MEXICO

SEIZING THE RIGHT OPPORTUNITY

Economic growth should slow significantly in 2023. The relative resilience of private consumption will not be enough to offset the slowdown in external demand, particularly from the US. In addition, the investment outlook remains limited. In the medium term, the Mexican economy could benefit from the relocation of American companies, a trend recently accelerated by the disruption of value chains linked to the pandemic and trade tensions between China and the United States. To take full advantage of this, Mexico will need to restore investor confidence and meet its energy policy commitments.

SIGNIFICANT SLOWDOWN IN GROWTH

Real GDP grew by 3.1% in 2022 (after reaching 4.9% in 2021), which was higher than expected. Exports of manufactured goods remained dynamic despite an unfavourable external environment, and private consumption continued to rebound, buoyed by the improvement in the labour market and transfers of expatriate workers. Lastly, in Q4 2022, total investment was slightly higher than the pre-pandemic levels reached in Q4 2019. The significant increase in public investment is due to the government's desire to complete several of its flagship projects before the end of its mandate (end of 2024), such as the Dos Bocas refinery and the Tren Maya railway. That said, expressed as a percentage of GDP, total investment remains at just over 19%.

Although the data available (monthly activity index, exports, PMI index) for January and February remains positive, we expect a marked slowdown in growth to 1.0% in 2023. The slowdown in the US economy should cause a significant hit to the Mexican exporting sector and lead to a drop in remittances and tourism revenues. Net exports are expected to contribute negatively to growth in the first half of the year, contributing to a widening of the current account deficit. At the same time, persistent inflation and ongoing restrictive monetary policy should slow the recovery in private consumption and hit investment.

Persistence of inflation

Inflation rose continuously between mid-2021 and mid-2022, reaching 8.7% year-on-year in August and September last year. Total inflation and core inflation have fallen in recent months (to 7.6% and 8.3% year-on-year respectively in February), but both remain high. The drop in inflation is expected to continue in the coming months. However, inflation should remain above the Central Bank's inflation target (between 2% and 4%) throughout 2023. In addition, a survey conducted by the Central Bank showed that expectations regarding inflation remain high.

At its monetary policy meeting on 30 March, the Central Bank raised its main key rate for the fifteenth time since the tightening cycle began in June 2021, taking the rate to 11.25% (or a total of 725 basis points). According to the press release, inflation forecasts were only changed marginally for 2023 (the annual average should be slightly below 6% in 2023, whereas it was barely above 6% last September). However, the forecasts for 2024 and the medium term have not changed, and the press release emphasises that the conditions are now being met for the inflation rate to converge towards the target (3%) by the end of 2024. Unlike at previous meetings, future rate hikes are no longer being mentioned, suggesting that the tightening cycle is being paused, at least for the time being.

FORECASTS

	2020	2021	2022	2023e	2024e
Real GDP growth, %	-8.1	4.9	3.1	1.0	0.3
Inflation, CPI, year average, %	3.4	5.7	7.9	6.2	5.0
Budget balance / GDP, %	-4.1	-3.8	-3.8	-4.1	-3.8
Public debt / GDP, %	50.8	47.8	48.5	49.5	51.0
Current account balance / GDP, %	2.4	-0.4	-1.2	-1.0	-0.9
External debt / GDP, %	43.1	35.7	31.7	30.4	30.1
Forex reserves, USD bn	195.0	202.4	201.0	209.0	210.0
Forex reserves, in months of imports	5.3	5.1	4.8	4.1	4.1

e: ESTIMATES & FORECASTS

TABLE 1 SOURCE: BNP PARIBAS ECONOMIC RESEARCH

MEXICO: INFLATION AND POLICY RATE

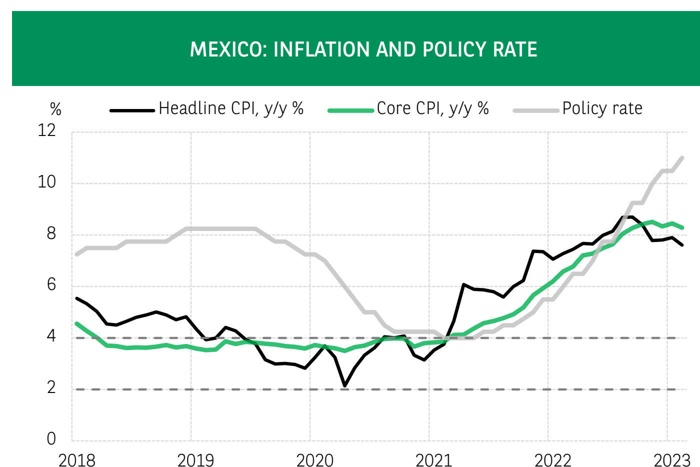

CHART 1 SOURCE: CENTRAL BANK

A DRAMATIC YEAR IN ON THE POLITICAL FRONT

The political climate could remain tense until the next elections in July 2024. Last February, Congress passed an electoral reform of the National Electoral Institute (INE), the body responsible for organising elections. Sought by President Andres Manuel Lopes Obrador (AMLO) who considered the INE to be 'partisan', this reform includes a drastic reduction in its budget, involving a reduction in staff and the closure of many polling stations.

The passing of this reform has led to several large-scale popular protests, with opponents saying there is a risk of elections being manipulated by the government. The reform was suspended by the Supreme Court on 18 March, but the government announced that it would be filing an appeal.

Although President AMLO is still very popular, five years after coming into power, the strength of opposition to this reform has shaken his popularity. However, the President's party, Morena, remains for the time being the favourite for the next general and presidential elections in 2024 (constitutionally, President AMLO is not authorised to run for a second consecutive term). In the coming months, the focus will be on the candidate chosen by the Morena Party, and the relative strength of opposition parties.

The two main candidates to represent the Morena Party are currently Claudia Sheinbaum (Head of Government of Mexico City and President AMLO's favourite, with a political agenda even more radical than the current government's), and the Minister of Foreign Affairs, Marcelo Ebrard, whose ambition is to pursue a more centrist policy, drawing on the country's middle class. The party candidate should be nominated through opinion polls, which could create tension within the party.

Against this backdrop, the local elections for the governors of the States of Mexico City and Coahuila, scheduled for June, are highly anticipated. Although the results are unlikely to have a significant impact on domestic policy, they will give an indication of which way the wind is blowing in political terms for the coming year, and will in particular help weigh up the strength of the opposition parties against the President's party.

SEIZING THE RIGHT OPPORTUNITY

In the medium term, the growth outlook remains mixed. Although the economy has returned to its pre-pandemic level, the gap with the 2015-2019 trajectory is wider for Mexico than for its peers. The government's decision to implement an austerity policy as soon as it came into power in 2018 (including in 2020-2021) has, admittedly, helped it curb the public deficit during its term of office and limit the increase in public debt. However, the drop in productivity caused by the fall in public investment (particularly in infrastructure), the lack of support for the economy in 2020-2021 and the deterioration in the business climate and investor confidence since AMLO was elected have all contributed to reducing potential growth (estimated at 2%, whereas it was close to 2.5% before the crisis).

As a result, the Mexican economy may not be able to take full advantage of the opportunities created by the disruptions and shortages that have spurred many countries to reorganise their value chains. This phenomenon was emphasised in the US by trade tensions with China, and Mexico is a natural candidate for the relocation of American companies, i.e., the transfer of supply chains closer to the target country (nearshoring).

Beyond the geographical situation, several factors look very favourable in Mexico. Both countries are members of the USMCA, the free trade agreement between Mexico, the United States and Canada, in force since 1 July 2020, both economies are highly integrated, and Mexican wages are competitive.

MEXICO: US' CONTRIBUTION TO TOTAL EXPORT GROWTH (3MMA, Y/Y %)

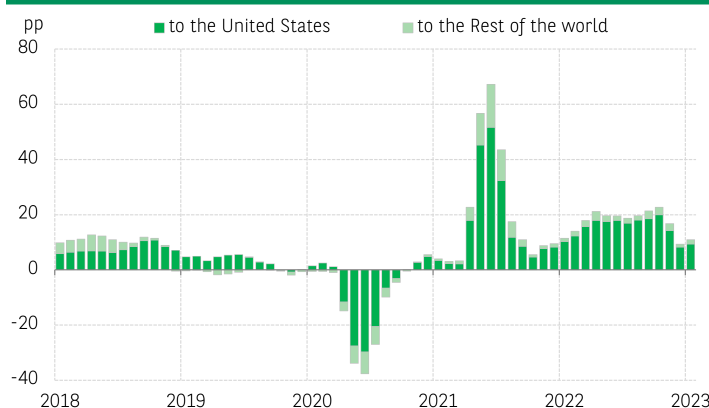

CHART 2 SOURCE: CENTRAL BANK

For the time being, however, not much nearshoring towards Mexico can be seen in the data. It could be curbed or even hampered by Mexican energy policy, which continues to promote and generously fund the national oil company PEMEX. At the same time, the United States and Canada have committed to ambitious energy transition policies to reduce their greenhouse gas emissions by 2030, and achieve carbon neutrality by 2050.

However, there are some positive signs: during the North American Leaders' Summit last January, Mexico undertook, with its two partners, to reduce methane emissions and develop a clean hydrogen market in North America, in particular. The three countries also reaffirmed their desire to strengthen value chains (particularly in the automotive industry, including the production of 'clean' vehicles). PEMEX also announced in mid-March that it intends to improve its ESG policy from H2 2023 onwards. Against this backdrop, the energy policy of the next government and the decisions taken regarding the ongoing reform of the sector (the current government wants to restrict participation of private, domestic and foreign investors in the energy sector as much as possible) will be key.

Hélène DROUOT
helene.drouot@bnpparibas.com