

Mexico in the face of slowing emerging economies

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BANCO DE MÉXICO

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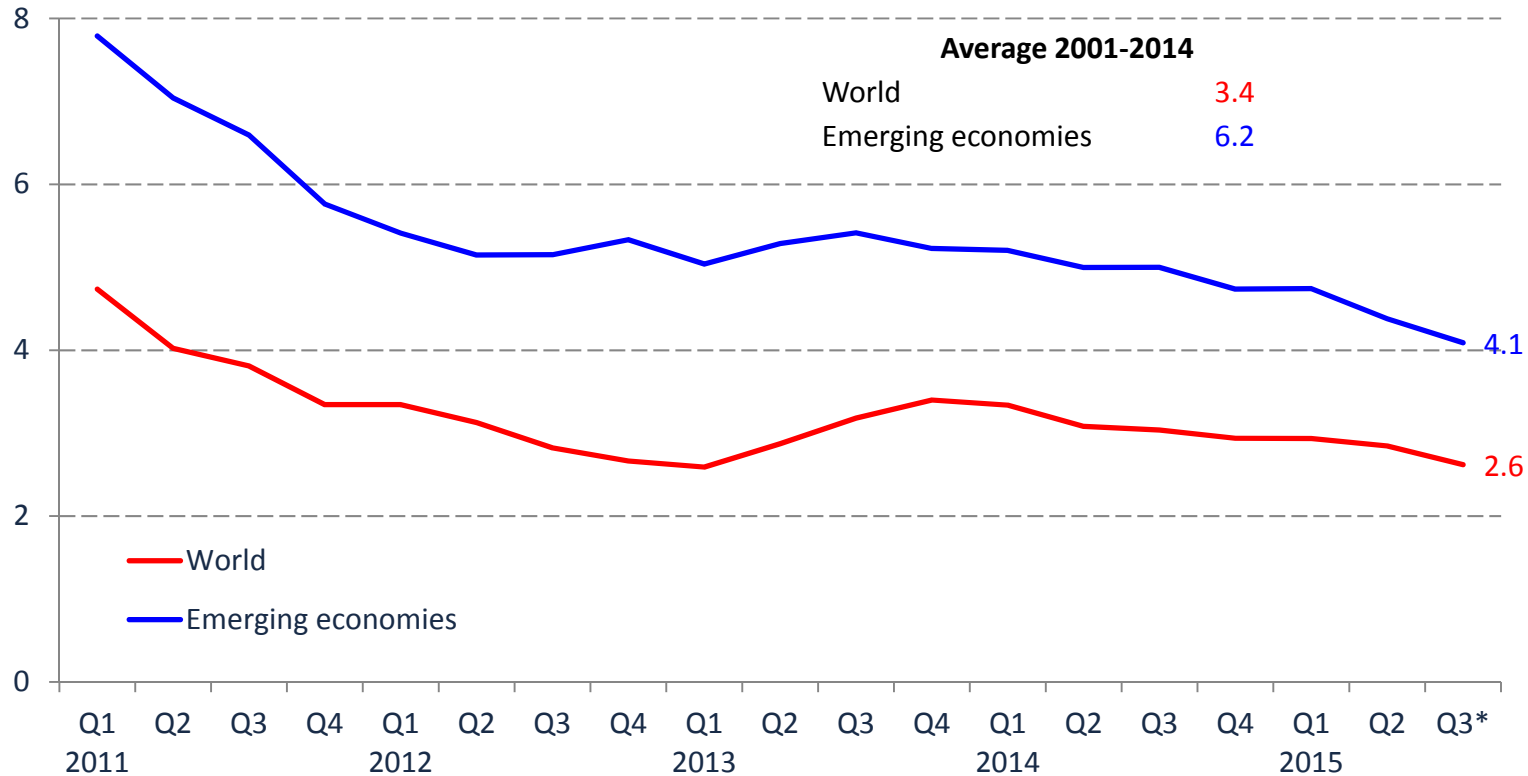
1 Soft economic rebound

2 Coping with higher risk aversion

3 Tamed inflation

Since 2014, global growth has been slowing, largely reflecting trends in emerging economies

World and emerging economies: GDP¹
Weighted average YoY % change, s.a.

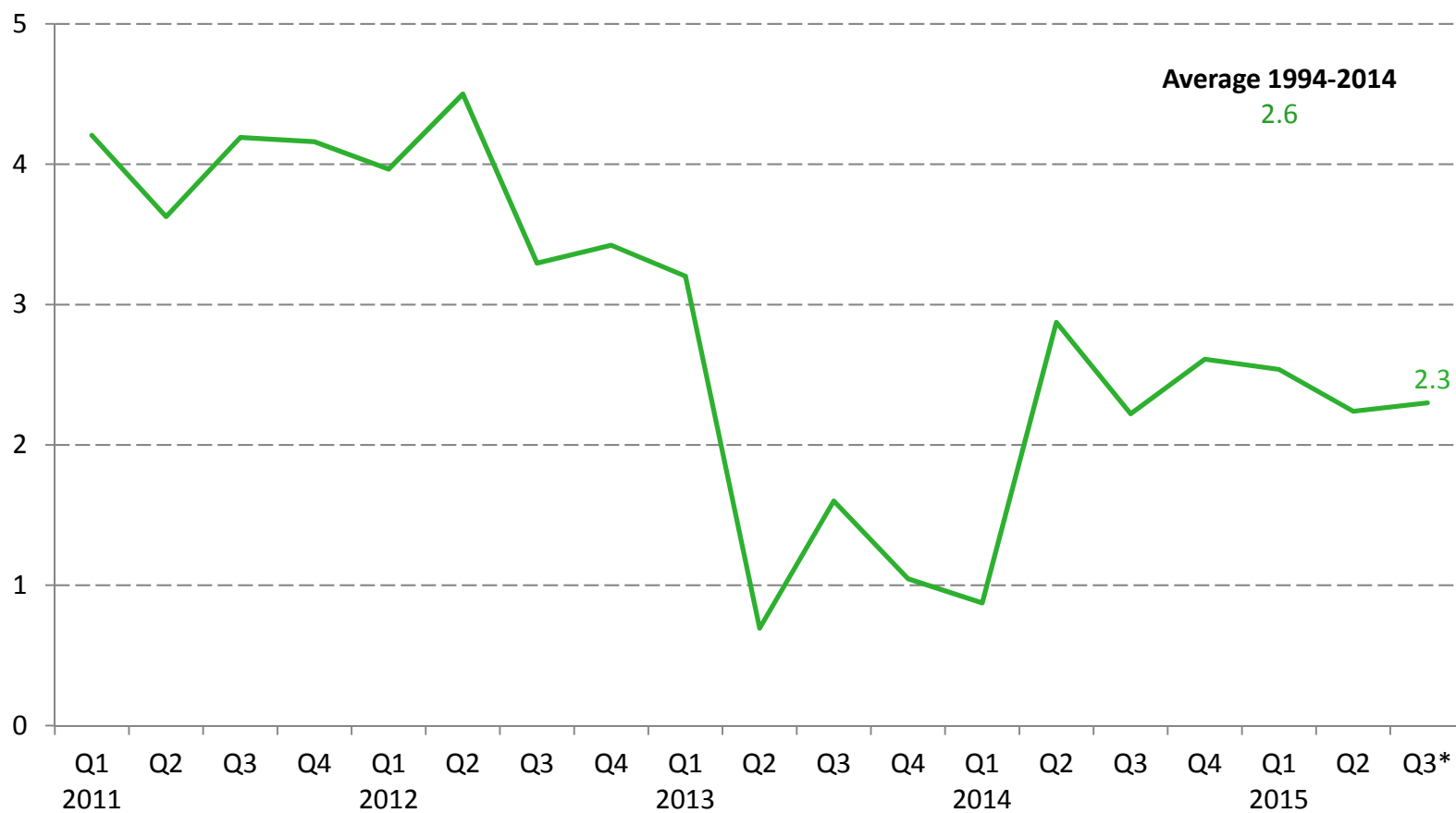


1/ Emerging economies are Brazil, Chile, China, Colombia, Czech Rep., Denmark, Hong Kong, Hungary, India, Indonesia, South Korea, Malaysia, Mexico, Peru, the Philippines, Poland, Russia, Singapore, South Africa, Taiwan, Thailand and Turkey. World equals emerging economies plus the following advanced economies: Australia, Canada, Eurozone, Japan, Norway, Sweden, Switzerland, United Kingdom and United States. */ Estimated for some countries. Denmark and Switzerland are not included s.a. / Seasonally adjusted

Source: Own calculations based on Haver Analytics, JP Morgan and WEO, IMF

In Mexico, a GDP rebound has been restrained by domestic and external shocks

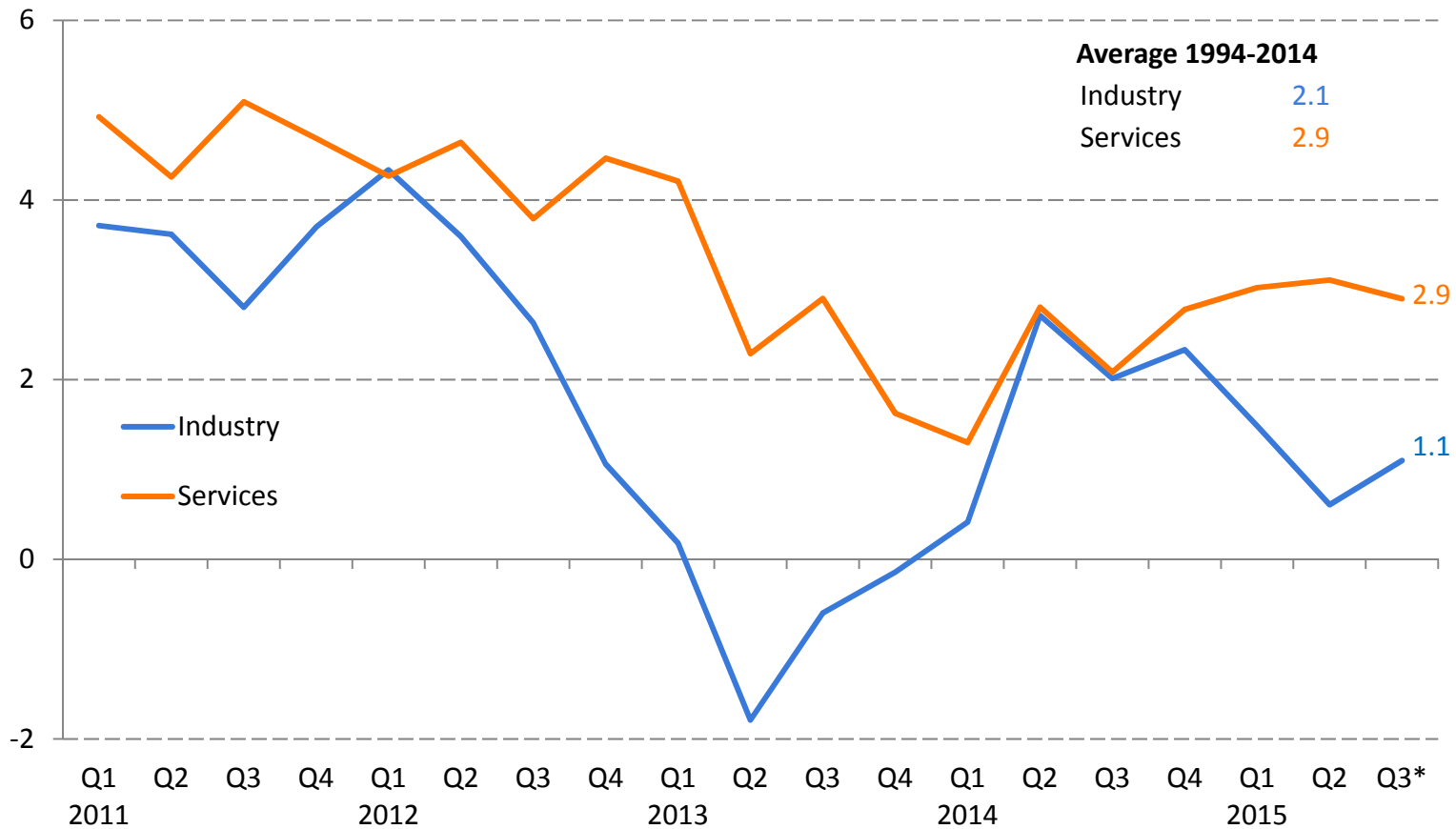
Mexico: GDP
YoY % change, s.a.



* / Flash estimate
s.a. / Seasonally adjusted
Source: INEGI

In particular, industrial production has been less dynamic

Mexico: GDP by sector
YoY % change, s.a.



*/ Flash estimate
s.a. / Seasonally adjusted
Source: INEGI

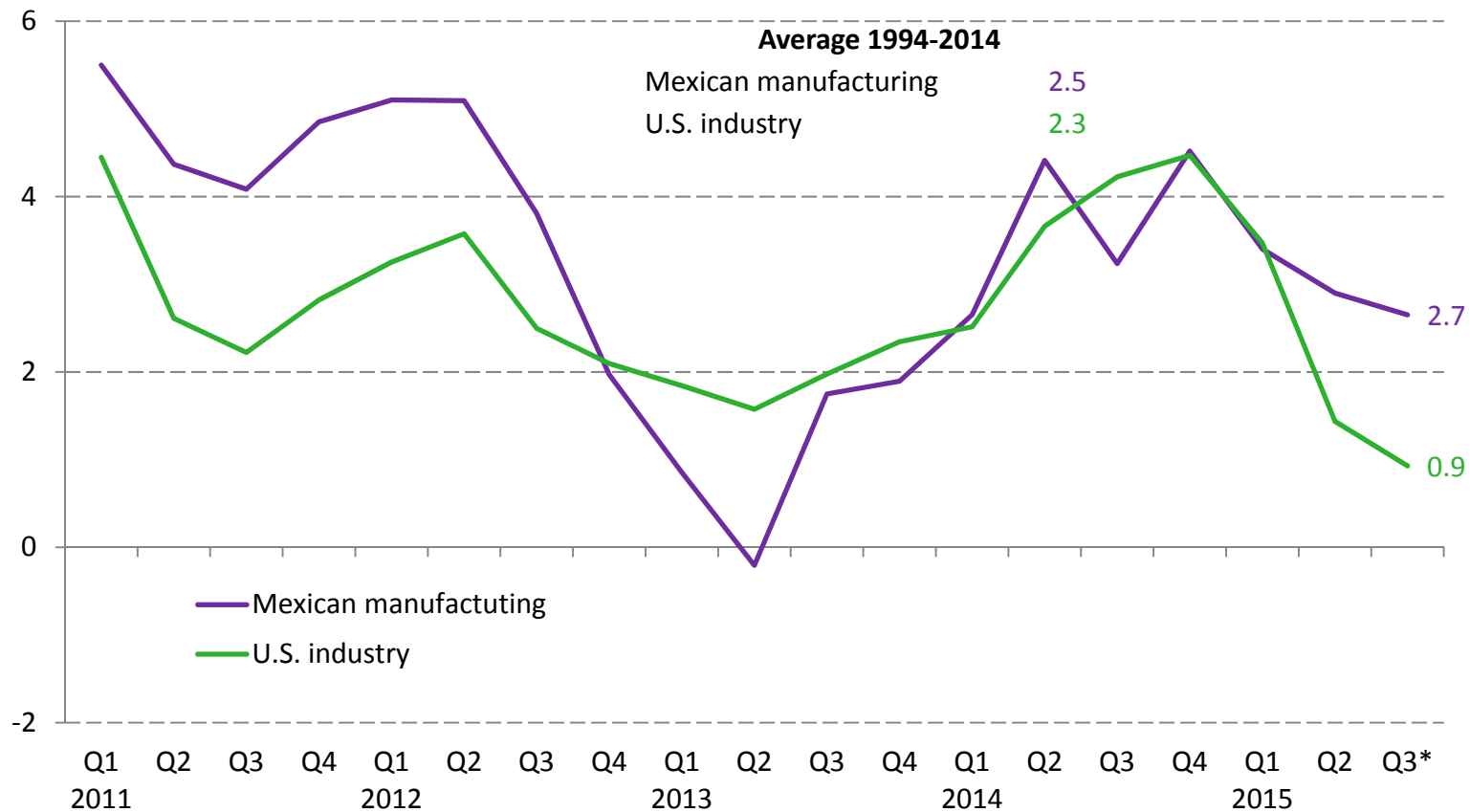
... resulting notably from a contraction in mining,
related to lower oil output



*/ Based on the July-August average of the Global Economic Activity Indicator
s.a. / Seasonally adjusted
Source: INEGI

Additionally, slower U.S. industrial production has weighed on Mexican manufacturing output

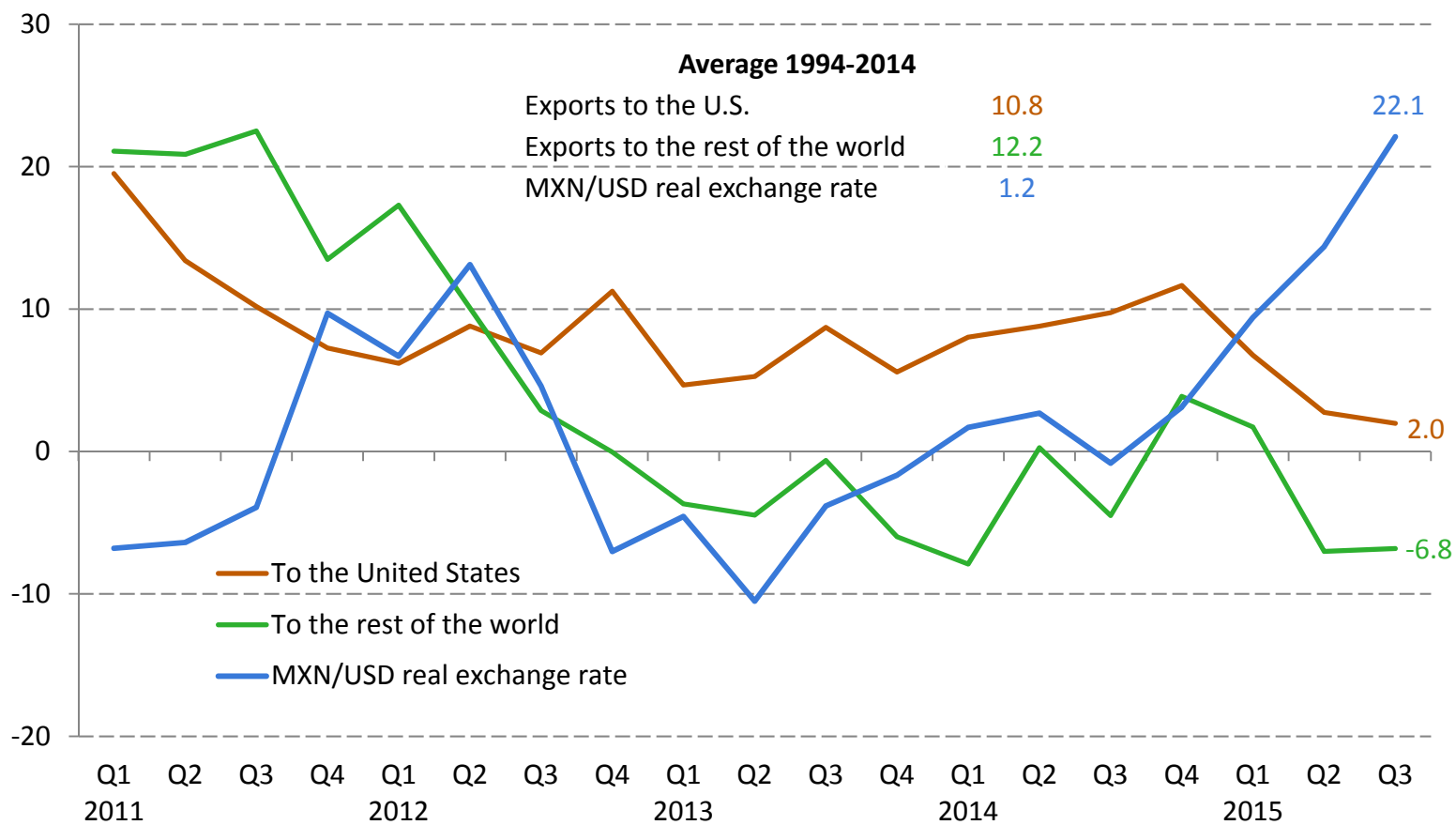
The United States and Mexico: Production
YoY % change, s.a.



*/ Mexican manufacturing based on the July-August average
s.a. / Seasonally adjusted
Source: INEGI and the U.S. Federal Reserve

... which has coincided with lower growth in the dollar value of manufacturing exports, in spite of significant real peso depreciation

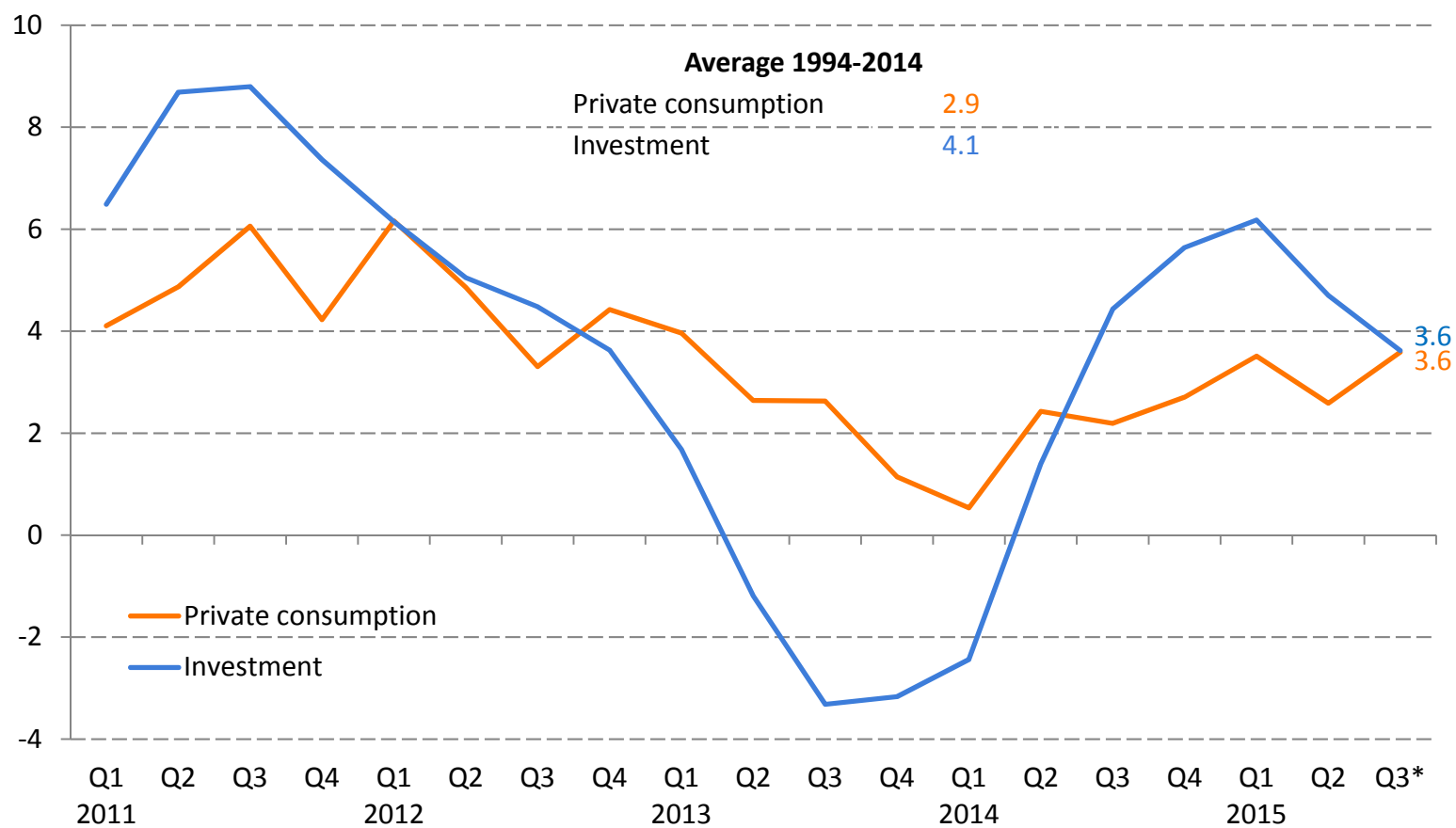
Mexico: Manufacturing exports and the real exchange rate
YoY % change, s.a.



s.a. / Seasonally adjusted
Source: Banco de México

Furthermore, domestic spending has proceeded at a measured pace

Mexico: Private consumption and investment
YoY % change, s.a.



*/ July-August average
s.a. / Seasonally adjusted
Source: INEGI

A gradual recovery this year and in 2016 is expected for Mexico on the back of that of the United States

The United States and Mexico: Growth forecasts
%

	2014	2015 ^F	2016 ^F	2017 ^F
U.S. Industrial production <i>Blue Chip</i>	3.7	1.5	2.1	2.8
Mexico's GDP <i>Banxico survey</i>	2.1	2.3	2.8	3.3
Mexico's GDP <i>Banxico</i>	2.1	1.9 – 2.4	2.5 – 3.5	3.0 – 4.0

F/ Forecast

Source: Blue Chip and Banco de México (2015), *Survey of private-sector economic analysts' expectations and Informe Trimestral, Julio – Septiembre 2015*

Downside risks to the growth scenario may prevail

- Lower-than-anticipated U.S. industrial production growth
- Damped automobile production stemming from legal restrictions on a large assembler
- A further drop in oil production
- Additional deterioration of producer sentiment

Mexico's reform agenda should encourage long-term productivity growth

- Some data indicate initial benefits in the form of higher investment and lower prices in telecoms and energy
- The effect with the greatest significance, however, should be higher long-term productivity growth
- This impact necessarily requires time and hinges on the quality of reform implementation

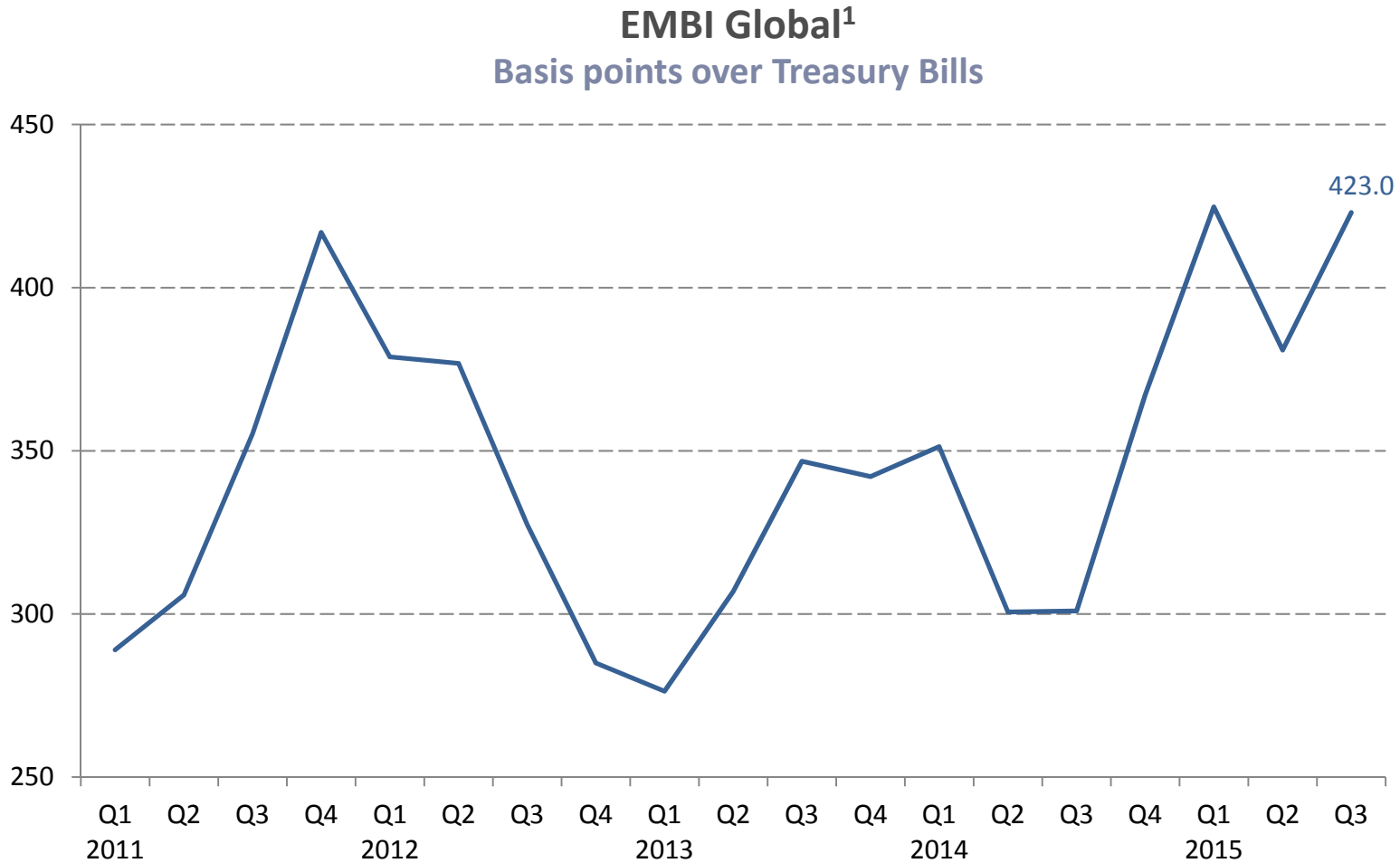
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Uncertainty on U.S. monetary policy and China's prospects have increased risk aversion towards emerging economies

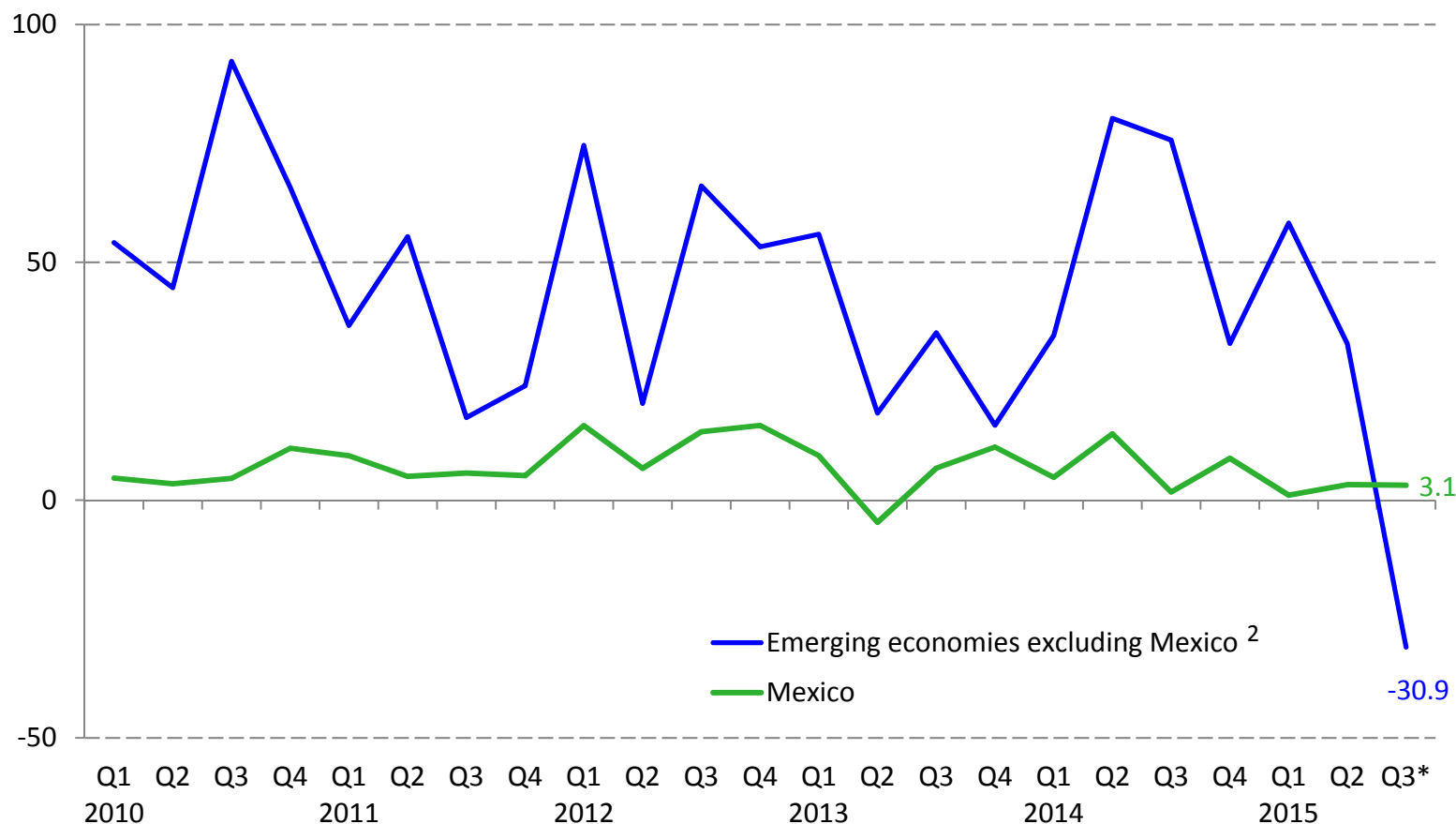


1/ The EMBI Global is a benchmark index tracking the total return from traded emerging market external debt instruments considered sovereign and meeting certain liquidity and structural requirements

Source: JP Morgan

Hence, capital flows to emerging economies have contracted

Net portfolio flows to emerging economies¹
Billions of dollars by quarter



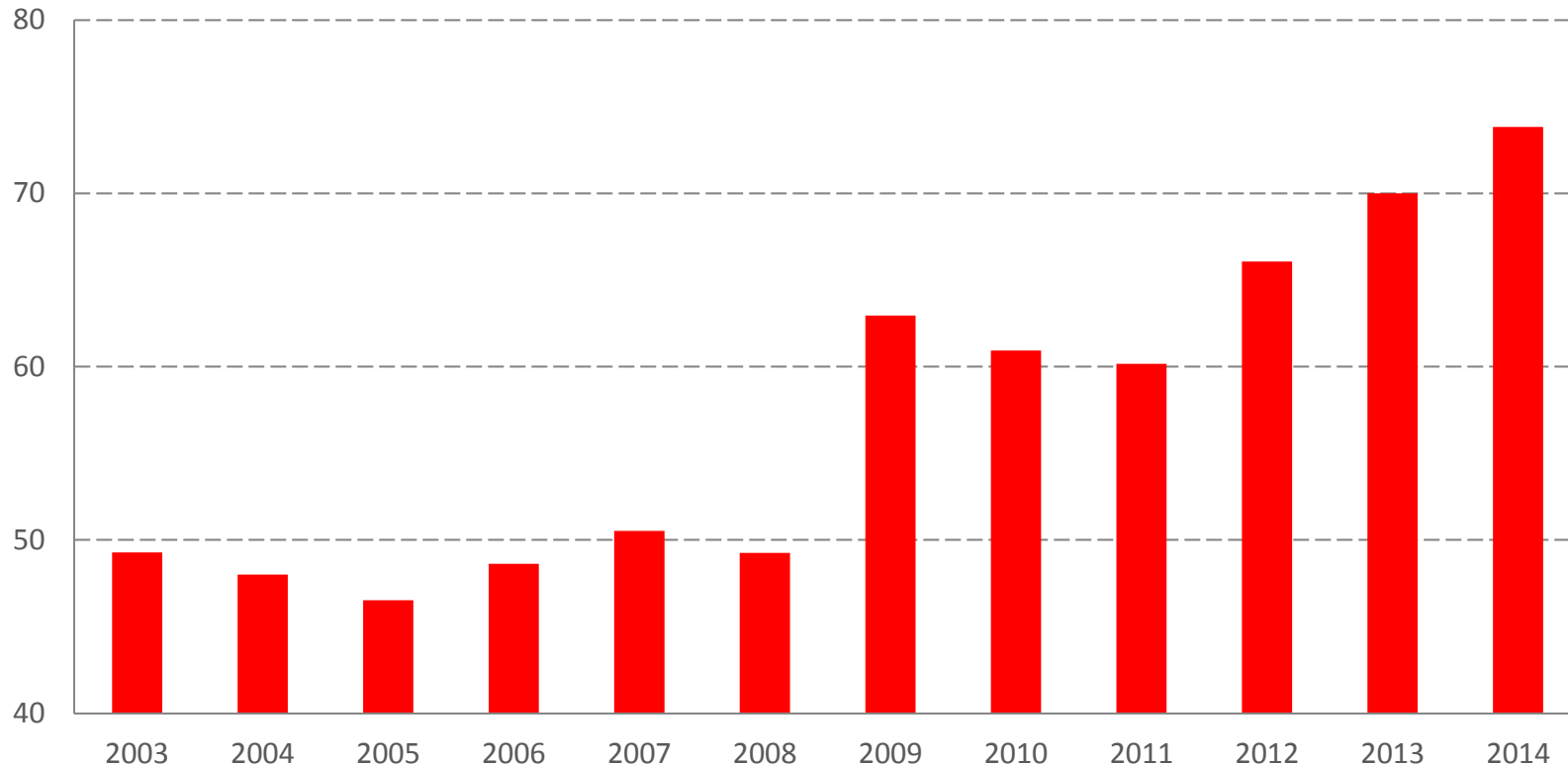
1/ Includes net non-resident purchases of emerging markets stocks and bonds as measured in the balance of payments

2/ Emerging economies excluding Mexico are China, India, Indonesia, South Korea, Philippines, Thailand, Brazil, Chile, Bulgaria, Czech Republic, Hungary, Poland, Turkey, Ukraine and South Africa. */ Based on available data

Source: Institute of International Finance

... in the context of an already high corporate leverage in emerging economies

Emerging economies: Corporate debt¹
% of GDP

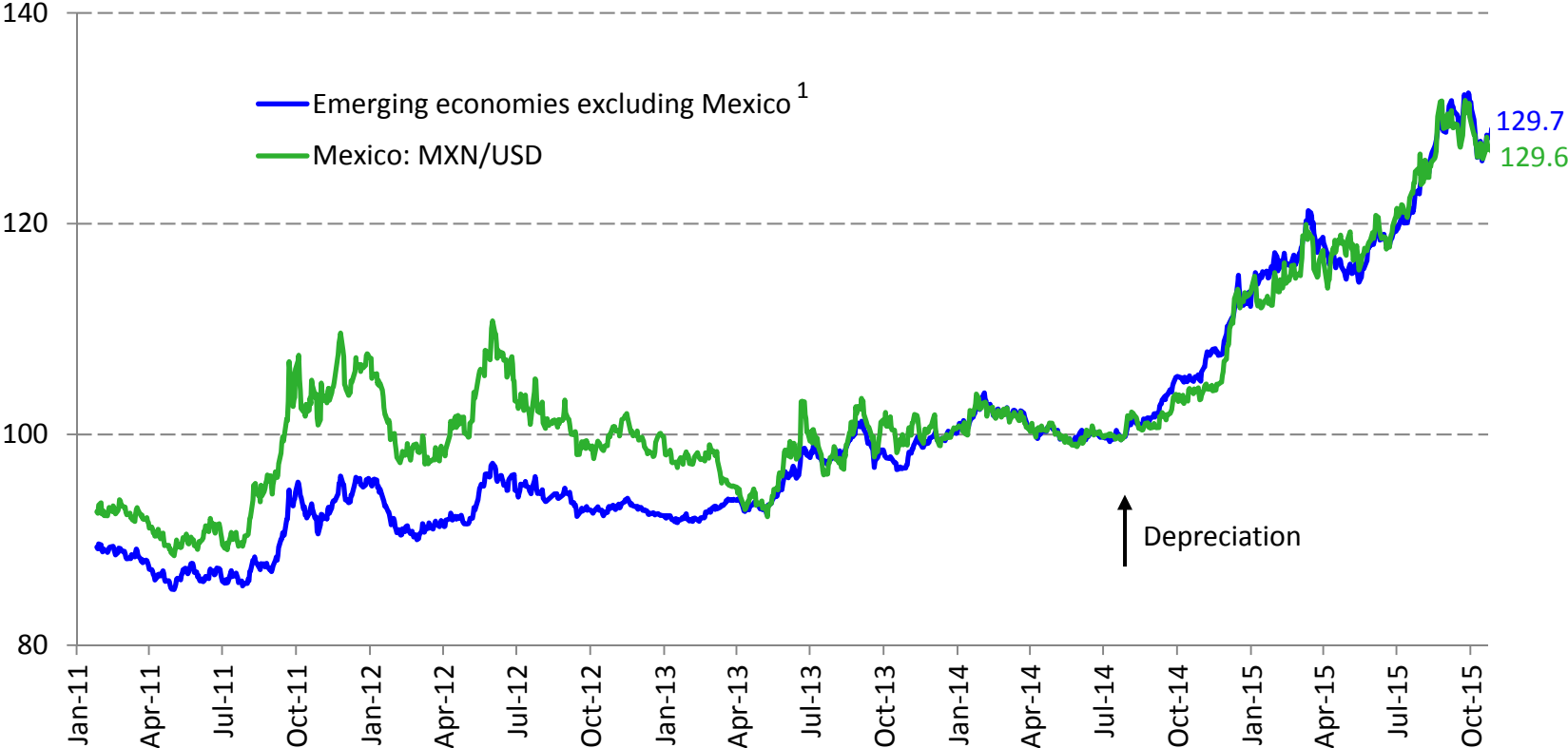


1/ Includes bank loans and bond financing for Argentina, Bahrain, Brazil, Bulgaria, Chile, China, Colombia, Croatia, Egypt, Hungary, India, Indonesia, Jordan, Kazakhstan, South Korea, Kuwait, Lebanon, Lithuania, Malaysia, Mauritius, Mexico, Morocco, Nigeria, Oman, Pakistan, Peru, Philippines, Poland, Qatar, Romania, Russia, Saudi Arabia, Serbia, South Africa, Sri Lanka, Thailand, Turkey, Ukraine, United Arab Emirates, and Venezuela

Source: IMF (2015). Global Financial Stability Report, Chapter 3

In Mexico, as in other EMEs, international financial pressures have mainly been absorbed through the exchange rate

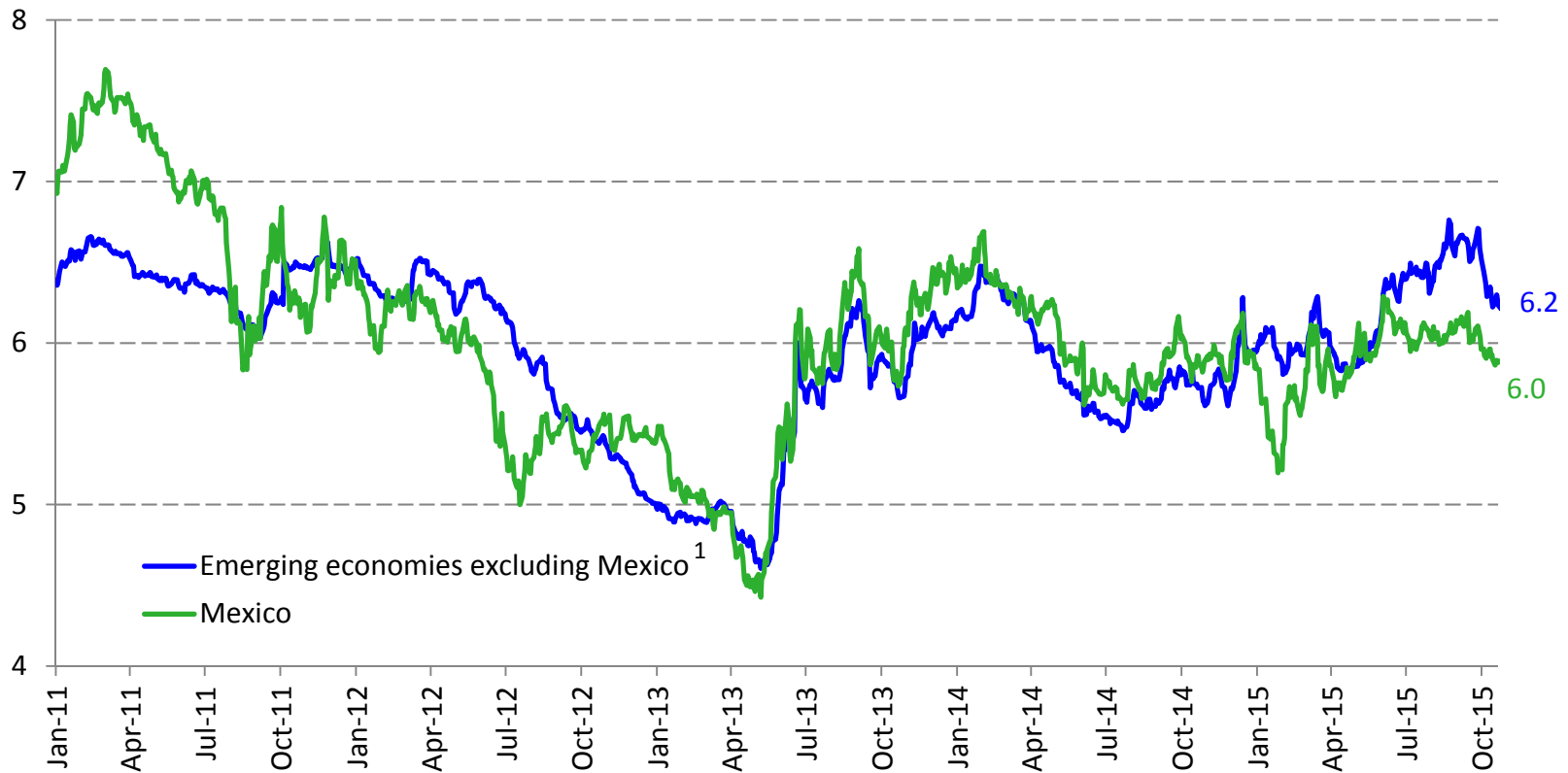
Mexico and emerging economies: Local currency per U.S. dollar
 June 2014 = 100



1/ Emerging economies excluding Mexico means the unweighted average of currencies encompassing the Chinese yuan, Russian ruble, Turkish lira, South Korean won, South African rand, Brazilian real, Indian rupiah, Polish zloty, Hungarian florin, Malaysian ringgit, Thai baht, Chilean peso, Indonesian rupiah, Philippine peso, Colombian peso, and Peruvian nuevo sol
 Source: Bloomberg

... while market interest rates have remained less affected

Mexico and emerging economies: 10-year interest rate
%

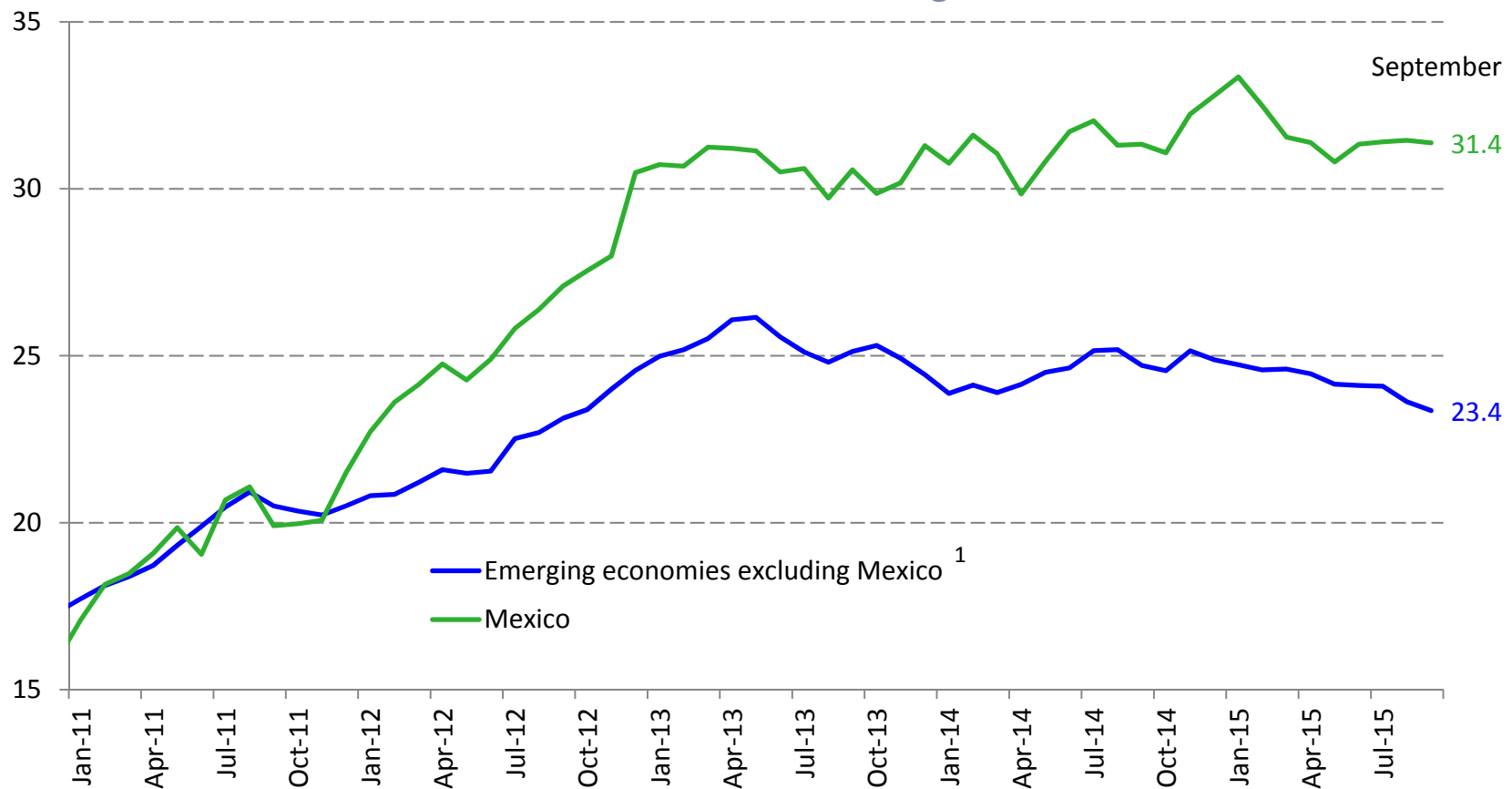


1/ Emerging economies excluding Mexico means the unweighted average of rates in Brazil, Bulgaria, Chile, China, Colombia, the Czech Republic, Hungary, India, Indonesia, South Korea, Malaysia, Nigeria, Peru, the Philippines, Poland, Romania, Russia, South Africa, Thailand, Turkey and Venezuela

Source: Bloomberg

Mexico has been somewhat differentiated by the stability of foreign holdings of local-currency government securities

Emerging economies and Mexico: Nonresident holdings of local-currency-denominated government securities
% of total outstanding

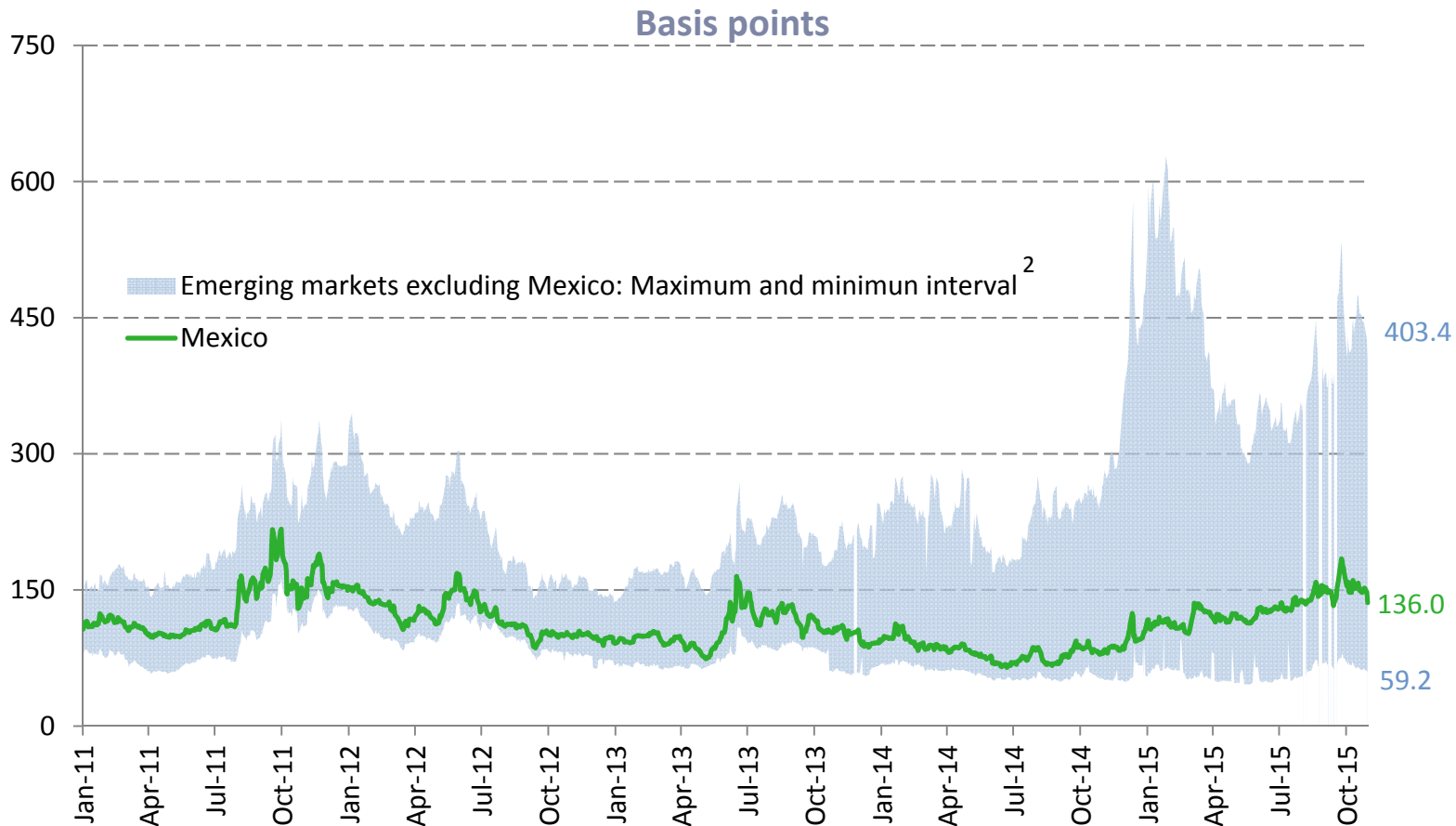


1/ Emerging economies excluding Mexico means the unweighted average of securities shares in Brazil, Colombia, Hungary, Indonesia, Israel, Malaysia, Peru, Poland, Russia, South Africa, South Korea, Thailand and Turkey

Source: Finance ministries, central banks and other national authorities

Although slightly rising, country risk perception continues to be on the lower side within emerging economies

Emerging economies: Sovereign credit risk¹



1/ Five-year credit default swaps are defined as default insurance instruments. 2/ Based on available data from Brazil, Chile, China, Colombia, South Korea, Peru, Poland, Russia, South Africa, and Turkey

Source: Bloomberg

With more financial uncertainty likely, Mexico needs to stand out further from other emerging economies

- Growth
 - ✓ Structural reforms implemented well and deeply
 - ✓ Stricter rule of law and enhanced public security
- Macroeconomic policy
 - ✓ Public-debt-to-GDP ratio kept sustainable
 - ✓ Monetary policy adjusted in a timely way
- Monetary policy will continue to consider the relative stance vs. the United States, among other factors

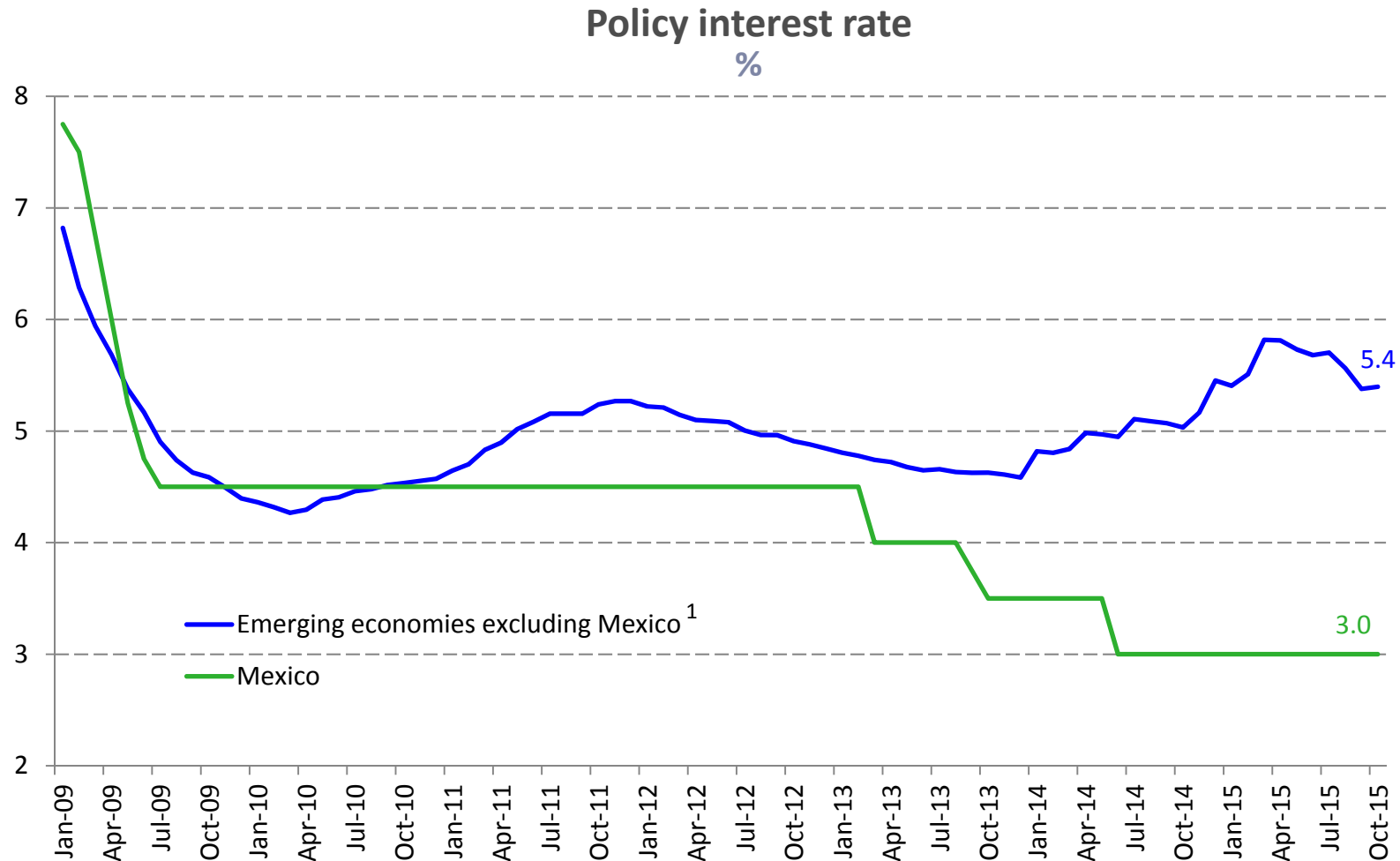
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Given soft economic activity, Mexico's monetary policy interest rate has been cut

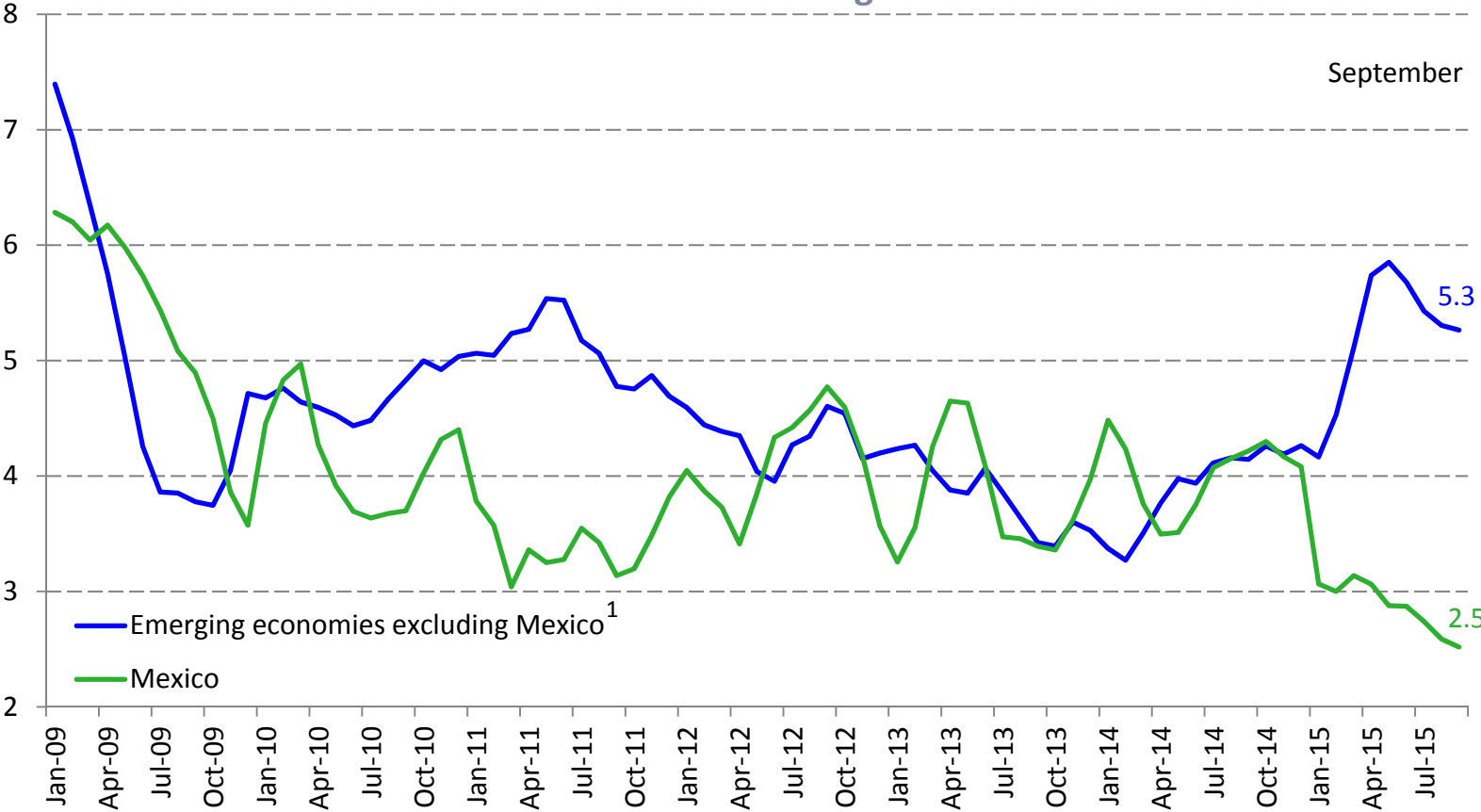


1/ Emerging economies excluding Mexico means the unweighted average of inflation in Brazil, Bulgaria, Chile, China, Colombia, the Czech Republic, Ecuador, Egypt, Hungary, India, Indonesia, South Korea, Lebanon, Malaysia, Morocco, Nigeria, Peru, the Philippines, Poland, Romania, Russia, Saudi Arabia, South Africa, Thailand, Turkey, Ukraine and the United Arab Emirates

Source: Haver Analytics

Mexican inflation has headed down, reaching all-time lows this year

Emerging economies and Mexico: CPI
Annual % change

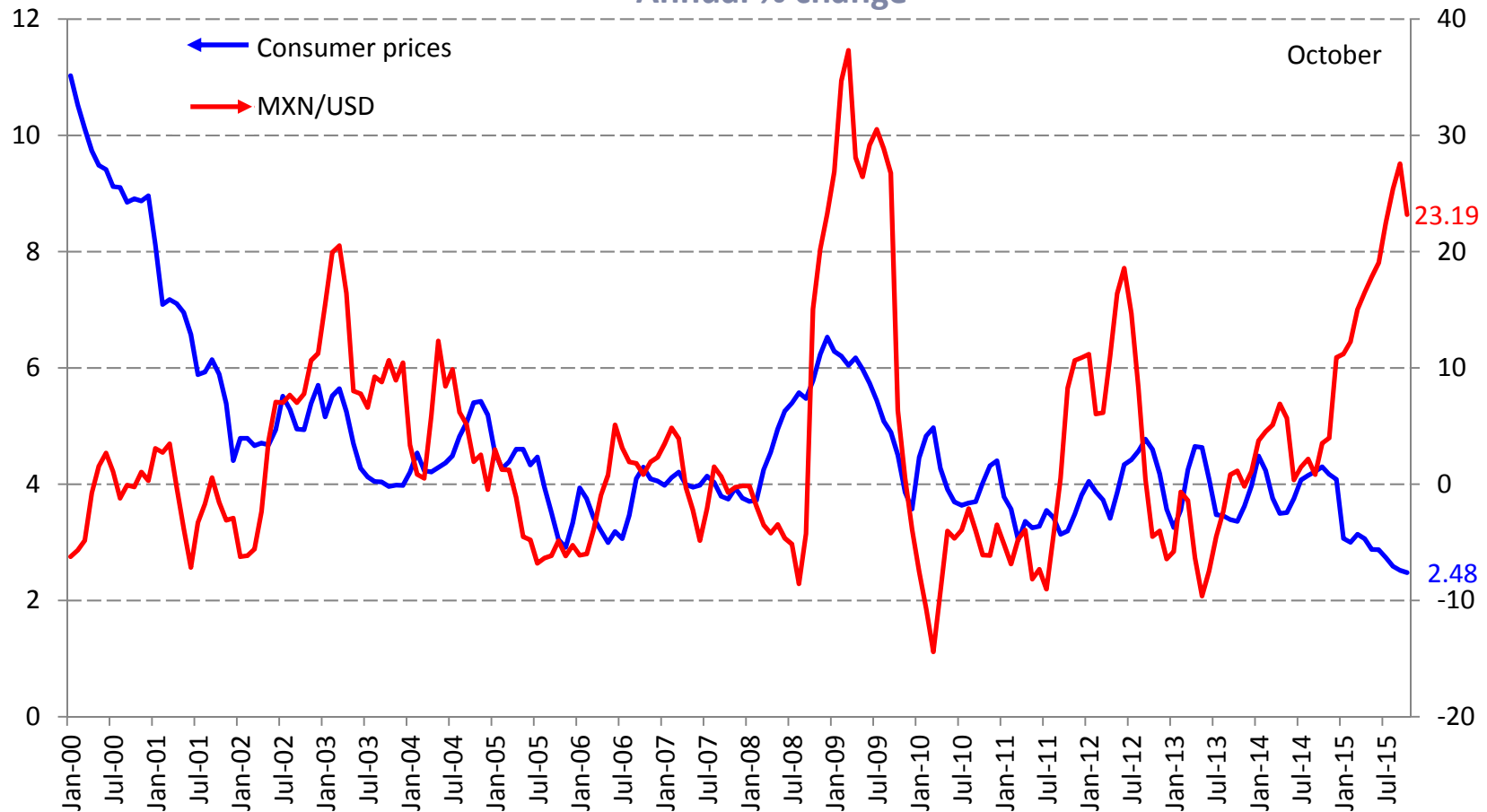


1/ Emerging economies excluding Mexico means the unweighted average of inflation in Brazil, Bulgaria, Chile, China, Colombia, the Czech Republic, Ecuador, Egypt, Hungary, India, Indonesia, South Korea, Lebanon, Malaysia, Morocco, Nigeria, Peru, the Philippines, Poland, Romania, Russia, Saudi Arabia, South Africa, Thailand, Turkey, Ukraine and the United Arab Emirates

Source: IMF and Haver Analytics

Pass-through from peso depreciation to prices has been modest

Mexico: Consumer prices and the nominal exchange rate¹
Annual % change



1/ Monthly average for the exchange rate

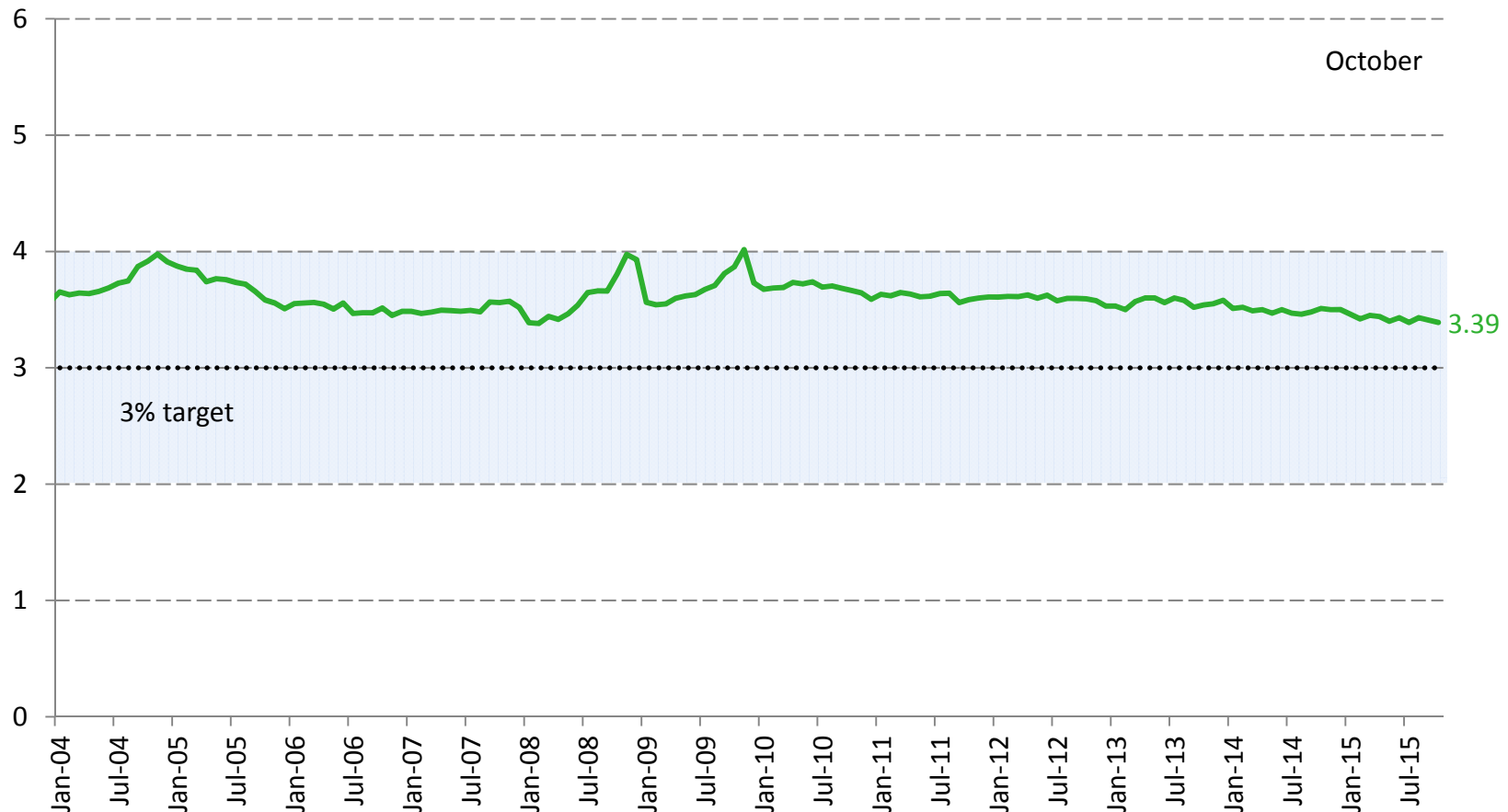
Source: Banco de México

Upside risks to the inflation outlook must be monitored, especially given the possibility of second-round effects

- Persistent peso weakness, with greater pass-through to prices and second-round effects
- Less favorable performance from energy and agricultural prices
- Incipient pressures from aggregate demand, in a context of unknown potential GDP

Anchoring of medium-term inflation expectations on the target remains a challenge

Mexico: Inflation expectations for one to four years ahead
Average forecast, %



Source: Banco de México, *Survey of private-sector economic analysts' expectations*

Final remarks

- In the context of slowing emerging economies and sluggish global growth, Mexico's GDP rebound has been restrained by domestic and external shocks
- On the back of higher expected growth for U. S. industrial production, Mexico is forecast to post a gradual recovery
- With more financial uncertainty likely, Mexico needs to stand out further from other emerging economies
- Mexican inflation has headed down, reaching all-time lows in 2015
- Upside risks to inflation must be monitored, given the possibility of second-round effects, in order to consolidate convergence to the target



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