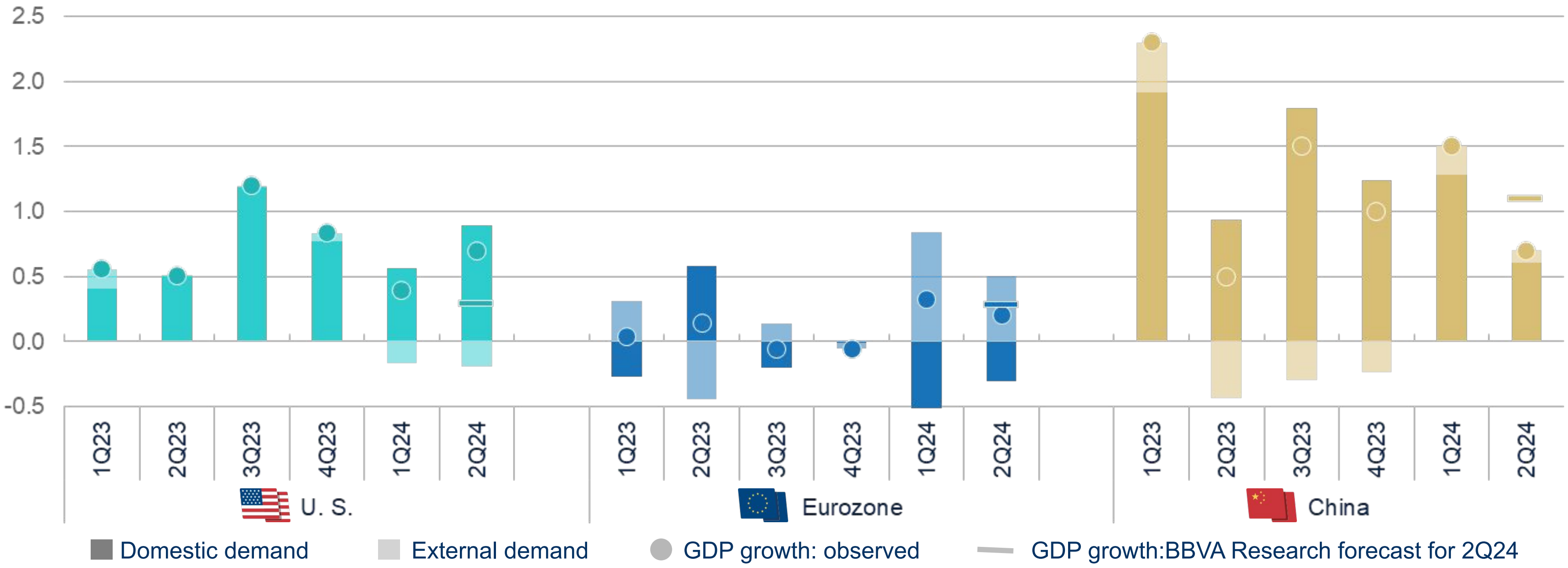
Risks to growth and inflation are now more balanced. The recent labor market slowdown and China's structural problems raise concerns about a hard landing. However, strong demand, fiscal policy, and geopolitical tensions, among other factors, keep upward inflation risks alive.

Recent developments: lower inflation and interest rates as well as resilient growth in a context of demand moderation and improvements in supply



Growth remains strong in the US, slightly positive in the Eurozone, and relatively weak in China despite policy support

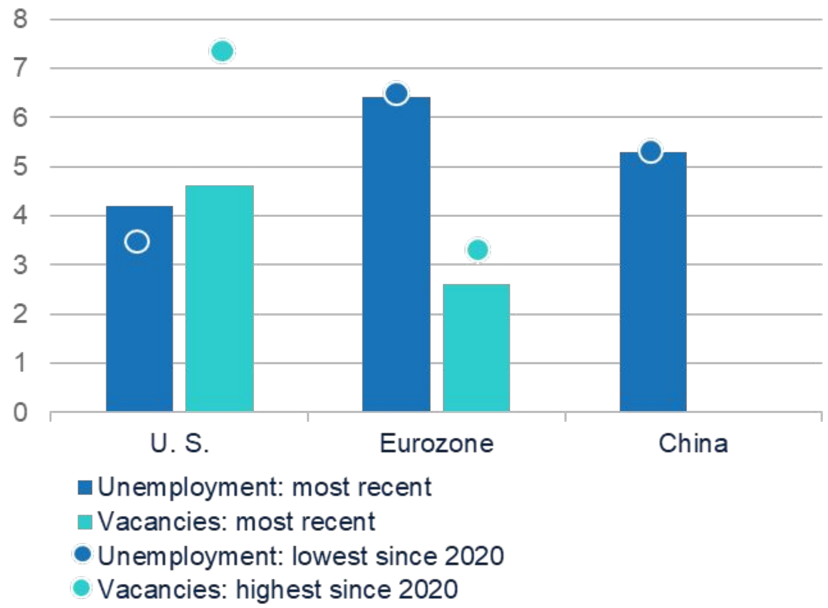
GDP: CONTRIBUTION OF DOMESTIC AND EXTERNAL DEMANDS TO GDP GROWTH
(GDP GROWTH: Q/Q%; CONTRIBUTIONS TO GDP GROWTH: PERCENTAGE POINTS)



Source: BBVA Research based on data from Haver and China's NBS.

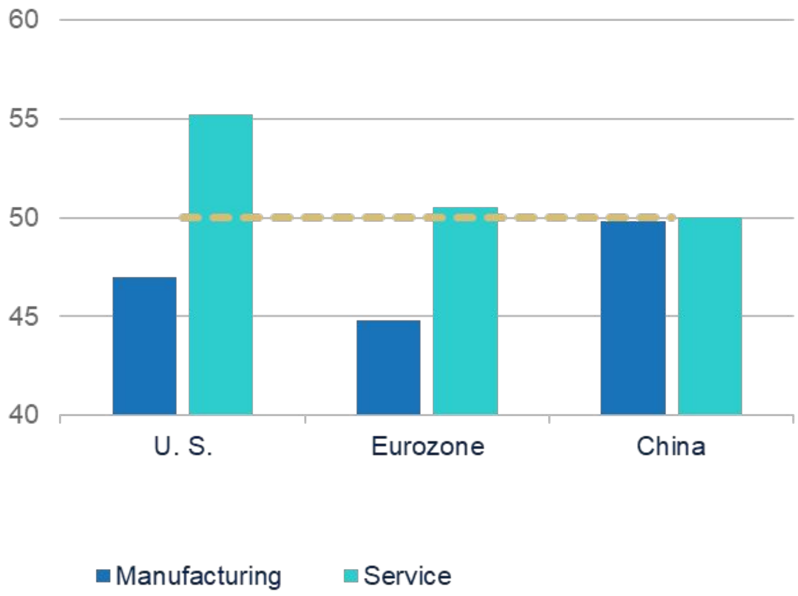
Hard-landing fears have risen following labor market deceleration, but services remain relatively strong; weakness in manufactures persist

UNEMPLOYMENT AND VACANCY RATES (*)
(%)



(*) Unemployment rate: unemployment as share of the labor force. Vacancy rate: job vacancies as share of the sum of total employment and job vacancies. Vacancies data not available for China.
Source: BBVA Research based on data from BLS , Eurostat and Haver.

PMI INDICATORS: MOST RECENT DATA (*)
(MORE THAN 50: EXPANSION; LESS THAN 50: CONTRACTION)

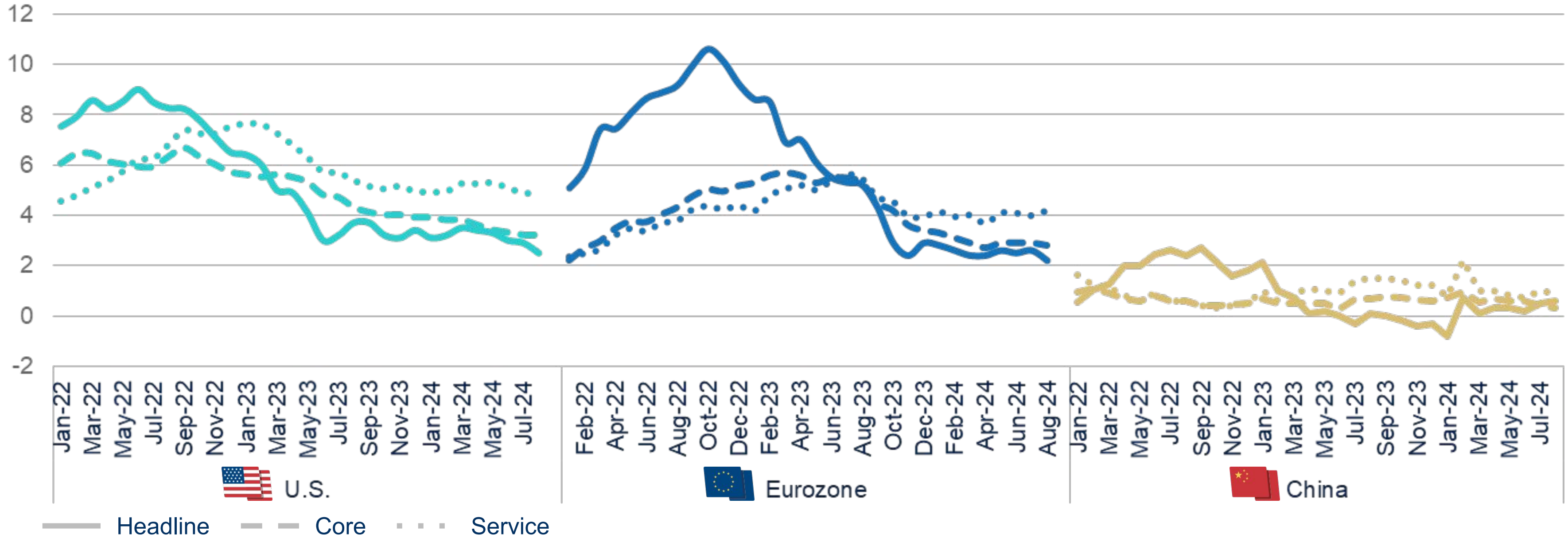


(*) September 2024.
Source: BBVA Research based on data from Haver.

Inflation has eased more than expected in the US, and has been broadly in line with forecasts in the Eurozone, but services inflation remains high

CPI INFLATION: HEADLINE, CORE AND SERVICE

(Y/Y %)

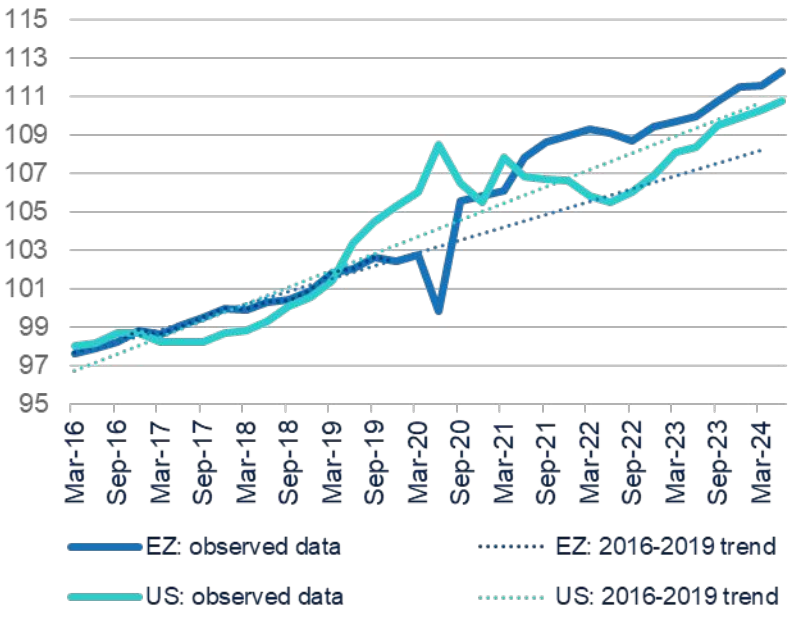


(*) Analysts expectations collected by Bloomberg.

Source: BBVA Research based on data from Haver.

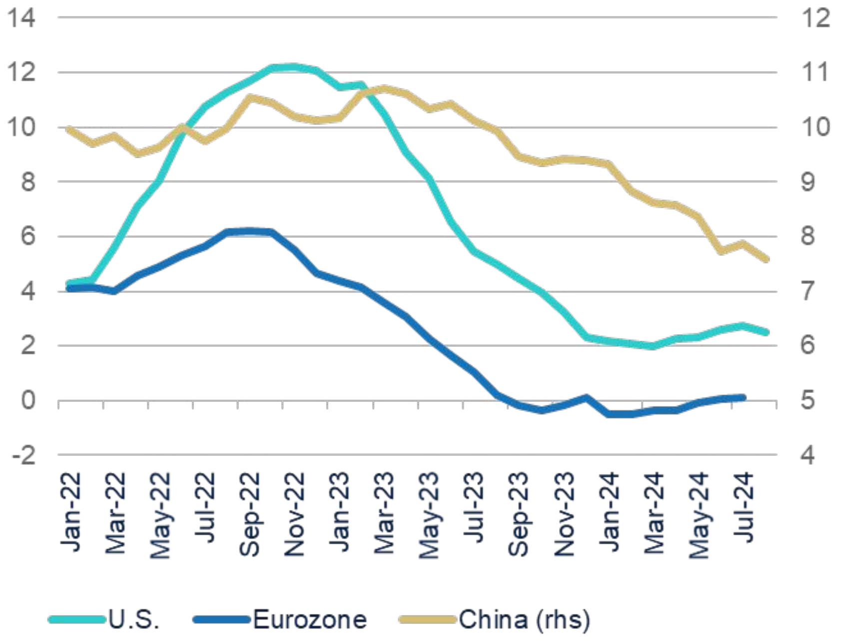
Despite still supportive fiscal policy, demand continues to weaken gradually amid still tight monetary conditions and weakness in China

GOVERNMENT CONSUMPTION
(INDEX: 2016-2019 AVERAGE = 100, CHAINED VOLUMES)



Source: BBVA Research based on BEA and ECB data.

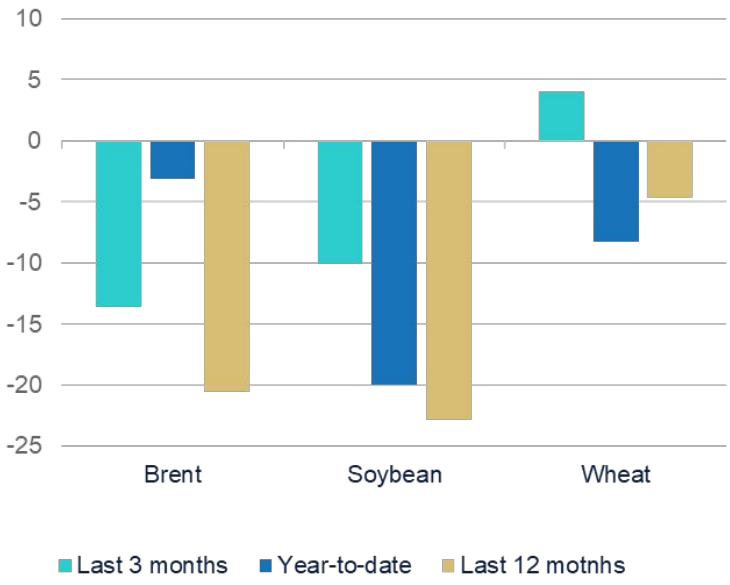
BANKING LENDING
(YOY %)



Source: BBVA Research based on data from Haver.

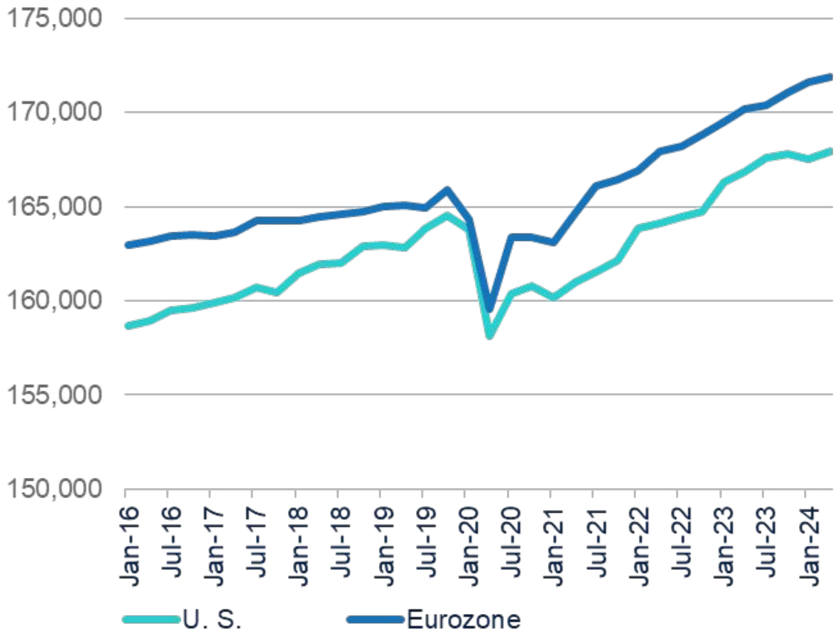
A fall in commodity prices, the expansion of the labor force and incipient productivity gains in the US have helped to improve supply conditions

COMMODITY PRICES (*)
(% CHANGE DURING SELECTED PERIODS)



(*) Last available data: September 19th.
Source: BBVA Research based on data from Haver.

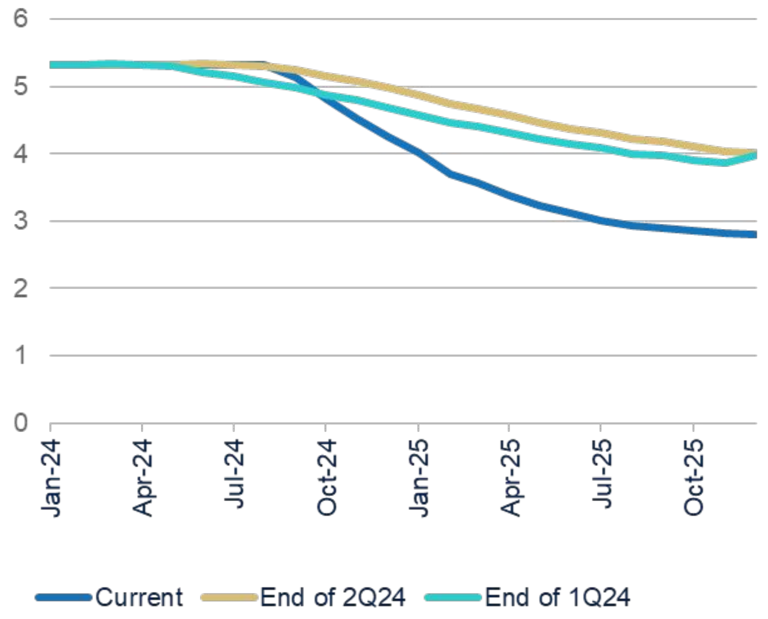
LABOR SUPPLY: LABOR FORCE LEVEL (*)
(THOUSANDS, QUARTERLY DATA)



(*) U. S.: 16 years or older. Eurozone: 25 to 74 years old.
Source: BBVA Research based on data from the Fred and Eurostat.

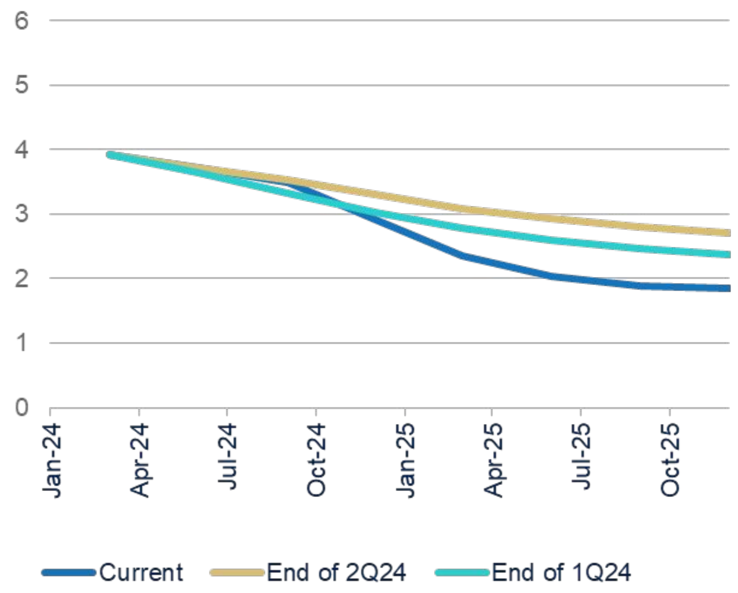
Monetary easing has begun in the US (with a 50 bps cut) and has continued in the EZ (with a second 25 bps cut); markets see larger room for further cuts

US: IMPLICIT RATE IN FED FUND FUTURES (*)
(%)



(*) Last available data: September 25th, 2024.
Source: BBVA Research based on data from Haver.

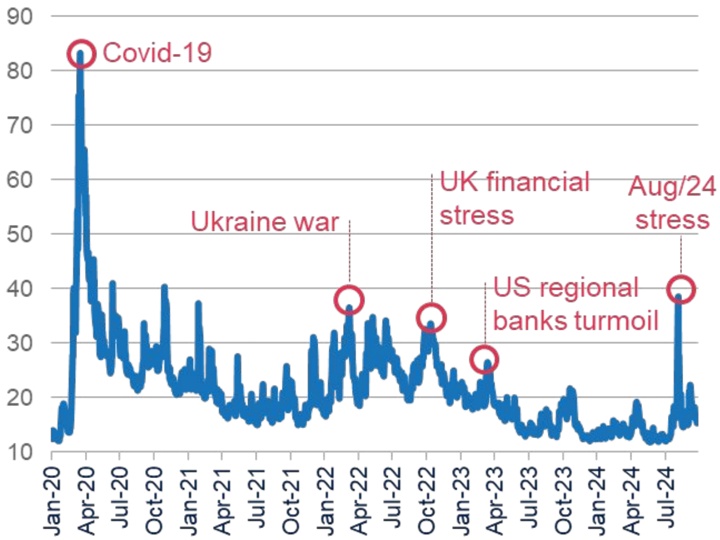
EZ: IMPLICIT RATE IN 3-MONTH EURIBOR FUTURES (*)
(%)



(*) Depo interest rates. Last available data: September 25th, 2024.
Source: BBVA Research based on data from Haver.

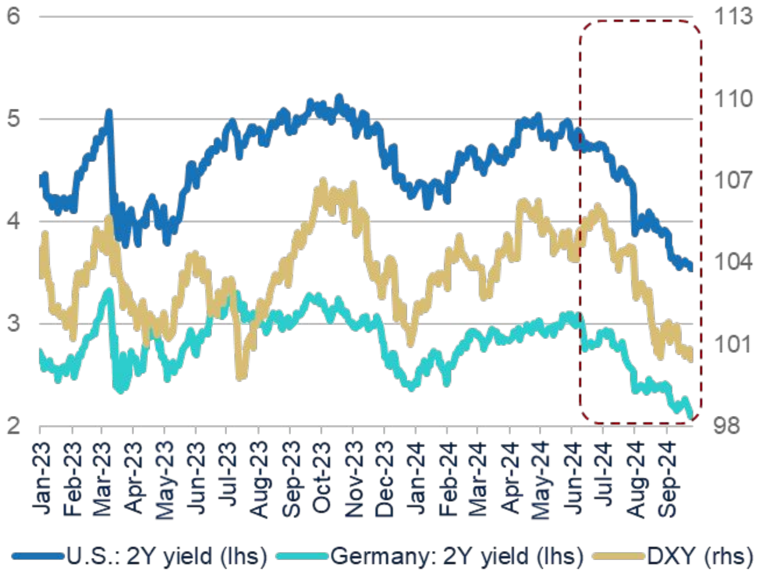
Financial volatility has risen on growth deceleration concerns but soft-landing view continues to prevail; sovereign yields and the USD have trended down

VIX (*)
(INDEX)



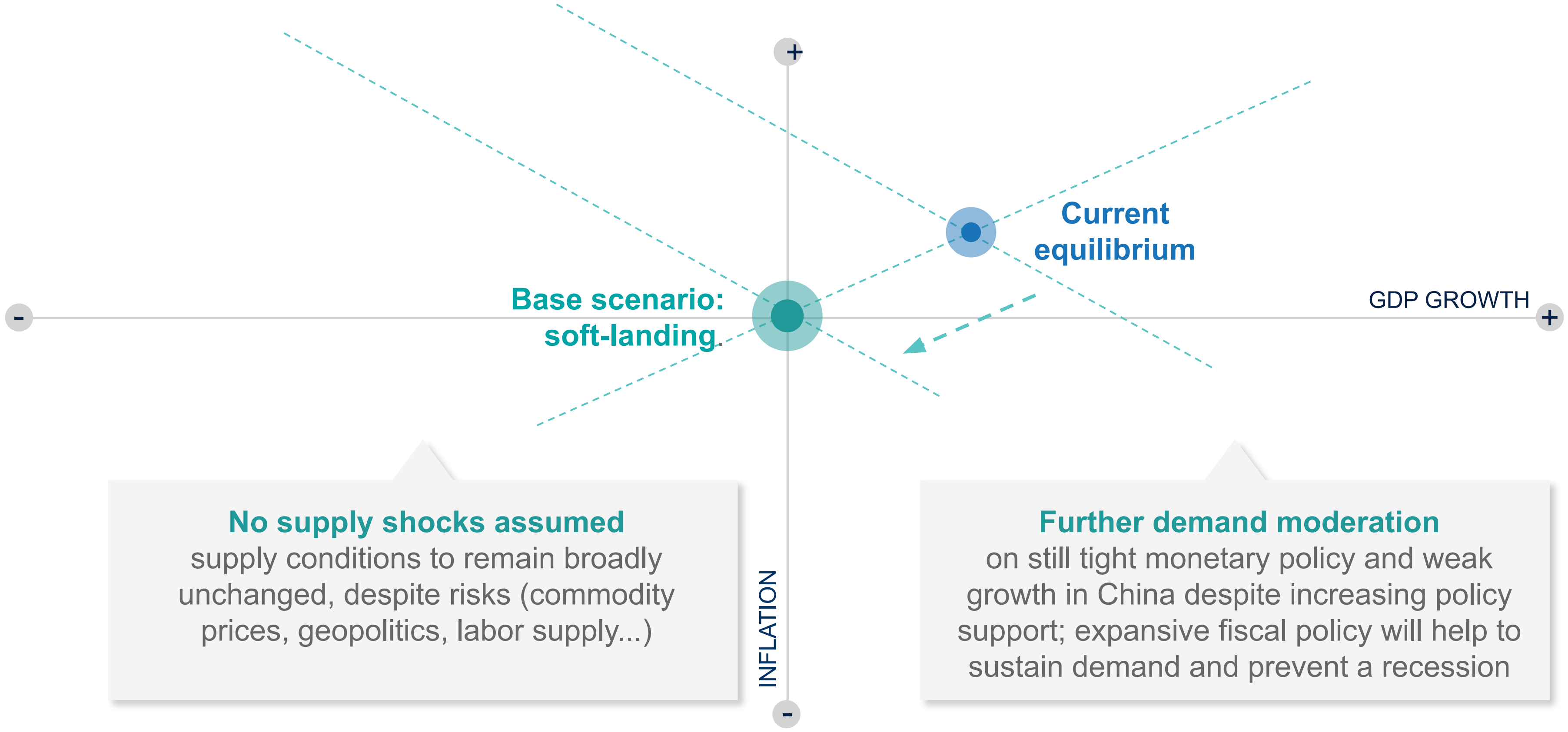
(*) Last available data: September 25th, 2024.
Source: BBVA Research based on data from Haver.

SOVEREIGN YIELDS AND USD INDEX (DXY) (*)
(SOVEREIGN YIELDS: %; DXY: INDEX)



(*) A lower DXY index represents a weaker US dollar. Last available data: September 25th, 2024.
Source: BBVA Research based on data from Haver

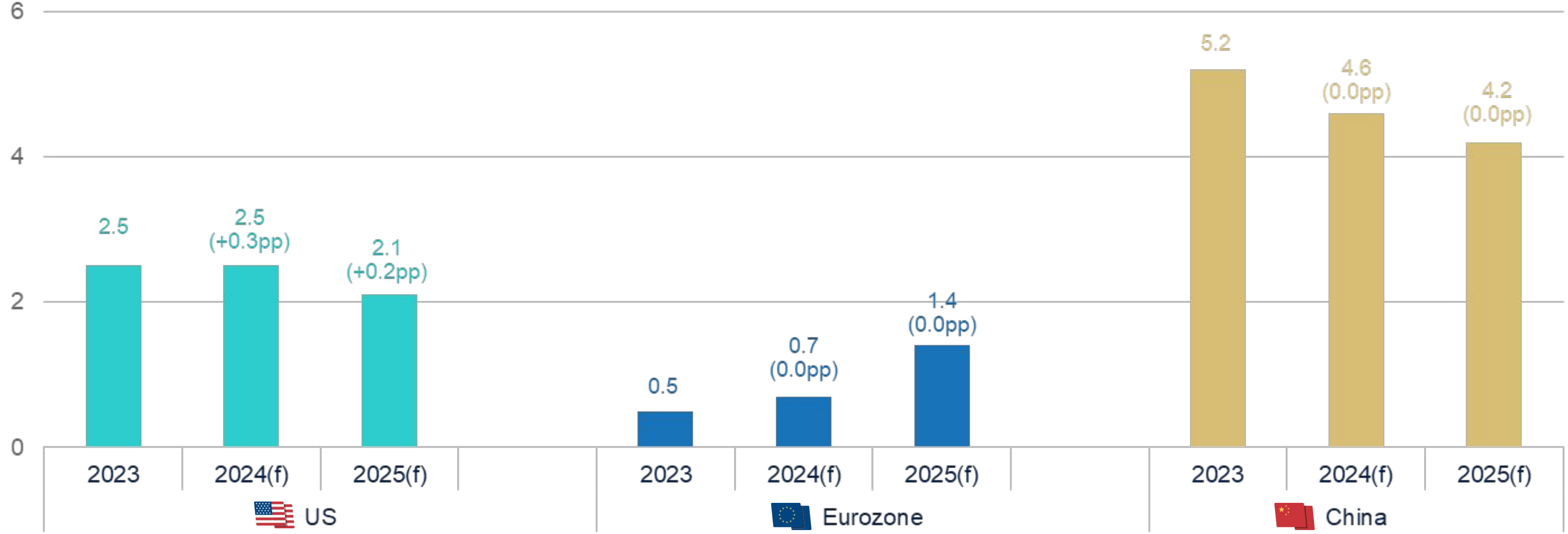
Base scenario: controlled inflation and demand slowdown will pave the way for more aggressive rate cuts; growth is likely to converge to moderate levels



GDP forecasts: growth revised up on resilient demand in the US; cyclical recovery in Eurozone; policy stimulus will help to sustain growth in China

GDP GROWTH (*)

(%, CHANGE WITH RESPECT TO PREVIOUS FORECAST IN PARENTHESES)



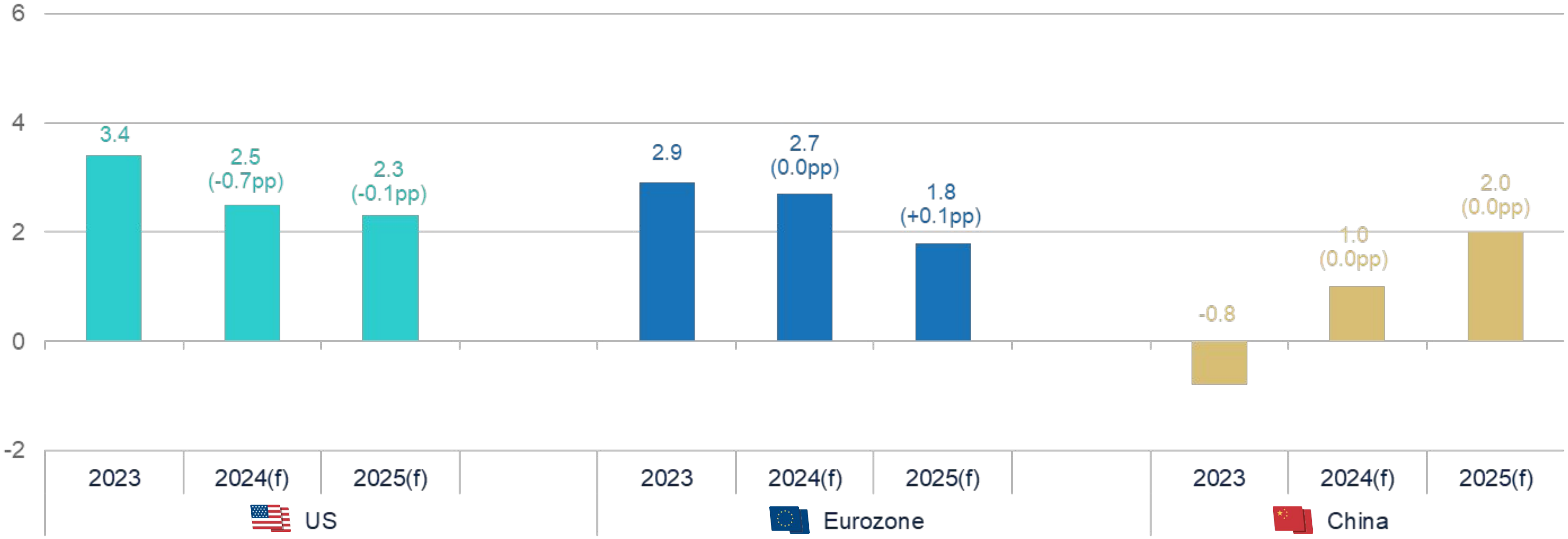
(*) Global GDP growth: 3.1%in 2023, 3.1% (unchanged in comparison to the previous forecast) in 2024 and 3.3% (unchanged in comparison to the previous forecast) in 2025.

(f): forecast.

Source: BBVA Research.

Inflation forecasts: downward revision in the US on clearer labor market easing and favorable incoming data; no significant changes in Eurozone and China

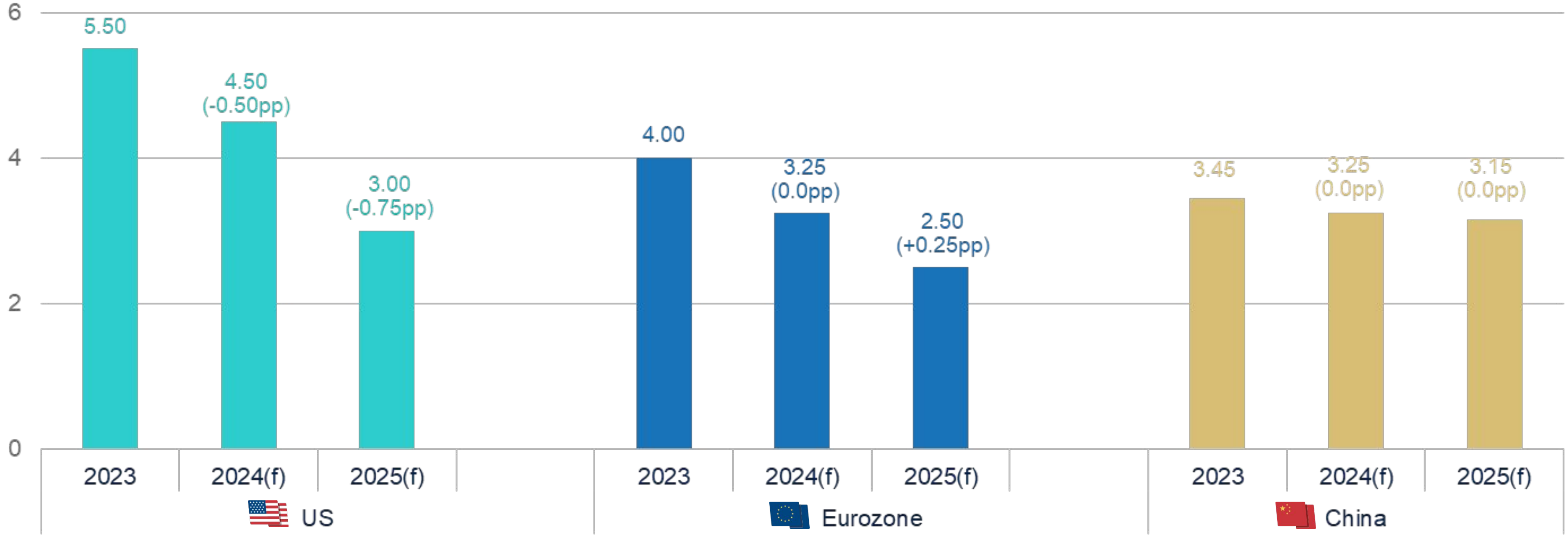
HEADLINE CPI INFLATION
(Y/Y %, END OF PERIOD, CHANGE WITH RESPECT TO PREVIOUS FORECAST IN PARENTHESES)



(f): forecast.
Source: BBVA Research.

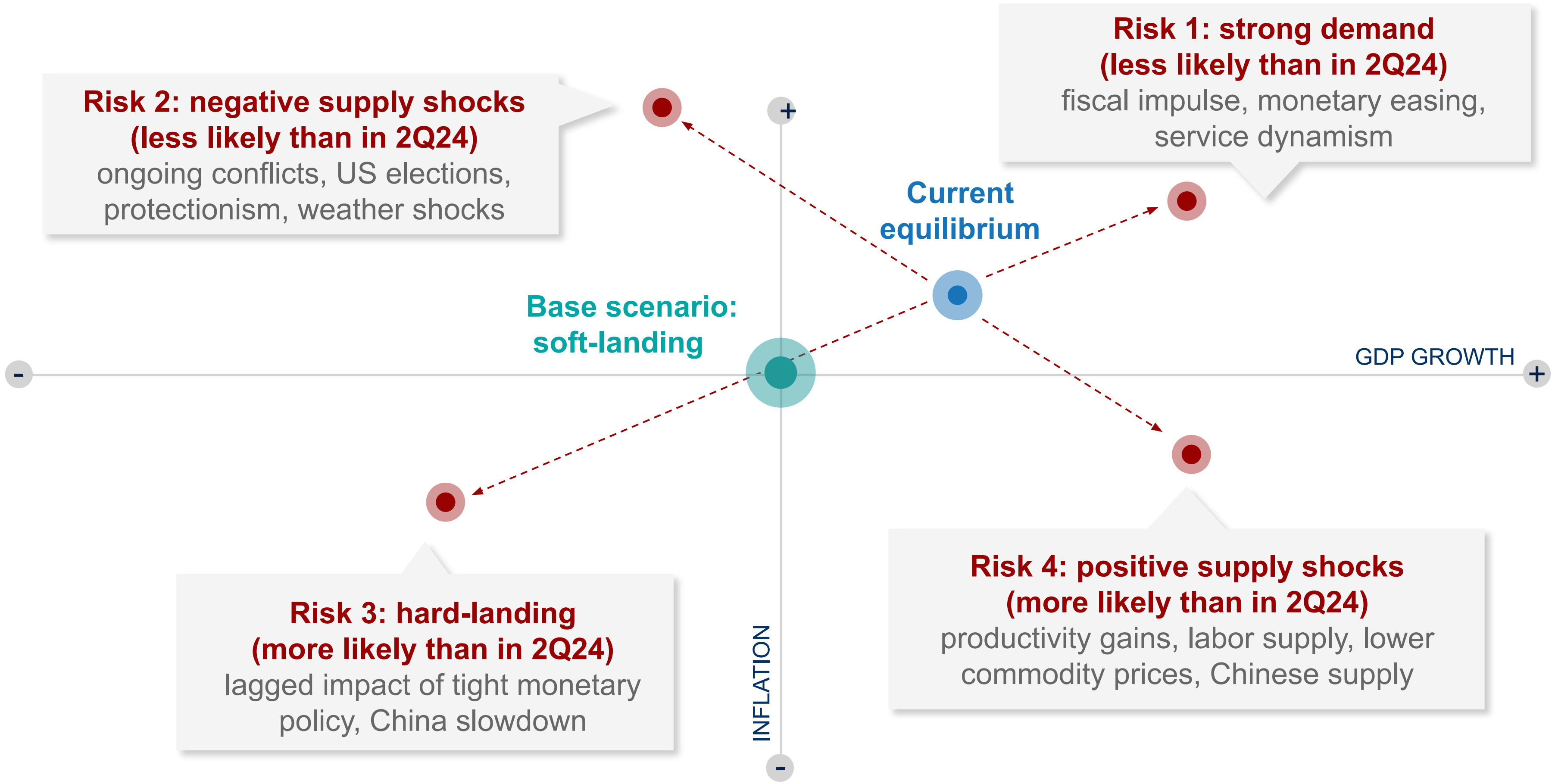
Rate forecasts: further monetary easing is expected; the Fed is likely to cut rates at a 25bps pace till mid-2025; slightly higher long-term ECB rates

POLICY INTEREST RATES (*)
(%, END OF PERIOD, CHANGE WITH RESPECT TO PREVIOUS FORECAST IN PARENTHESES)



(f): forecast.
(*) In the case of the Eurozone, interest rates of the deposit facility.
Source: BBVA Research.

Risks: still sizeable, but more balanced than before



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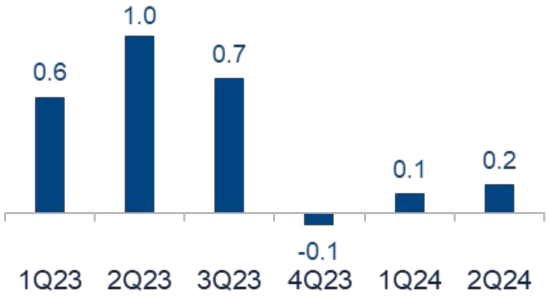
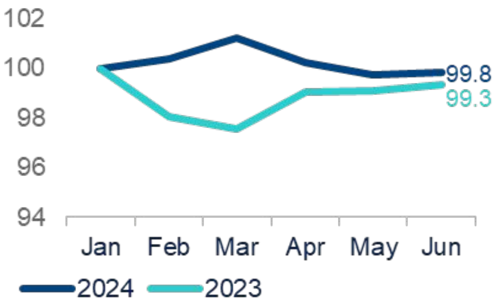
02

Economic activity weakens

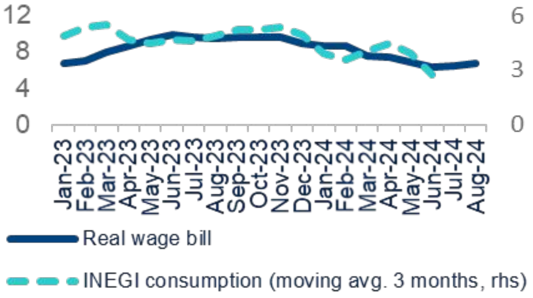
GDP
(Q/Q%, REAL, SA)



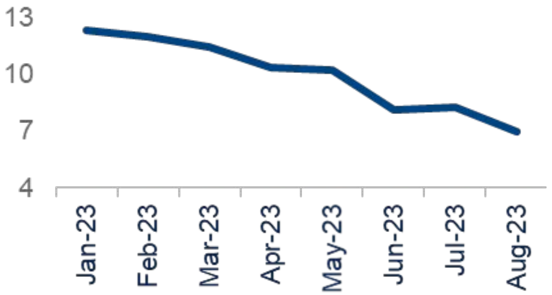
PRIVATE CONSUMPTION
(INDEX JAN=100)



CONSUMPTION & REAL WAGE BILL
(Y/Y%, REAL, SA)



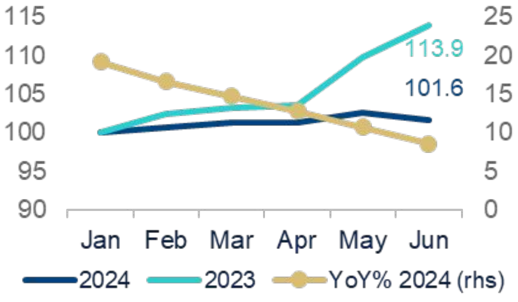
BBVA CONSUMPTION INDICATOR
(Y/Y%, REAL, SA, 3-MONTH MOVING AVERAGE)



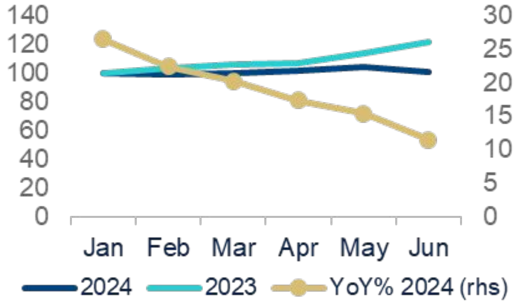
Source: BBVA Research / INEGI.

- The economy is **slowing down** due to weak domestic demand.
- Consumption is **losing ground**; it is below its Jan-2024 level.
- The real **wage bill slows** down due to lower job creation in the industrial sector.
- The BBVA Consumption Indicator confirms **lower growth** for 3Q24.

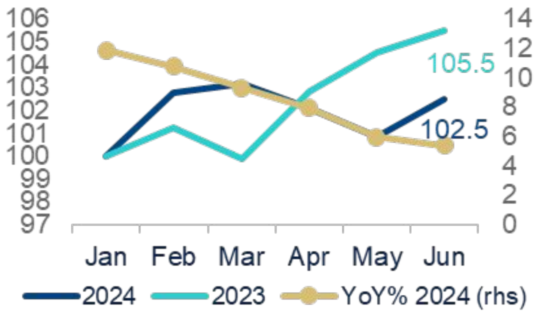
TOTAL INVESTMENT
(INDEX JAN=100)



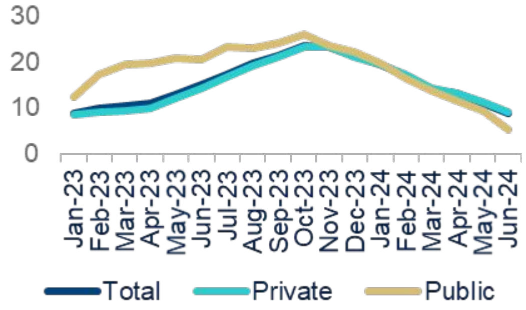
CONSTRUCTION
(INDEX JAN=100)



MACHINERY AND EQUIPMENT
(INDEX JAN=100)



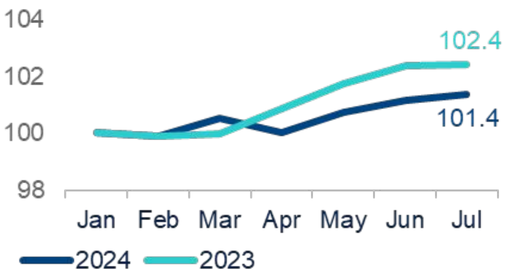
PUBLIC VS. PRIVATE INVESTMENT
(Y/Y%, 6M MOVING AVERAGE)



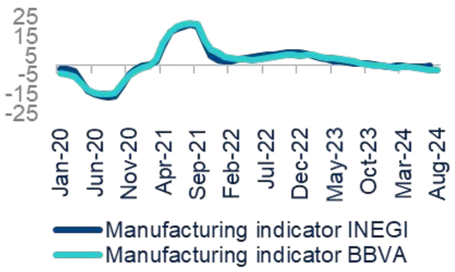
Source: BBVA Research / INEGI.

- The 2023 investment expenditure boost **fades.**
- Construction **stagnates** after accelerated growth in flagship projects in 2023; the machinery and equipment segment loses momentum in line with the fall in construction.
- Both the public and private **sectors have reduced** their spending on gross fixed investment.
- INEGI **revises investment growth for 1Q24 downward** (from 0.4% to -1.3% q/q); confirms a weaker outlook for this sector.

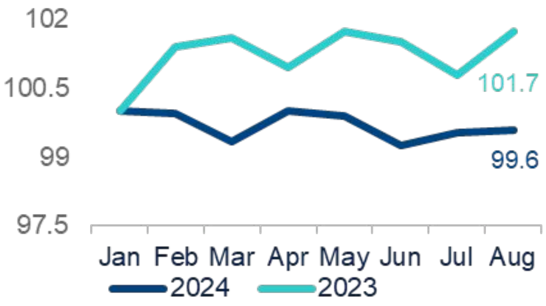
MANUFACTURING
(INDEX JAN=100)



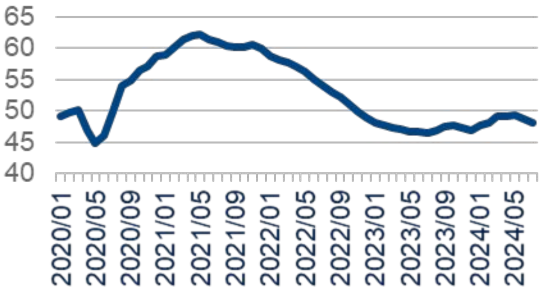
MANUFACTURING INDICATORS: INEGI & BBVA (Y/Y, 6-MONTH MOVING AVERAGE)



U.S. MANUFACTURING OUTPUT
(INDEX JAN=100)



U.S. ISM MANUFACTURING
(6-MONTH MOVING AVERAGE)



Source: BBVA Research / INEGI.

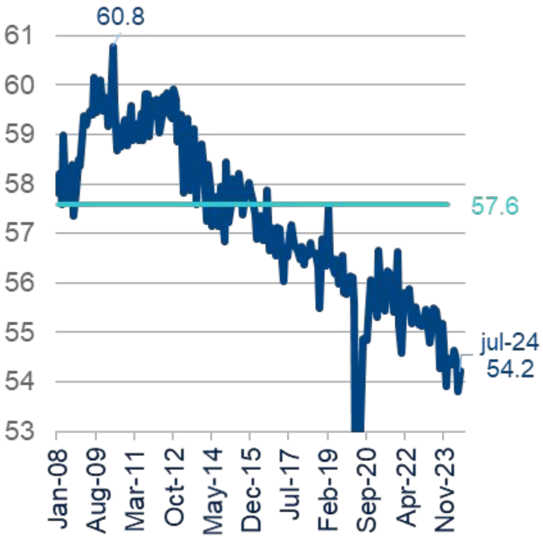
- Manufacturing **slows down** but with relative gains compared to Jan-24 due to the resilience of external demand.
- The most recent **U.S. manufacturing data** suggests that the sector is at its Jan-24 level.
- Sustained demand for durable goods in the U.S. **has prevented** further slowdown in the sector.

Unemployment and informal employment contained; however, formal employment slows down more than expected

UNEMPLOYMENT RATE (% OF EAP, SA)

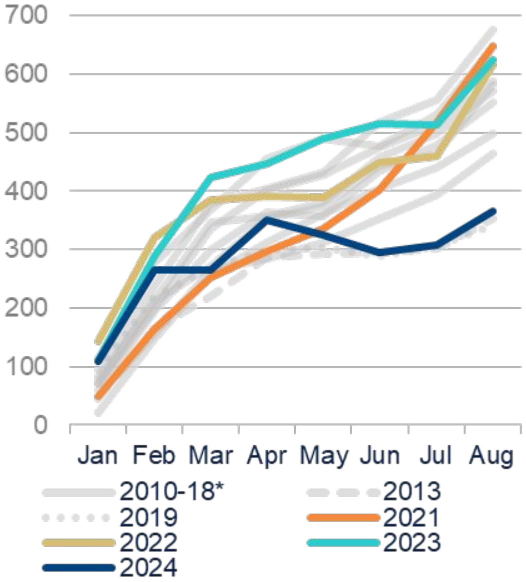
Avg. from 2005 to 2023.

INFORMAL LABOR RATE (% EMPLOYED, SA)



Avg. from 2005 to 2023.

JOBS AFFILIATED WITH THE IMSS (CUM. MONTHLY CHG. JAN-AUG, THOUSANDS)

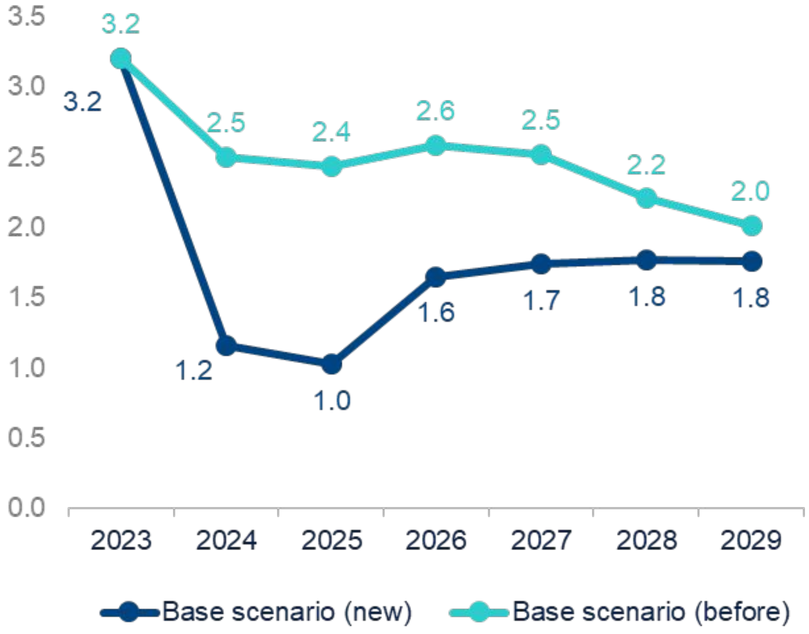


* 2020 is omitted due to the effect of the pandemic

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

Downward revision to our 2024 and 2025 forecasts: 1.2% and 1.0% respectively (2.5% and 2.4% previously)

GDP
(REAL ANNUAL % CHG., SA)

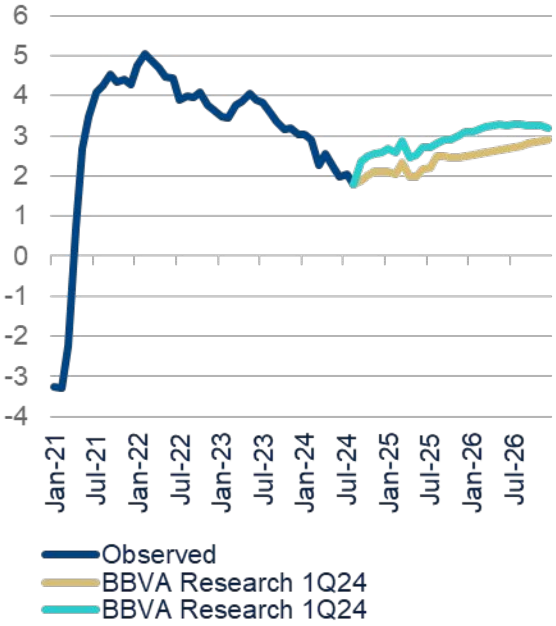


Source: BBVA Research / INEGI.

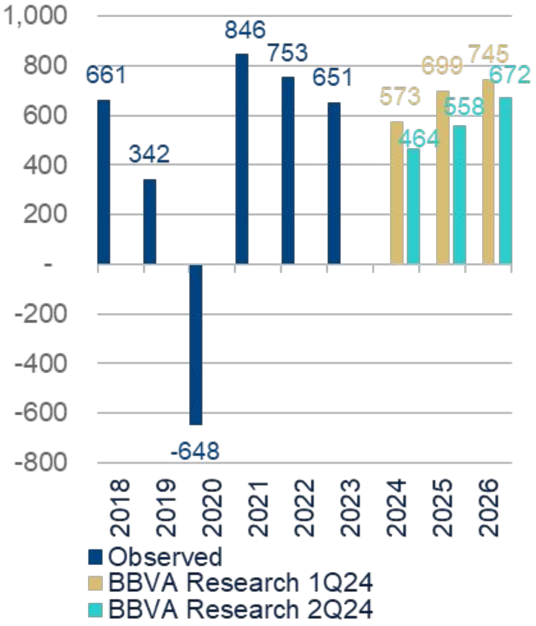
- The **weak growth** in 2024 (revisions to the series and observed data from 2Q24) explain most of the year's downward revision
- Changes to the **2025** assumptions: Fiscal consolidation, investment uncertainty and lower monetary policy rate

We have adjusted the forecast for formal job creation by year-end downward; less optimistic medium-term outlook

JOBS AFFILIATED WITH THE IMSS
(ANNUAL CHG., %)



FORMAL EMPLOYMENT OUTLOOK



Forecast	2024	2025	2026
Thousands, EoP			
BBVA Research 3Q24	**464**	**558**	**672**
BBVA Research 2Q24	573	699	745
Annual Change, % EoP			
BBVA Research 3Q24	**2.1**	**2.5**	**2.9**
BBVA Research 2Q24	2.6	3.1	3.2

Source: BBVA Research / IMSS.

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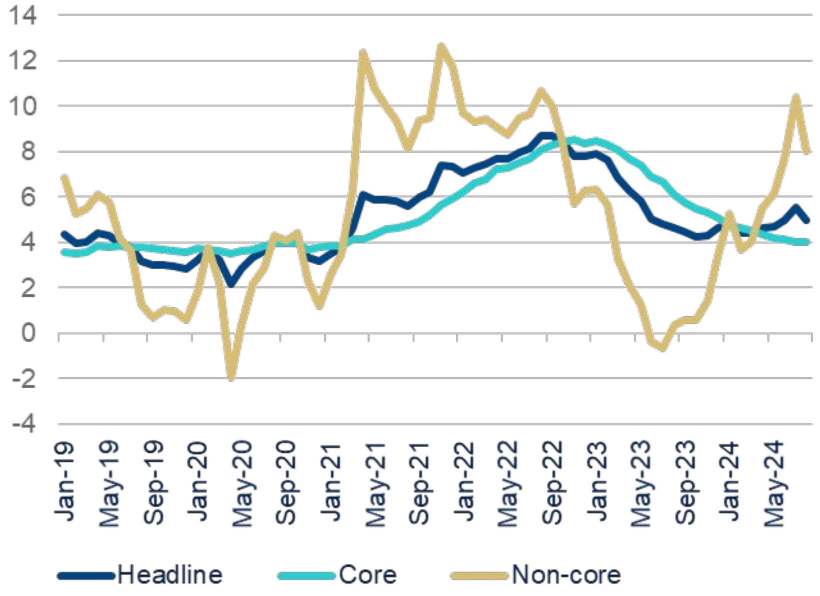
03

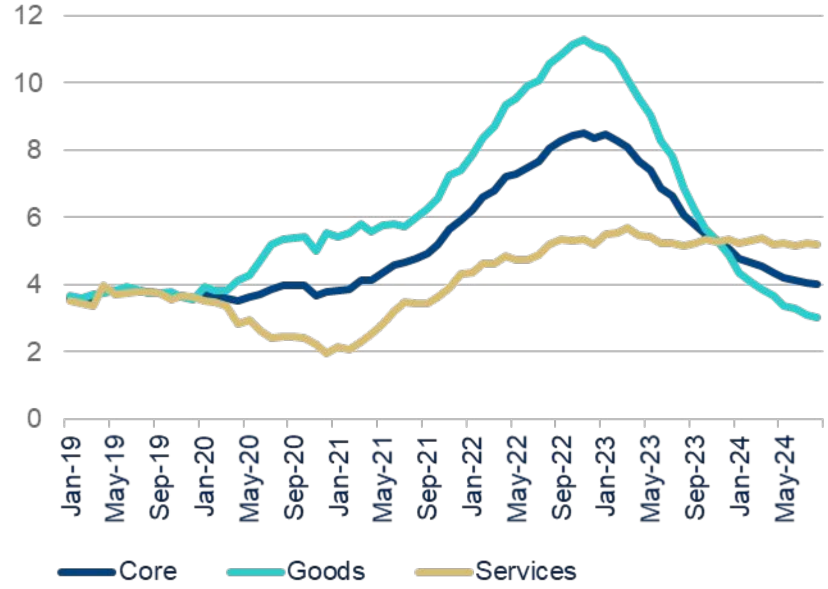
Lower inflation, weaker demand and the Fed's rate cut cycle create ample room for Banxico to continue cutting the policy rate

The supply shock that had impacted inflation began to dissipate in August; core inflation slowed for the 19th consecutive month

BREAKDOWN OF HEADLINE INFLATION
(ANNUAL % CHANGE)



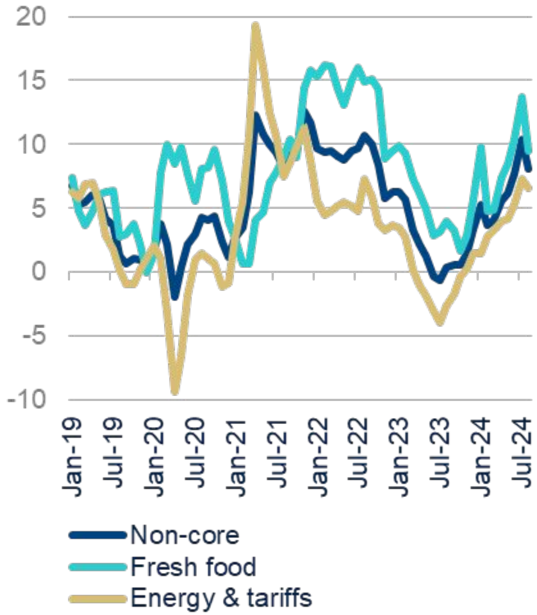
BREAKDOWN OF CORE INFLATION
(ANNUAL % CHG.)



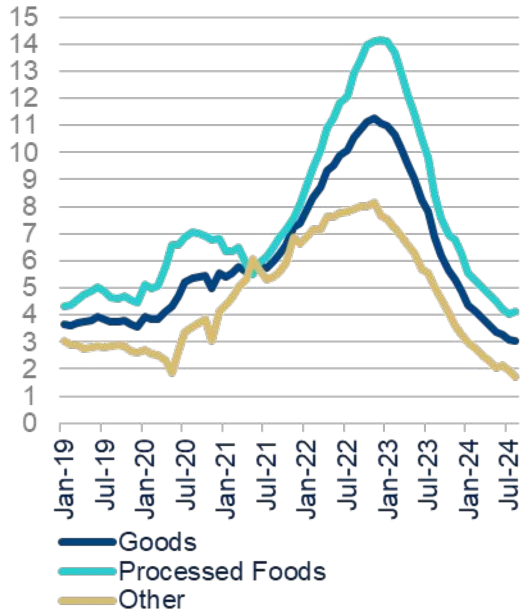
Source: BBVA Research, INEGI.

Non-core inflation will continue to slow down; services inflation excluding housing and tuition is cooling slowly

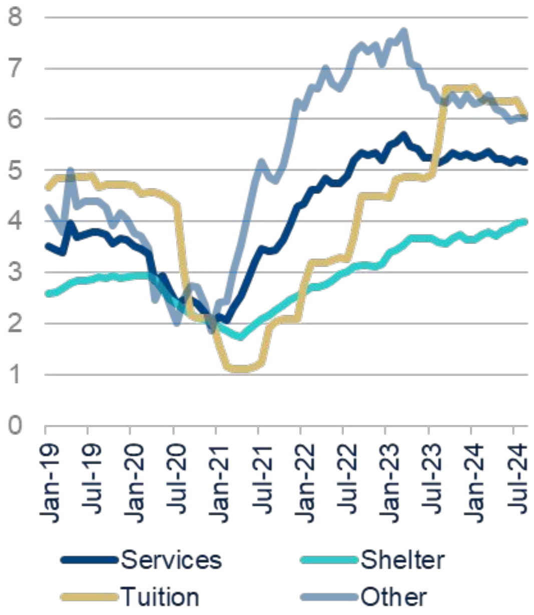
NON-CORE INFLATION COMPONENTS
(ANNUAL % CHG.)



COMPONENTS OF CORE GOODS INFLATION
(ANNUAL % CHG.)



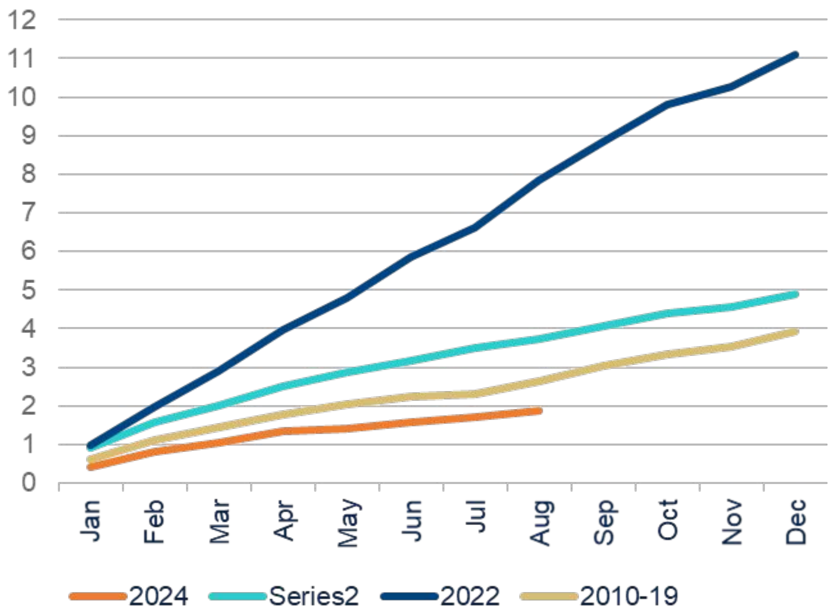
COMPONENTS OF CORE SERVICES INFLATION
(ANNUAL % CHG.)



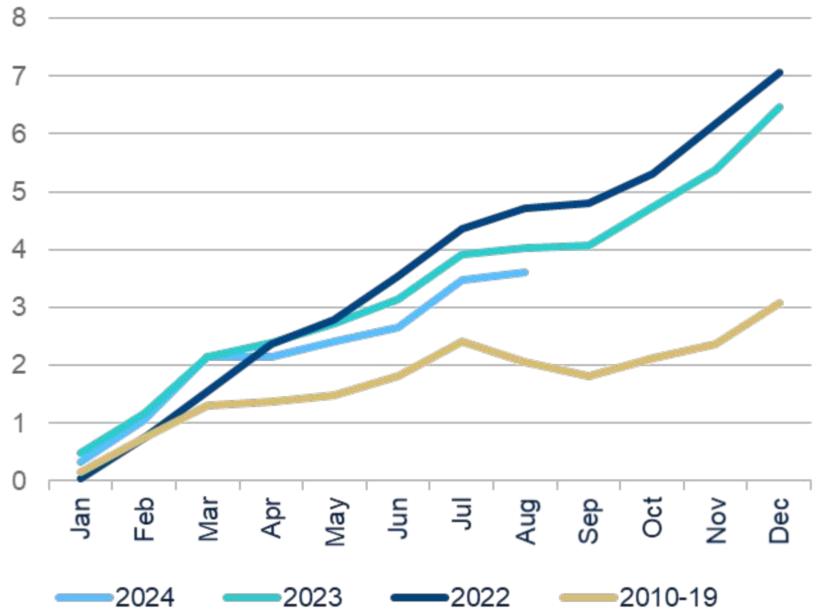
Source: BBVA Research, INEGI.
*

Core goods inflation shows very favorable performance; core services inflation may soon break its stickiness

CORE GOODS INFLATION: CUMULATIVE PER YEAR
(%)



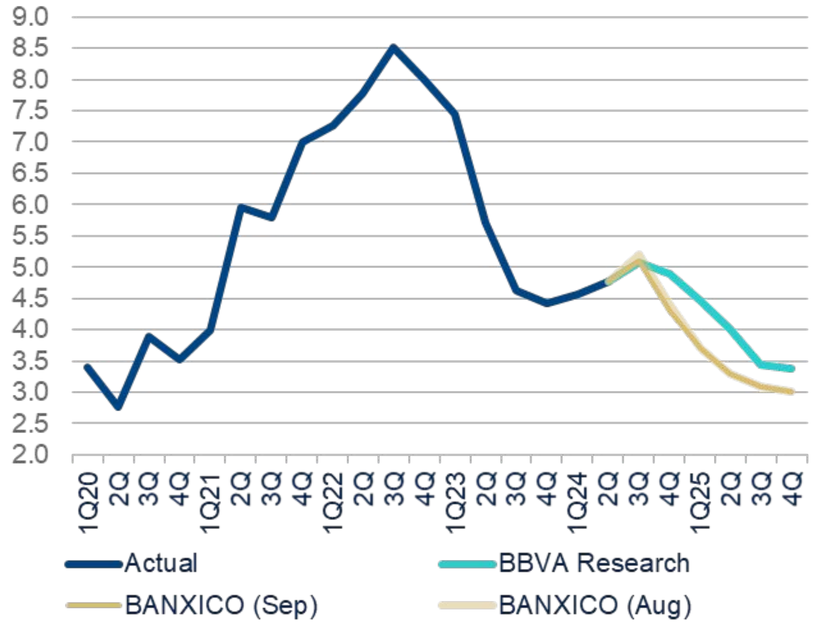
CORE SERVICES INFLATION EXCL. HOUSING AND TUITION: CUMULATIVE PER YEAR
(%)



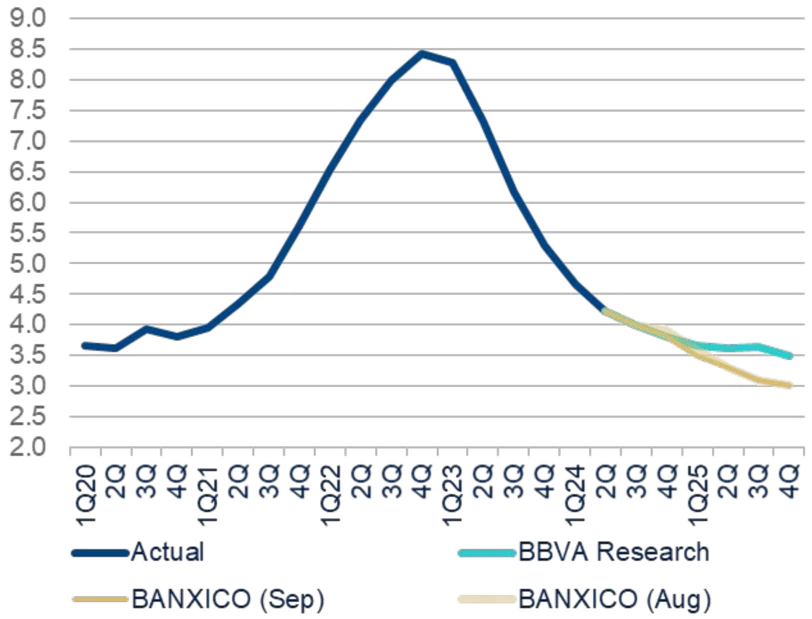
Source: BBVA Research, INEGI.

Headline inflation will resume its downward trend as of Q4; core inflation will be below 4.0% at the end of this year

HEADLINE INFLATION FORECASTS
(ANNUAL % CHANGE, QUARTERLY AVERAGE)



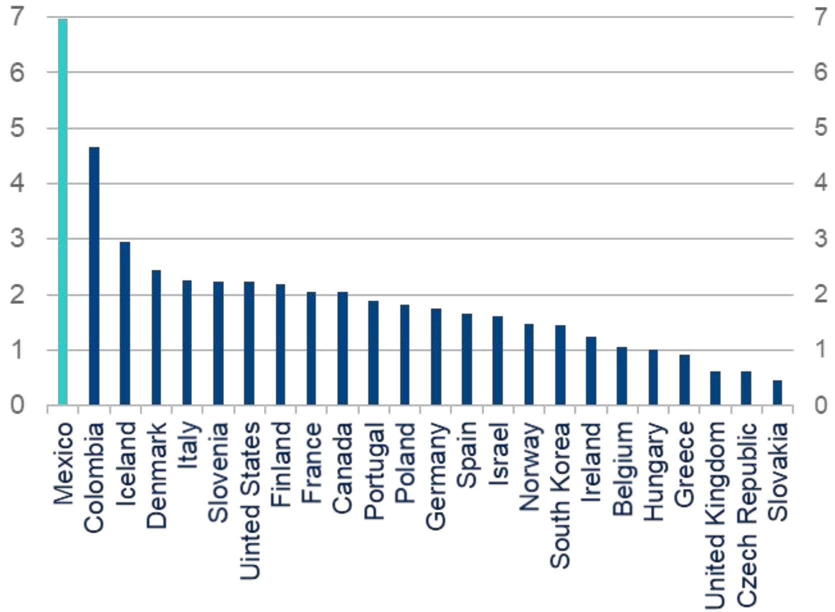
CORE INFLATION FORECASTS
(ANNUAL % CHANGE, QUARTERLY AVERAGE)



Source: BBVA Research, INEGI, BANXICO.

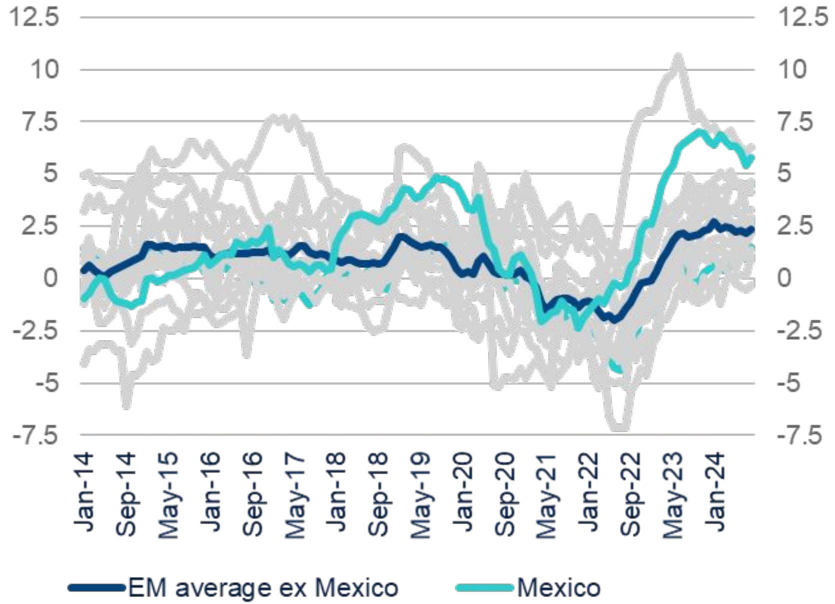
Worsening growth prospects and improving inflation mean that there is ample room for further normalization of the monetary policy stance

POLICY RATE MINUS CORE INFLATION IN SELECTED OECD COUNTRIES (%)



Source: BBVA Research / National sources / OECD.

EX-POST REAL POLICY RATE IN SELECTED EMERGING MARKETS (%)

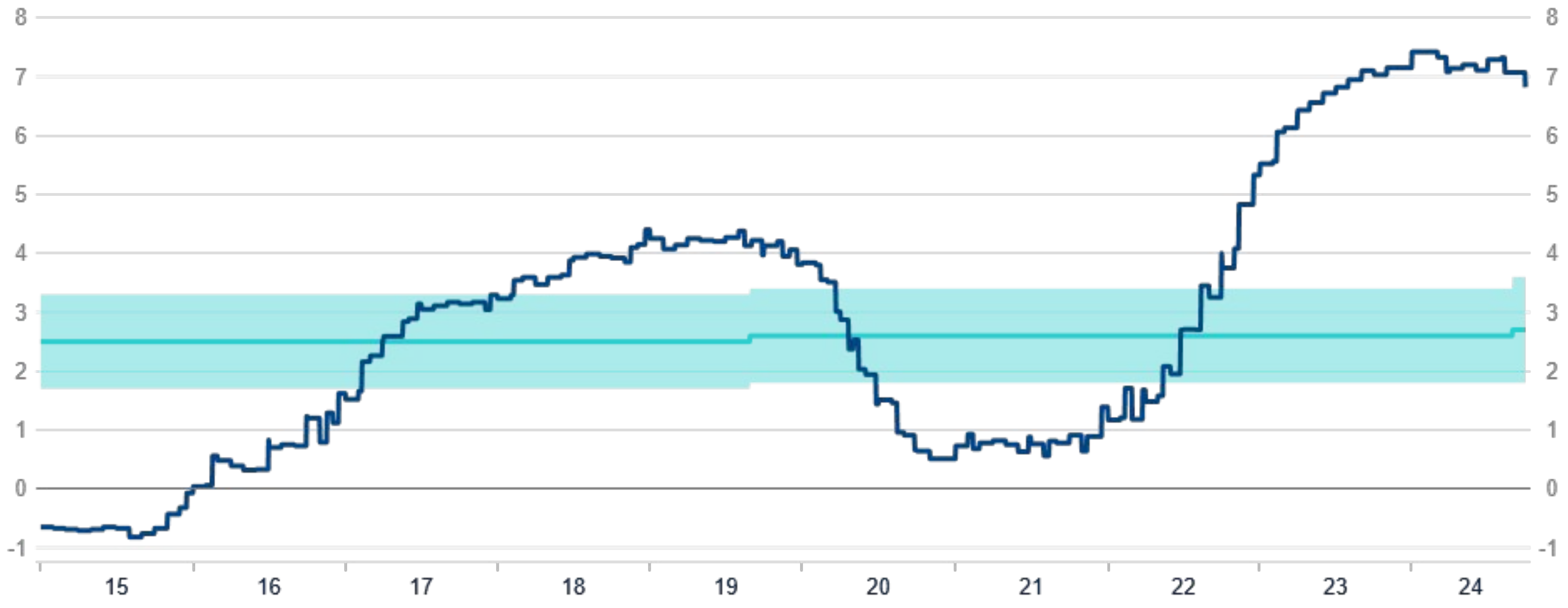


The gray lines indicate ex-post real reference rates in Brazil, Chile, China, Colombia, Hong Kong, India, Indonesia, Israel, South Korea, Malaysia, Philippines, Saudi Arabia, Singapore, Taiwan, Thailand and Vietnam. Source: BBVA Research / National sources.

The very high level of the ex-ante real rate implies that despite the cycle of declines, monetary policy will continue to weigh on economic activity

EX-ANTE REAL POLICY RATE

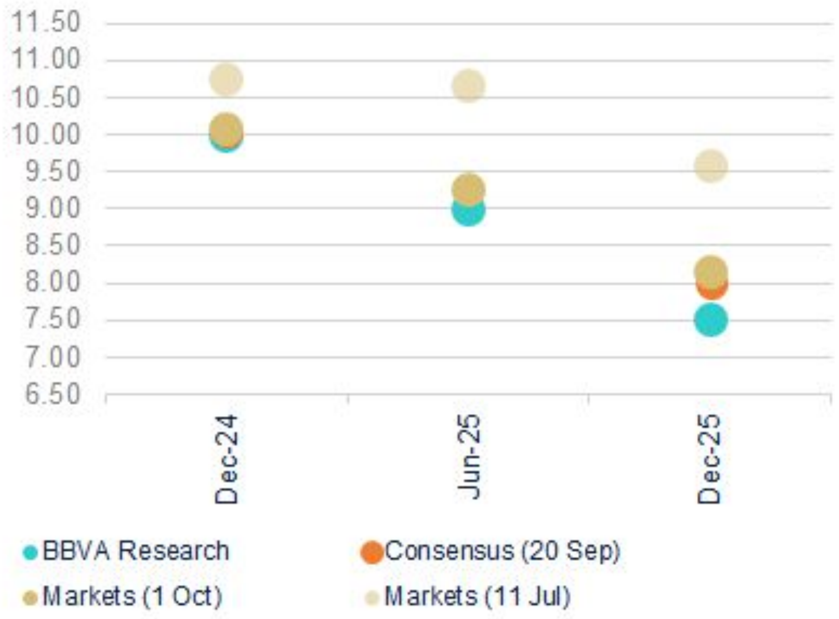
(%)



The shaded area indicates Banxico's estimated range for the long-term real neutral reference rate; the solid aqua line indicates the central estimate.
Source: BBVA Research / Banxico / INEGI.

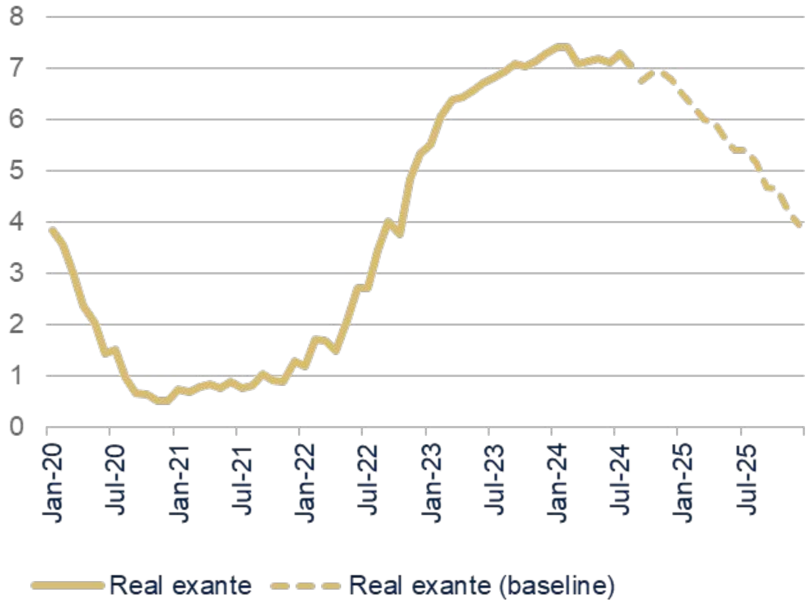
Banxico seems poised to embark on a steady downward streak; we expect it to decline to 7.50% by the end of 2025

OUTLOOK FOR THE MONETARY RATE: BBVA RESEARCH VS. MARKETS AND CONSENSUS
(%)



Source: BBVA Research; Banamex and Bloomberg surveys.

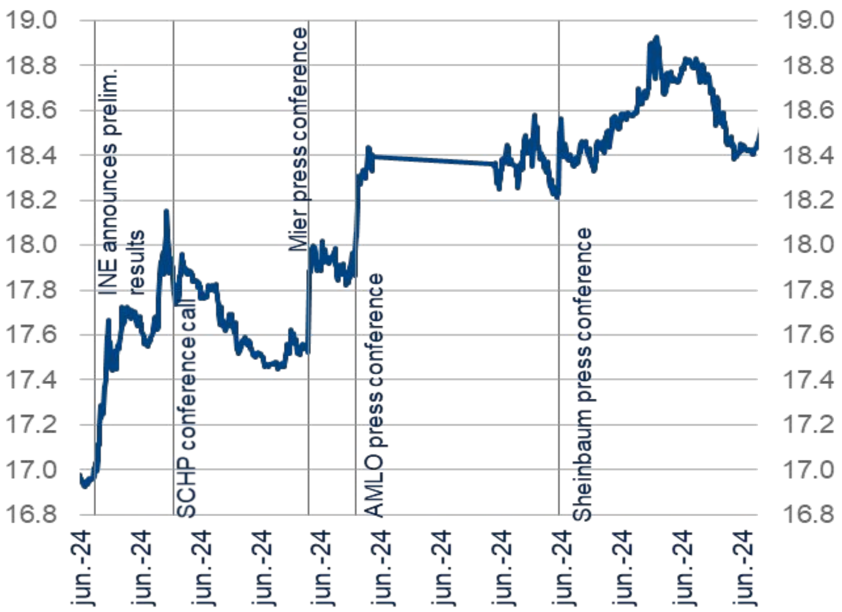
OUTLOOK FOR THE EX-ANTE REAL RATE
(%)



Source: BBVA Research, Banxico and INEGI.

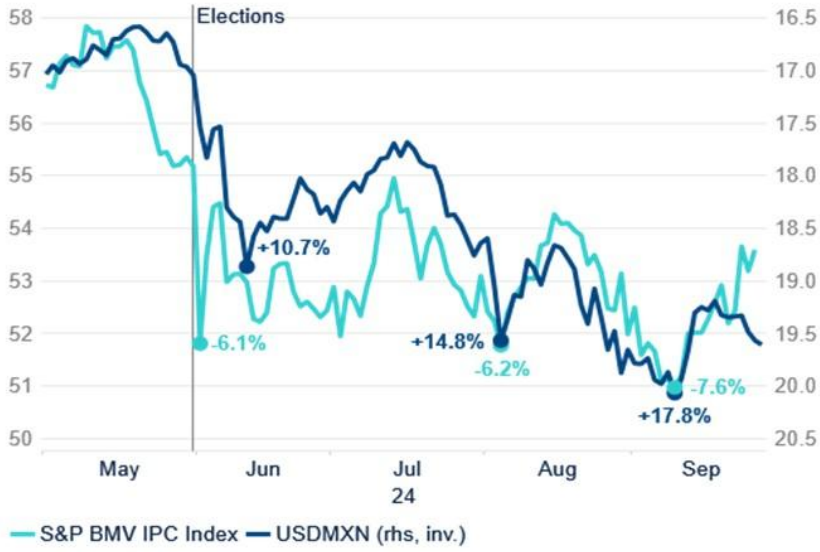
The exchange rate surpassed 20 ppd for the first time in two years due to the approval and publication of the judiciary reform, ...

EXCHANGE RATE AND INITIAL STATEMENTS ON JUDICIAL REFORM (PPD)



Source: BBVA Research / Bloomberg.

POST-ELECTION MARKET TRENDS (THOUSANDS AND PPD)

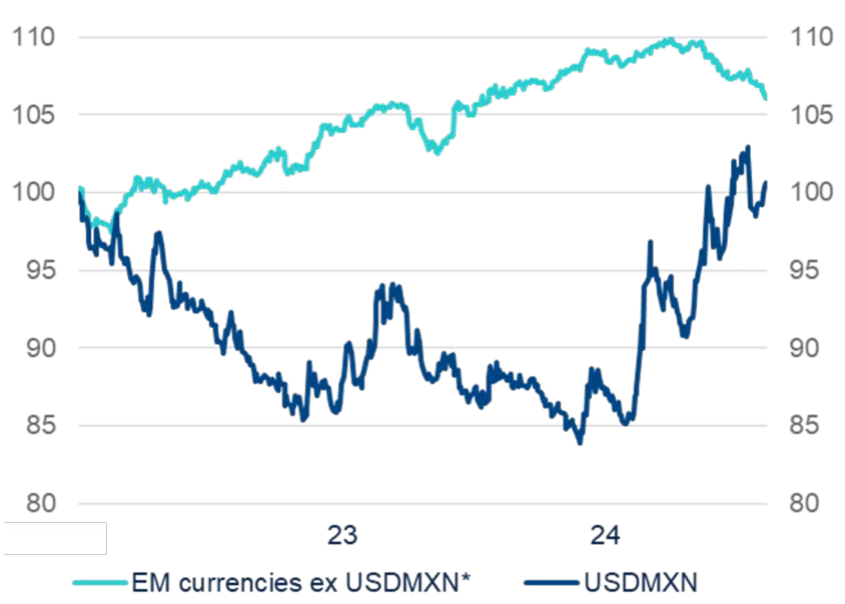


Source: BBVA Research / BMV / Macrobond.

… fully reversing the 15% appreciation that the Mexican peso had accumulated until before the elections

RELATIVE PERFORMANCE OF THE EXCHANGE RATE

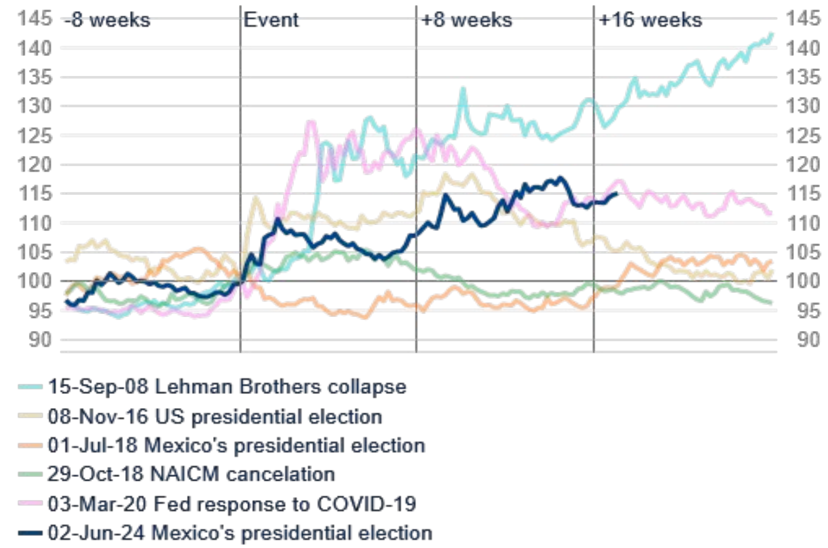
(01-JAN.-23=100)



* Reweighted version of the Fed's Emerging Market Economies (EME) Dollar Index
Source: BBVA Research / Fed / Macrobond.

EXCHANGE RATE TREND IN SELECTED EVENTS

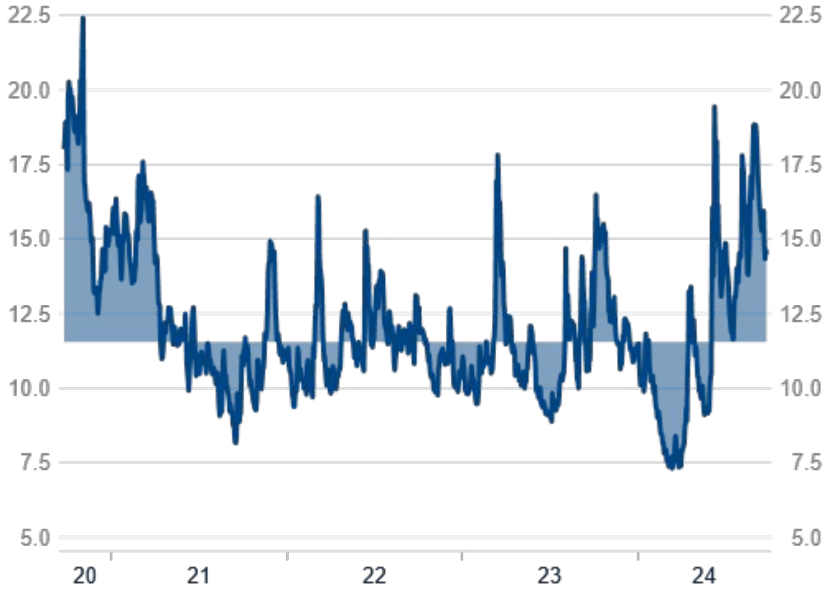
(EVENT DATE=100)



Source: BBVA Research / Macrobond.

Higher volatility, intensified by global developments, has made the peso less attractive despite a still-high policy rate differential

EXCHANGE RATE VOLATILITY
(%)



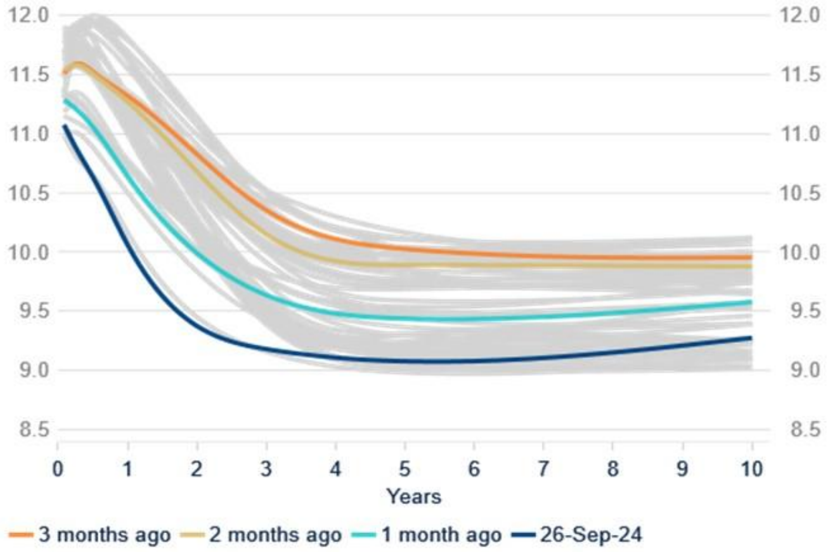
Implied volatility in 1-month ATM options; the shaded area indicates the deviation from the historical average. Source: BBVA Research / Bloomberg.

MXN-USD CARRY AND CARRY-TO-RISK RATIO
(%)

Source: BBVA Research / Bloomberg.

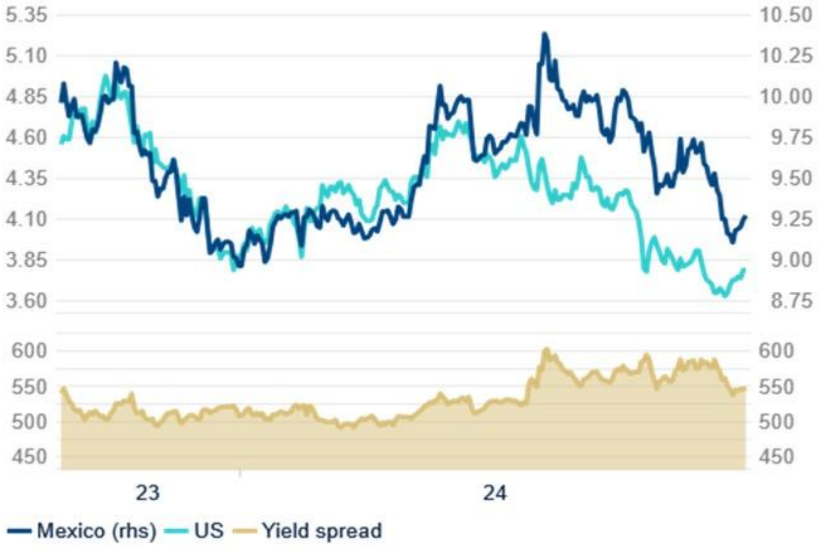
Longer-term rates also reflect the increased uncertainty associated with the possible economic effects of constitutional reforms, ...

GOVERNMENT YIELD CURVE
(%)



Gray lines indicate weekly curves over the last year; intermediate rates calculated with natural cubic spline interpolation. Source: BBVA Research / Banxico / Macrobond.

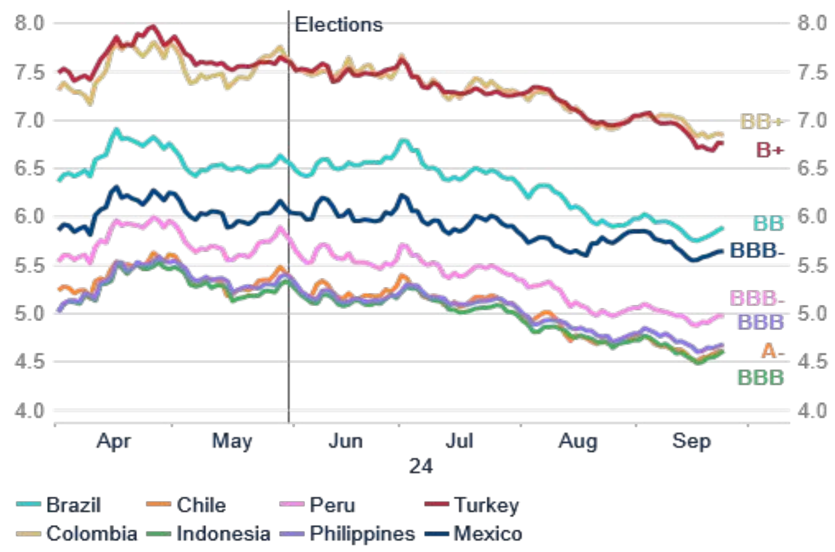
10-YEAR GOVERNMENT YIELDS AND YIELD SPREAD
(% AND BP)



Source: BBVA Research / Macrobond / Dept. of the Treasury.

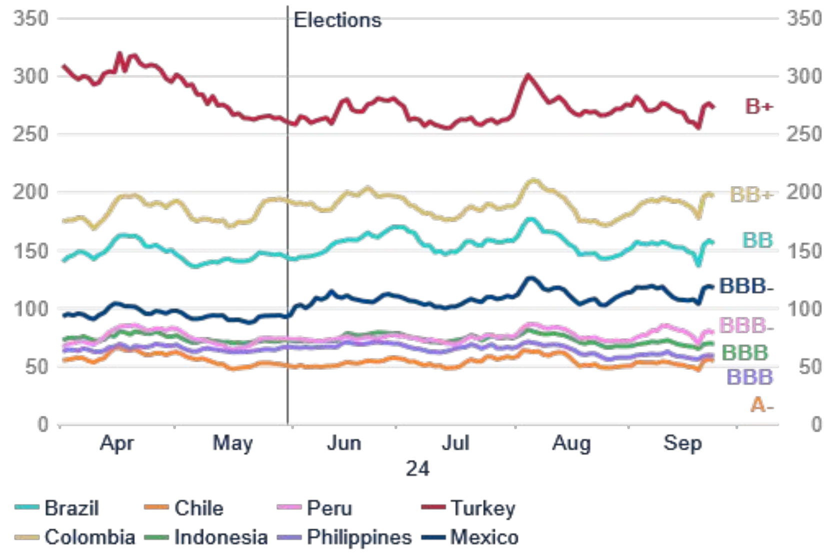
… which has contributed to raising the perception of country risk and, therefore, to increasing risk premiums on Mexican debt instruments

10-YEAR USD YIELD IN SELECTED EMERGING MARKETS (%)



The credit rating shown is the lowest among Moody's, S&P and Fitch
Source: Bloomberg.

5-YEAR CDS IN SELECTED EMERGING MARKETS (BP)



The credit rating shown is the lowest among Moody's, S&P and Fitch
Source: Bloomberg.

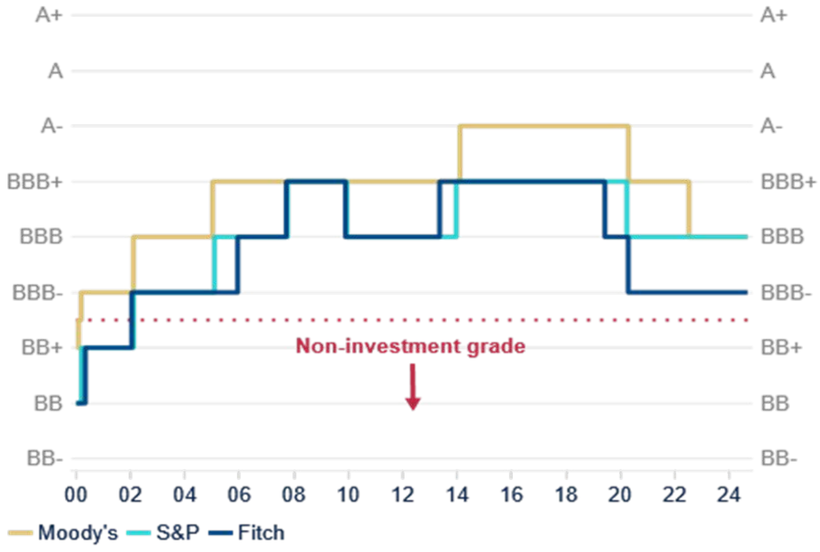
Strong macro fundamentals would help support Mexico's prospects of maintaining the investment-grade rating over the next two years

CREDIT RATING OF THE LONG-TERM SOVEREIGN DEBT OF SELECTED ECONOMIES

Country	Moody's	S&P	Fitch
Chile	A2	A	A-
Peru	Baa1	BBB-	BBB
Philippines	Baa2	BBB+	BBB
Indonesia	Baa2	BBB	BBB
Mexico	Baa2	BBB	BBB-
Colombia	Baa2	BB+	BB+
Brazil	Ba2	BB	BB
Türkiye	B1	B+	B+

Credit ratings without investment grade in red
Source: Bloomberg.

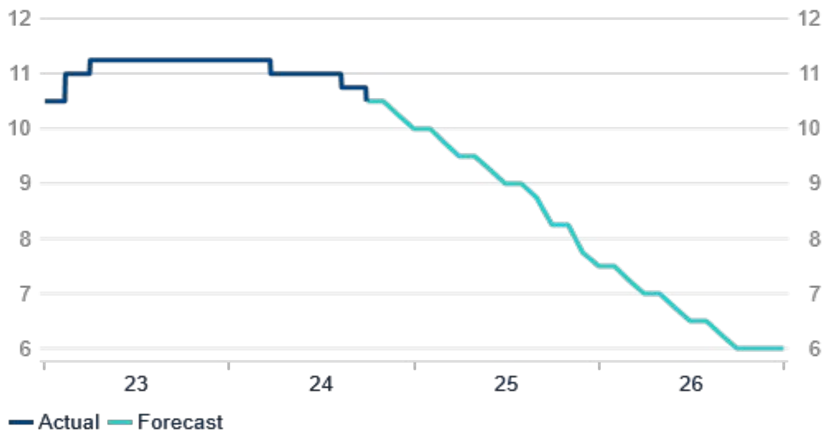
CREDIT RATING OF MEXICO'S LONG-TERM SOVEREIGN DEBT



Source: Bloomberg.

Although there is room for lower rates in all maturities, higher risk premiums would limit the downside potential for long-term rates

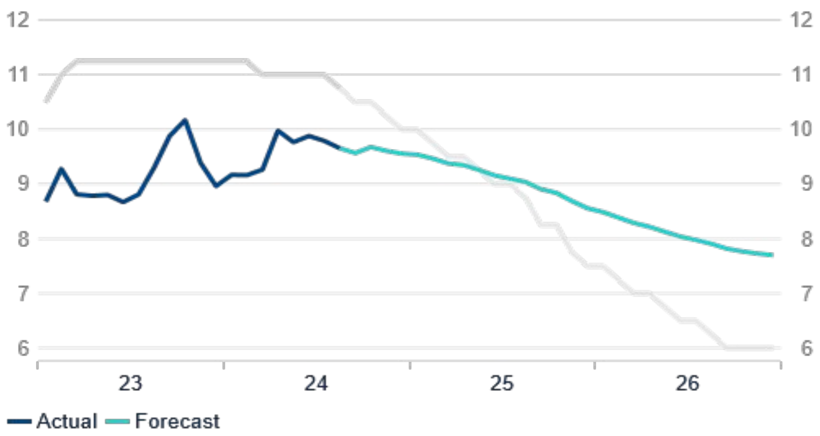
BANXICO'S REFERENCE RATE
(%)



Ref Rate (EoP)	2024	2025	2026
Forecast	10.00	7.50	6.00

Source: BBVA Research / Banxico.

10-YEAR GOVERNMENT YIELD
(%)

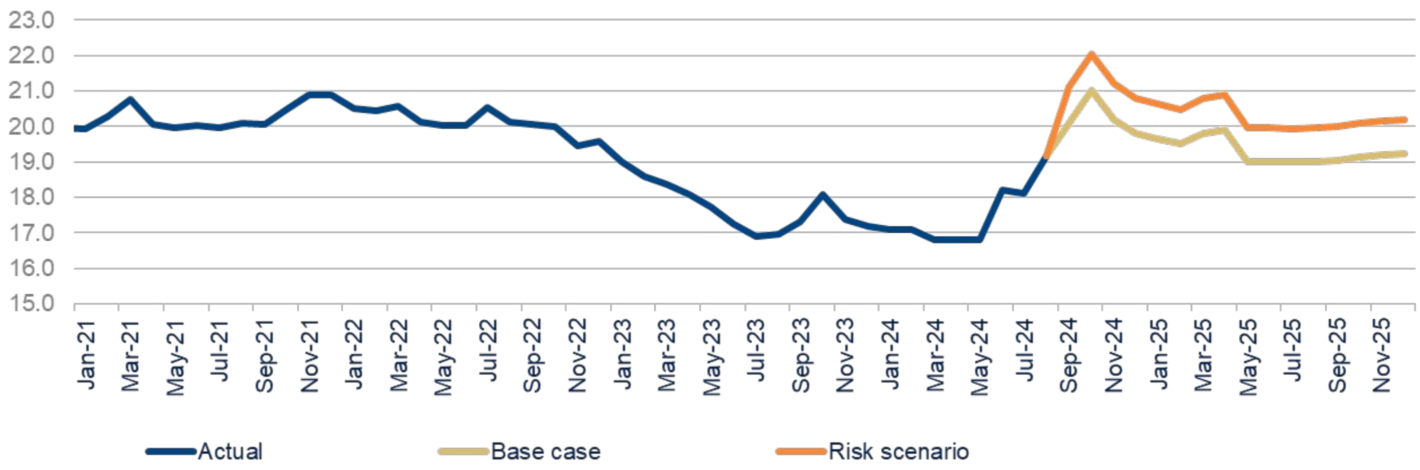


Yield 10 years (EoP)	2024	2025	2026
Forecast	9.6	8.5	7.7

The gray line indicates Banxico's policy rate.
Source: BBVA Research / Banxico.

Risks to the exchange rate remain biased to the upside despite the recent depreciation; possible additional overreaction in the near term

EXCHANGE RATE OUTLOOK: ALTERNATIVE SCENARIOS
(PPD)



Exchange rate (EoP)	2024	2025
Base	19,80	19,23
Risk	20,79	20,19

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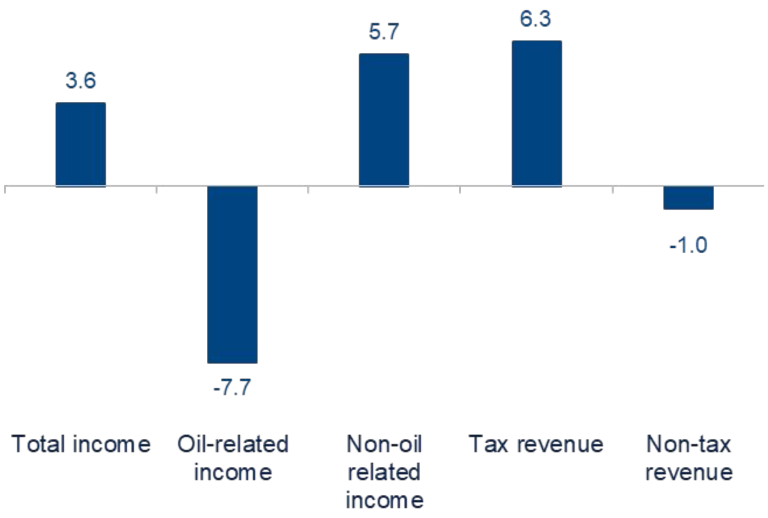
04

If the fiscal consolidation planned for 2025 is not gradual, there would be a downside risk to growth

Tax revenues boosted total revenue growth; higher spending on capital, subsidies and transfers drove public spending

GOVERNMENT REVENUE AND MAIN COMPONENTS IN JANUARY-AUGUST 2024

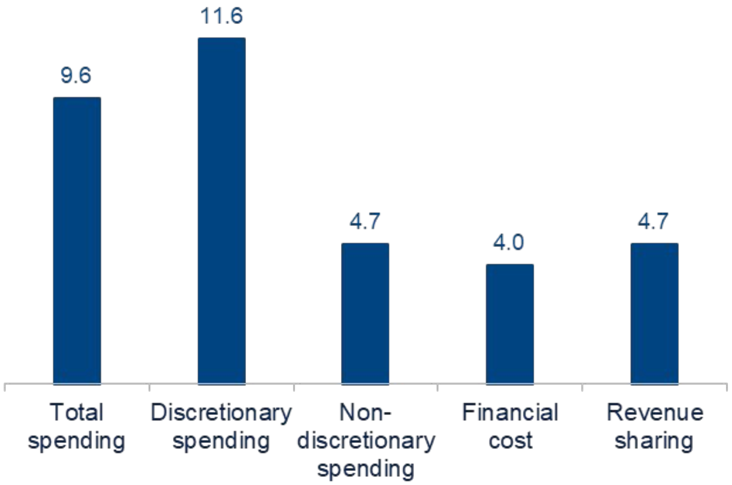
(% Y/Y REAL)



Source: BBVA Research / SHCP.

PUBLIC EXPENDITURE AND MAIN COMPONENTS IN JANUARY-AUGUST 2024

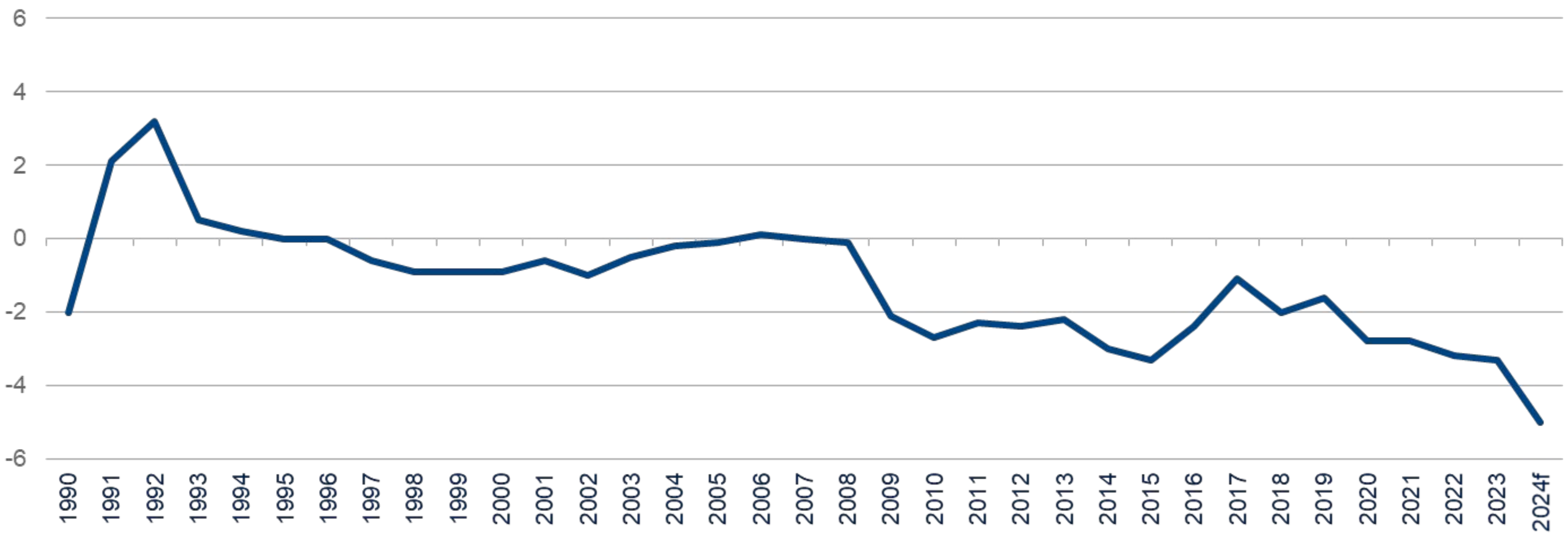
(% Y/Y REAL)



Source: BBVA Research / SHCP.

We expect the public deficit to be 5.0% of GDP this year (a 35-year high); the new government will have to make a fiscal consolidation effort

TRADITIONAL PUBLIC BALANCE
(% OF GDP)

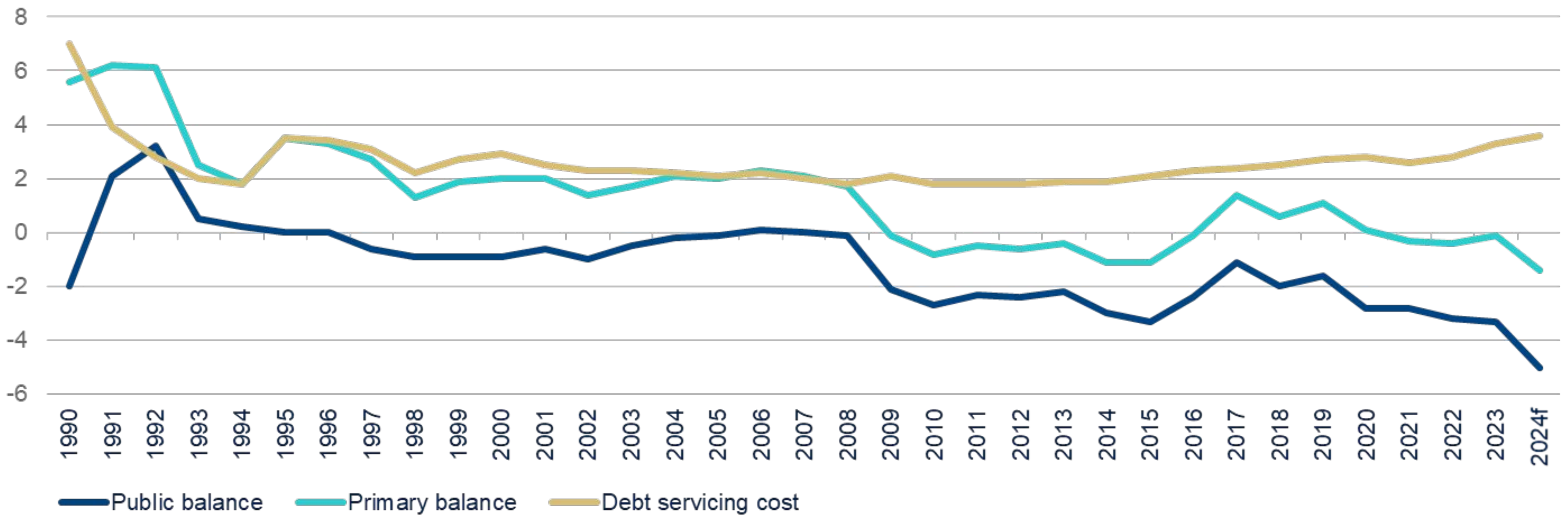


Source: BBVA Research / SHCP.

The expected increase in the public deficit from 3.3% to 5.0% of GDP in 2024 is mainly due to the primary deficit rising from 0.1% to 1.4% of GDP

PUBLIC BALANCE, PRIMARY BALANCE AND FINANCIAL COST

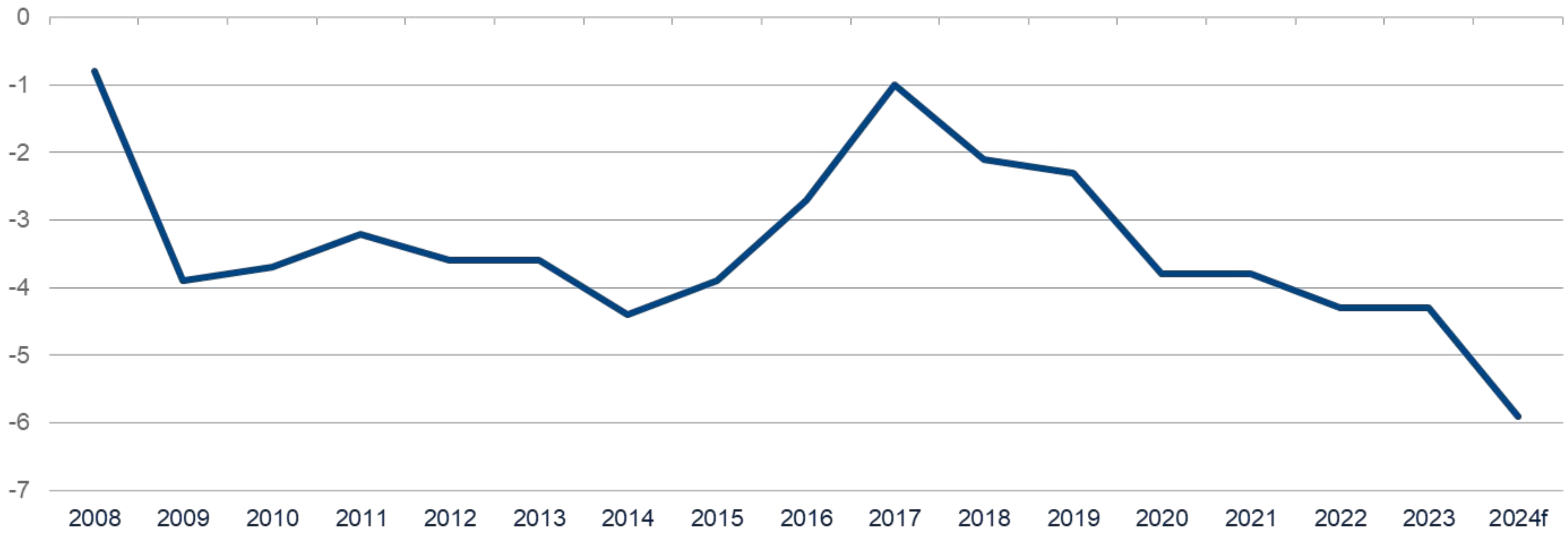
(% OF GDP)



Source: BBVA Research / SHCP.

We expect PSBR to be -5.9% of GDP this year; this will be the largest deficit in the entire historical series

PUBLIC SECTOR BORROWING REQUIREMENTS
(% OF GDP)

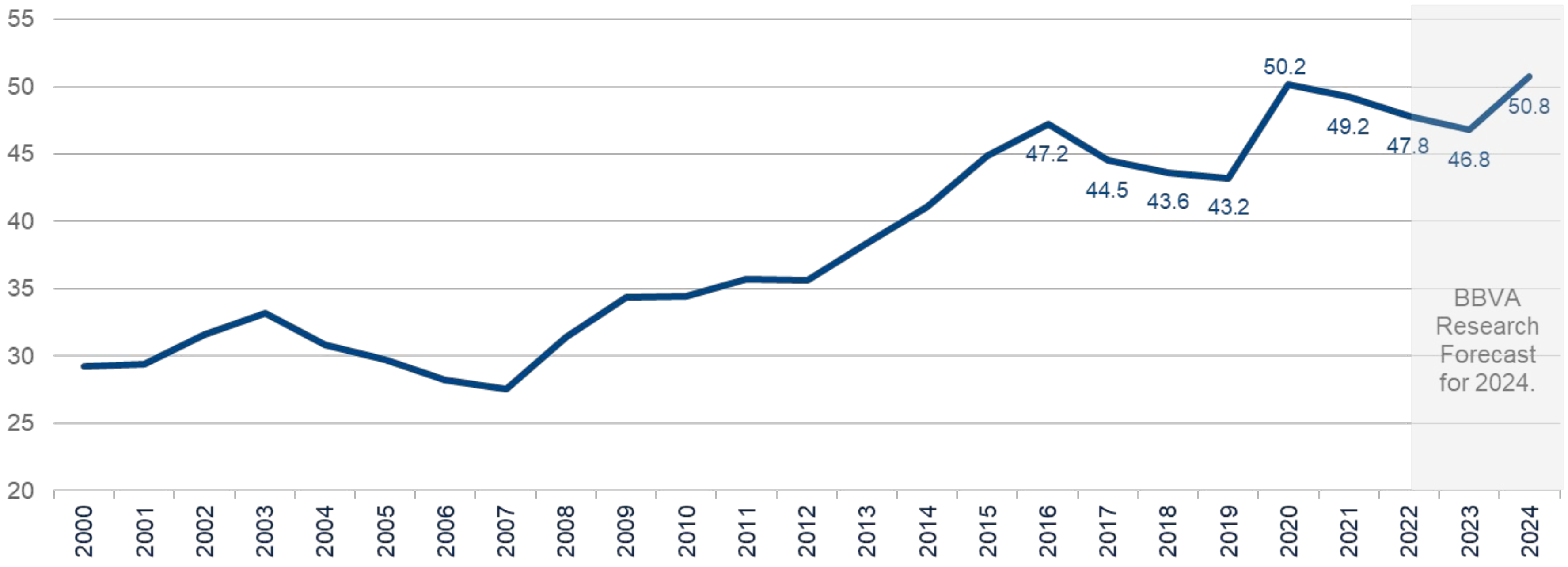


Source: BBVA Research / SHCP.

Public debt could approach 60% of GDP by the end of 2030 and the investment grade would most likely be lost in the absence of fiscal discipline

HISTORICAL BALANCE OF PUBLIC SECTOR BORROWING REQUIREMENTS

(% OF GDP)



Source: BBVA Research / SHCP.

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05

Key points and forecast summary

Key points

Recent behavior

Growth and inflation are moderating; a continuous downward rate cycle has begun. Weakening of domestic demand and slowdown in the pace of job creation. **Lower inflation** as the supply shocks that affected it are dissipating, and continued decline in core inflation. With inflation "improving" and growth prospects worsening, **Banxico has significant room to cut the monetary rate.**

Growth estimate

We revised our growth forecast for 2024 downward to 1.2% (previously 2.5%) given the prolonged weakness in domestic demand

- **Consumption recorded its largest drop since the beginning of the pandemic,** due to the real wage bill losing momentum
- **Investment is moderating its growth due to the fall in public expenditure**; the slowdown in investment will be accentuated in the coming quarters, in an environment of greater uncertainty derived from the recent changes to the judicial system.
- The slow dynamism of consumption and investment, as well as the fiscal consolidation proposed for next year, **would impact economic activity in 2025: BBVA 1.0% (2.4% previously).**

Labor market continues to show resilience, but the slowdown is evident: Moderate growth in formal employment is also expected in 2025, reflecting the weakness of the economy.

Key points

Inflation and monetary policy

Headline inflation has resumed its downward trend, which we expect to continue going forward; **core inflation is expected to fall below 4.0% by 4Q24.**

- We expect **both to be below 3.5% by the end of 2025**; we continue to expect that they will end this year at 4.8% and 3.8%, respectively.

We believe that there is ample room to normalize the monetary stance in the face of the favorable trend in core inflation and the weakening of domestic demand.

- We now **forecast that the monetary rate will end 2024 at 10.00%, and 2025 at 7.50%,** below consensus expectations.
- **Higher risk premia in long-term rates** will probably offset part of the effect of the downward revision in the monetary rate by the end of 2025.

Exchange rate and public finances

We forecast the exchange rate to close 2024 and 2025 at 19.8 and 19.2 pesos per dollar, respectively.

Public debt will be around 50.8% of GDP in 2024 vs. 46.8% in 2023. To keep this ratio constant from 2025 it will be necessary to reduce the public deficit to around 2.0% of GDP.

Forecast summary

		2020	2021	2022	2023	2024	2025	2026
GDP (Annual chg. %)	new	-8.8	6.0	3.9	3.2	**1.2**	**1.0**	**1.6**
	previous					2.5	2.4	2.6
Employment (%, at close)	new	-3.2	4.3	3.7	3.0	**2.1**	**2.5**	**2.9**
	previous					2.6	3.1	3.2
Inflation (%, at close)	new	3.2	7.4	7.8	4.7	**4.8**	**3.2**	**3.4**
	previous					4.8	3.5	3.6
Monetary policy rate (%, at close)	new	4.25	5.50	10.50	11.25	**10.00**	**7.50**	**6.00**
	previous					10.50	8.50	6.50
Exchange rate (ppd, at close)	new	20.0	20.9	19.6	17.2	**19.8**	**19.2**	**19.5**
	previous					18.2	18.6	18.9
M10 (%, at close)	new	5.5	7.6	9.0	9.0	**9.6**	**8.6**	**7.7**
	previous					9.5	8.8	7.8
Fiscal balance (% of GDP)	new	-2.8	-2.8	-3.2	-3.3	**-5.1**	**-3.5**	**-3.5**
	previous					-4.9	-3.0	-3.0
Current account (% of GDP)	new	1.9	-0.7	-1.3	-0.5	**-0.5**	**-0.7**	**-0.8**
	previous					-0.7	-1.4	-1.3

Source: BBVA Research.

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Mexico Economic Outlook

October 2024

Creating Opportunities