February 26, 2021

Latam Daily: Mexico GDP, Data-Dependent Banxico, Weak January Labour Market

- **Mexico: Q4 GDP confirms a better than expected recovery; Banxico minutes signal data-dependent approach; disappointing January labour market**

MEXICO: Q4 GDP CONFIRMS A BETTER THAN EXPECTED RECOVERY; BANXICO MINUTES SIGNAL DATA-DEPENDENT APPROACH; DISAPPOINTING JANUARY LABOUR MARKET

I. Q4 GDP confirms a better than expected recovery

According to INEGI, the final estimate for Q4-2020 GDP revealed Mexico's recovery was slightly better than the early estimate. Growth slowed from 12.4% q/q sa in Q3 to 3.3% sa in Q4 (chart 1), versus a the prior estimate of 3.1% q/q. Industrial growth slowed from 22.3% q/q in Q3 to 3.9% q/q in Q4; growth in services also ratcheted back from 9.0% q/q to 3.2% q/q and growth in the agricultural sector moderated from 12.4% q/q to 3.3% q/q.

The Q4 numbers imply that the average real GDP growth rate during 2020 was -8.3% y/y, the largest calendar-year drop in real GDP since the current series began in 1994, but below our earlier estimate of -9.1% y/y. GDP has now contracted for two consecutive years for the first time since the 2001–02 period owing to the structural weaknesses the Mexican economy faced before the COVID-19 crises began.

On the same day, INEGI also released, in a separate report, the monthly GDP proxy for December which revealed that the recovery of the Mexican economy lost momentum after growing at the slowest pace observed since the "re-opening" of the economy last June. Economic activity grew 0.1% m/m in December from November and contracted -2.7% y/y. Recent data (retail sales, ANTAD same store sales and PMIs) suggest that we underestimated Q4-2020, but may be somewhat over-estimating the level of activity for Q1-2021. In next week's LATAM weekly we'll release our updated forecasts, which will reflect a weaker Q1-2021, but a stronger H2–2021 forecast based on what is likely stronger services activities due to vaccination campaign progress both domestically and abroad and robust US growth.

II. Banxico minutes signal data-dependent approach

Mexico's central bank (Banxico) published the minutes of its last monetary policy meeting on Thursday, where the Board cut the reference rate -25 bps to 4.00%. The February 11 decision took many investors by surprise, as the majority were anticipating a split vote, which came out as unanimous. Our view from the minutes is that the message was more balanced than the dovish interpretation that was given to the unanimity of the vote. Although the Board does leave the door open to more easing, it leads us to believe it will be on a strongly data-dependent basis as we had already anticipated. Once the expected pickup in inflation in the second quarter has passed, a window of opportunity for additional cuts should open again. Our current forecast anticipates -50 bps in cuts during Q3-2021.

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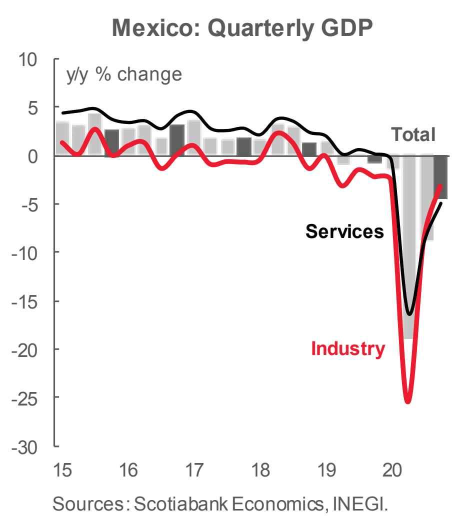
Chart 1



Sources: Scotiabank Economics, INEGI.

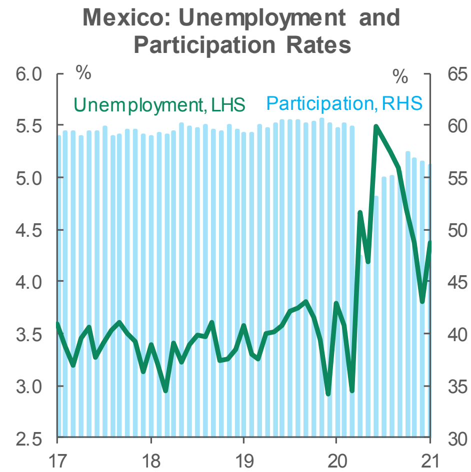
The most notable comments we saw in the minutes suggest that there are 2 more cautious members of the Board, which we believe are Governor Diaz de Leon, and Deputy Governor Espinoza, who see less room for further easing. However, there are still 3 Board members who appear to see room for further stimulus going forward—implying that our 2 expected additional cuts are likely to be delivered based on the information we currently have available. At least one member of the Board seemed somewhat more cautious given the adjusting external conditions, where higher rates could limit Banxico's room for additional stimulus. One Board member noted that easing had to be undertaken with caution due to the risk of capital flow reversal. In addition, another member, hinted that a window to ease further may have been missed in November–December, and that with the looming base-effect & energy price driven spike in inflation we're likely to see in the coming few months, it could become necessary for Banxico to take a more measured approach. Overall, we still see room for further cuts, but the minutes suggest a more prudent stance by the Board than what we, and we believe markets, perceived in the post-decision statement.

III. Labour market deteriorates in January

January's unemployment rate, released on Thursday, was 3.73%, above the consensus expectation of 4.37% and the previous 3.80% (chart 2) suggesting that employment remains vulnerable and that labour market conditions have deteriorated for a large part of the population. Moreover, one quarter of the people who became unemployed at the beginning of the pandemic are still out of work, which puts about three million Mexican workers in a very difficult situation. Uncertainty and still shaky investment are likely weighing on employment at the start of 2021. In absolute terms, participation in the labour market shrunk in January:

- Total labour force contracted from 54.9 to 54.5 mn persons;
- The formally employed population decreased from 52.8 mn to 52.0 mn persons;
- The number of informally employed also decreased from 29.5 mn to 28.9 mn; and
- 15% of the employed population would like to work more hours to obtain a higher income.

Chart 2



Sources: Scotiabank Economics, INEGI.

The non-economically active population increased on a monthly basis from 9.4 mn to 9.5 mn persons, indicating a small increase in discouraged workers.

—Eduardo Suárez & Paulina Villanueva