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Mexico: Economic Overview: August 2014

Summary

- The National Institute of Statistics and Geography (INEGI) published GDP results for 2Q2014. The economy grew 1.56% during Q2 compared to the same period last year. The Ministry of Finance maintained its annual growth forecast at 2.7%, but there is consensus amongst independent analysts that it is unlikely that the recovery will be enough to meet this target.
- President Peña Nieto and Finance Minister Luis Videgaray announced the formation of a new development bank, the "National Finance for the Agricultural, Rural, Forestry and Fishing Development" which will provide accessible loans to agricultural producers with an interest rate less or equal to 10%. These loans will be extant for 15 years, without the need to provide real estate guarantees. If the programme is well implemented, its effects could be significant, helping tackle poverty and low productivity in the primary sector. After Congress' approval of the secondary legislation of the energy reform, President Enrique Peña Nieto announced the shift of Governmental attention towards implementation. According to the President, these changes will enhance the productivity and competitiveness of the economy, and provide a more solid and transparent legal framework to improve the business environment within the country.

Chart 1: Quarterly growth rates of GDP and its

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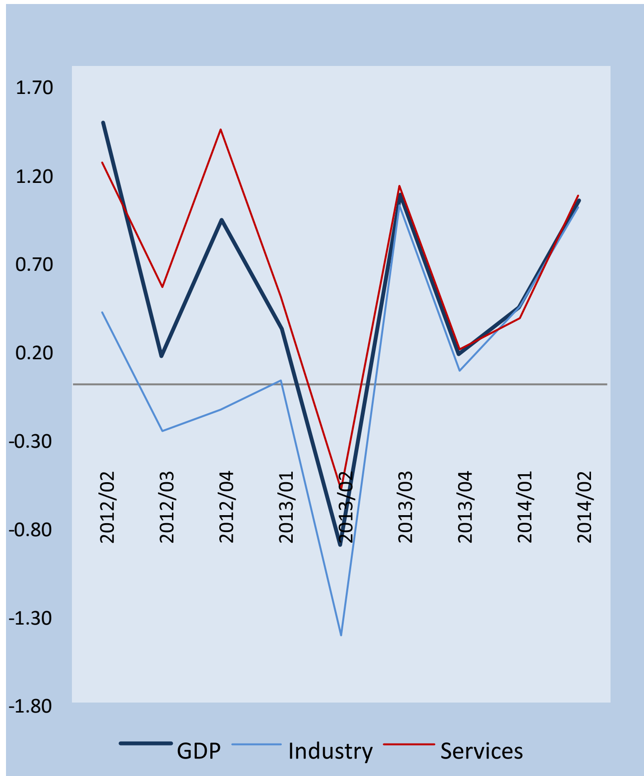
Macroeconomic Overview: GPD

sectors, 2012-2014 **figures of 2Q-2014**

On 21 August 2014, the National Institute of Statistics and Geography (INEGI) published the results of Mexico's GDP for 2Q2014. During the second quarter of the year, the economy grew 1.56% compared to the same period last year. However, correcting by seasonal effects, the new figures suggest a weak recovery, since the quarterly growth rate was only 1.04% compared to the first quarter of the year. That same day, the Deputy Minister of Finance, Fernando Aportela, gave a press conference to update the Government's 2014 growth forecast, which was maintained at 2.7%.



Source: National Institute of Statistics and Geography. Time series corrected by seasonal effects

According to Aportela, the new information provided by INEGI confirms that the economy is entering into an expansionary period. The Treasury expects higher growth rates for the second half of the year, provided by an increase in Government expenditure and higher growth rates in the retail sector. The figure proposed by the Finance Ministry is more optimistic compared to the latest forecasts made by Banxico (2.4%), the IMF (2.4%) and the private sector (2.5%).

The annual growth rate for the first half of the year was 1.7%. This means that, in order to achieve the growth target of 2.7% promised by the Government for 2014, the economy should grow at an annual rate of 3.5% in the second half of the year. This seems unlikely. Even though the services sector is recovering the construction sector is still struggling to survive and adapt from last year's crisis, which means that a lot of public resources allocated this year for housing credits and subsidies are not going to be spent since the demand for housing services is still low.

Looking at the performance of each economic sector, the services sector, which represents around 60% of the GDP, registered an improvement in its quarterly growth rate (1.07%) compared to the last two quarters (0.20% and 0.37% respectively), which suggests a recovery of the domestic demand. However, things still look grim for industry, which only grew 1% this quarter. Finally, the primary sector quarterly growth rate was 0.9%, but the impact of this sector on GDP is negligible, since it only represents 3% of total output.

For the second half of the year, there would need to be a speeding up of public infrastructure projects for 2014, in order to increase aggregate demand and improve aggregate supply, in order to provide a non inflationary economic expansion. Finally, a factor to take into account is the monetary stance of the Central Bank, which has maintained a 3.5% interest rate target. Expected inflation is just below Banxico's upper bound of 4%. If the international environment changes or the FED speeds up its QE tapering, a possible increase of the interest rate could affect growth recovery this year.

Policy in Focus 1: Peña Nieto launches a new development bank for rural producers

On 20 August 2014, President Peña Nieto and Finance Minister Luis Videgaray announced the formation of a new development bank for the agricultural sector, the "National Finance for the Agricultural, Rural, Forestry and Fishing

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Development". The newly created institution will have a budget of GBP £2bn for the remainder of 2014, and the task of providing cheap credit to small and medium producers with little red tape and long repayment terms. This bank has been created on the back of the financial reform, and will replace "Financiera Rural", a second floor development bank created in 2003, which received a lot of criticism from rural workers unions for focusing its resources on medium and large businesses, which represent only 5% of the agricultural producers.

According to the President, this new bank will provide agricultural producers with accessible loans with an interest rate less or equal to 10%, which will be paid in a 15 years period without the need to provide real estate guarantees. The interest rate will be significantly lower compared to the average commercial interest rate for these activities (14%). Small producers and female entrepreneurs will have access to credits up to GBP£11,000 with very low interest rates of 7% and 6.5%, respectively.

Table 1: a radiography of the rural economy, 2012

By type of locality	National	Rural	Urban
Total population	117,449,649.00	27,214,761.00	90,234,888.00
Average household monthly current income	GBP£603	GBP£679	GBP£330
% living in poverty	45.5%	61.6%	40.6%
% living in extreme poverty	9.8%	21.5%	6.3%
% of people with left behind in education	19.2%	32.4%	15.3%
% of people with no access to health services	21.5%	20.6%	21.8%
% of people with no access to social security	61.2%	81.5%	55.1%
% of people with insufficient access to food	23.3%	30.9%	21.0%

Source: National Institute of Statistics and Geography (INEGI) and National Council for the Evaluation of Social Policy (CONEVAL)

The primary sector in Mexico is mostly made up of small scale units with almost no access to credits and low productivity. As a result, poverty in rural areas is significantly higher in comparison to urban zones. In addition, Mexico lacks the necessary amount of food to be self sufficient in the case of any economic shocks. Also, informality remains an unsolved challenge. In 2012, 93% of the gross added value of the primary sector came from the informal economy. The average farmer produces for subsistence rather than trading, uses outdated technology and works without any type of social security.

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The Government will try to increase available credit for poor farmers through the creation of this bank. If well implemented, the impact of the programme could be huge: an increase in household incomes, more chances to increase production and sell the surplus in local markets and technological improvements. The success will depend on complementary actions needed to improve rural

productivity: more public infrastructure in rural zones, an improvement in social security for the workers of the sector, and maintain social programmes such as Oportunidades to keep improving the access to basic education and health.

Policy in Focus 2: The Federal Government and the international media

After the Congress' approval of the secondary legislation of the energy reform, President Enrique Peña Nieto announced the end of the reform period and the change in the Administration's focus towards implementation. This means that, the Government will focus its efforts on promoting concrete, visible, and immediate improvements to the economy, including investment in public infrastructure and other new programmes. The Government's reforms have had a big impact internationally. But it still faces domestic economic challenges: the ongoing insecurity in some regions of the country, the high levels of poverty and informality, the reduction of the purchasing power of workers' wages during the year and, more generally, the lack of concrete changes in the day to day life of Mexicans.

The Government has launched what appears to be a new campaign to maintain international investors' appetite for all things Mexican. On 30 July the Mexican Ministry of Trade, Ildefonso Guajardo, gave an interview to the financial magazine "The Business Year". Guajardo underscored the benefits of the reform programme, but insisted that the education, energy and labour reforms will only have significant impacts in the medium to long term. Whilst he recognised the problems affecting the economy (informality, lack of investment in technology, low growth etc) he confirmed that the Government's proposed solutions remained the same: attracting increased FDI, increasing competition in the financial sector and supporting high value industrial sectors through special programmes aimed at increasing productivity.

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On 20 August, President Peña Nieto published an editorial in the Financial Times. His article underlined that, thanks to the Pact for Mexico, the country had enjoyed a radical transformation over the previous 20 months, with Congress approving eleven reforms. The article considered that the changes will enhance the productivity and competitiveness of the economy, and provide a more solid and transparent legal framework to improve the business environment within the country. The article argued that, if Mexico unleashes its potential, it could become a more active global player.

Monthly Economic Monitor

Banxico's August survey registered a downgrade in GDP growth expectations, decreasing them from 2.56% to 2.47%. It seems that there is a downward trend in the survey which will continue through the end of the year. If the negative trend continues throughout the last quarter of the year, the expected growth rate of the survey could fall to 2% by December. Whilst the July survey had a 2.56% and 3.85% forecast for 2014 and 2015, in August the forecast for 2014 fell to 2.47% and remained in 3.85% for 2015. The forecast of this survey is very similar to the middle point of the range established by Banxico in its last quarterly report (2%2.8%). In this context, the 2.7% promise of the Ministry of Finance seems unlikely.

The end year general inflation forecast for 2014 slightly increased to 3.84%, and the expected inflation for 2015 marginally decreased to 3.45%, within Banxico's benchmark (3%+/-1). It is worth mentioning that there are no signs of inflationary pressures caused by underlying factors.

Forecasts for the Mexican peso (MXN) reflect a solid and stable currency and a more optimistic environment during the year for emerging markets. The USD/MXN year-end expected exchange rate for 2014 is 12.94.

Consensus Forecast (August 2014)	2014	Vs. July 2014	2015	Vs. July 2014
GDP (growth)	2.47%	⇩	3.85%	=
Inflation	3.84%	⇧	3.45%	⇩
Exchange Rate (year-end)	12.94	⇩	12.85	⇩

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Source: Bank of Mexico survey on private sector expectations

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