The ECONOMY in brief

Economex
by AMERICAN CHAMBER/MEXICO

2nd Quarter & July
2023

The ECONOMY in brief

Introduction

The outlook for the second quarter of 2023 suggests a mixed and challenging global economic landscape. Although the recent resolution of the US debt ceiling conflict and efforts to stabilize the banking sector in the US have reduced immediate financial risks, risks persist in terms of global growth. Inflation could remain high due to external shocks like the military conflict in Ukraine or unprecedented weather events, leading to stricter monetary policies. On the other hand, inflation might decrease more rapidly, reducing the need for restrictive monetary policy, and domestic demand could remain strong.

Global growth picked up in early 2023, but the tightening policies since 2022 could result in a decline in growth due to the impact on spending and industrial production. Additionally, the recovery of China's economy might slow down due to issues in the real estate sector, causing cross-border impacts. The eurozone faces moderate growth due to inflation, high rates, and weak external demand, projecting a GDP decline and slight recovery. Some Asian economies exhibit strong growth in 2023, backed by consumption and investment.

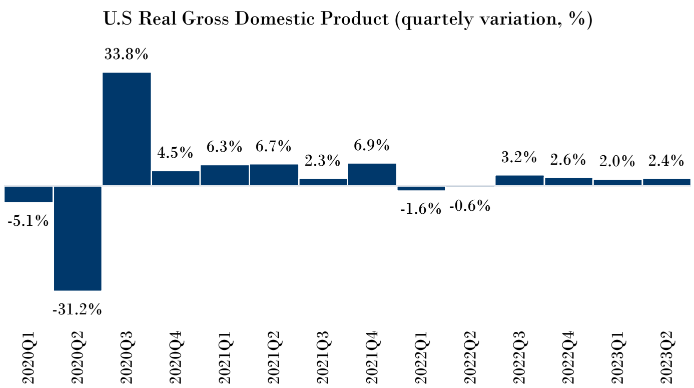
In July, favorable estimates for Mexico's GDP were announced by the International Monetary Fund and the Ministry of Finance and Public Credit, attributed to various factors: a resilient labor market, government spending on social welfare, and the growing Nearshoring phenomenon. Despite inflation remaining above target, it has decreased to its lowest level in two years, while average wages in real terms are increasing.

This report contains a concise explanation of the economic behavior of each of the major economies worldwide. Subsequently, the case of Mexico will be covered, the GDP, its investment and consumption components; exports and imports through the trade balance; industrial production; inflation and the interest rate; the financial markets; public finances; the employment situation, as well as other economic indicators of interest, to finally present forecasts for both, this year and the next.

International Context

United States

The U.S. economy has seen growth in the first half of 2023, wherein the second quarter of 2023, Real Gross Domestic Product reached 2.4%. Despite business pessimism and slowing business investment, consumer spending has provided some positivity. However, there's a possibility of a 'soft landing' scenario for the economy a mild recession by the end of the year if consumer spending moderates further.



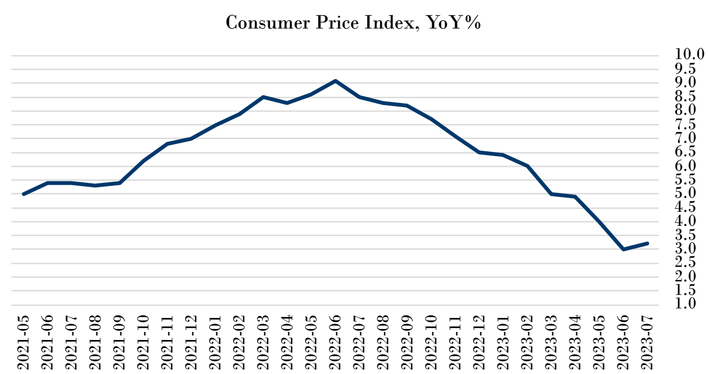
Source: Bureau of Economic Analysis

The tight labor market is predicted to ease somewhat. Despite the low 3.6% unemployment rate, signs of mixed signals are emerging. Although open jobs and payroll gains remain above average, declining productivity, reduced temporary employment, and a lower quit rate suggest a slight weakening in labor supply and demand.

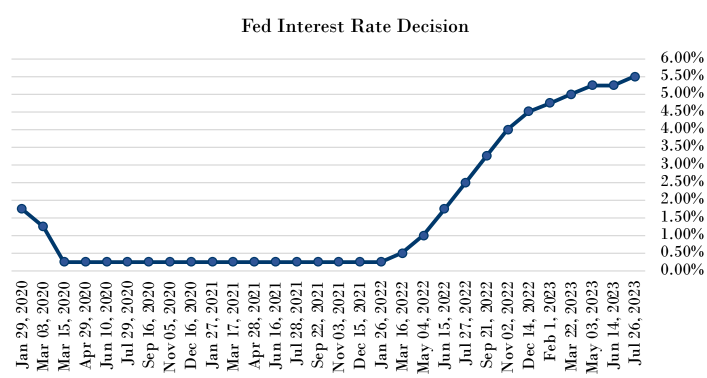
Consumer spending in the U.S. is slowing down as the excess savings from the pandemic era are being utilized. Although spending has remained resilient in the first half of the year, growth is slowing, and there's a shift toward services. The restart of student loan payments could further dampen spending. Nonetheless, household financial stability remains intact.

Inflation is showing gradual improvement, but certain areas still experience elevated levels. Falling energy prices have contributed to lower headline inflation. Core inflation, which excludes energy and food, has been slower to improve, particularly in service categories. Although inflation is expected to improve gradually, reaching the Fed's 2% target might take until late 2024.

The Federal Reserve's aggressive rate hikes, totaling 500 basis points since March 2022, are approaching an end. In July, the interest rate had a 25-basis points hike that was followed by a pause in rate increases, reaching 5.50%. Quantitative tightening continues, removing liquidity from the economy at a monthly pace of $100 billion.



Source: Bureau of Labor Statistics



Source: Board of Governors of the Federal Reserve System

Supply chain disruptions are easing, leading to lower shipping costs, increased container ship capacity, and shorter delivery times. While some commodity inputs and components have not fully recovered, there's a sequential improvement.

The housing market is finding stability after a significant drop-in activity in the latter half of 2022. Mortgage rates in the 6.5-7.0% range have contributed to this stabilization, with home values remaining close to historical highs.

China

China's GDP growth accelerated in the second quarter of 2023, reaching a healthy growth rate of 5.5% year-on-year for the first half of the year. The second quarter saw a notable increase in GDP growth, reaching 6.3% year-on-year, up from the 4.5% growth in the first quarter. The growth was distributed among primary, secondary, and tertiary industries, which saw year-on-year growth rates of 3.7%, 4.3%, and 6.4% respectively.

Foreign trade also picked up momentum in Q2 2023, with imports declining slightly. Exports grew by 3.7% year-on-year, while imports fell by 0.1% year-on-year, resulting in a trade surplus of approximately $389.97B. Private companies accounted for 52.7% of total trade, while foreign-invested enterprises (FIEs) and state-owned enterprises (SOEs) made up 30.7% and 16.4% respectively.

China's economic recovery from the pandemic has been steady, with the 5.5% growth rate aligning with the full-year target of around 5% for 2023. However, there are challenges ahead as the growth rate in the second quarter fell below-projected rates, indicating a need for additional stimulus to maintain momentum. The government is considering policy measures to enhance economic development, expand demand, optimize the real economy, and mitigate risks in key sectors.

China's exports, particularly electronic products, have been a major driving force, accounting for 58.2% of total exports. The electronic export sector saw significant growth in various categories, including electrical equipment, automobiles, and machinery. Labor-intensive exports also increased slightly. Hong Kong's economy is also rebounding after the border reopening, with the city benefiting from the end of COVID-19 restrictions and its role as a financial hub for China.

Despite the positive economic outlook, the Chinese economy faces potential headwinds, including a cooling global economic environment and challenges in the real estate market. Residential property sales have dropped significantly, and real estate investment fell in the first half of the year. China's property sector is likely to face ongoing weakness, particularly in lower-tier cities and private developer financing. This persistent weakness is anticipated to continue to negatively impact the country's economic growth.

Japan

Japan's economy is making progress, albeit at a slow pace. In Q1, real GDP increased by 1.8% compared to the previous year, though it remains below 2019 levels. Indicators like purchasing managers' indices suggest the manufacturing sector has plateaued or declined in Q2, while the services sector is recovering from pandemic-related weaknesses. The pent-up demand and an accommodative central bank are expected to keep the economy on a positive trajectory. However, the growth rate might be limited by high inflation and global economic weakness.

The Bank of Japan (BoJ) is maintaining its accommodative monetary policy despite high inflation. The policy rate remains at -0.1%, and the 10-year government bond yield is held near zero. The BoJ uses various measures of underlying inflation, with differing results. While some measures indicate inflation is below the 2% target, others show higher levels, possibly due to rising commodity prices and a depreciating yen.

Consumer demand's outlook is mixed, offering the BoJ room to maintain its current monetary policy stance. While some data indicates weak consumer spending, other measures, such as retail sales and consumption activity index, show positive trends. The unemployment rate is relatively low, yet labor-force participation remains high, impacting wage growth.

Japan's manufacturing sector has benefited from a weak yen, supporting export growth. While exports have faced challenges due to economic slowdowns and semiconductor industry headwinds, renewed demand for automobiles and an accommodative policy from the BoJ are expected to contribute to the export recovery.

As income-to-spending cycles strengthen, the economy is likely to grow above potential rates. The consumer price index is anticipated to decelerate temporarily due to past import price increases but may accelerate again as inflation expectations and wage growth improve.

Europe

Eurozone's growth prospects remain subdued due to inflation affecting real incomes, high-interest rates impacting the economy, and weak external demand hurting manufacturing.

The European Central Bank (ECB) may continue tightening monetary policy based on data-dependent decisions and the trajectory of core inflation. The European labor market remains robust, supporting the region's strength, and labor shortages have led to higher employment levels. The European economy faces challenges like high inflation, tight financial conditions, and the withdrawal of fiscal measures, which might constrain growth.

In the UK, elevated inflation erodes household income and pressures the Bank of England to tighten monetary policy. Central and Eastern European countries are expected to rebound strongly due to disinflation and realize their potential growth.

However, European economies, in general, remain below pre-Covid trends due to the pandemic's long-term effects and geopolitical tensions. Upside risks include increased inflation, banking sector stress, and geopolitical tensions, while downside risks involve energy and food price spikes, financial market turbulence, and vulnerability due to elevated debt levels. The structural labor market tightness could drive productivity-enhancing technology adoption, boosting productivity, especially in Europe where there's room for improvement digiin tal technology adoption.

Mexico

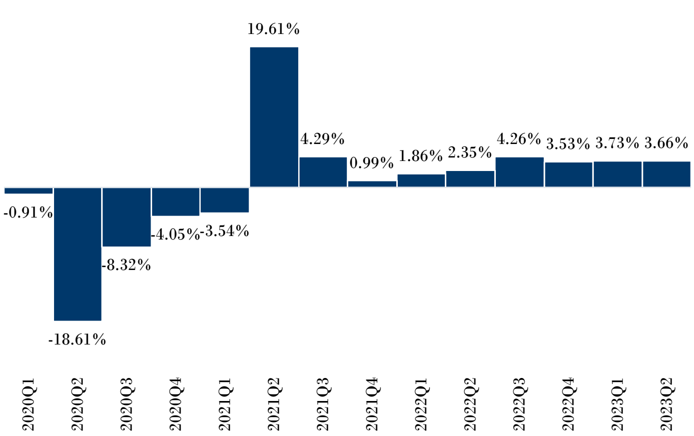
Inflation continues to decrease, and manufacturing has shown positive variations during the first semester, with employment and remittances still growing. We anticipate the Mexican economy to grow by 2.7% this year, with an annual general inflation rate of 5.0%, alongside a reference rate of 11.25%.

Gross Domestic Product

For the second quarter of 2023, the quarterly variation of Mexico's GDP registered an increase of 3.66%. A significant element contributing to the enhancement of predictions about Mexico is the removal of the risk of a recession in the United States. The projected GDP growth from SHCP for 2023 exceeds 3%, owing to the influx of companies to the country through supply chain relocation, a phenomenon referred to as nearshoring.

Total Global Economic Activity (IGAE) is expected to increase monthly in June by 0.2%, according to INEGI timely indicator. Primary, Secondary, and Tertiary Activities increased by 0.27%, 0.96%, and -0.36%, respectively.

Mexico Real Gross Domestic Product (quartely variation, %)



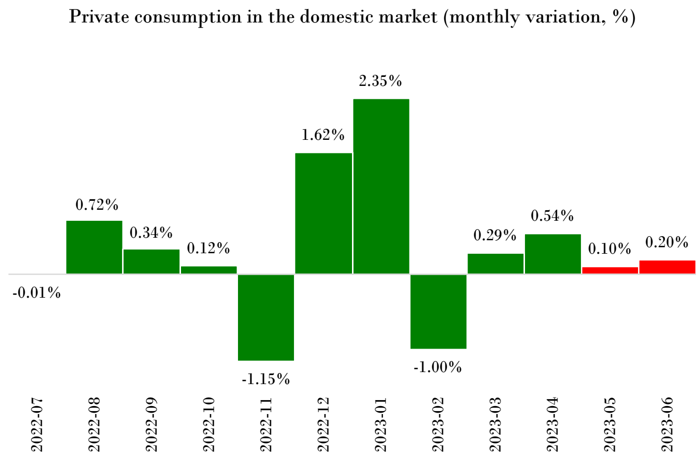
Source: Instituto Nacional de Estadística y Geografia. Banco de Información Económica. Seasonally adjusted.

Private Consumption

In May 2023, with seasonally adjusted and annualized data, the IMCPMI (Mexican Monthly Indicator of Economic Activity) increased by 3%. Within it, spending on imported goods grew by 16.1%, while spending on domestic goods and services increased by 0.7% (services increased by 3.8% while goods declined by 1.9%). The INEGI timely indicator for private consumption in the domestic market is 0.20% in June 2023.

In June 2023, nominal sales on a Same-Store basis, accounting for all those stores with over a year of operation, exhibited a positive change of 9.3 percent. For Total Stores, which encompasses stores opened in the last 12 months, growth reached 12.4 percent compared to the same month in 2022.

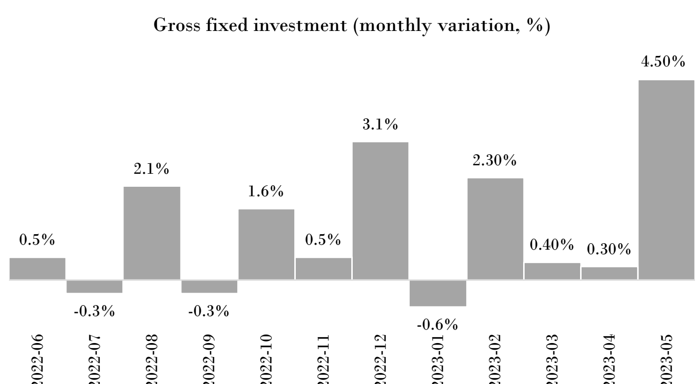
Cumulative sales for the first six months of 2023 reached 720.7 billion pesos. By the end of 2022, the retail chains forming the National Association of Self-Service and Departmental Stores (ANTAD) collectively comprise over 47,000 stores.



*Source: Instituto Nacional de Estadística y Geografía. Banco de Información Económica. Seasonally adjusted. *Note: color red is for INEGI timely indicator.*

Gross Fixed Investment and Foreign Direct Investment

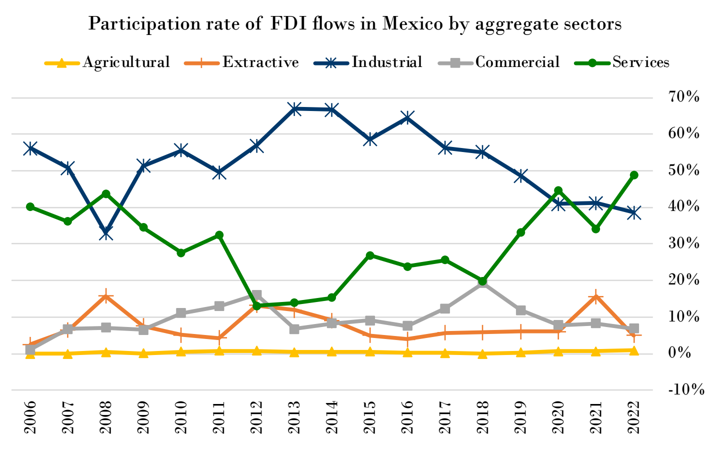
In May, Gross Fixed Investment grew by 4.5%, the largest increase since August 2020, reaching a historic high. The Construction sector was the primary driver, with a monthly growth of 7.6%, the best since August 2020. This positive trend marks four consecutive months of growth in Gross Fixed Investment, with an annual growth of 15.1%, the highest in 22 months. The Construction industry's remarkable 30% growth in May and June 2023 stands out as well.



Source: Instituto Nacional de Estadística y Geografía. Banco de Información Económica. Seasonally adjusted.

In the first half of 2023, Mexico experienced a notable 41% increase in Foreign Direct Investment (FDI), totaling $29.041 billion. Spain contributed a record high of $4.356 billion in FDI to Mexico during the same period, reflecting strong investor confidence despite legal uncertainties, particularly in the energy sector. The manufacturing sector led the FDI, constituting around 57% of the total, with significant investments in transportation equipment, chemicals, and food industries. Financial services remained a crucial sector, with Spanish financial entities dominating the Mexican banking market. The states benefiting most from Spanish investment were Mexico City, Nuevo León, Baja California, the State of Mexico, and Jalisco, collectively making up 60% of the total FDI received.

Mexico is one of the top 10 world's largest recipients of foreign direct investment (FDI). With revised figures from Secretaría de Economía, Mexico recorded a value of 36.215 billion dollars in Foreign Direct Investment (FDI) in 2022, marking a 14.77% increase compared to 2021. Among the main recipients of this FDI is the service sector with 48.71%, followed by the manufacturing sector with 38.56%. In terms of states, Mexico City, the State of Mexico, Nuevo León, and Chihuahua were the primary destinations for FDI.



Source: Secretaría de Economía.

Desbloquea este documento:

Para leer y descargar documentos completos de esta debes formar parte de la membresía Economex. Que es un foro mensual para empresas socias de AmCham en donde pueden contar con información económica oportuna y ser parte del análisis y discusión que encabeza Luis Foncerrada, asesor económico de AMERICAN CHAMBER/MEXICO.

Para más información, contacta a:

Arturo Martínez | amartinez@amcham.org.mx

Economex by AMERICAN CHAMBER/MEXICO