Scotiabank

GLOBAL ECONOMICS

LATAM DAILY

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Latam Daily: A Mexican Omnibus: Banxico's Minutes, GDP Revisions, and Trade Balance

- **Mexico: Banxico's minutes; GDP revisions raise growth; trade balance reverses**

MEXICO: BANXICO'S MINUTES; GDP REVISIONS RAISE GROWTH; TRADE BALANCE REVERSES

I. Banxico's minutes—rising risk of a 75 bps hike?

Banxico released the minutes from its May 12 MPC meeting, in which the Board voted 4:1 to raise the policy rate by 50 bps. The minutes reveal that most of the Board saw a recent downside bias to the global growth outlook, combined with rising inflation risks stemming from Russia's invasion of Ukraine that could lead to additional strains on global supply chains. Board members also took note of the accelerating pace of monetary policy tightening globally, with one observing that, if market expectations are correct, the Fed's policy setting would end up on the tight side.

Based on Deputy Governor Heath's comments over the past couple of weeks (with which we agree), the best approach for Banxico in the current monetary policy tightening cycle is to look at the spread over US rates (consistent with the policy decisions taken in past monetary policy tightening episodes). In this regard, we also agree with Deputy Governor Heath's comments that Mexico will likely need to keep a spread of around 600 bps over US rates (Heath mentioned 600–650 bps).

On the domestic macro front, the Board pointed to an improvement in domestic economic activity, which has since been confirmed by INEGI, driven by industrial activity and services. Board members observed that manufacturing continues to drive the recovery in the secondary sector, and pointed to the improvement in services activity, though growth there is much more mixed. The Board also noted that consumption has now overtaken pre-pandemic levels, even if investment remains subdued, while exports have been robust.

Notably, most Board members continues to see slack in the economy (and thus no demand-pull inflation). As we have explained before, we are not convinced, as we believe data used to measure the economy's recovery is biased by pre-pandemic habits. That said, two Board members acknowledged that spare capacity is uneven across sectors, which we attribute to shifts in spending habits. In this respect, we think the perceived slack in the economy could be overstated.

Board members were unanimous that there has been a deterioration with respect to the outlook for the inflation. Most also took note of the rise in long-term inflation expectations, which points to a possible contamination of the price setting process. The main inflation risks are viewed as coming from energy, agricultural prices, and from persistent high core inflation. In this regard, the majority of the Board not only see upside risks to inflation, but a continued deterioration of the inflation outlook, consistent with repeated upward revisions to Banxico's inflation forecasts.

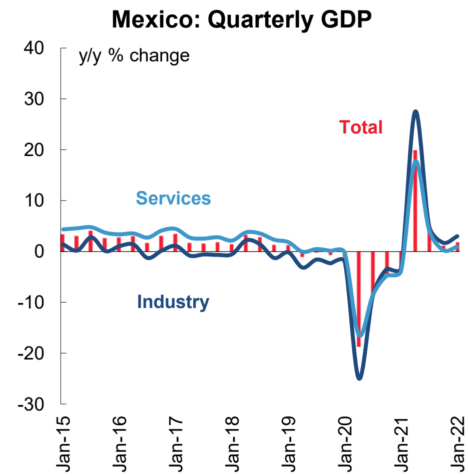
These minutes, together with recent comments by deputy Governor Heath, lead us to believe there are rising odds that the Board will support a 75 bps hike in the upcoming meeting. That said, based on the minutes, we think that one or two members remain unwilling to accelerate the pace of hikes.

—Eduardo Suárez

II. Revised GDP for Q1-2022 came in slightly higher than preliminary numbers

INEGI's revised GDP numbers for the first quarter of 2022 came in at 1.8% y/y in real terms (1.1% previously) (chart 1), slightly higher than the preliminary figure of 1.6% and in line with expectations. By sector, industry output rose 3.0% y/y (1.7% previously), mainly owing to an increase in manufacturing, which increased 4.7% y/y from 2.1%. The services sector registered an increase of 0.9% y/y (0.3% previously). Tourism services decelerated with respect to the previous quarter, but nevertheless grew by 42.7% y/y, down slightly from 45.7%. Business support services declined at a steep pace, -73.6% y/y (somewhat higher than the previous figure of -70.3%). Primary sector growth slowed to 1.9% y/y from 4.6% in the previous quarter. In seasonally adjusted quarterly terms, GDP accelerated to 1.0% q/q from 0.2% previously. By sector, industry grew 1.2% q/q (0.8% previously), services grew 1.3% q/q (-0.7% previously) and the primary sector fell -2.0% (1.1% previously). Going forward, we expect activity to continue at a moderate pace, affected by supply chain disruptions and higher prices globally. However, we anticipate services, especially tourism-related activities, to continue with the positive trend observed so far.

Chart 1



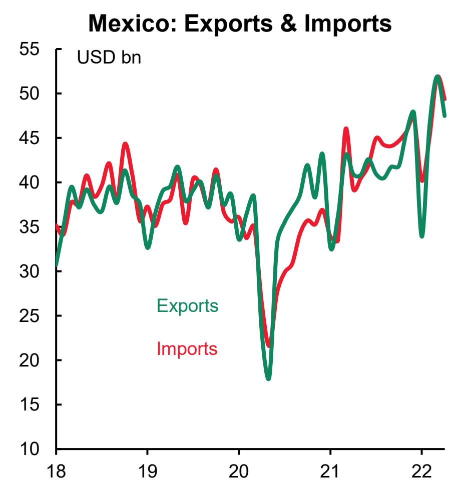
Sources: Scotiabank Economics, INEGI.

March's IGAE indicator of economic activity increased 0.4% y/y, down from 2.5% in February, on a seasonally unadjusted basis. On a seasonally adjusted basis, the IGAE increased 0.3% m/m (compared to -0.1% previously), with the primary sector up 4.5% (-1.4%), the secondary sector growing 0.4% (-1.2%), and the tertiary sector down -0.1% (0.5%).

III. Trade deficit of USD 1.8 bn reverses previous surplus

In April, the trade balance registered a deficit of USD -1.8 bn, reversing the previous surplus of USD 104 bn. Exports totaled USD 47.5 (chart 2), equivalent to an annual increase of 16.0% y/y, down from 20.6% in March, led by oil exports (81.3%) reflecting higher oil prices, followed by manufacturing (12.3%). Within manufacturing exports, automotive exports rose by 5.2%, while the rest rose by 16.0%. Imports reached USD 49.4 bn during April (chart 2), accelerating to 25.7% y/y from 12.7% previously. Imports of consumer goods rose 40.6%, followed by intermediate goods (23.9%), and capital goods (22.5%). The accumulated January-April balance recorded a deficit of USD -6.8 bn, with an increase in exports of 17.4% and in imports of 22.1%. Finally, in monthly seasonally adjusted terms, exports rebounded from -2.5% m/m to 0.86%, while imports accelerated from 1.66% to 5.20%.

Chart 2



Sources: Scotiabank Economics, INEGI.

Looking ahead, we expect exports to continue to advance, driven by a favorable pace in US demand, although with risks from supply chain disruptions limiting production capacity in manufacturing products. On the import side, we maintain an outlook of modest monthly advances, in line with a moderate recovery in domestic demand.

—Brian Pérez