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Mexico Consensus Economic Forecast, Volume 14, Number 2

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CONSENSUS ECONOMIC FORECAST

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Economic Performance in Mexico: 1985-2008

Between 1985 and 2008, real per capita GDP in Mexico grew at an average annual growth rate of 1.1%, higher than Venezuela's 0.8%, but much lower than the 4.2% pace set by Chile, the fastest growing Latin American economy. This somber performance occurred in spite of at least some market-oriented reforms implemented in the late 1980s and the 1990s. The latter include state-owned firm privatizations, trade and foreign investment liberalization, monetary, and fiscal reforms.

One way to assess what ails Mexico is by studying its economic freedom index. Among other things, this index measures public sector economic prevalence. Higher values represent greater economic flexibility or freedom, while lower values indicate greater inflexibility due to government participation. The Mexico index reached its low point of 4.94 in 1985. The index value for 2008 was 6.88, ranking Mexico 60 out of 140 countries for which these calculations are tallied. By comparison, the index for China was only 4.23 in 1980, but rose to 6.44 in 2008. The latter value ranked China 83 out of 140. The greater relative improvement of the China index helps account for the difference in growth rates between these two economies.

Of course, Chinese incomes were much lower than Mexico's in 1980, allowing it to achieve higher growth rates during the years in question. In spite of its spectacular growth, Chinese income per capita in 2008 was only 42.5 percent of that in Mexico. This evidence strongly suggests that when China initiated its market reforms, it suffered from a substantial knowledge gap relative to other countries. Its numerous policy reforms have helped erase much of that gap.

International evidence suggests that economic expansion in Mexico can accelerate by implementing additional market oriented reforms that increase its economic freedom index value. One area for potential improvement is legal structure and property rights protection. Business efficiency would likely benefit from greater judicial independence and more impartial courts. Other areas of concern are a needlessly complicated business registry process, high costs of tax code compliance, plus administrative and financial burdens imposed by a sclerotic labor code.

Several consequences of Mexico's regulatory hurdles stand out. The labyrinthine business registry process leads to a high level of "informality." Because so many businesses are not legally registered, it is difficult for them to qualify for commercial credit or bank loans. The prevalence of unregistered private enterprise also hurts the tax base and weakens government revenues. Lending to the private sector is further reduced due to poor protection of creditor rights, rendering bank loan collateralization lower than it should be in a country as advanced as Mexico.

High prices for telecommunication and internet services indicate an absence of competition in these markets. State monopolies in key energy sectors (oil, electricity, natural gas) have pronounced levels of under investment. While Mexico is an important oil producer, it imports a very high percentage of its gasoline. The observed inefficiencies are at least partially due to skewed incentive structures.

Economic performance in Mexico lags behind that observed in many other countries. Some lower income countries such as China are rapidly closing the regulatory gap that once separated them from Mexico. Income gains in those economies have been impressive. Mexico can likely also benefit from allowing its economy to operate more flexibly.

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Improved Short-Term Outlook

As the second quarter of 2011 comes to a close, the economy of Mexico continues to expand. Gross domestic product (GDP) expanded by 4.6 percent between the fist quarter of 2010 and the corresponding period in 2011. In response, five survey analysts raised their GDP forecasts for 2011. The consensus outlook calls for GDP to grow by 4.2 percent this year, a 20 basis point increase relative to last quarter's report. All but one of the panelists now expect GDP growth of greater than 4 percent in 2011. The outlier in this regard anticipates growth to decelerate to less than 3 percent for the year as a whole.

Although the outlook for GDP has improved this quarter, the consensus for private consumption has been revised downward by 20 basis points. At 4.1 percent, this forecast closely matches overall economic expectations, but a closer look at the individual forecasts indicate that most survey participants anticipate balance sheet repair work by households in 2011. Five of the respondents predict that private consumption will increase at rates of 3.7 percent or less. Two panelists anticipate greater consumer willingness to shoulder more indebtedness and forecast consumption growth to exceed that of GDP.

The stronger economic outlook is expected to bolster public sector expenditures this year. Government consumption is expected to increase at a consensus rate of 3.1 percent, a 30 basis point improvement relative to last quarter's survey. While oil prices have increased substantially this year, all but one of the panelists expect government outlays to grow by less than 3.2 percent in 2011. Clearly, the consensus is for Mexico to continue reducing its fiscal deficit for a second consecutive year.

Reflective of continued improvement in Mexican business conditions, the rate of change for total fixed investment is expected to jump all the way to 5.5 percent in 2011. That marks an increase of 70 basis points from the consensus forecast last quarter. All but two of the respondents expect fixed investment to grow by rates of 5.3 percent or more.

The expansion of economic activity on the north side of the border continues to bring pronounced changes in expectations for the current account in 2011. Panelist projections have been revised upwards this quarter and now reach 15.6 percent. Panelist growth rates range from 12.2 percent to 23.6 percent. Mexican imports of goods and services are also expected to increase. The consensus forecast for imports in 2011 is now 15.1 percent, as intra-industry trade between the two countries accelerates along with industrial activity north of the border. Respondent forecasts for imports range from 10.8 percent to 20.2 percent.

Even though the panel now forecasts stronger growth is for 2011, the consensus outlook for consumer prices is now slightly lower than what it was last quarter. Five of the eight panelists predict consumer price increases of greater than 4.0 percent, while the remainder anticipates price increases ranging from 3.6 to 3.9 percent. The overall consensus inflation rate of 4.0 percent for 2011 is in line with econometric model simulations for Mexico this year. The more stable outlook probably reflects central government efforts to hold the federal deficit in check.

Given the lower rate of inflation now predicted by the panel, it is perhaps not surprising that the peso is expected to appreciate against the dollar by even more than what was forecast last quarter. The consensus outlook calls for the nominal exchange rate to average 11.97 pesos per dollar for 2011. That represents a 23 centavo per dollar change from the prior consensus. Among the various survey responses, estimates range from 11.70 to 12.50 peso per dollar.

At 4.4 percent, the panel forecast for the yield on 28-day Treasury Certificates (CETES) is unchanged from the previous quarter. All of the respondents anticipate that yields on this instrument will remain positive in real terms in 2011. The forecasts range from a low of 4.2 percent to a high of 4.7 percent.

Panelist expectations for 2012 again call for a slightly more moderate pace of growth. Real GDP is expected to grow at a rate of 3.8 percent next year. The consensus forecast for private consumption has declined by 60 basis points to 4.4 percent. In contrast, public sector consumption is now expected to grow more rapidly at a consensus rate of 3.6 percent. As the business sector continues to strengthen, total investment in 2012 is expected to reach 5.8 percent, an increase of 70 basis points relative to the prior quarter survey. Exports and imports of goods and services are both expected to continue to grow at double digit rates, although imports are still projected to expand at faster rate next year. Consumer prices are forecast to essentially hold steady at a 4.1 percent rate of change. In real terms, the outlook for the peso remains robust. The panel expects it to depreciate to 12.26 pesos per dollar for 2012 as a whole, a 24 centavo per dollar decline for the greenback. Tighter monetary policy is still projected for 2012. Survey responses indicate that the nominal yield on 28-day CETES will increase by 70 basis points to 5.1 percent.

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2011 Mexico Consensus Economic Forecast **Annual Average**

Annual Percent Change, 2011 from 2010

	GDP	Private Consumption	Government Consumption	Total Investment	Exports	Imports	Consumer Price Index	Exchange Rate	CETES 28 Day
American Chamber Mexico	4.3	4.6	2.8	5.3	14.2	14.2	4.1	12.0	4.4
BBVA Bancomer	4.7	3.6	2.5	7.0	12.2	10.8	3.6	11.8	4.5
Wells Fargo Bank	4.3	4.0	3.0	6.5	13.0	15.1	3.9	11.73	4.2
Center for Economic Forecasting of Mexico	4.2	3.5	2.8	6.5	15.5	17.5	4.0	11.70	4.5
UACJ	4.5	3.5	2.8	5.5	15.0	13.0	4.0	12.00	4.5
ITESM	4.3	3.0	4.5	6.0	16.0	12.0	3.7	11.80	4.7
COLEF	2.8	7.0	3.0	4.0	15.0	18.0	4.1	12.30	4.2
UAdeC	4.5	3.7	3.2	3.5	23.6	20.2	4.3	12.50	4.3
Consensus -- this quarter	4.2	4.1	3.1	5.5	15.6	15.1	4.0	11.97	4.4
-- last quarter	4.0	4.3	2.8	4.8	13.2	13.6	4.1	12.20	4.4

2012 Mexico Consensus Economic Forecast **Annual Average**

Annual Percent Change, 2012 from 2011

	GDP	Private Consumption	Government Consumption	Total Investment	Exports	Imports	Consumer Price Index	Exchange Rate	CETES 28 Day
American Chamber Mexico	4.6	3.9	3.0	5.9	8.7	14.1	4.1	12.1	5.3
BBVA Bancomer	3.8	3.4	3.6	5.0	10.7	10.5	3.8	12.2	5.6
Wells Fargo Bank	4.4	4.2	3.4	6.3	12.0	13.9	3.9	11.56	4.4
Center for Economic Forecasting of Mexico	4.8	4.6	4.5	8.5	6.5	8.8	4.5	12.50	4.5
UACJ	3.8	4.0	2.6	6.0	13.0	15.0	4.2	12.20	5.0
ITESM	4.0	3.0	4.0	5.5	15.0	13.0	4.0	12.00	5.0
COLEF	2.0	8.0	5.0	2.5	12.5	19.2	4.0	12.10	4.5
UAdeC	3.2	3.9	2.3	6.3	12.7	15.0	4.0	13.50	5.5
Consensus -- this quarter	3.8	4.4	3.6	5.8	11.4	13.7	4.1	12.26	5.1
-- last quarter	3.8	5.0	3.2	5.1	11.6	14.8	4.2	12.5	5.0

Annual Averages

Historical Data		GDP (2003 Pesos, billions)	Private Consumption (2003 Pesos, billions)	Government Consumption (2003 Pesos, billions)	Total Investment (2003 Pesos, billions)	Exports (2003 Pesos, billions)	Imports (2003 Pesos, billions)	Consumer Price Index June 02 = 100	Nominal Exchange Rate Pesos/ Dollars	CETES 28 Day
2010		8860.7	6024.7	999.3	1834.0	2758.8	2924.3	141.38	12.64	4.40
	Percent Change	*5.50%*	*3.85%*	*2.10%*	*0.03%*	*19.01%*	*19.16%*	*4.16%*	*-6.47%*	
2009		8398.7	5801.1	978.7	1833.5	2318.2	2454.1	135.74	13.51	5.39
	Percent Change	*-6.08%*	*-7.06%*	*3.47%*	*-11.27%*	*-13.73%*	*-18.64%*	*5.06%*	*21.27%*	
2008		8,942.4	6,241.6	945.9	2,066.3	2,687.2	3,016.3	129.2	11.14	7.68
	Percent Change	*1.50%*	*1.77%*	*1.09%*	*5.88%*	*0.45%*	*2.81%*	*5.13%*	*1.92%*	
2007		8,810.1	6,133.1	935.7	1,951.6	2,675.1	2,934.0	122.9	10.93	7.19
	Percent Change	*3.26%*	3.99%	3.07%	6.94%	*5.75%*	*7.08%*	3.97%	*0.28%*	
2006		8,532.0	5,897.9	907.8	1,824.9	2,529.7	2,740.0	118.2	10.90	7.19
	Percent Change	*5.15%*	*5.67%*	*1.87%*	*9.88%*	*10.94%*	*12.57%*	3.63%	*-0.16%*	
2005		8,114.1	5,581.3	891.1	1,660.8	2,280.3	2,434.0	114.1	10.92	9.20
	Percent Change	*3.21%*	*4.78%*	*2.52%*	*7.46%*	*6.75%*	*8.47%*	*3.99%*	*-3.29%*	
2004		7,862.1	5,326.6	869.2	1,545.6	2,136.1	2,243.8	109.7	11.29	6.82
	Percent Change	*4.05%*	*5.63%*	*-2.76%*	*8.01%*	*11.50%*	*10.74%*	*4.69%*	*4.63%*	
2003		7,555.8	5,042.8	893.8	1,430.9	1,915.8	2,026.2	104.8	10.79	6.23
	Percent Change	*1.35%*	*2.22%*	*0.81%*	*0.37%*	*2.69%*	*0.70%*	*4.55%*	*12.05%*	
2002		7,455.4	4,933.1	886.7	1,425.6	1,865.5	2,012.2	100.2	9.63	7.09
	Percent Change	*0.09%*	*1.59%*	*-0.33%*	*-0.64%*	*1.44%*	*1.46%*	*5.03%*	*3.10%*	
2001		7,448.7	4,856.1	889.6	1,434.8	1,839.0	1,983.2	95.42	9.34	11.31
	Percent Change	*-0.95%*	*2.48%*	*-1.98%*	*-5.64%*	*-3.60%*	*-1.63%*	*6.36%*	*-1.27%*	
2000		7,520.3	4,738.7	907.6	1,520.5	1,907.6	2,016.1	89.71	9.46	15.24

Note: 2010 data are preliminary and subject to revision

*GDP: Producto Interno Bruto, INEGI, 2003 Pesos

*Private Consumption: Consumo Privado, INEGI, 2003 Pesos

*Government Consumption: Consumo de Gobierno, INEGI, 2003 Pesos

*Total Investment: Formacion bruta de capital fijo, INEGI, 2003 Pesos

*Exports: Exportacion de bienes y servicios, INEGI, 2003 Pesos

*Imports: Importacion de bienes y servicios, INEGI, 2003 Pesos

*CPI, Banco de Mexico, Annual Average, Base = June 2002

*Exchange Rate, Banco de Mexico, Peso-to-dollar, Fecha de Liquidacion, Annual Average

*CETES 28 Days, Banco de Mexico, Annual Average

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