Macro scenario - Mexico

May 14, 2024

Another pause is likely

- AMLO's priority reforms are unlikely to be discussed in the current Congressional session, meaning that if the new President wants to continue with AMLO's legacy reforms, they will need to be presented again to the new Congress, starting September 1. According to the Bloomberg poll tracker, Claudia Sheinbaum leads preferences with an average lead of 30 percentage points over second-place Xochitl Galvez (opposition coalition candidate).
- We reduced our GDP growth forecast for this year to 2.3% (from our previous estimate of 2.8%), given a soft 1Q24 despite a strong rebound in February's activity print and our expectation of higher growth in the U.S. Still, we expect GDP growth to rebound sequentially in 2Q24, supported by the effects of fiscal expansion in the first half of the year.
- The central bank of Mexico kept its policy rate unchanged at 11.00% in May. While the new monetary forward guidance suggests a rate cut in the next meeting (June 27) is likely (assuming no ugly inflation surprises), the statement's hawkish tone on the inflation environment suggests a another pause cannot be discarded after the June meeting. As a result, we increased our end of 2024 and 2025 policy rate forecast to 10.00% (previously at 9.75%) and 8.00% (from 7.75%), respectively.

AMLO's reforms stuck in Congress

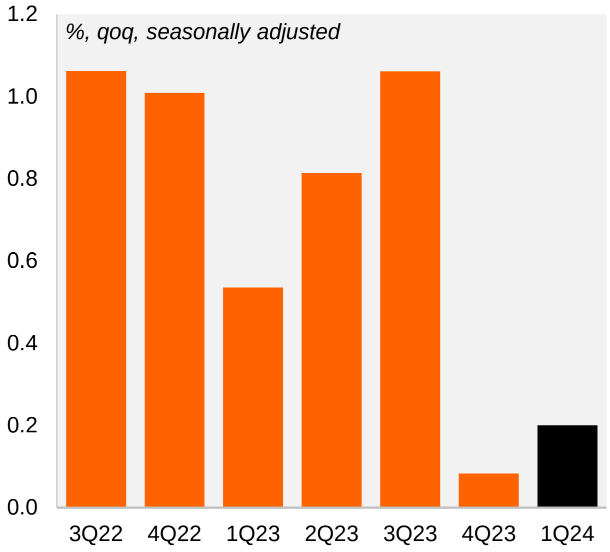
Congress did not formally begin discussing AMLO's legacy reforms in the ordinary legislative period, which ended on April 30. AMLO sent twenty reforms to Congress several months ago, including proposals calling for higher pension replacement rates, constitutional protection to several social programs, and changes to the appointment process for judges (see our note for further details), among others. Said reforms were only discussed in open parliament, where experts commented, but Congress did not present them to congressional commissions to start formal proceedings. While the current Congress can still call for an extraordinary legislative session (until August 31), we think the odds of that taking place are low given the ongoing process of general elections. If the new president wants to continue with AMLO's legacy reforms, the proposals would need to be presented again to the new Congress, which would start September 1. In our view, these reforms had the purpose of boosting the ruling-party candidates during the current election. They will likely also serve as a guide for the next president's term. According to the Bloomberg poll tracker, Claudia Sheinbaum (the governing coalition's candidate), leads preferences with an average lead of 30 percentage points over second-place Xochitl Galvez (opposition coalition candidate).

However, Congress approved two reforms, proposed by ruling-party members, which are likely to be ruled unconstitutional. First, Congress approved an initiative that would create a fund using unclaimed resources from pension-fund affiliates. This reform complements AMLO's pension reform mentioned above, which would use the resources from the proposed fund to increase pension replacement rates. The second approved initiative limits the power of the judiciary, precluding judges from halting public works, decrees, and regulations as a precautionary measure when there is possible violation of rights. These reforms could be appealed in courts (with a possible suspension) and eventually end up in the supreme court for a ruling.

Weak 1Q24 GDP, despite strong February

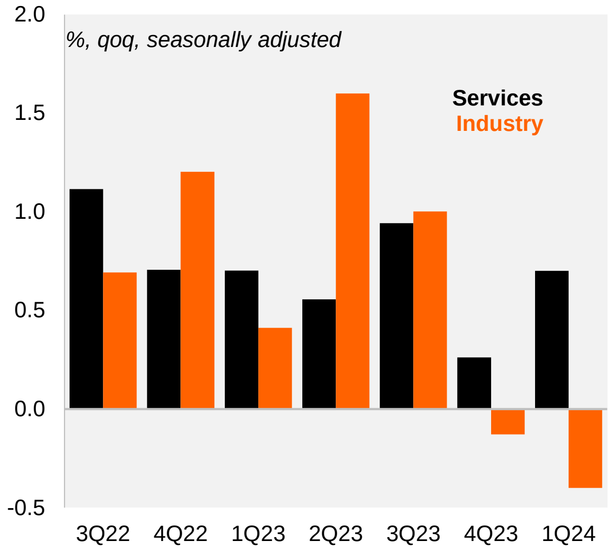
After a weak activity print at the beginning of the year, monthly GDP rebounded strongly in February. The monthly GDP grew 1.4% mom/sa driven by a surprisingly strong primary output (16.5%) and a sound services sector (1.5%, after a weak -0.5%). The latter is consistent with strong fiscal spending in 1Q24, especially in subsidies & transfers. Still, given the downside surprise in activity in January, we will likely have a soft GDP print in 1Q24. In fact, the flash GDP estimate for 1Q24 from Mexico's statistics institute (INEGI) points to a seasonally adjusted sequential expansion of 0.2%, compared with our initial forecast of 0.4%. The quarterly GDP flash estimate implies the monthly GDP expanded further in March (1.2% mom/sa) driven by a resilient services sector (0.9%).

Soft GDP in 1Q24



Source: INEGI, Itaú

..dragged by industrial production, but sound services sector



Source: INEGI, Itaú

Signaling a rate cut, but hawkish on inflation

In the monetary policy meeting held in May, the central bank of Mexico kept its policy rate unchanged at 11.00%, yet signaled a rate cut along with a hawkish tone on the inflation outlook. The monetary forward guidance was changed slightly, adding the word "adjustments", which in our view opens the possibility for a rate cut in the June meeting: "*Looking ahead, it will assess the inflationary environment in order to discuss reference rate adjustments*". The real ex-ante rate currently stands at 7.19%, well above Banxico's 2.6% neutral real rate, and the highest among major economies in the region. However, the statement noted that inflationary shocks will dissipate at a slower pace, leading to higher headline and core inflation forecasts for the next six quarters. Also, the new projection implies a delay in the convergence of headline inflation to the 3% target to the 4Q25, instead of 2Q25. The communique emphasized that services inflation is expected to be more persistent, relative to previous forecasts.

Higher rates

Even though we revised our call for higher growth in the U.S., a weaker start in economic activity in Mexico led us to reduce our 2024 GDP growth forecast to 2.3% (from our previous estimate of 2.8%). Still, we expect sequential GDP growth to improve in 2Q24, supported by an expansionary fiscal stance concentrated in the first half of the year. A favorable evolution of the U.S. economy will also be a driver for activity this year, although curbed by a still-strong peso. Our end-of-year currency forecast is at 17.9 pesos to the U.S. dollar.

We revised our year-end inflation forecasts for 2024 and 2025 up to 4.3% (previously at 4.2%) and 3.9% (from 3.7%) respectively, on the back of higher energy prices.

While the new monetary forward guidance suggests a rate cut in the next meeting (June 27) is likely (assuming no ugly inflation surprises), the statement's hawkish tone on the inflation environment suggests another pause cannot be discarded after the June meeting. As a result, we increased our end of 2024 and 2025 policy rate forecast to 10.00% (previously at 9.75%) and 8.00% (from 7.75%), respectively, also considering the increasing uncertainty of the start of Fed's easing cycle.

Our trade balance forecasts for 2024 and 2025 are now a deficit of USD 14 billion (previously a deficit of USD 17 billion) and a deficit of USD 17 billion (previously a deficit of USD 20 billion), respectively. Consistently, we adjusted our current account balance forecasts for 2024 and 2025 to a deficit of 0.6% of GDP (previously at a deficit of 0.7% of GDP) and a deficit of 0.7% of GDP (previously at a deficit of 0.8% of GDP), respectively. The improvement in our external-account estimates reflect a smaller-than-expected evolution of the trade deficit in 1Q24 and improved U.S. GDP growth prospects, although limited by still-strong MXN.

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Mexico | Forecast

	2019	2020	2021	2022	2023	2024F		2025F	
						Current	Previous	Current	Previous
Economic Activity									
Real GDP growth - %	-0.3	-8.6	5.7	3.9	3.2	**2.3**	2.8	**1.9**	1.8
Nominal GDP - USD bn	1,300	1,129	1,313	1,464	1,796	**2,035**	2,043	**2,016**	2,019
Population (millions)	125.6	127.7	129.0	130.1	131.2	**132.3**	132.3	**133.4**	133.4
Per Capita GDP - USD	10,352	8,844	10,183	11,248	13,688	**15,382**	15,442	**15,120**	15,143
Unemployment Rate - year avg	3.5	4.4	4.1	3.3	2.8	**2.7**	2.7	**2.7**	2.7
Inflation									
CPI - %	2.8	3.2	7.4	7.8	4.7	**4.3**	4.2	**3.9**	3.7
Interest Rate									
Monetary Policy Rate - eop - %	7.25	4.25	5.50	10.50	11.25	**10.00**	9.75	**8.00**	7.75
Balance of Payments									
MXN / USD - eop	18.9	19.9	20.5	19.5	17.0	**17.9**	17.9	**18.9**	18.9
Trade Balance - USD bn	5.4	34.2	-10.8	-26.9	-5.5	**-14.0**	-17.0	**-17.0**	-20.0
Current Account - % GDP	-0.3	2.4	-0.3	-1.2	-0.3	**-0.6**	-0.7	**-0.7**	-0.8
Foreign Direct Investment - % GDP	2.3	2.8	2.6	2.7	1.7	**3.0**	3.0	**3.5**	3.5
International Reserves - USD bn	180.9	195.7	202.4	199.1	212.8	**210.0**	210.0	**215.0**	215.0
Public Finances									
Nominal Balance - % GDP	-1.6	-2.8	-2.8	-3.2	-3.3	**-5.0**	-5.0	**-2.5**	-2.5
Net Public Debt - % GDP	43.8	50.0	49.0	47.6	46.8	**49.9**	49.9	**50.3**	50.3

Source: IMF, Bloomberg, INEGI, Banxico, Haver and Itaú

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