

## Revising down our growth forecast for 2015

- **INEGI** released today GDP figures in 1Q15 along with March's economic activity indicator (IGAE)
- **Gross Domestic Product (1Q15): 2.5%yoy (Banorte-Ixe: 2.6%; consensus: 2.4%; estimated range: 2.2% to 2.6%; previous: 2.6%)**
- **Growth in 1Q15 was explained by three factors:**
  - (1) **A contraction in oil output;**
  - (2) **The slowdown in U.S. economic activity, which affected the performance of the Mexican manufacturing sector; and**
  - (3) **A more dynamic domestic demand**
- **In seasonally-adjusted figures, the economy expanded 0.4%q/q, below the 0.7% observed in previous quarter**
- **We are revising down our growth forecast for the Mexican economy in 2015 to 3.2%yoy from 3.6%**
- **Our new growth estimate takes into account:**
  - (1) **A slower external demand;**
  - (2) **No changes in inertial growth levels;**
  - (3) **Lower-than-expected oil output; and**
  - (4) **A positive effect coming from public spending, which we still believe is about to kick in GDP numbers in 2Q15**

**1Q15 Growth in line with expectations.** According to *INEGI*, GDP expanded 2.5% yoy in the first quarter of the year (Banorte-Ixe: 2.6%; consensus: 2.4%, previous: 2.6%). In our opinion, this figure is explained by three factors: (1) A contraction in oil output; (2) the slowdown in U.S. economic activity, which affected the performance of the Mexican manufacturing sector; but on the positive side (3) a more dynamic domestic demand, reflected in an improvement of the services sector (+4.7% yoy) and construction (4.2% yoy). Elsewhere, agricultural activities expanded 6.8% yoy, well above the 1.4% growth rate observed in the previous quarter. Meanwhile, industrial output expanded a scant 1.5% yoy, resenting the contraction in the mining sector (-5% yoy), along with a slowdown in manufacturing activities (+2.9%) on the back of adverse weather in the U.S. and labor strikes in various ports of that country. Nevertheless, construction output expanded a whopping 4.2% yoy, driven by the dynamism of residential construction in particular. Finally, the services sector expanded 2.9%, as shown in the table below.

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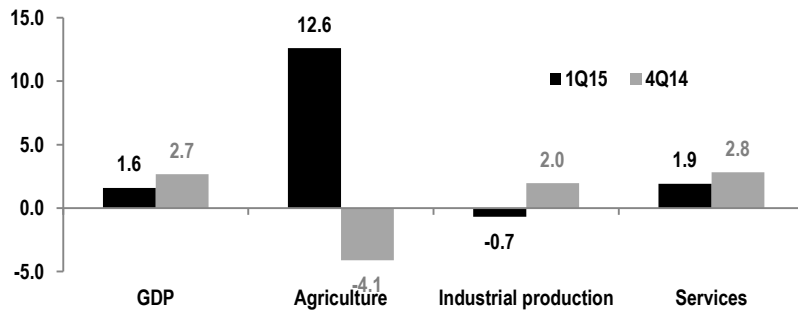
**GDP growth**  
% yoy

	1Q15	1Q14	2014
<b>Gross domestic product</b>	2.5	2.0	2.1
Agriculture	6.8	2.8	3.5
Industrial	1.4	1.9	1.9
Mining	-5.0	-0.2	-2.2
Utilities	3.3	2.2	1.8
Construction	4.2	-1.6	1.8
Manufactures	2.9	4.5	3.8
Services	2.9	2.0	2.2
Whole and Retail sales	4.7	2.1	3.3
Transportation and storage	3.0	2.3	2.0
Mass media information	6.0	2.6	2.2
Financial services	1.2	3.7	2.0
Real estate	1.6	1.9	2.1
Educational services	0.0	2.4	1.5
Temporary lodging services	3.6	1.9	2.9

Source: INEGI

**Seasonally-adjusted figures show a quarterly expansion of 0.4%.** As a result, economic activity increased at a 1.6% seasonally adjusted annualized rate (saar), lower than the 2.7% observed in 4Q14. By components, agricultural output increased 12.6%q/q saar, while industrial activities contracted 0.7%. Within this sector, manufacturing output was up 2.5%, while construction output came down 1.4%q/q saar. Finally, the services sector expanded 1.9% on the same calculation.

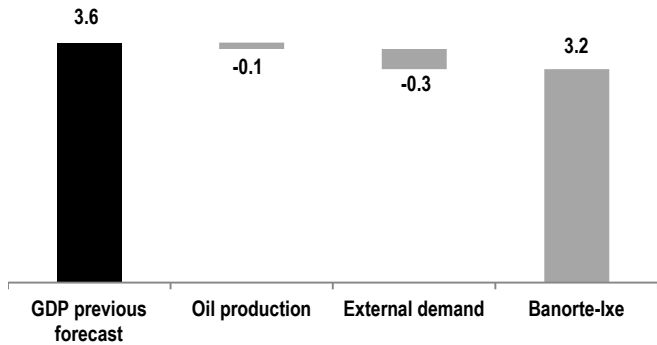
**GDP growth**  
%q/q saar



Source: Banorte-Ixe with data from INEGI

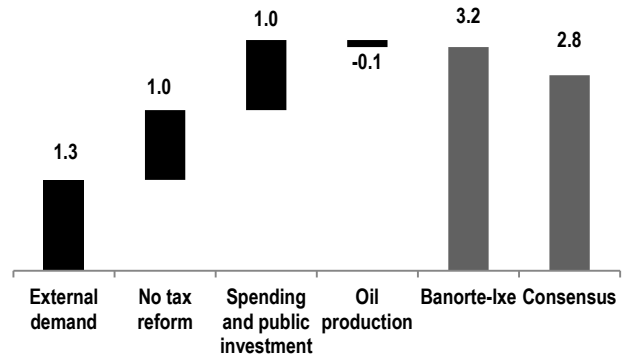
**We are revising down our growth forecast for the Mexican economy in 2015 to 3.2%yoy from 3.6%.** We continue to have a constructive view on the prospects of the Mexican economy. Nevertheless, recent developments both on a domestic and international level, lead us to revise down our forecast for GDP expansion in 2015 from 3.6% to 3.2% yoy. Our new growth estimate takes into account: (1) A slower expected external demand; (2) no changes in inertial growth levels; (3) lower-than-expected oil output; and (4) a positive effect coming from public spending, which we still believe is about to kick in GDP numbers.

**Change in 2015 growth forecast**  
Contribution



Source: Banorte-Ixe

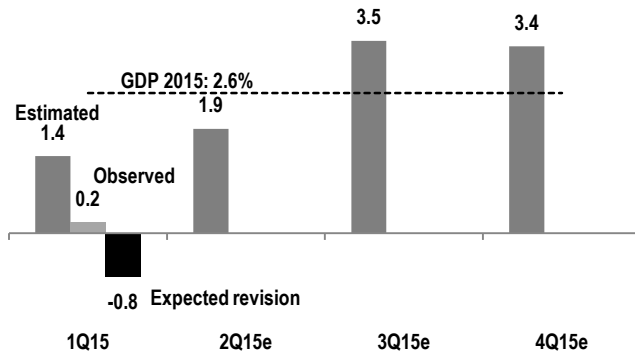
**Change in 2015 growth forecast**  
Contribution



Source: Banorte-Ixe

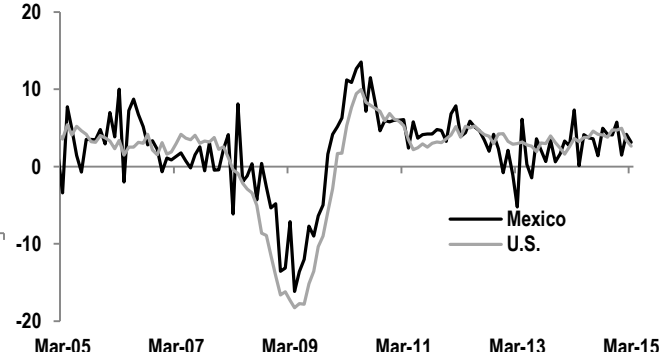
**(1) A slower expected external demand.** While manufacturing output will probably have a significant expansion this year, numbers in the first quarter were disappointing due to the following factors: (1) Adverse weather conditions in the U.S., affecting both the demand for Mexican manufactured goods; and (b) labor strikes in various ports of the United States. Moreover, our U.S. economists recently revised down their forecast for U.S. GDP growth (refer to the chart below on the left). In this context, we now consider that the contribution of external demand will be of only 1.3%-pts (vs. 1.6%-pts previously), given the strong correlation between manufacturing output in both countries, as shown in the chart below on the right.

**GDP growth forecast**  
% q/q saar



Source: Banorte-Ixe with data from BEA

**Mexico & US manufacturing output**  
% yoy

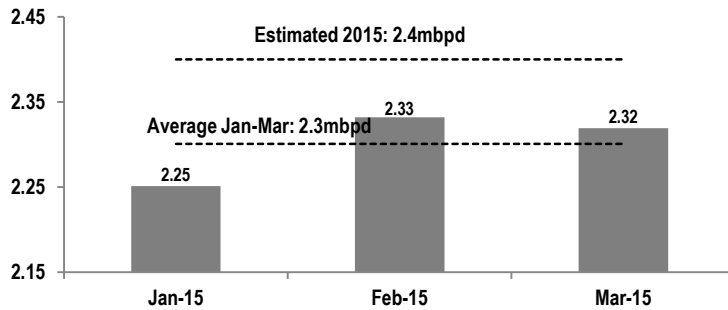


Source: Banorte-Ixe with data from INEGI and Federal Reserve

**(2) No changes in inertial growth levels.** Today's report meant no changes in our previous estimation of the *carry-over* rate of growth, which remained at 1%-pts. It is worth noting that this rate takes into account both economic activity inertia, and base of comparison effects. In our view, this above-trend carry-over growth rate is explained by the fact that last year the government implemented a tax reform, in which there were not only tax increases –and the creation of new ones–, but also it was a comprehensive tax-regime overhaul. The latter kept businessmen totally focused on tax-planning issues, instead of their own businesses. This year, businessmen have already adjusted to the modifications that stemmed from the fiscal reform.

**(3) Lower-than-expected oil output.** For 2015, we expected oil output in the area of 2.4 million barrels per day (mbpd), based on what the government estimated in its 2015 budget. Year to date, Pemex has reported an average production of 2.3mbpd, as shown in the chart below. This lower level of oil output will subtract, according to our estimations about 0.1%-pts to GDP growth this year.

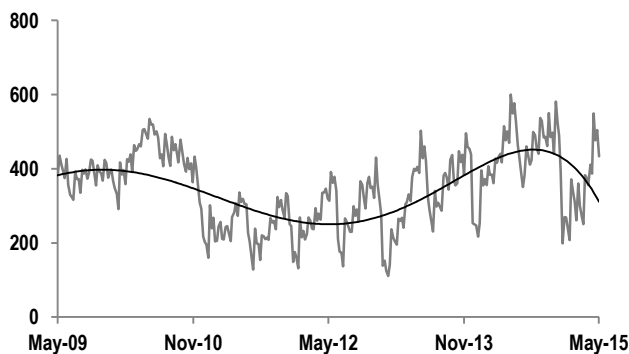
**Oil output**  
mbpd



Source: Pemex and MoF

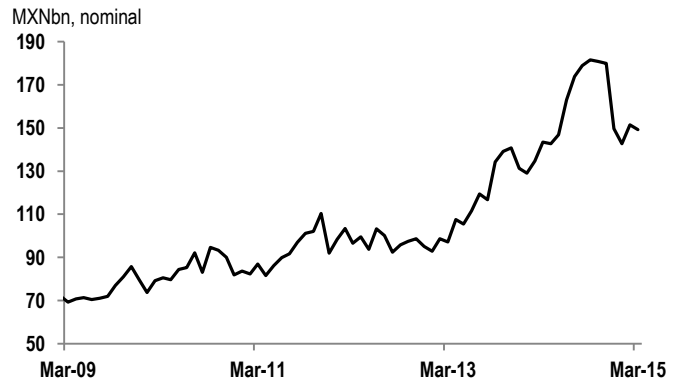
**(4) A positive effect coming from public spending, which we still believe is about to kick in GDP numbers.** Even though the government announced a couple of months ago a MXN124.3bn (US\$8.2bn or 0.7% of GDP) spending cut, we believe that spending on the upcoming electoral process (to take place on June 7<sup>th</sup>) will translate into a more dynamic economic activity. Usually, during a mid-term electoral year, government spending adds about 0.4-0.5%-pts to GDP growth. Moreover, the balance of the MoF's deposit account at the central bank (at the Federal level), and the state and municipal government's current accounts at commercial banks –which had increased significantly in the past two and a half years-, have already to come down in the first few months of 2015 (see charts below). In our view, we expect the effect of government spending to start showing in the figures in 2Q15.

**MoF deposit account at Banxico**  
MXNbn, nominal



Source: CNBV

**Balance of state and municipal governments' deposit accounts in commercial banks**  
MXNbn, nominal



Source: Banxico

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