LATIN AMERICA ECONOMICS UPDATE

Best of Mexico's recovery now over

- **Mexico's economy has put in a decent performance over the past year or so, but we think that most of the factors that have supported robust growth have now run their course. Tight policy and a looming recession in the US mean that the economy is likely to lose steam over the coming quarters and we expect Mexico's recovery from the pandemic to continue to lag behind its regional peers.**
- Having recorded decent growth of 3.1% in 2022, the latest data show that Mexico's economy made a surprisingly strong start to the year, expanding by 1.1% q/q in Q1.
- **A closer look at the industry breakdown shows that the recovery over the past year or so has been driven in large parts by a rebound in secondary (industry) and tertiary (services) activity.** (See Chart 1.) Within the latter, output expanded in most subsectors, with rises particularly large in the transportation, wholesale trade and hospitality subcategories. But these gains were partly offset by weakness in business support services, which have been hit by the outsourcing law introduced in 2021.
- **Turning to industry, manufacturing has been the bright spot**, with output 6% above its pre-pandemic level. (See Chart 2.) In contrast, production in other parts of industry (mining, construction and utilities) was still some way below its pre-Covid levels. Digging a bit deeper, the strength in manufacturing was concentrated in the production of electronic equipment, and to a lesser extent, transport equipment.
- Given that a large part of Mexico's manufactured goods are exported, it's perhaps not surprising that, on the expenditure side, the recovery has been driven by exports. A swift recovery in tourism – which falls under services exports – contributed to the strength in exports too. Domestic demand has been sluggish.
- **Taking a step back, though, the bigger picture is that Mexico's economy remains a regional laggard.** What's more, we think that the factors that have supported the economy over the past year or so have largely run their course. Admittedly, strong wage growth should support household incomes and offset some of the hit from tight policy. But with the US set to fall into recession, demand for Mexico's (manufactured) exports is likely to take a hit. (See Chart 3.) And given that tourist arrivals are above their pre-pandemic level, services exports are unlikely to make further large gains either. **All told, given the strong start to the year we now expect above-consensus growth of 2.3% this year (previously 1.8%). But contrary to most other analysts, we think that growth will slow further next year.** (See Chart 4.)

Chart 1: Contribution to GDP (%-pts)

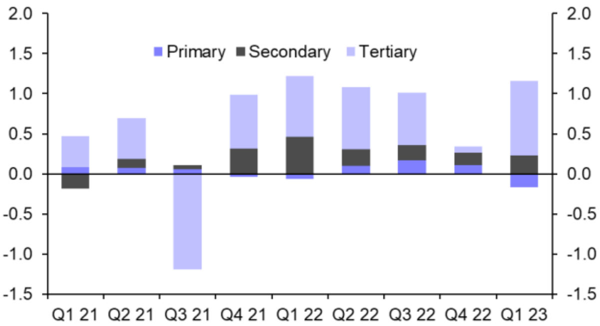


Chart 2: Industrial Output (SA, Q4 2019 = 100)

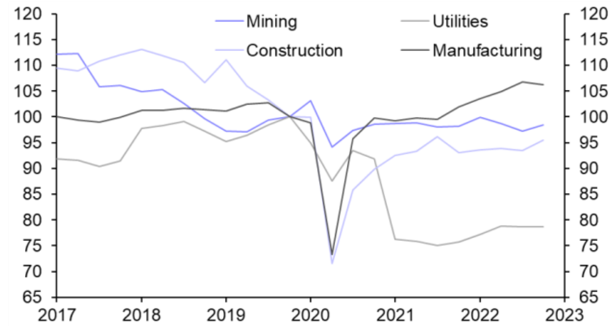
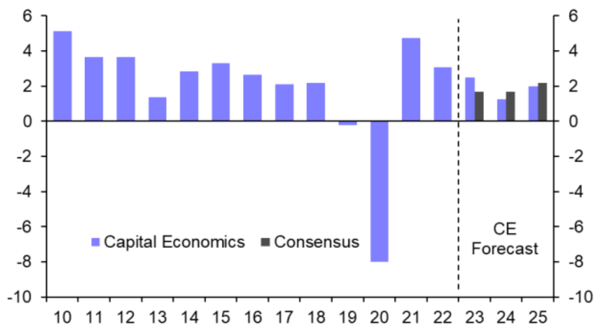


Chart 3: US Imports & Mexico Exports (% y/y)

Chart 4: Mexico GDP (% y/y)



Sources: Refinitv, FocusEconomics, Capital Economics

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