MEXICO

After decelerating in late 2016, the pace of economic activity is projected to pick up somewhat, mainly reflecting stronger exports. Improved business confidence will support the upturn in investment. Consumer spending, the engine of growth in the past two years, will grow at a slower pace, as rising inflation damps consumers' purchasing power and credit conditions tighten.

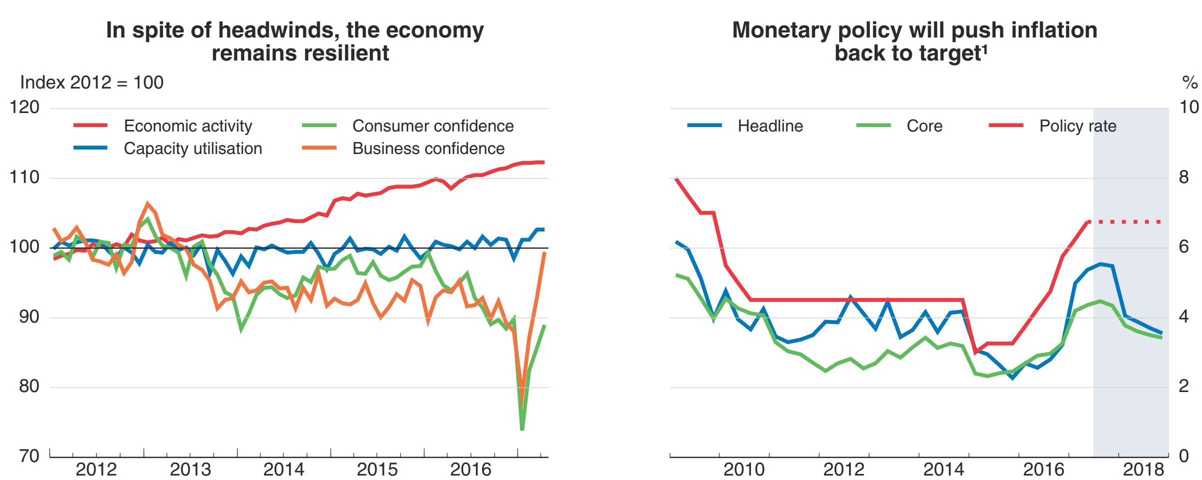
At 6.75%, the monetary policy interest rate is at its highest level in eight years, and is projected to remain so to contain the transitory surge in inflationary pressures. Going forward, monetary policy should continue to consider all the determinants of inflation and its expectations, particularly the pass-through to other prices from exchange rate depreciation and gasoline price adjustment, as well as the relative monetary policy stance with the US and the output gap. To slow the rapid rise in public debt, fiscal consolidation is projected to continue.

The Mexican economy has benefitted from open borders, foreign direct investment inflows and integration in global value chains. Remaining barriers to foreign investment and services trade should be lifted to move up in global value chains, increase the diversification of exports and strengthen geographical linkages. However, certain locations and categories of workers have benefitted less from open borders than others. Improving education outcomes and reducing informality would help to spread the benefits of globalisation more widely.

The Mexican economy has remained resilient

Private consumption has supported growth, buoyed by a strong labour market, credit expansion and an upsurge in remittances. Private investment has also contributed to growth, offsetting a sharp fall in public investment. Inflation has risen temporarily, due to the depreciation of the peso and the liberalisation of gasoline prices, prompting the central bank to tighten monetary policy to avert the de-anchoring of inflation expectations.

Mexico



1. Banco de Mexico's inflation target band is 3±1%.
Source: OECD Economic Outlook 101 database; and Banco de Mexico.

StatLink http://dx.doi.org/10.1787/888933503491

Mexico: **Demand, output and prices**

	2013	2014	2015	2016	2017	2018
	Current prices MXN billion	Percentage changes, volume (2008 prices)				
GDP at market prices	16 112.9	2.3	2.7	2.0	1.9	2.0
Private consumption	11 045.4	1.8	2.2	2.5	2.2	1.9
Government consumption	1 962.5	2.1	2.3	1.1	0.8	0.0
Gross fixed capital formation	3 401.2	2.9	4.3	0.4	0.5	1.2
Final domestic demand	16 409.1	2.0	2.7	1.9	1.7	1.5
Stockbuilding[1]	- 150.9	0.0	-0.2	-0.1	-0.2	0.0
Total domestic demand	16 258.2	2.1	2.4	1.8	1.6	1.6
Exports of goods and services	5 118.6	6.9	10.4	1.2	3.2	2.7
Imports of goods and services	5 263.9	5.9	8.7	0.4	1.2	1.7
Net exports[1]	- 145.3	0.3	0.5	0.3	0.7	0.4
Memorandum items						
GDP deflator	_	4.7	3.1	4.8	6.2	4.4
Consumer price index	_	4.0	2.7	2.8	5.3	3.8
Private consumption deflator	_	4.2	4.0	4.4	6.3	4.3
Unemployment rate[2]	_	4.8	4.3	3.9	4.2	4.3
Public sector borrowing requirement[3,4]	_	-4.6	-4.0	-2.9	-1.4	-2.5
Current account balance[4]	_	-2.0	-2.9	-2.6	-2.7	-2.6

1. Contributions to changes in real GDP, actual amount in the first column.
2. Based on National Employment Survey.
3. Central government and public enterprises. In 2016 and 2017, the public sector borrowing requirement includes the operating surplus of the central bank.
4. As a percentage of GDP.

Source: OECD Economic Outlook 101 database.

StatLink http://dx.doi.org/10.1787/888933505980

Macroeconomic policy aims to secure stability

The government is committed to its multi-year fiscal consolidation plan, set in 2013, to reduce the budget deficit (measured by the public sector borrowing requirement) by 2 percentage points of GDP over four years. The public sector borrowing requirement is projected to fall to 1.4% GDP in 2017, and a primary surplus is expected to be attained for the first time since 2008. However, there is ample scope to make the tax and transfer system more redistributive. Measures to curb tax evasion and to lower tax avoidance would raise additional revenues that could be used to further strengthen social spending and eliminate extreme poverty. Expanding early childcare and pre-school education, while improving its quality, would encourage female labour force participation, reduce income inequalities and alleviate skill shortages in the future.

Monetary policy has been tightened pre-emptively to avoid second-round effects from the peso depreciation and the adjustment of gasoline prices early in 2017, with the aim of keeping inflation expectations anchored and pushing inflation back to the target range of 3±1%. The monetary policy rate was lifted by 250 basis points in 2016 and has been increased by another 100 basis points so far in 2017.

External risks remain significant and will determine growth

Growth is projected to remain at around 2% in 2017-18. Investment plans that were put on hold due to recent heightened uncertainty and turbulence are expected to resume as confidence is gradually restored, while the strong manufacturing sector and the weak peso support exports. However, consumer spending will be damped by rising inflation and tighter credit conditions.

Risks to the outlook are sizeable. The Mexican economy is highly open and deeply integrated in regional supply chains. So far, industrial production, investment and exports have been resilient to the possibility of NAFTA renegotiations or other protectionist measures. However, unfavourable policy announcements in this area could derail investment, manufacturing production and exports. Lower revenue collection stemming from weaker growth could endanger fiscal consolidation plans and call for further cuts in government spending, weighing further on growth. On the upside, a full implementation of planned structural reforms, in particular to improve the efficiency of the judiciary system, reduce corruption and boost education quality, would strengthen productivity growth.