Mexico's better growth outlook – We now forecast GDP to grow 1.9% in 2017

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- **The Mexican economy has shown not only resiliency, but strength during the first half of the year due to the following factors:**
  - **(1) Lower uncertainty around the impact of Trump's policies on the Mexican economy;**
  - **(2) A quicker recovery of the manufacturing industry; and**
  - **(3) Higher growth dynamics in household spending, which has been reflected in the upward trend of the services sector**
- **Given the abovementioned factors, we know forecast that the Mexican economy will grow 1.9% yoy in 2017, from previously at 1.6%**
- **However, we consider that there are still certain risks ahead, where we highlight:**
  - **(1) Geopolitical risks;**
  - **(2) Uncertainty regarding NAFTA renegotiation;**
  - **(3) A marginal slowdown in households' spending due to the uptick in inflation; and**
  - **(4) Lower investment and a deeper decline in Mexico's oil output;**
- **Looking ahead, we maintain a more positive outlook for the growth prospects of the Mexican economy**

We now forecast a 1.9% growth for the Mexican economy in 2017. The Mexican economy has shown not only resiliency, but strength during the first half of the year due to the following factors: (1) Lower uncertainty around the impact of Trump's policies on the Mexican economy; (2) a quicker recovery of the manufacturing industry; and (3) higher growth dynamics in household spending, which has been reflected in the upward trend of the services sector. Given these factors, we revised our GDP growth forecast of 2017 to 1.9% from 1.6% (refer to the Annex in the fourth page).

Lower uncertainty. During recent months, market participants have discounted lower uncertainty around the impact of Trump's policies on the Mexican economy. Particularly, in the case of family remittances, financial reality has prevailed with regard of taxation of those flows. On the other hand, we forecast a brighter outlook for the renegotiation of NAFTA, especially considering the recently published objectives from the Office of the US Trade Representative (USTR) to renegotiate the treaty (refer to: *NAFTA renegotiation – USTR objectives provide a brighter outlook* <here>).

Fast recovery in manufacturing output. The recovery of the Mexican manufacturing industry during the first half of the year has been marginally higher than our previous forecasts, which has been partially supported by the uncertainty surrounding the future of the US-Mexico trade relationship, resulting in a greater flow of manufacturing exports during the first half of the year. Going forward, we believe that this trend will continue throughout the second half of the year, albeit at a slower pace, as the uncertainty dissipates.

Greater dynamism of Mexican household spending. Both income and spending of Mexican households posted a higher growth during the first half of the year. In both cases, this expansion has been supported by the growth of the Mexican labor market and the dynamism of banking credit to the private sector. However, household consumption been higher than our initial projections, given that because we anticipated lower growth derived from the upward trajectory of inflation. In this context, our current estimate takes into account the strength of private consumption in the first half and a slight moderation during the second half of 2017.

Persisting risks. Despite today's revision to our growth forecast, we believe that certain risks persist that could limit Mexico's economic growth, such as:

(1) **Geopolitical risks:** It has become apparent that there are counterweights in the political framework of the United States, which have limited the most extreme actions of the Trump administration. Likewise, France did not choose Le Pen's populist option. However, there is a continuing political concern about the threats posed by the North Korean government and the Islamic State, which would also be reflected in greater volatility in financial markets;

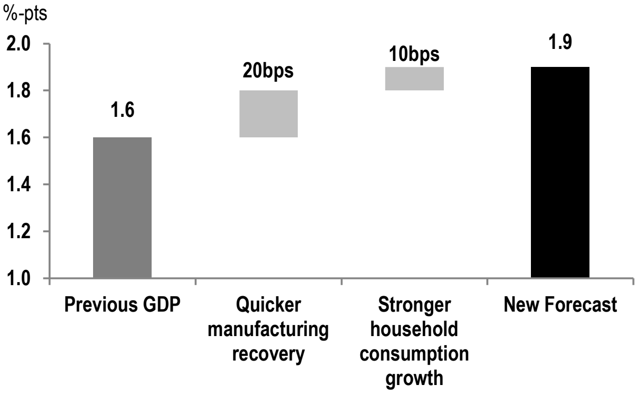
(2) **NAFTA renegotiation.** While there is still greater optimism about prospects for the renegotiation, particularly after the release of the objectives issued by the US Trade Representative's Office, it will not all be smooth sailing. Any difference that could trigger any of the participants to leave the negotiating table –however temporary–, could lead to greater volatility in both international and domestic financial markets;

(3) **Consumption and inflation:** Although we consider that private spending will continue to be one of Mexico's main growth drivers, we expect a marginal deceleration, as a result of inflation's upward trend. However, this will be partially offset by the higher growth of the labor market; and

(4) **Investment and oil production.** On the one hand, it is difficult to identify –at the aggregate level– in which part of the investment cycle we were before the electoral process that took place in the US, so there is no clarity about the duration and persistence of the investments made before last November, and thus when there will be a significant slowdown. This takes place in a context in which construction activity has been limited by the fall of public investment projects, given the fiscal consolidation effort of the Federal Government. In addition, we believe that the recession of the mining industry –mainly due to lower oil production– will continue during the second half of the year, which will continue to partially offset the positive effects of a higher manufacturing output.

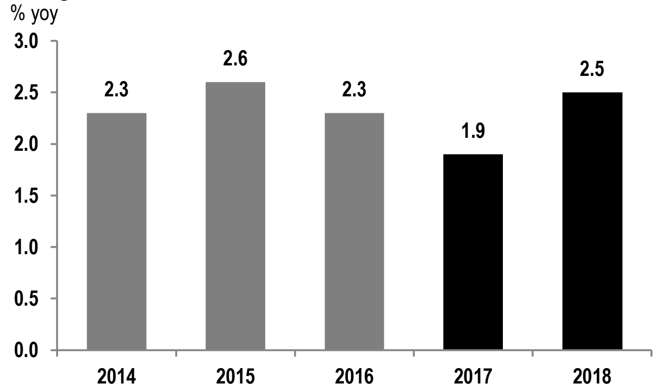
Looking ahead, we maintain a more positive outlook for the Mexican economy. The energy sector has been the biggest drag of the Mexican economy in the last three years. However, we believe that this sector will show a greater growth momentum. In particular, *Talos Energy* and *Sierra Oil & Gas*, recently announced that the Zama-1 exploration well in Block 7, has made an oil discovery equivalent to 1 billion barrels. We highlight that this is the first offshore well drilled by a private company in Mexico. In addition, we also highlight the good demand observed in the bids of rounds 2.2 and 2.3, in past days, with allocation percentages of 70% and 100%, respectively. These results suggest that domestic and international oil companies continue to show interest in Mexico's oil industry, despite the uncertain scenario around oil prices, where there is still a relative excess of supply and where OPEC members -and some guests- have had to agree on cuts in production in order to sustain the price at current levels.

New GDP forecast
%-pts



Source: Banorte-Ixe

GDP growth forecasts
% yoy



Source: Banorte-Ixe

Mexico's economic forecasts

GDP Forecasts: Supply-side equation
%

% yoy (nsa)	1Q17	2Q17	3Q17	4Q17	2017
GDP	2.8	1.5	1.8	1.6	1.9
Primary activities	6.6	0.2	1.3	3.0	2.8
Industrial production	0.5	-1.0	0.5	0.8	0.2
Manufacturing	-10.8	-8.6	-8.0	-8.2	-8.9
Construction	-0.3	-1.3	-1.3	-0.5	-0.8
Services	1.5	-1.9	-1.0	-0.6	-0.5
% qoq (sa)	**1Q17**	**2Q17**	**3Q17**	**4Q17**	
GDP	0.7	0.1	0.3	0.5	
Primary activities	1.1	0.4	0.5	0.3	
Industrial production	0.1	-0.3	0.1	0.4	
Manufacturing	0.2	-1.1	-0.5	0.8	
Construction	2.1	0.3	0.6	0.5	
Services	1.0	0.4	0.5	0.5	

Source: Banorte-Ixe

GDP Forecasts: Demand-side equation
%

% yoy (nsa)	1Q17	2Q17	3Q17	4Q17	2017
GDP	2.8	1.5	1.8	1.6	1.9
Private consumption	3.1	2.7	2.1	1.7	2.4
Government consumption	0.9	-1.0	1.2	1.6	0.7
Gross fixed investment	0.0	-1.6	-0.5	-0.4	-0.6
Public	-9.1	-11.7	-2.1	-3.3	-6.5
Private	1.5	0.2	-0.3	-0.5	0.2
Exports	9.1	10.4	7.9	7.3	8.7
Imports	7.7	8.5	7.3	9.1	8.1
% qoq (sa)	**1Q17**	**2Q17**	**3Q17**	**4Q17**	
GDP	0.7	0.1	0.3	0.5	
Private consumption	-0.3	0.3	0.4	0.4	
Government consumption	-0.8	-0.3	0.2	1.2	
Gross fixed investment	-0.7	0.0	0.2	0.3	
Public	-3.1	-1.1	0.6	1.1	
Private	-0.1	0.2	0.1	0.1	
Exports	1.7	1.1	0.9	0.7	
Imports	0.9	0.9	0.8	0.9	

Source: Banorte-Ixe

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