Mexico Watch

What you missed while on holiday

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GEM Economics
LatAm | Mexico

Carlos Capistran
Canada and Mexico Economist
BofAS
+1 646 743 2921
carlos.capistran@bofa.com

Key takeaways

- We compiled the main releases since December 18 so you can catch up on Mexico's latest.
- The domestic economy was strong at the end of 2023, in part supported by government expenditure, which pressures inflation.
- The government issued US$7.5bn and increased excise taxes by more than Banxico's 3% inflation target in January.

Summary: domestic economy still strong at end-2023

Data during the holidays showed that the domestic economy remains strong, mostly driven by public investment (AMLO's infrastructure projects such as the Maya train), but also by private investment (likely due to nearshoring) and consumption (supported by low unemployment, real wage growth and remittances). However, external demand looks weak, and the peso seems strong, as reflected in contractions in exports and in Banxico accumulating international reserves (without a formal accumulating program). Remittances remain high but decelerated significantly in November and, along weak exports, anticipate a slowdown in Mexico's economic activity in 2024.

The strength of the domestic economy is reflected in increasing services' inflation, from high levels, which makes it difficult for Banxico to cut rates in 1Q, in our view, although the central bank has communicated that it will consider start cutting as soon as 1Q. In addition, large increases to the minimum wage (20% yoy) and to excise taxes that impact gasoline, sodas, and tobacco (4.3% yoy) put further upside pressure on inflation, as do the increase in pensions (25%) and government expenditure ahead of the June 2024 federal election. To support the large increase in government expenditure in 2024, the government issued US$7.5bn on January 2 (the largest EXD in recent years).

Data releases (in chronological order)

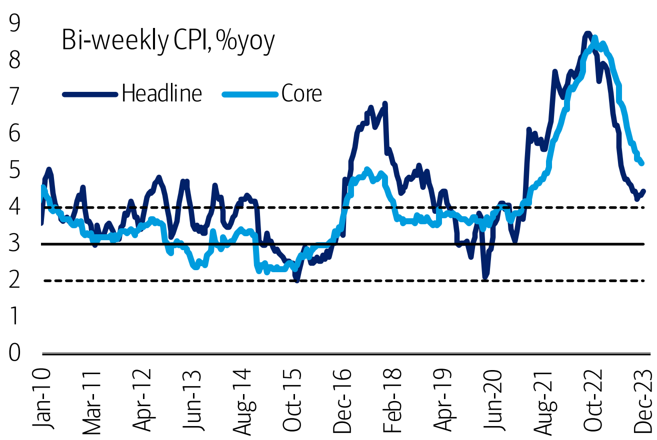
The **breakdown of 3Q GDP on the demand side** showed that the domestic economy remains strong but that external demand has already decelerated. Aggregate demand in 3Q was below expectations at 2.7% yoy nsa (E. 3.8%). At the margin, aggregate demand decreased -0.07% qoq saar (vs 3.7% in 2Q). By components, exports were the main downward driver at -14.1% qoq saar (vs -12.4% in 2Q), and inventories fell -126% qoq saar (vs. 77.5% in 2Q). On the other hand, investment (public + private) increased 17.7% qoq saar (vs 27.6% in 2Q) followed by private consumption at 4.7% qoq saar (vs 2.7% in 2Q) and government consumption at 1.9% qoq saar (vs 4.9% in 2Q). On the supply side, GDP increased 4.3% qoq saar (vs 3.7% in 2Q) while imports decreased -9.3% qoq saar (vs 2.8% in 2Q). So, investment (public and private) and consumption (domestic and imported) remained strong and will likely continue helping activity in the following quarters. On investment, you can see our report here: Investment is booming.

Retail Sales in October surprised to the upside at 0.8% mom sa (E. -0.3%, BofA -0.3%), up from -0.2% mom sa in September, showing that despite the volatility with seasonally adjusted data, consumption remains strong in Mexico. Employment in retail increased 0.3% mom sa (vs -0.5% in September; downward revision from -0.4%) while wages increased 0.1% mom sa (vs 0.4% in September). However, wholesale sales fell -6.1% mom sa (vs 3.5% in September; downward revision from 3.9%). In annual terms, retail sales increased 3.4% yoy nsa (E. 2.0%, BofA 2.5%) from 2.3% in September, while wholesale sales rose 1.6% yoy nsa from 7.1% a month ago.

Biweekly headline inflation surprised to the upside in 1H December at 0.52% (E. 0.42%, BofA 0.47%). However, core inflation was slightly below expectations at 0.46% (E. 0.49%, BofA 0.46%). The main driver to the upside for headline was non-core inflation at 0.68%, which in turn was driven by fruits and vegetables prices at 3.32% (onion at 35.86% and tomato at 6.87%). Core inflation was mainly helped by (processed) food inflation at 0.19% (soda at 0.41% and sugar at -0.65%). In annual terms, headline inflation increased to 4.46% yoy from 4.33% yoy, while core inflation kept falling and is now at 5.19% yoy from 5.30% yoy a fortnight ago (although services increased to 5.40% yoy from 5.27% yoy). Increasing headline and increasing services inflation makes it more difficult for Banxico to cut soon. Increasing services inflation shows the domestic economy remains strong. We continue to expect Banxico to cut in June 2024 with risks for an earlier cut.

Exhibit 1: Headline and core inflation

Headline has recently been on the rise again



Source: BofA Global Research, INEGI

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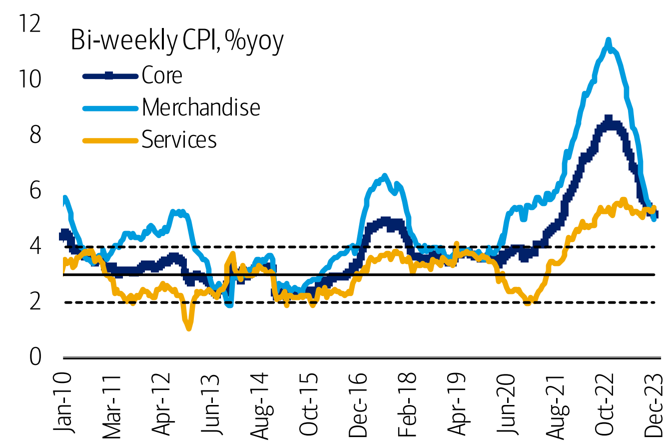
Exhibit 2: Core inflation breakdown

Services inflation remains high and is increasing at the margin



Source: BofA Global Research, INEGI

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The **trade balance** in November posted a larger than expected surplus at US$0.6bn (E. surplus US$0.2bn). Once adjusted for seasonality, the trade balance showed a surplus of US$0.03bn, in contrast to the surplus of US$0.24bn in October. Exports fell -1.62% mom sa (vs. -0.30% in October), mostly driven by a decrease of non-oil exports of -0.57%, which in turn was mainly explained by auto exports (-6.38% mom sa). Imports fell -1.20% mom sa (vs. -2.35% in October) mostly driven by intermediate goods imports at -1.38% mom sa and consumption goods imports at -1.08% mom sa. Capital goods imports remained virtually unchanged at -0.03%. The trade surplus continues to support the peso, but it also shows that the strong MXN is having a negative impact on activity through exports.

Monthly GDP (IGAE) surprised to the downside in October at -0.09% mom sa (E. 0.05%, BofA 0.00%), from 0.57% mom sa in September. By components, the main driver to the downside was services at -0.55% mom sa (vs. 0.82% in September; revised from 0.90%), drove mostly by recreational services, which fell -3.53%. On the other hand, industry increased 0.62% mom sa (vs. 0.23% in September; revised from 0.15%), with construction increasing 4.66%. Agriculture posted an increase as well at 1.61% mom sa (vs. -2.49% in September; revised from -2.99%). However, notice that in annual terms, IGAE surprised to the upside at 4.24% yoy nsa (E. 3.93%, BofA 2.90%), so the monthly weakness could just be due to the seasonal adjustment, which introduces a lot of volatility to the series in Mexico. Year-to-date, IGAE has increased 3.49%. All-in-all this is a noisy data point that Banxico could interpret either way (point to the monthly figure to cut, point to the annual figure to argue the economy remains in a boom).

The **unemployment rate** in November was higher than expected at 2.71% nsa (E. 2.65%, BofA 2.75%). Once adjusted for seasonality, unemployment increased to 2.79% sa from 2.66% in October. The participation rate increased to 60.46% sa, from 60.13% in October, while the underemployment increased to 8.17% sa, from 8.01% (revised from 7.95%) in October. On the other hand, the informality rate decreased to 54.97% sa, from 55.23% in October. The labor market may be beginning to cool down, although it is too early to tell if the trend has finally changed. The unemployment rate (sa) remains near record lows.

The Ministry of Finance released the **public finance data** for November. Year to date (ytd), the public balance reached a deficit of MX$790.5bn (vs. a deficit MX$548.9bn a year ago), while the primary balance reached a surplus of MX$59.2bn (vs. a surplus of MX$87.3bn a year ago). Public expenditure was MX$7,137.4bn ytd (an expansion of 4.0% ytd in real terms) driven by higher capital expenditure (1.1% ytd in real terms) and social expenditure (6.7% ytd in real terms). In addition, financial cost kept increasing at 26.5% ytd in real terms, due to higher interest rates. Public revenues were MX$6,346.9bn ytd (an expansion of 1.1% ytd in real terms). The expansion was driven by higher non-oil revenues (8.7% ytd in real terms) mainly due to higher IEPS revenues at MX$404.3bn (vs. MX$93.6bn in Jan-Nov 2022). Higher non-oil revenues were offset by the fall in oil-revenues (-26.6% ytd in real terms). All-in-all, it is likely that the federal government will end 2023 with a primary deficit (instead of the 0.1% of GDP primary surplus it announced when it presented the budget for 2024), due to higher expenditure.

Remittances in November surprised to the downside at US$4.9bn (E. 5.8bn). In annual terms, remittances increased 1.9% yoy (vs 8.4% in October; 3.3% last year), the number of remittances increased 3.9% yoy (vs 5.2% in October; 5.0% last year) while the average remittance decreased -2.0% yoy (vs 3.1% in October; -1.5% last year) to US$386. In MXN, remittances fell -9.0% yoy (vs -3.9% last year). Year to date, remittances totaled US$57.8bn (8.7% ytd). This is a significant deceleration in remittances, which could anticipate more softness in future prints, which in turn would impact MXN and consumption in Mexico.

Minimum wage, pensions, and tax increases for 2024:

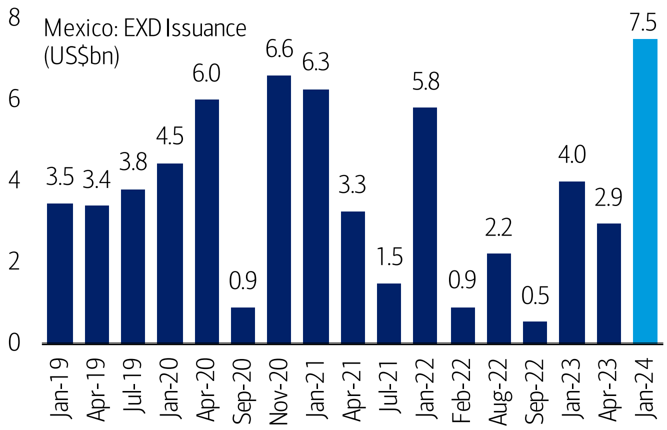
- As announced on December 1, Mexico's minimum wage rose as expected to MX$248.93 per day (~US$14.6) (vs. MX$207.44 in 2023) on January 1.
- Pension payments from government's program "Pension para el Bienestar de las Personas Adultas Mayores" increased by 25% in 2024, to reach MX$6,000 (~US$350 per person bimonthly). There will be a double payment in March to avoid election rules violations during the June election, according to AMLO.
- Special Tax on Production and Services (IEPS) quotas increased 4.32% in 2024. This excise tax is levied on products such as fuel, sugary soft drinks, and tobacco. Quotas for 91-octane "green" gasoline increased to MX$6.18 per liter, while for plus 91-octane "red" gasoline increased to MX$5.21 per liter. Regarding other products, soft drinks' quota increased to MX$1.57 per liter, and the quota for tobacco increased to MX$0.62 per cigarette.

All of these are upward pressures for inflation in Mexico. We already incorporated the increase to the minimum wage and the increase to gasoline prices on our inflation forecasts. But the increase in other excise taxes (soda, tobacco) is not yet included in our forecasts and hence it is an upside risk. Inflation in January will be under an important upside pressure and is one of the reasons we believe that a hike by Banxico in February and even March is not as likely as the market or even Banxico considers.

UMS issuance (US$7.5bn). On January 2, the Mexican government announced the issuance of 3 EXD bonds in international capital markets, for a total amount of US$7.5bn. According to the Ministry of Finance (MoF), the bonds were placed in three segments: a 5-year bond that will pay a rate of 5.07%, with a coupon of 5% for US$1bn; a 12-year bond that will pay a rate of 6.09% with a coupon of 6% for US$4bn; and a 30-year bond that will pay a yield rate of 6.45% with a coupon of 6.4% for US$2.5bn. With this issuance, Mexico becomes the largest sovereign issuer with a BBB rating, according to the MoF. Our EXD strategists have Mexico's EXD as underweight given the large issuance by the federal government (both external and local) that we expect in 2024.

Exhibit 3: Mexico EXD issuance

Issuance in January 2024 constitutes the largest of recent years



Source: BofA Global Research, Bloomberg

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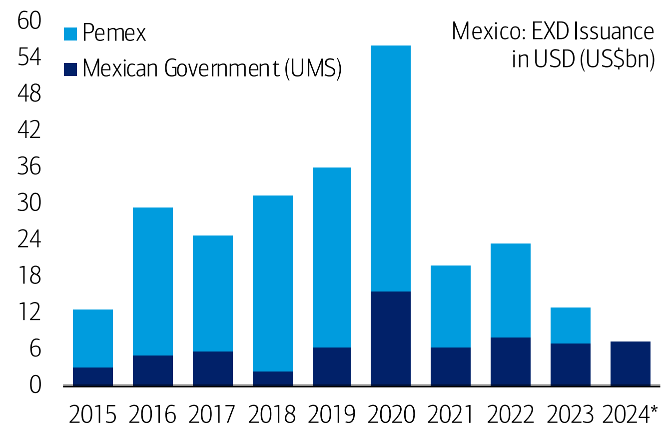
Exhibit 4: Mexican Government and Pemex EXD Issuance in USD

UMS issuance already above previous years in January 2024 alone



Source: BofA Global Research, Bloomberg. **Note:*** not full year (only January so far)

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International Reserves closed 2023 at US$212.8bn, growing 6.86% yoy from US$199.1bn at the end of 2022. Most of the accumulation occurred in 4Q: reserves were US$203.8bn in September, so Banxico accumulated almost US$9bn in 4Q, despite no formal accumulation program. It seems that after all, and as many investors suspected when Banxico reduced its hedging program (see our report) at the end of August 2023, Banxico is accumulating reserves.

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