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Mexico – struggle for growth and progress

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The peso weakened significantly in response to Donald Trump's election as US President in November 2016 and the decision of Ford Motor Co. to cancel plans for a new plant in Mexico. These developments added to the depreciation trend that began in mid-2014. The existing close economic ties between Mexico and the USA suggest that the peso will continue to react sensitively to news and announcements of possible economic-policy measures from the US.

Economy faces major risks

Mexico's real gross domestic product is estimated to have grown at an unsatisfactory rate of approximately 2 % in 2016. Economic output increased only moderately in the second quarter in particular because of weak exports and investment activity. Third quarter output was slightly better, at 2 % year-on-year.

There is little scope for expansive economic policy measures. The central bank was facing rising inflation driven by the depreciation of the peso, causing it to raise the policy rate from 3.25 % at the end of 2015 to currently 5.75 %. And in order to limit the budget deficit, public spending cuts are necessary that are likely to have a negative fiscal impact until 2018.

This year the economy is unlikely to even achieve last year's economic momentum again. The IMF has lowered its growth forecast from October 2016 by 0.6 percentage points to 1.7 % this year and 2.0 % next year. The reason is that financing conditions are tightening and the investment climate is suffering from the uncertain future relation with the US with respect to trade, direct investment and remittances.

Accordingly, possible deviations from the forecast will be primarily dictated by the US. This is because industrial production in Mexico and the USA runs in parallel. Seen in isolation, the economic stimulus package announced by the US will therefore boost Mexico's economy as well.

This contrasts with Trump's initiatives and announcements in the area of trade and direct investment. Since as early as the year 1994, when NAFTA came into force, the USA has consolidated its position as Mexico's main export partner, recently taking around 80 % of Mexico's exports. For example, if the free trade agreement were to be renegotiated, it seems unlikely that existing cross-border value chains would benefit. With a degree of openness of 73 % (exports plus imports as a percentage of GDP), Mexico would be severely affected by trade barriers.

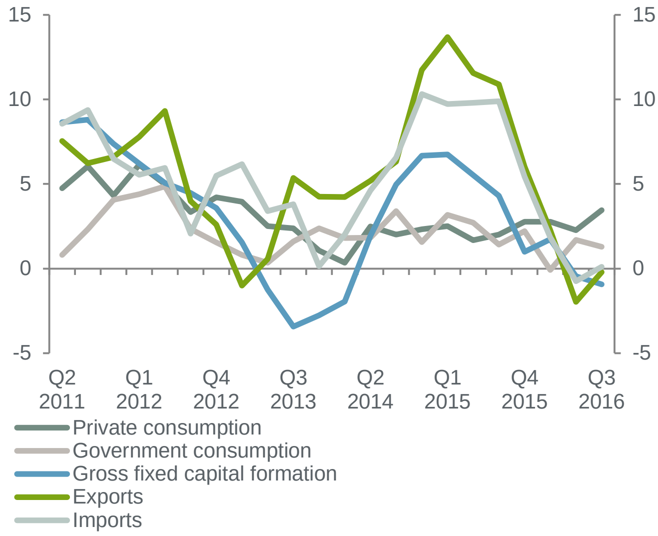
Reforms take time to bear fruit

The structural reforms that were set in motion since 2012 are not a short-term growth package but, rather, will become effective in many areas only in the long term. This is only natural because, for example, students affected by the education reform will first have to enter the labour market. In addition, the adopted constitutional amendments have to be translated into secondary law. Furthermore, the reforms relate not just to business but also to democratic governance, justice and security, and the fight against corruption.

The monetary and fiscal policy framework provides the conditions for stabilising Mexico's economy in the short to medium term. In the long term, current developments provide an incentive to think about diversifying Mexico's foreign trade relations. ■

Figure 1: GDP components

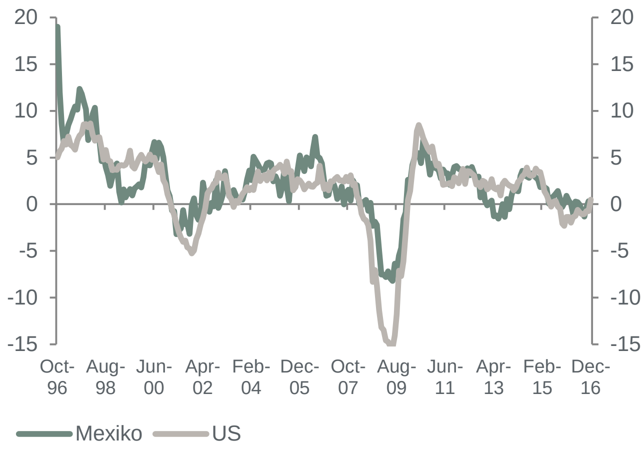
(Changes compared to the same quarter in the previous year in per cent)



Source: OECD

Figure 2: Industrial output

(Changes compared to the same month in the previous year, in per cent)



Sources: Thomson Reuters Datastream: INEGI. Federal Reserve.