

Revising down our growth forecast for 2015

August 20, 2015

- **INEGI released today its GDP figures for 2Q15 along with June's economic activity indicator (IGAE)**
- **Gross Domestic Product (2Q15): 2.2%yoy; Banorte-Ixe: 2.2%; consensus: 2.1% (range of estimates: 1.6% to 2.5%); previous: 2.6%**
- **Growth in 2Q15 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 0.5%q/q, above the 0.4% observed in previous quarter**
- **In our opinion, the dynamics in private consumption and public spending have not been translated into higher rates of economic growth**
- **In addition, external demand and the carry over growth of the economy as a whole has been less than expected**
- **In this context, we are revising down our 2015 growth estimate from 3.2% to 2.5%**

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GDP in 2Q15, in line with our forecast. According to *INEGI*, GDP expanded 2.2% yoy in the second quarter of the year, in line with our forecast (consensus: 2.1%; previous: 2.6%). On the positive side, we observe a more dynamic domestic demand, reflected in an improvement in activities such as commerce (+4.2) and other services (+3.1% yoy). Nevertheless, the deceleration in U.S. industrial production, which affected the performance of the Mexican manufacturing sector; along with recession in the mining sector (accumulating 5 quarters in contraction), have affected growth. By sectors, agricultural activities expanded 2.7% yoy, below the 6.7% growth rate observed in the previous quarter, while industrial output expanded a scant 0.5% yoy, resenting the already mentioned contraction in the mining sector (-7.6% yoy), along with a moderate growth in manufacturing activities (+3% yoy). In addition, construction output expanded 2.8% yoy, driven by the moderate recovery of residential construction, and the significant slowdown in non-residential construction, as shown in the table below.

GDP growth

% yoy

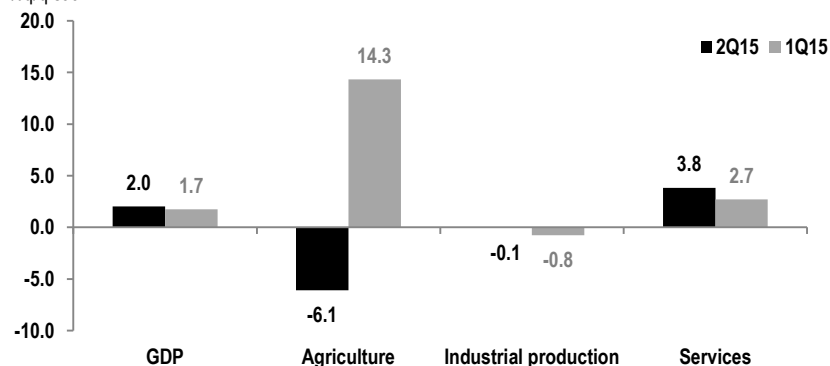
% yoy	2Q15	1Q15	1H15	1H14
Gross domestic product	2.2	2.6	2.4	1.8
Agriculture	2.7	6.7	4.5	2.7
Industrial	0.5	1.5	1.0	1.5
Mining	-7.6	-5.7	-6.6	-0.6
Utilities	1.6	3.5	2.6	1.9
Construction	2.8	4.4	3.6	-1.1
Manufactures	3.0	3.2	3.1	3.5
Services	3.1	3.0	3.0	2.0
Whole and Retail sales	4.2	4.8	4.5	2.0
Transportation and storage	3.1	3.0	3.0	2.2
Mass media information	4.7	6.1	5.4	3.7
Financial services	0.2	0.8	0.5	2.7
Real estate	3.3	1.7	2.5	2.1
Educational services	0.0	0.0	0.5	1.3
Temporary lodging services	3.6	3.6	4.0	3.0

Source: INEGI

Seasonally-adjusted figures show a quarterly expansion of 0.5%. As a result, economic activity increased at a 2% seasonally adjusted annualized rate (saar), above the 1.7% observed in 1Q15. Taking a look at the breakdown, agricultural output decreased 6.1% q/q saar, while industrial activities contracted 0.1%. Within this sector, manufacturing output was up 0.4% q/q saar, while construction output edged up 1.5% q/q saar. Finally, the services sector expanded 3.8%, as shown in the chart below.

GDP growth

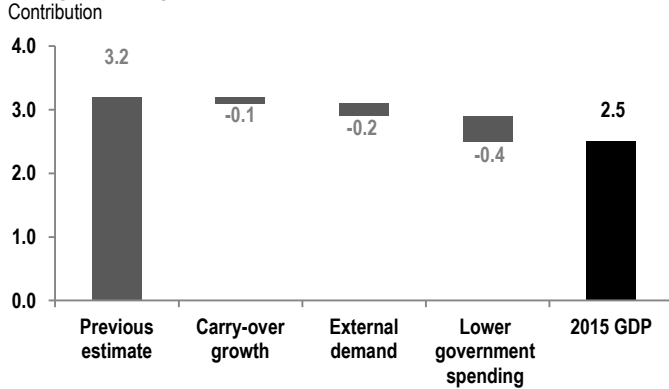
%q/q saar



Source: Banorte-ixe with data from INEGI

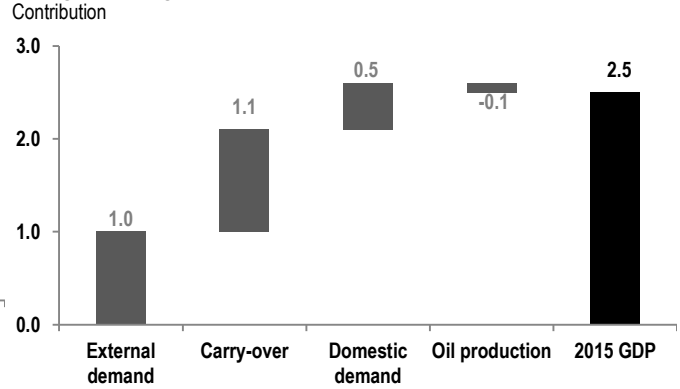
We now expect that the Mexican economy will grow 2.5% in 2015. We continue to have a constructive view on the growth prospects of the Mexican economy. Nevertheless, recent developments –both on a domestic and international level–, lead us to revise down our GDP growth forecast in 2015 from 3.2% to 2.5% yoy. Our new growth estimate takes into account the following factors: (1) The fact that a more dynamic private consumption and public spending have not been reflected in higher rates of GDP growth (we now expect domestic demand to contribute only with 0.5%-pts to growth in 2015); (2) a slower external demand, which will add 1%-pts; and (3) a lower *carry over* rate of growth.

Change in 2015 growth forecast



Source: Banorte-Ixe

Change in 2015 growth forecast

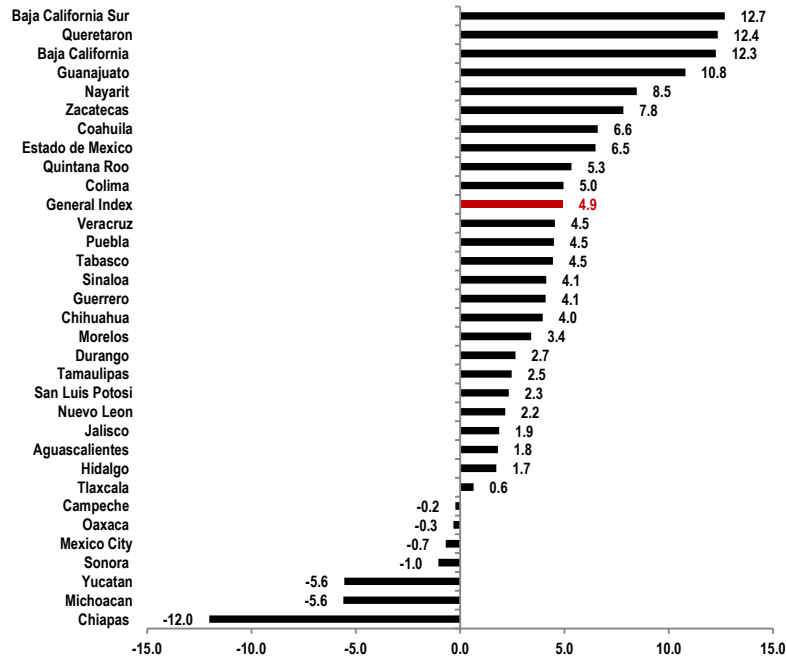


Source: Banorte-Ixe

(1) A more dynamic private consumption and public spending have not been reflected in higher rates of GDP growth. In the first half of the year, private consumption has recovered significantly, which has been reflected in an 4.5% yoy increase in commerce GDP, and a 4.9% expansion in retail sales (refer to the following chart). In particular, private consumption has been favored by the following factors: (i) A recovery in disposable income levels (*proxied* by total payroll); (ii) positive growth dynamics in the labor market; and (iii) the downward trend in inflation, which has resulted in increased purchasing power for Mexican consumers.

Retail sales

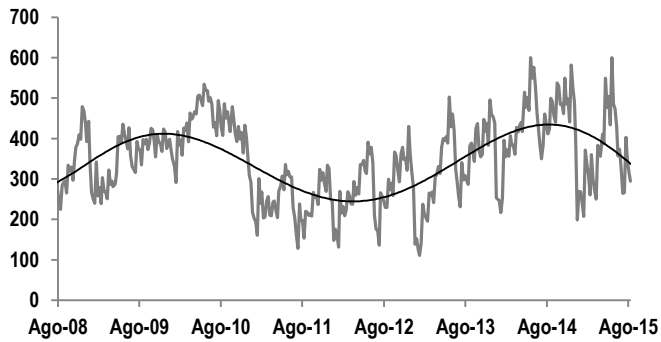
% yoy, YTD



Source: Banorte-Ixe; INEGI

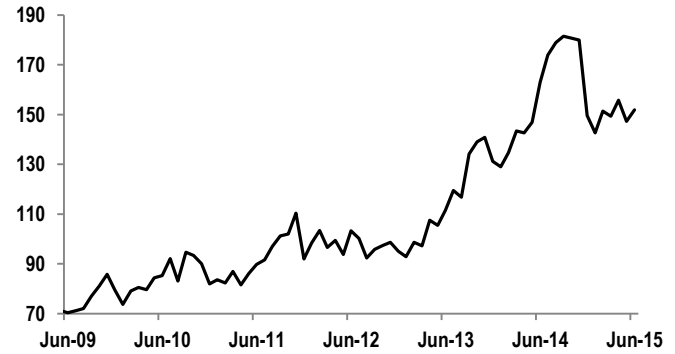
Moreover, even though the government announced an MXN124.3bn (US\$7.4bn or 0.7% of GDP) spending cut, we believe that public spending has maintained an upward trend amid the electoral process that took place on June 7th. It is worth noting that during a mid-term electoral year, government spending usually 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 had a significant decrease in the first half of the year (refer to the charts below).

MoF deposit account at Banxico
MXNbn, nominal



Source: Banxico

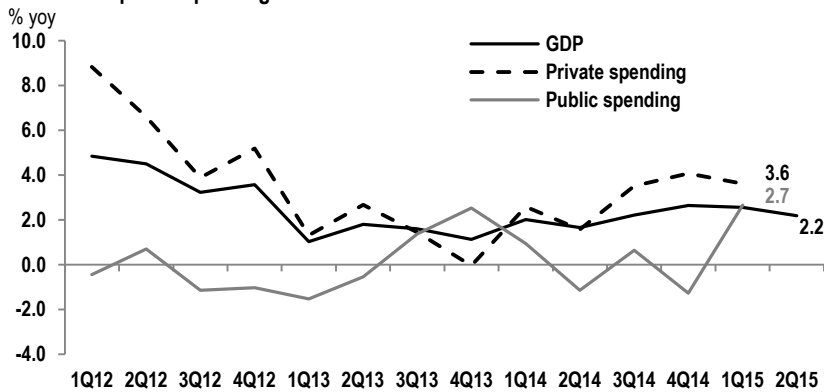
Balance of state and municipal governments' deposit accounts in commercial banks
MXNbn, nominal



Source: Banxico

Nevertheless, these two factors have not been reflected in higher economic growth rates. In particular, growth in both private spending (defined as the sum of private consumption, private investment and change in inventories) and government spending (determined by the sum of public investment and government consumption) has been higher than what recent GDP figures suggest. We believe that even though Mexico's domestic demand has experienced a significant recovery, the contribution of these two factors to Mexico's overall GDP growth may be lower than we initially anticipated.

Private and public spending vs. GDP

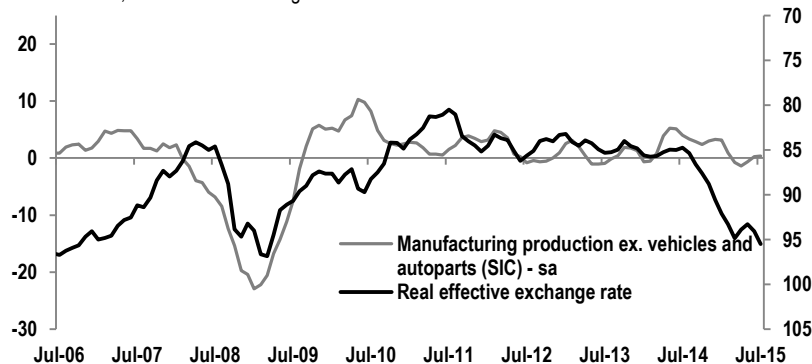


Source: Banorte-Ixe; INEGI

(2) Lower external demand. While manufacturing output will probably have a 3.2% expansion this year, numbers in the first half were disappointing given the severe deceleration of the U.S. manufacturing industry, on the back of the appreciation of the U.S. dollar, and the strong correlation between Mexico’s exports and the U.S. manufacturing industry (refer to the following charts). In this context, we now consider that the contribution of external demand will be of only 1%-pts (vs. 1.2%-pts previously).

US manufacturing production and USD

% 3m/3m saar; effective real exchange rate



Source: Banorte-Ixe; Federal Reserve

Correlation between MX manufacturing exports to the U.S. and U.S. manufacturing output

Sector	% Total manufacturing exports in 2014	Correlation: 2008 to 2015
Total manufacturing	100	0.83
Motor vehicles and and auto parts	32.07	0.95
Computer and communications equipment	23.78	0.75
Electricity equipment and accessories	9.09	0.62
Machinery and Equipment	8.45	0.68
Food, beverages and tobacco	3.67	0.32
Metal Products	3.3	0.91
Basic Metal Industries	3.22	0.67

Source: Banxico

(3) Lower in inertial growth. Today’s report meant a downward revision in our previous estimation of the *carry-over* rate. We highlight that this rate takes into account both economic activity inertia, and a base of comparison effect. In our view, despite that Mexico’s 2014 GDP’s growth was significantly affected by the implementation of the Federal Government’s tax reform –which would imply a higher growth given this artificially higher base of comparison–, the significant deceleration of the industrial sector during the first half of the year has offset this positive base effect. In this regard, we now forecast Mexico’s carry-over rate contribution at 1.2%-pts. from 1.3%-pts.

Disclaimer

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