

Mexico Business Forecast Report Q2 2014

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Abstracts

Core Views

We remain optimistic about Mexico's long-term growth outlook on the back of a booming manufacturing sector, an increasingly strong private consumer and favourable demographics.

The passage of energy sector reform will bolster sentiment towards Mexican assets and contribute to stronger real GDP growth in the coming years.

Major Forecast Changes

We have upgraded our 10-year average real GDP growth from 3.8% to 4.1% following the passage of energy sector reform, which we expect will garner significant foreign investment in the coming years. We have revised our 2014 average exchange rate forecast from MXN12.65/US\$ to MXN12.55/US\$, as the peso was stronger than initially expected in 2013, when it averaged MXN12.76/US\$. We have revised our 2014 current account deficit forecast from 1.0% of GDP to 0.7% of GDP, owing to a strong export outlook, particularly regarding the manufacturing sector.

We have revised our 2014 fiscal deficit forecast from 2.6% of GDP to 3.1% of GDP following the announcement of additional government spending this year.

Key Risks To Outlook

A further deterioration in the construction sector poses significant downside risk to our 2014 real GDP growth forecast. We expect the sector to recover after it contracted for several consecutive quarters since late 2012. However, homebuilders remain in a critical state financially, which could lead to an additional deterioration of the sector.

A deteriorating security environment also poses downside risk to our growth outlook. Growing violence, particularly in the state of Michoacán, could spread to other regions of the country and drive investor pessimism. Under such scenario, the exchange rate would be under pressure, which would weigh on household spending.

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Energy Liberalisation Means A Bumpy Road For Peña Nieto
The recent approval of an energy sector liberalisation bill in Mexico, while monumental for the economy's long-term growth prospects, will create an extremely challenging political environment for President Enrique Peña Nieto throughout the rest of his term. Popular perceptions towards energy sector reform remain highly divisive, and we expect social and political tensions to increase over the coming months.

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Strengthening, But Challenges Remain
The next decade looks set to be challenging for Mexico owing to a weak security situation, high levels of income inequality and endemic corruption. That said, our core view remains that the country will end the decade in a better position than where it is starting, with potential for some economic reform and a modest improvement in the country's security situation, which will strengthen Mexico's political risk profile.

CHAPTER 2: ECONOMIC OUTLOOK

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We forecast Mexico's government budget deficit to widen from 2.5% of GDP in 2013 to 3.1% of GDP in 2014. Greater fiscal expenditure, following significant spending delays, will be the main driver of a wider budget shortfall in 2014. Fiscal reform will have a positive longterm impact on revenue growth, though it will not be enough to offset greater spending.

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We forecast Mexico's current account deficit to narrow to 0.7% of GDP in 2014 from 1.5% of GDP in 2013, driven by stronger manufactured goods exports. In addition, an expected increase in foreign investment amid an acceleration in economic growth and the recent liberalisation of the energy sector will bolster the financial account.

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We expect Banco de México to commence a monetary tightening cycle in 2014 as consumer price inflation heads above target and economic activity accelerates. We forecast a 25 basis points (bps) rate hike to 3.75% by end-2014 and 50bps in additional hikes to 4.25% in 2015.

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