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E FACTOR NETWORK NEWSLETTER

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Company News and Highlights

Supply Chain Finance Solutions for Cash Requirement.

Fintech products and market development based on Fundamentals of Economic Theory and Financial Risk.

MEXICO'S GROWTH AT RISK: THE ECONOMIC OVERVIEW IS OVERSHADOWED IN THE SHORT TERM .

Written by Edgardo A. Ayala G.

Synthesis.

We reviewed the estimation growth of the GDP during 2019, at the same time, the main indicators of the circumstances of April and May:

- . The industrial activity presents an annual decrease of 3.3% in May.
- The debacle is especially stronger in the construction sector, which decreases by almost 10%.
- The investment deteriorates rapidly at rates above 3% per year.
- In an inertial scenario, the economy will grow by 0.6%. If companies continue to restrain their spending, the GDP could fall almost half percentual point in 2019.

Analyisis.

The alert is turned on, about the evolution of the Mexican economy. The resignation of Carlos Urzúa to the Department of Finance follows an unexpected fall of an annual 3.3% of the Indicator of Industrial Activity for May. The reduction in industrial activity is explained for a fall of 9% in mining activity, and almost 10% in construction. The manufacturing sector grows barely 0.7% in contrast with the indexes of May 2018.

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According to the survey made by Mexico's Bank to the private analysts, the average expectation of growth for 2019 is 1.13 and the median 1.1 in June. However, the incorporation of the recent information, the uncertainty caused by the changes in the cabinet and the next PEMEX rescue plan made it necessary to review the low growth of this year.

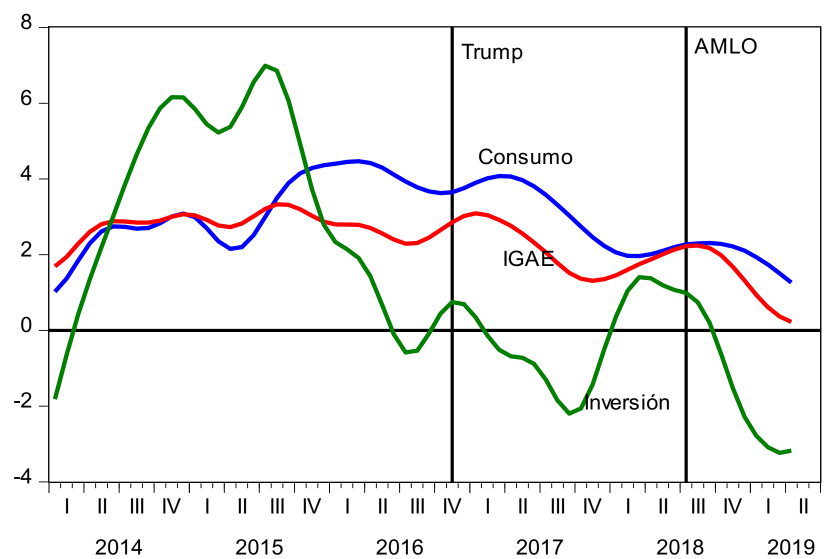
What are the implications that the fall of the industrial activity indexes will have? An important component of the Global Indicator of Economic Activity (IGAE from its Spanish initials) are the industrial activity indexes. Though an economic model, which explains 80% of the variation of IGAE as a function of the industrial activity. We estimate that the annual rate growth of the IGAE, would incur at 1.23% during the second quarter, which involves a contraction of the GDP near a percentual point in this quarter.

The economic activity contraction focuses on the collapse of the gross fixed investment. In chart 1, we present the indexes of IGAE tendency, private consumption, and investment. As it shows, the private consumption growth, which represents two-thirds of the GDP, it continuously grows at low rates. In April 2019 the consumption tendency growth was just 1.3%. Otherwise, the private investment which represents a fifth part of the GDP, presents important order contractions little over than 3%.

The investment has been affected, as a consequence of several factors. But mainly to a less optimistic performance of the economy, due to a hike of the real interest rate caused by the rise of the inflation at the beginning of 2017. We exemplify in the chart, that the growth of the investment it turns negative, firstly caused by the election of Donald Trump in November 2016, surely due to the uncertainty about the free trade agreement. At the end of 2017, it starts to recover, but the low rates barely exceed 1%. But at the end of 2018, it starts with a quite quickly reduction in private investment, in the same way, that coincides with the cancelation of the airport and the oil-rich and electricity auction.

Chart 1

The recent evolution of the annual growth rate in IGAE, the tendency of Mexico's consumption and investment.



Source: INEGI

Where does the GDP growth target for 2019? We can do an exercise based on the assumptions of the 2019 General Economic Policy Criteria (CGPE), but adjusting the expected growth of the components of GDP. The CGPE assumed a consumption growth of 2%, with both investment and government spending steady, exports were down 4% and imports 2%. The current evidence is only consistent with external variables, so under a conservative scenario, we might think that private consumption is growing, but only at 1.3% and investment keeps the decline of 3.2%, and government consumption contracts 2%. Under these circumstances, GDP growth would be 0.6% during 2019, still positive but minuscule.

However, in a more negative but likely scenario, the investment will continue to deteriorate, given the threats of possible US tariffs, but above all because of the uncertainty caused by the regression of energy policy, the financial crisis of PEMEX and the lack of quality and stable cabinet. A contraction in the order of 5 to 6% is feasible under these conditions, which, in addition to a greater contraction in public spending, could result in GDP decreasing 0.3% during the year.

The problem is that the signals sent by the current government make it more reasonable to postpone investment plans for companies, until waiting for the picture to be cleared. But the brake on investment makes things worse, which feeds back skepticism. To stop this vicious cycle, the government should strike a rudder, measures in the right direction could be to develop a credible rescue plan for PEMEX (e.g. use stabilization fund, remove fracking ban), renew the management of the energy secretariat and the state's productive companies, rethink a scheme to take advantage of the international airport now cancelled (e.g. concession it), among others.

Implications for Fintech Sector. So far, the financial sector, in general, has been shielded from slowing down the economy. The problem is that without solid growth, then the economy becomes very vulnerable. In a scenario where growth is very slow for two consecutive years, as can happen, it would be feasible for credit demand to grow more slowly. This, together with the no sharp declines in Banco de México's target interest rate expected, suggests that the profitability of the financial sector may be affected, at least marginally.

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