MEXICO'S ECONOMIC OUTLOOK

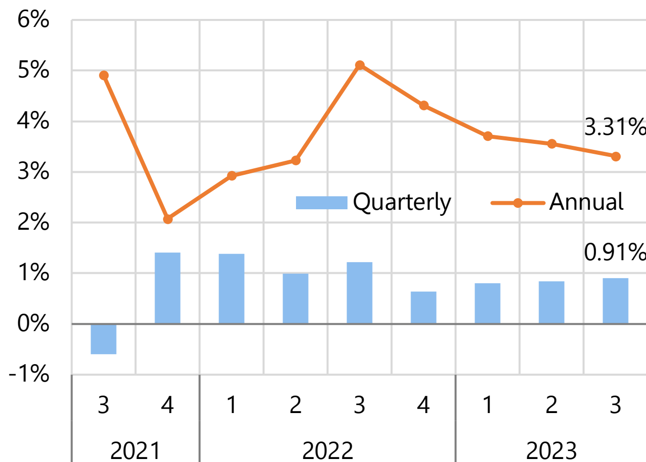
Third quarter 2023

Introduction

In the third quarter of 2023, Mexico's Gross Domestic Product (GDP) grew 0.91% with respect to the immediately preceding quarter, according to INEGI's timely estimate (Fig. 1). This is the highest quarterly growth rate since the third quarter of 2022, and with it, GDP accumulates 8 consecutive quarters of growth. With respect to the same quarter of the previous year, GDP registered an annual growth rate of 3.31%. This is the lowest annual rate since the second quarter of 2022, so we continue to observe a deceleration in the pace of growth. For purposes of comparison with the 4.9% economic growth published by the United States, the Mexican economy grew at an annualized quarterly rate of 3.7%.

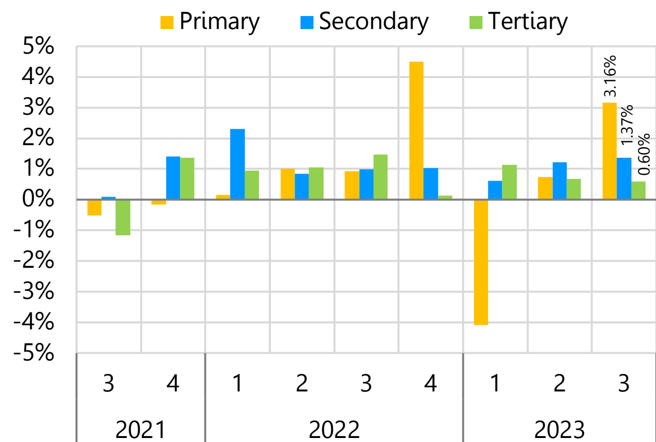
A breakdown by major groups of economic activity shows that the highest growth was in the primary sector, with a quarterly rate of 3.16%. However, primary activities only account for 4% of GDP, so their contribution is not that large. Instead, growth was driven by the secondary sector, which grew 1.37% over the previous quarter, its highest rate since the first quarter of 2022. With this, secondary activities recorded their tenth consecutive month of quarterly expansion, something not seen since 3Q 2009 - 3Q 2012, in the recovery from the Great Recession. Finally, tertiary activities (~58% of GDP) grew 0.60% quarter-over-quarter, accumulating eight consecutive quarters of growth. At annual rates, primary activities grew 5.34%, secondary activities 4.53% and tertiary activities 2.52%.

Fig. 1. GDP growth, % variation



Source: Grupo Financiero BASE with information from INEGI.

GDP by economic activity
var. quarterly % var.



Source: Grupo Financiero BASE with information from INEGI.

With the third quarter growth, Mexico's GDP stands 4.42% above the level observed prior to the pandemic (2019) and 3.89% above the peak it had previously registered in the third quarter of 2018.

In 2023, the Mexican economy shows an average annual growth of 3.53%. This implies that even if the economy were to stagnate in the last quarter of the year and not grow at all, the GDP in 2023 would show a growth of 3.27%.

The greater dynamism in the Mexican economy during the year was the result of growth in consumption and gross fixed investment, which reached record highs in the third quarter. Consumption has been driven by the growth of the wage bill,

remittances, government transfers to various population groups and the granting of credit. Gross fixed investment reached record highs due to *nearshoring* and the construction of public works.

High growth is a very positive thing, but it must be taken into account that Mexico's recovery was slow compared to the 45 largest economies in the world (See Annex 1), where Mexico is in 31st place. Finally, GDP per capita, a more accurate measure of what is happening in the economy, is still below the level observed in 2018, and growth forecasts suggest that it could barely close the six-year term with 0.5% growth.

In fact, growth driven in part by government transfers paints a picture in which Mexico could be following Argentina's economic model. To make it viable, it will need to collect more taxes, which will imply in the long run a restrictive fiscal policy, which could, among other things, slow down the inflow of foreign direct investment.

For this year, Mexico's GDP is expected to grow around 3.5%, for 2024 growth is expected to be between 2.5% and 3% and for 2025 growth is expected to be between 0.8% and 1.0%, as a result of 1) economic slowdown in the United States, 2) lower public spending in Mexico and 3) accumulation of consumer debt.

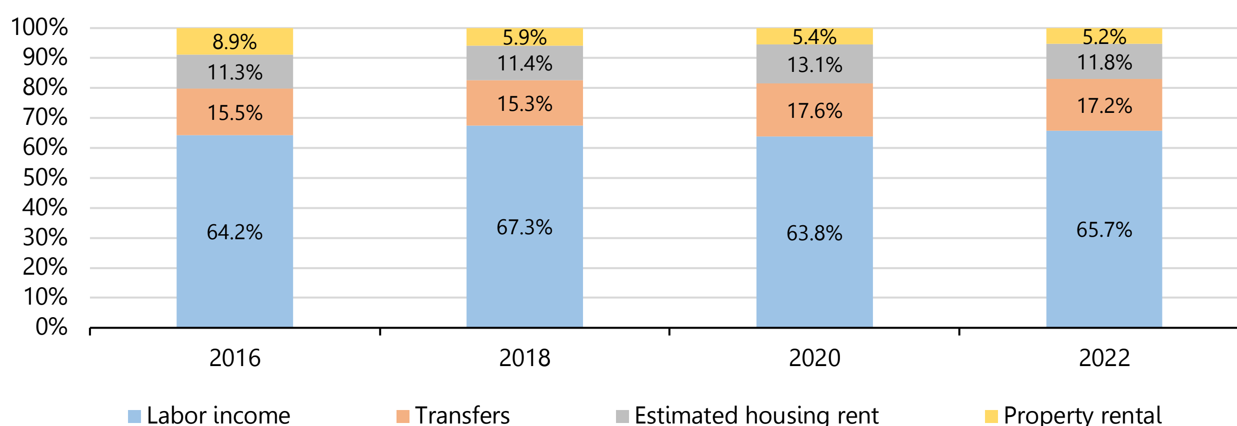
If the recession materializes in 2025, this administration will have started with a recession and will have inherited a recession to the next administration. In addition, it is possible that the next six-year term will have limited economic growth due to the inability to carry out major infrastructure projects and the need for fiscal reform.

Risks to the Mexican economy include: 1) high budget deficit by 2024, which will put upward pressure on inflation, force the interest rate to remain at a high level for longer and could lead to changes from stable to negative in Mexico's sovereign debt credit rating, 2) new supply shocks that generate inflationary pressures, 3) corn panel under the TMEC, which could rule against Mexico, imposing trade sanctions, 4) possibility of an energy panel against Mexico under the TMEC, 5) uncertainty regarding domestic economic policy, 6) deterioration of governance, 7) further weakening of the Mexican economy, 8) further weakening of the Mexican economy, 9) further weakening of the Mexican economy, 10) further weakening of the Mexican economy, and 11) further weakening of the Mexican economy, 7) further weakening of institutions, 8) elections in Mexico with the possibility of the presidency and the majority of Congress remaining in the hands of a single party, 9) exchange rate volatility, 10) possibility of a lack of electricity and water infrastructure, which would slow the growth of fixed investment, 11) possibility of an economic slowdown in the United States at the end of 2024 and 12) elections in the United States due to the possibility of policies that encourage the return of companies to that country, which would slow the arrival of fixed investment in Mexico through *nearshoring*.

Source of Mexico's economic growth

According to the National Household Income and Expenditure Survey (ENIGH), the share of labor income in total personal income is 65.7% in 2022, increasing 1.9 percentage points (pp) compared to 2020, but still standing 1.6 pp below that observed in 2018 (Fig. 3). For their part, transfers have gained 1.7 pp of share in total income since 2018. If the wage bill has risen and transfers have gained share, it implies that transfers have grown at a faster rate than labor income.

Fig. 3. Main sources of household income



Source: Grupo Financiero BASE with information from INEGI.

This point is relevant, as households have obtained higher income from labor due to the decrease in the unemployment rate and the increase in real wages, but also from transfers[1] . This suggests that the circular flow of Mexico's economy has accelerated, but in part due to the large amount of transfers that the government distributes and remittances from abroad.

Government transfers have grown at a high rate and this is expected to continue in 2024, as this is an election year. In Mexico, an important component of transfers are non-contributory pensions, mainly explained by the Pension for the Welfare of the Elderly program, with 92.8% of the total, and the program for the Permanently Disabled with 7.2% of the total. Contributory pensions include pensions and planned pensions from IMSS, ISSSTE, PEMEX, CFE and contributions to social security in the general branches.

In 2018 non-contributory pensions accounted for 0.64% of total government spending, while contributory pensions accounted for 13.35%. In 2023, 4.38% of total budgeted spending goes to non-contributory pensions and 15.33% for contributory pensions, with total pension spending standing at 19.71% of total government spending. In the 2024 Economic Package, total spending on contributory and non-contributory pensions is expected to continue to rise and account for 22% of total spending.

It is not only pensions that imply higher government spending. There are other social programs that involve government transfers: Sembrando vida, Jóvenes construyendo el futuro, Programa de becas de educación básica, Beca universal para el Bienestar Benito Juárez de Educación Media Superior, Beca para el Bienestar Benito Juárez de Educación Superior, Programa para el bienestar de niñas y niños hijos de madres trabajadoras, La escuela es nuestra, Producción para el bienestar, Fertilizantes, Vivienda social, Programa nacional de reconstrucción and Precios de garantía. For comparison purposes, spending on these programs is equivalent to 67.8% of spending on non-contributory pensions. This means that the transfers that the government grants to various population groups will represent almost 25% of total budgeted spending in 2024.

It is worth mentioning that several of these programs did not exist prior to the current administration and in their place were other assistance programs, mainly dedicated to basic education.

Considering total spending on pensions and transfers for the aforementioned programs, social spending as a proportion of total government spending rose from 18.04% in the first year of the administration to 21.49% in the last full fiscal year (2022). As a proportion of GDP, social spending rose from 4.16% in 2019 to 5.50% in 2022.

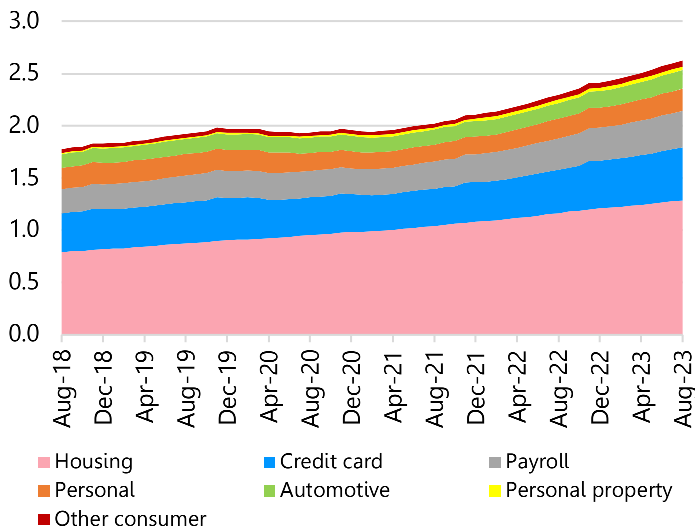
Non-contributory pensions and other government assistance in the form of transfers do not generate more income tax revenue and only more revenue can be captured for the government through the value added tax. This implies a change in

[1] Transfers include: pensions and pensions; scholarships from government and institutions; cash donations from institutions and other households; income from other countries; benefits from government programs; in-kind transfers from other households; and in-kind transfers from institutions.

Mexico's economic model, where the government would now be the major driver of consumption (and GDP growth) by providing transfers. This model is used by Argentina[2] , a country that recovered quickly from the pandemic crisis, but has also had to go into moratorium because it does not have enough money to meet its obligations. This type of model is not sustainable in the long term.

Another relevant factor in Mexico's growth is the granting of credit. According to data from Banco de México, the outstanding credit portfolio to the non-bank private sector grew at a real annual rate of 5.54% in August, with consumer credit growing 12.97%, driven by credit cards (+17.15% annual rate), auto loans (+13.91%), payroll loans (+10.47%) and personal loans (+8.11%), while housing loans grew 5.45% annual rate (Fig. 5). The increase in credit granting in Mexico is supported by a better economic outlook and by the expectation that the amount of transfers that the government distributes to various population groups will increase in 2024. However, economic growth via credit is only sustainable when the increase in people's real income is greater than what they will have to pay in interest. Otherwise, buying today implies sacrificing future consumption. In other words, credit must be repaid at some point, which forces households to reduce their future consumption.

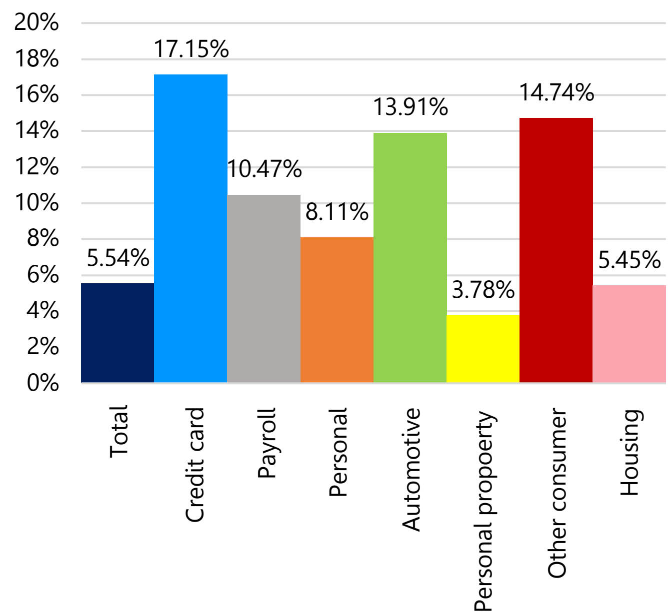
Fig. 4. Outstanding credit portfolio granted to the private sector by Commercial Banking*, billions of nominal pesos



*Excluding credit to companies, individuals with business activity and non-bank financial intermediaries.

Source: Grupo Financiero BASE with information from Banxico.

Fig. 5. Real annual growth of the performing loan portfolio granted to the private sector by commercial banks.



Source: Grupo Financiero BASE with information from Banxico.

In addition to consumption, gross fixed investment is another component of GDP that has shown an extraordinary rebound, as a consequence of the construction of public works, such as the Tren Maya, the Dos Bocas refinery and the AIFA. Under circumstances of social profitability and sound public finances, higher infrastructure spending is a good thing. However, there has been uncertainty surrounding the infrastructure works of this administration due to the continuous rise in their

[2] In Argentina, non-contributory pensions accounted for about 3.9% of total pensions between 2001 and 2003. The growth of non-contributory pensions occurred in the years of recovery from the 2001 crisis, when social programs were launched and strengthened to improve the situation of people in poverty on a "transitory" basis. In 2004, non-contributory pensions as a proportion of total pensions rose to 5.5% and peaked at 13.4% in 2014, to stabilize at an average of 11.3% in the last 10 years. As a proportion of total Argentine government spending, contributory pensions stood at about 1.5% in 2004, rising to a peak of 4.15% in 2013. Since that year, non-contributory pensions have been between 3 and 4% of total spending. However, total pensions, which include contributory and non-contributory pensions, show a slow upward trend since 1994, rising from 26.88% of spending in 2004 to 31.49% of total spending in 2022. Including other transfers, Argentina's social spending accounted for 35.91% of total public spending in 2022. Argentina recovered more quickly from the coronavirus crisis, relative to Mexico, achieving a recovery to 2019 levels since the third quarter of 2021. Part of Argentina's rapid recovery is estimated to be due to non-contributory pensions and transfers, which generates higher consumption and GDP growth as most of the transfer received is spent.

costs, as well as the opportunity cost of resources[3] . In addition, a high fiscal deficit is expected for 2024, the largest since 1988, which will leave no room for the next administration to carry out major infrastructure works. This implies that in 2024 growth will continue in the construction sector (non-residential) and in gross fixed investment, with new historical highs, but in 2025 there will be slumps in these areas as there will be no fiscal space for new works.

This implies that the growth seen in 2023 and probably 2024 is not sustainable going forward, as it lacks an engine to drive it beyond the government's effort to build public works and give money to people.

Foreign Trade

In the first three quarters of 2023, Mexico's total exports amounted to 441,537 million dollars (mdd), showing a growth of 2.70% compared to the same period in 2022.

Within non-oil exports, manufacturing exports accumulated growth of 4.38%, driven by the automotive sector, which accumulated growth of 14.49%, while the accumulated exports of the rest of manufacturing showed an annual contraction of 0.42%. The drop in non-automotive exports is related to the appreciation of the peso against the dollar and the expectations of a possible recession in the United States. Although the same factors apply to the automotive sector, the increase in exports in this sector is due to the lagged demand due to the shortage of chips in 2022. This implies that, if the peso had remained stable around the levels observed in 2022, manufacturing exports could be showing growth of at least 6.5%, instead of the 4.38% observed.

On the other hand, imports show a slight contraction of 0.87% with respect to the same period of 2022, due to imports of intermediate goods, which accumulated a contraction of 4.36%. This drop is partially offset by the accumulated growth in consumer goods imports (+6.45%), favored by the appreciation of the peso, and by capital goods imports (+22.18%), driven by *nearshoring*.

It is important to mention that oil imports accumulated a contraction of 29.64% due to the decrease in the price of oil and its refined products. Thus, the trade balance for the first three quarters of 2023 is in deficit by $10,084 mdd, decreasing with respect to the deficit of $25,651 mdd in the same period of 2022. Internally, this deficit is explained by the oil balance, which shows a deficit of 16,628 million dollars, while the non-oil balance is in surplus by 6,545 million dollars.

It is also important to note that the autoworkers' strike in the United States, which began on September 15 and lasted through October, had a negative effect on manufacturing in Mexico. As of October 31, only an agreement has been reached between the autoworkers' union with Ford and Stellantis, but no agreement has been reached with General Motors. This strike affected the automotive industry and, in a domino effect, other types of manufacturing that supply the automotive industry. As a consequence of the strike, the appreciation of the peso and a lower dynamism in non-automotive exports, Mexico's total exports are now expected to grow 4% in 2023, revised downward from the 4.5% previously estimated.

It is worth noting that export growth has been revised downward several times this year, due to the possibility of a recession in the U.S. as of May and the appreciation of the Mexican peso.

Consumption

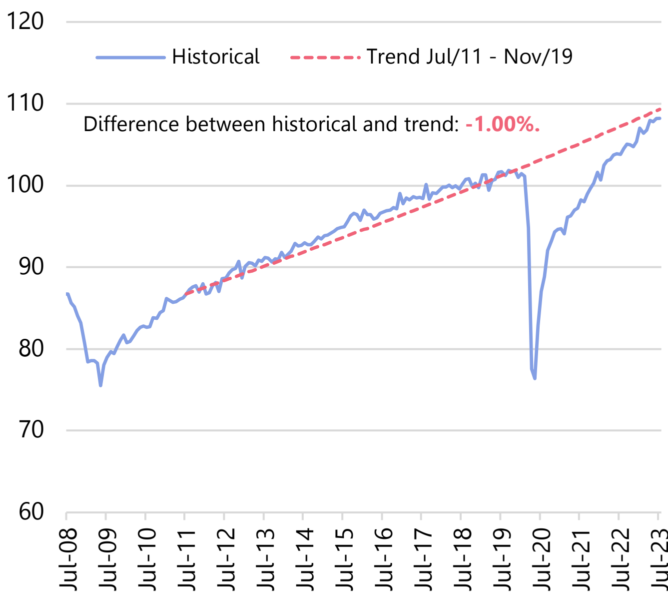
Consumption is the main component of Mexico's GDP. Its determinants are: the wage bill, other personal income (transfers), inflation, economic expectations, consumer confidence and interest rates. The Monthly Indicator of Private Consumption in the Domestic Market published by INEGI showed in July 2023 (most recent data) an annual growth of 4.29%, which accumulates 29 consecutive months of positive annual growth rates. In July 2023, this indicator reached its highest level since the series began to be published in January 1993. With this, the consumption indicator shows a growth of 6.97% with respect to its pre-pandemic level.

[3] During the pandemic, there were practically no fiscal stimuli in order not to put the government in debt. However, resources could have been temporarily redirected to this administration's major infrastructure projects to halt the decline in GDP and lay the groundwork for a faster recovery.

Analyzing the private consumption indicator by its components, it is observed that the highest growth is occurring in the consumption of imported goods, which in the last 12 months (from July 2022 to July 2023) has grown 19.09%. This is mainly due to the strengthening of the Mexican peso against the U.S. dollar, which in the same period showed an appreciation of 17.7%. On the other hand, the consumption of goods and services of national origin only showed an annual growth of 1.21% in July 2023, driven by the consumption of services, which grew 3.47%, while the consumption of goods decreased 0.79%.

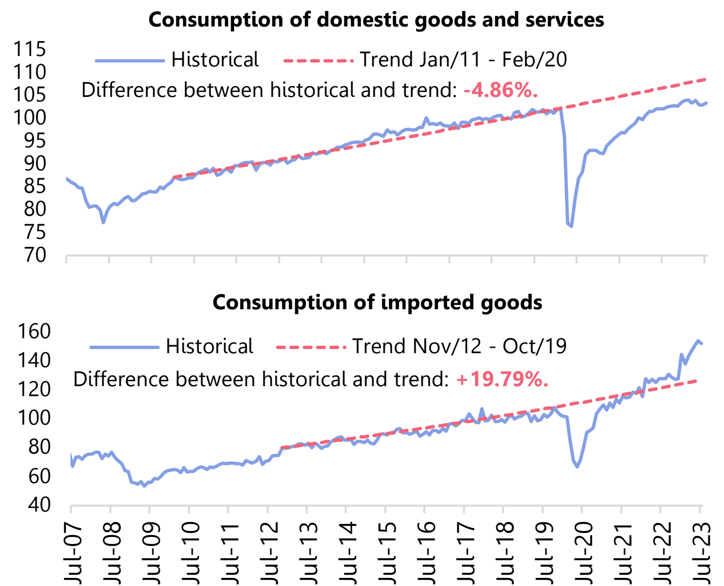
A comparison of the recent evolution of the consumption indicator with the historical trend prior to the pandemic crisis shows that the indicator is very close to the level it would have reached in a hypothetical scenario without the pandemic (Fig. 6). Thus, the acceleration in consumption can be understood as a return to the normal level of spending. Internally, consumption of imported goods is 17.79% above what its long-term trend suggests. In contrast, the level of consumption of domestic goods and services is 4.86% below its trend (Fig. 7).

Fig. 6. Indicator of private consumption in the domestic market



Source: Grupo Financiero BASE with information from INEGI.

Fig. 7. Consumption of domestic vs. imported goods and services



Source: Grupo Financiero BASE with information from INEGI.

Consumer Confidence

One of the main determinants of consumption is consumer confidence. A consumer who is optimistic will choose to spend, while a consumer who is fearful will be cautious in his or her spending, slowing down the economy. The Consumer Confidence Indicator (CCI), reached 46.84 points in September 2023 (most recent data), the second highest level on record, surpassed only by the February 2019 data[4] . The components that have driven this increase in confidence are those of the country's economic situation today compared to 12 months ago, which has grown 8.20 points annually, and that of consumers' possibilities of making purchases of durable goods, which has grown 6.87 points and is at its highest level since December 2002.

In contrast, the components that have grown the least are the two that refer to the economic situation of specific households. This indicates that consumers are optimistic about the general situation of the country, but not so much about

[4] Coincidentally, February 2019 also saw an all-time high in foreign holdings of government securities. This could indicate that both nationals and foreigners reached their highest point of confidence in the Mexican economy. However, consumer confidence in Mexico and government securities holdings show behaviors with no statistical relationship and while consumer confidence is again at high levels, government securities holdings in the hands of foreigners continue to show decreases, accumulating capital outflows from Mexico in 3 of the last 4 years.

their own situation. Likewise, the one that has grown the least is the household economic situation in the next 12 months, perhaps due to the fear that the economy will enter recession.

Remittances

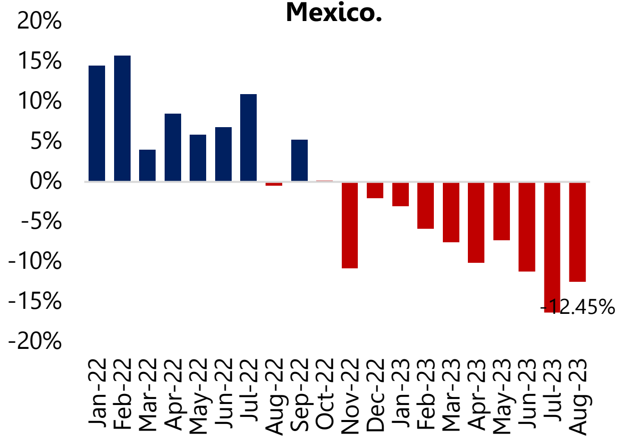
The most recent remittances data published by Banco de México, corresponding to August 2023, showed an annual growth of 8.58%, accelerating with respect to the two previous months. With this, the accumulated flow of remittances in the first eight months of the year reached a total of 41.459 billion dollars, a figure 9.27% higher than that accumulated in the same period of 2022. Likewise, the remittances received by Mexico in these first eight months exceeded the total remittances received in all of 2020.

In the last 12 months (September 2022 to August 2023), total remittances received amounted to US$62.028 billion, surpassing the US$60 billion level for the fifth consecutive month and accumulating 40 consecutive months of upward growth. However, it is important to distinguish between the flow of remittances in nominal dollars and what this flow represents in real pesos for the households that receive them, as this better captures the impact on their purchasing power.

As mentioned above, in August 2023 remittances grew at an annual rate of 8.58%. However, considering that in the period from August 2022 to August 2023 there was an accumulated inflation of 4.64% and that the Mexican peso appreciated 15.63% against the dollar, the real annual variation in remittances in pesos was -12.45% (Fig. 8). This marked the tenth consecutive month of annual contractions in the purchasing power of remittances, something that had not happened since August 2013.

Considering an expected growth of remittances in dollars of 8.1% in 2023, an inflation projection of 4.6% at year-end and an exchange rate at 18 pesos per dollar average for the rest of the year, it is estimated that the purchasing power of remittances will register an annual contraction of 9.2% in 2023, which would be the first drop since 2013 and the largest since 2010.

Fig. 8. Annual growth in the purchasing power of remittances in Mexico.



Source: Grupo Financiero BASE with information from INEGI.

Labor Market

According to the National Occupation and Employment Survey (ENOE) published by INEGI, in the third quarter the employed population grew by 412,146 people, while the unemployed only increased by 152,089. With this, the unemployment rate increased slightly from 2.66% in June to 2.70% in September according to seasonally adjusted figures, but remains at historically low levels. June's 2.66% figure is the lowest on record according to the ENOE series since 2005. The urban unemployment rate stood at 3.35% in September, also close to its historical low of 3.26% reached in June of this year.

Within the Non-Economically Active Population (NEAP), the population available for work (those people who are not looking for work, but would accept a job if it were offered to them) increased by 328,676 people, which is used to calculate the extended unemployment rate, also known as "hidden" unemployment. This extended unemployment rate stood at 10.70% in September, also a low level and close to the historic lows seen in the middle of this year.

Regarding labor underemployment, the rate was 8.17% in September, so it is estimated that close to 4.83 million people have the need and availability to work additional hours to those required by their current occupation. Although the unemployment rate has decreased considerably and is at historically low levels, it is important to note that many of these people are underemployed. In fact, the current percentage of underemployment is higher than those observed before the pandemic, between 6% and 7%.

Finally, the labor informality rate remains high at 54.3%. This represents a serious problem for the country, as it not only affects the rights and welfare of workers, but also translates into lower revenues for the government and complicates the development of an efficient market.

This implies that the labor market is far from optimal in Mexico and could move towards better conditions if better use were made of the *nearshoring* opportunity, due to greater job creation in the formal sector.

Table 1. Summary of the National Occupation and Employment Survey (Encuesta Nacional de Ocupación y Empleo, ENOE)

Concept	Pre-COVID-19		COVID-19	Recovery		
	Feb-20	Mar-20	Apr-20	Sep-22	Aug-23	Sep-23
EAP (millions)	**57.45**	**57.12**	**44.86**	**59.48**	**60.98**	**60.84**
Busy	55.43	55.46	42.76	57.49	59.18	59.09
Unemployed	2.03	1.66	2.10	1.98	1.80	1.75
PNEA (millions)	**38.02**	**38.39**	**50.23**	**40.26**	**39.76**	**39.96**
Available	5.59	5.79	19.94	5.74	5.29	5.33
Not available	32.42	32.59	30.29	34.52	34.47	34.63
National unemployment rate	3.65%	3.31%	4.68%	3.13%	2.72%	2.70%
Urban unemployment rate	4.65%	4.10%	5.13%	3.89%	3.33%	3.35%
Extended unemployment rate	12.09%	11.85%	34.01%	11.85%	10.70%	10.70%
Participation rate	60.56%	60.17%	47.19%	59.78%	60.35%	60.53%
Underemployment rate	8.63%	9.06%	25.40%	7.88%	7.91%	8.17%
Informality rate	56.11%	55.56%	48.02%	55.46%	55.09%	54.18%

Source: Grupo Financiero BASE with information from INEGI.

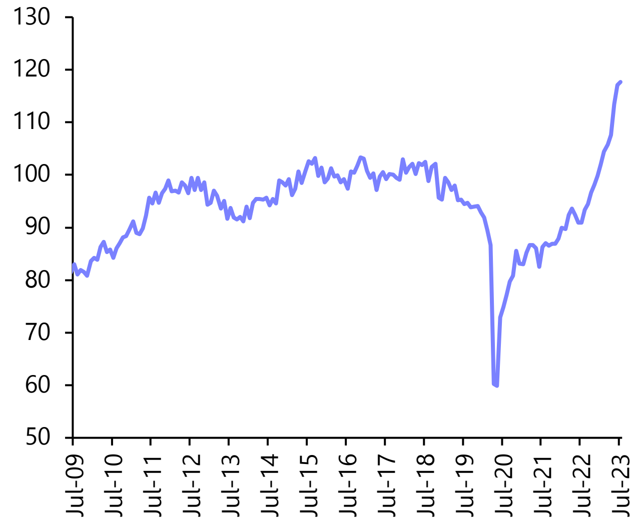
With respect to formal private employment, the Mexican Social Security Institute (IMSS) reported in September a total of 22,129,433 insured jobs, representing an increase of 3.36% with respect to the same month of the previous year. Although formal private employment continues to grow, it is growing at a slower pace than that observed in the previous year. The number of jobs created in the first nine months of the year was 756,537, 4.14% lower than in the same period of 2022. However, it is important to note that in 2022 the labor market was still finishing its recovery from the pandemic crisis and that the growth observed in 2023 has been above the pre-pandemic level.

It is also important to emphasize that the recent expansion in the labor market has occurred in an environment of restrictive monetary policy. In the latest minutes of Banco de México's monetary policy decision, the members of the Board of Governors expressed their concerns regarding the strength of the labor market, as wage growth continues to be high, putting pressure on inflation. Monetary policy operates with a time lag, so the impact of high interest rates has not been fully reflected in the real economy.

Investment

The most recent data of the monthly indicator of Gross Fixed Investment (GFI) published by INEGI showed an annual growth of 29.5% in July 2023, the highest annual rate since May 2021 (Fig. 9). However, that May 2021 figure was merely a rebound effect from the low May 2020 comparison base caused by the pandemic. Ignoring pandemic recovery effect rates, the July 2023 annual growth is the highest on record. This rebound in growth observed in 2023 has led the gross fixed investment indicator to reach a new all-time high, which is also 13.9% higher than previously recorded in November 2016.

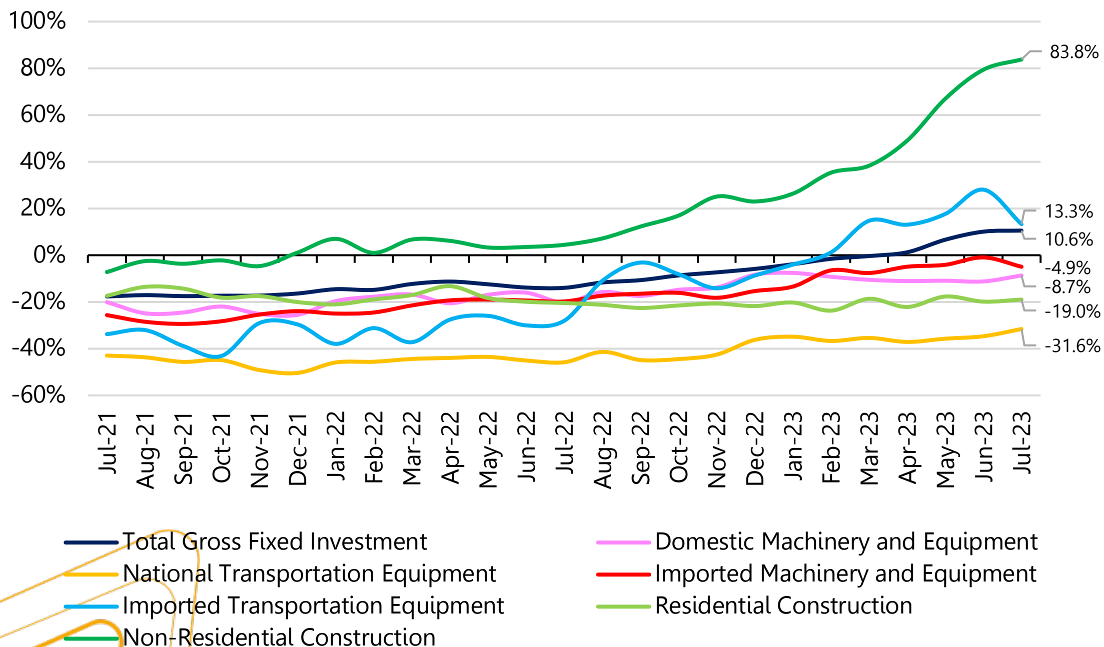
Fig. 9. Gross Fixed Investment, 2018=100



Source: Grupo Financiero BASE with information from INEGI.

While growth has been across the board in the indicator's components, the largest contributor has been non-residential construction, which in July showed annual growth of 70.91%, the highest annual rate on record. This ended a negative trend in non-residential construction that had been observed since 2011. In fact, if one compares the current level of the non-residential construction indicator with the level suggested by the continuation of its long-term trend, it is 83.8% above trend (Fig. 10).

Fig. 10. Performance of the components of the BFI with respect to their long-term trend



Source: Grupo Financiero BASE with information from INEGI.

Most of this growth is due to investment in public works, which is evident in the figures of the National Survey of Construction Companies (ENEC) and in the National Accounts figures, which show strong growth in the construction of civil engineering works, a sector in which the government participates with approximately 85% of the total. This presents the risk of a stagnation in investment in the coming years, since given the level of public indebtedness in 2023 and the proposed

level for 2024 according to the Proposed Federal Expenditure Budget, it is not viable for the government to maintain these levels of investment in public works beyond 2024 without compromising its credit quality and the sustainability of public finances. This implies that in 2024 gross fixed investment could continue to grow, reaching record highs, and then plummet in 2025 due to the government's lack of budget to carry out major infrastructure works.

It is worth noting that gross fixed investment has also grown outside of non-residential construction. Investment in machinery and equipment is also at historically high levels, growing 20.27% annually in July 2023, with investment in domestic transportation equipment growing at an annual rate of 36.00% and imported equipment 61.64%. Likewise, investment in machinery, equipment and other goods other than domestic and imported transportation equipment grew 23.09% and 17.91%, respectively.

Grupo Financiero BASE estimates that gross fixed investment will grow 18% in 2023, showing a clear acceleration which, as mentioned above, is mainly due to the increase in public works spending.

It is also important to consider some already known risks for investment in the country. While *nearshoring*[5] presents a great opportunity for the Mexican economy to receive Foreign Direct Investment (FDI) and is already being reflected, the government must ensure that the institutional environment is appropriate to attract and maintain investment.

Mexico is currently facing a trade dispute due to alleged violations of the T-MEC by the U.S. and Canadian governments.

- Allegations that Mexico violated the T-MEC by banning the use of GM corn have already been taken to the dispute settlement panel stage after no agreement was reached at the consultation stage. The corn panel is a risk for Mexico, but above all it can be considered as a warning, as the energy issue is much more relevant in size and impact that sanctions would have on Mexico.

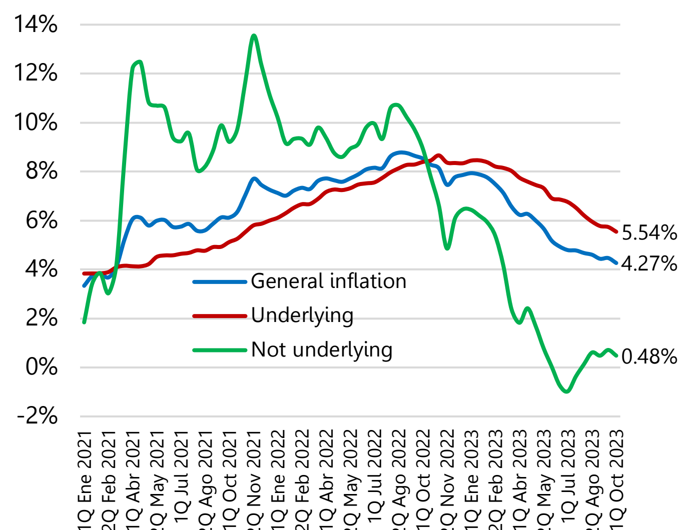
- In July 2022, the U.S. and Canadian governments accused Mexico of favoring state-owned companies in energy matters, affecting the interests of private companies, and violating principles of economic competition. Although no formal agreement was reached between the governments, this dispute appears to be on pause. However, in September 2023, Reuters, citing anonymous sources, reported that U.S. President Joe Biden has asked the companies concerned to document the alleged treaty violations and prepare their statements.

Inflation and Monetary Policy

Inflation continues its downward trend, standing at an annual rate of 4.27% in the first fortnight of October, the lowest rate since the first fortnight of March 2021. Core inflation, which determines the trajectory of general inflation in the medium and long term, shows a downward trend, but remains at a high annual rate of 5.54%. There is resistance to lower services inflation, which was located at an annual rate of 5.33% and since the second half of July 2022 has oscillated between 5.00% and 5.73%, with a lateral trend. Non-core inflation, which includes products whose price is more volatile (energy and agricultural products), remains at low levels, standing at 0.48% annual rate in the first fortnight of October. Thus, it can be said that the downward trend in headline inflation is mainly due to low non-core inflation (Fig. 11).

This carries risks. Core inflation maintains a slow downward trend and services inflation has remained stable above 5% since July 2022. Since the core component determines the

Fig. 11. Year-on-year inflation rates



Source: Grupo Financiero BASE with information from INEGI.

[5] Relocation of companies to a country close to where they wish to export.

medium- and long-term trajectory of inflation, its persistence at high levels raises the risk of expectations de-anchoring.

In addition, non-core inflation, being a volatile component, implies the risk of a rebound in prices and, therefore, there is the possibility of a rebound in headline inflation in the face of events that cause price fluctuations in agricultural and energy products, such as droughts and other adverse weather conditions, supply restrictions and military conflicts, factors that are difficult to predict and on which monetary policy has no effect.

In fact, the risk of military conflict materialized in October with the war between Israel and Hamas, which threatens the stability of the Middle East and has generated upward pressure on oil prices. This could raise energy prices and put upward pressure on general inflation. Even if the Mexican government were to impose a new stimulus on gasoline and diesel prices to soften the increase in international energy prices, the possible increase in energy prices would put upward pressure on U.S. inflation, which would have an indirect impact on inflation in Mexico. That is, if the conflict spreads to other countries in the region and energy prices rise, inflation would rebound in Mexico despite possible government efforts to contain inflationary pressures.

Considering the current trend of inflation in Mexico and its potential upside risks, inflation is expected to close the year at 4.6%. By 2024, without the high budget deficit contemplated in the 2024 Economic Package, inflation could have closed at 3.5%, returning to its pre-pandemic equilibrium level. Considering the high budget deficit of 3.9% of GDP, something not seen since 1988, inflation will continue to be under upward pressure, closing the year at around 3.9%.

There are multiple upside risks to inflation, so the downward trend in headline inflation is not enough for the Bank of Mexico to abandon its restrictive monetary stance. In fact, the core component needs to continue to decline to offset any possible increase in the non-core component.

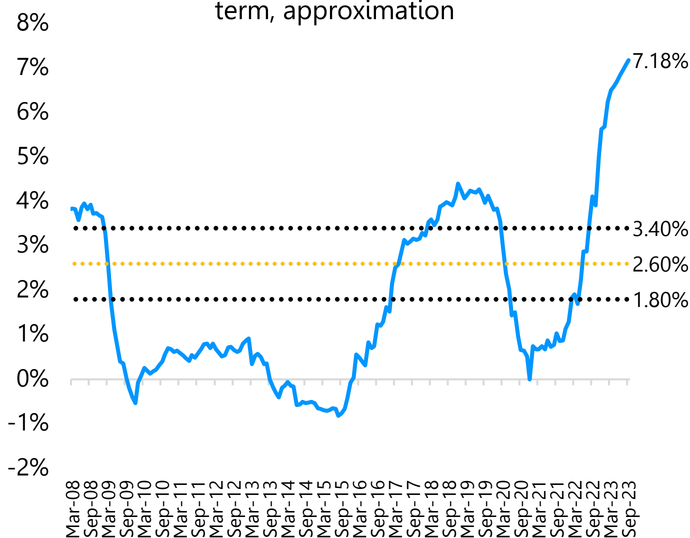
Banco de México has kept the interest rate unchanged at a level of 11.25% since March of this year, but the monetary stance has gradually become more restrictive in absolute terms as inflation expectations gradually adjust downwards. This is measured through the real ex ante short-term interest rate, which through September stood at 7.18% (Fig. 12), according to the approximation where the average 12-month inflation expectation (4.07%) is subtracted from the nominal interest rate (11.25%). Banco de México estimates that the neutral interest rate is between 1.80% and 3.40%, so the current monetary policy stance can be considered highly restrictive.

To understand Banco de México's future actions, it is important to understand previous monetary policy cycles. Since the interest rate has been an operational target, there have been three cycles of rate increases:

1. **First cycle.** The target rate started at 7.50%. The first increase was on June 20, 2008 and the cycle ended on August 15, 2008, when the rate reached 8.25%, with a total increase of 75 basis points in a period of 1 month and 26 days (almost 2 months). The rate remained at 8.25% for 5 months. Downward cuts began on January 16, 2009. The cycle of cuts lasted 6 months and totaled 375 basis points, with the rate standing at 4.50% in July 2009.

    a. **Intermediate period of rate cuts.** Several years later, on March 8, 2013, another cycle of rate cuts began. The cycle of cuts lasted 15 months and totaled 150 basis points, with the rate standing at 3.00% in June 2014.

Fig. 12. Ex-ante real interest rate, short term, approximation



Source: Grupo Financiero BASE with information from INEGI, Banxico.

2. **Second cycle.** The first increase was on December 17, 2015 and the cycle ended on December 20, 2018, when the rate reached 8.25%, for a total increase of 525 basis points over a 36-month period. The rate remained at 8.25% for 8 months. Downward cuts began on August 15, 2019. The cycle of cuts lasted 18 months and totaled 425 basis points, with the rate settling at 4.00% in February 2021.

3. **Third cycle.** The first increase was on June 24, 2021 and the cycle is presumed to end on March 30, 2023, when the rate reached 11.25%, for a total increase of 725 basis points over a 21-month period. The rate has remained at 11.25% for 7 months.

Two things stand out from the above that can provide guidance going forward:

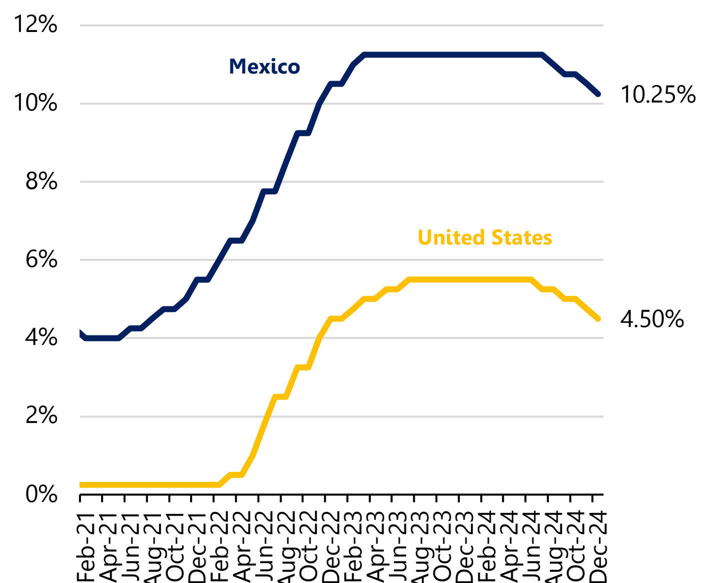
1. In the cycles mentioned above, Banco de México has kept the interest rate at the terminal level for a short period of time after the end of the increase cycle. The terminal rate remained unchanged for 5 months in the first cycle and 8 months in the second cycle. This compares to the 7 months that the rate has remained at 11.25% until the end of October.

2. The economic conditions that led to the beginning of the interest rate cutting cycles are very different from the current ones. In January 2009 when the first cycle of cuts began, the economy was in recession due to the impact of the Great Recession in the United States. In August 2019 the economy was also in recession, which deepened severely in 2020 due to the coronavirus pandemic. The economy is currently expanding and GDP is expected to grow between 3.3% and 3.5% in 2023 and at least 2.5% in 2024. In addition, inflation is above the 3% target and upside risks have accumulated that could cause inflation to spike. Thus, current conditions are not compatible with the beginning of a cycle of target rate cuts.

One factor that could prolong monetary tightening is the overheating of the economy. Mexico's growth has been higher than expected in the first half of the year, driven by an expansive fiscal policy through transfers to the population and investment spending focused on construction, mainly in priority projects. The 2024 Economic Package contemplates a budget deficit of 4.9% of GDP, which implies higher indebtedness and in turn could continue to drive economic growth. However, a high fiscal deficit could put pressure on inflation through a higher-than-potential growth of the economy (overheating) and a depreciation of the peso, which would increase the prices of imported goods, making production processes and final consumer products more expensive. This implies an inflation expectation of 3.9% in 2024, above the base scenario of 3.5%, as mentioned above.

Considering this and the factors that led to interest rate cuts in previous cycles, it is expected that the Bank of Mexico will keep the interest rate unchanged at the current level of 11.25% during the last months of 2023 and in the first half of 2024, to start the cuts in August of that year and close with a rate of 10.25% in December 2024 (Fig. 13).

Fig. 13. Interest rates and expectation



Source: Grupo Financiero BASE with information from Banxico and the Federal Reserve.

Capital outflows

In 2023 through October 17, foreign residents' holdings of government securities accumulated an outflow of 36,896 million pesos, resuming the capital outflows seen in 2020 and 2021 (Fig. 14).

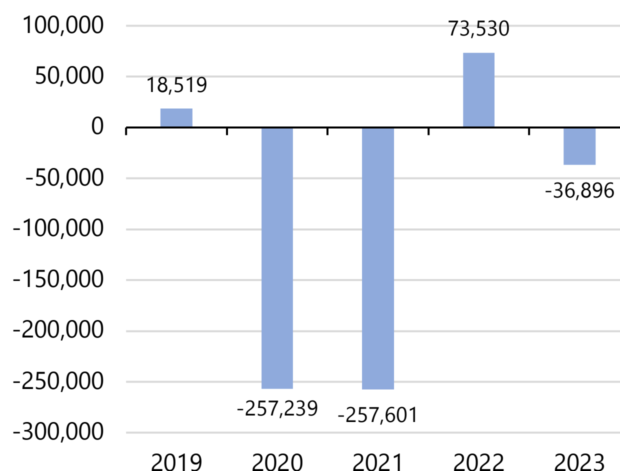
Capital outflows are mainly concentrated in Bonos M, whose holdings by foreign residents have accumulated four consecutive years of decreases. In 2023, M Bond holdings decreased by 61,354 million pesos. This contrasts with Cetes holdings, which showed an increase of 50.270 billion pesos during the year, rising for two consecutive years (Table 2).

The dynamics of a decrease in Bonos M holdings and an increase in Cetes holdings indicate that foreign investors are choosing to reduce their exposure to longer-term instruments, moving to short-term instruments due to the following factors:

1. The expectation that the monetary policy stance will be restrictive for an extended period of time. Since the Bank of Mexico is expected to keep the rate unchanged towards the end of the year and in the first half of 2024, the attractiveness of increasing positions in long-term instruments is reduced. It is worth remembering that holding long-term positions implies greater risk for investors, as Mexico's debt profile may deteriorate over time and adverse events may occur that cause losses in portfolios before the maturity of the instruments. In 2024, with signs that the Bank of Mexico is preparing to lower the interest rate, demand for longer-term instruments could increase somewhat to ensure a high yield for a prolonged period.

2. Risk aversion about Mexico has increased. Although economic growth has been higher than expected at the beginning of the year, the government is incurring a higher deficit and is projected to reach 4.9% of GDP in 2024. At the same time, the Economic Package projects that debt as a proportion of GDP will rise from 46.5% (estimated for 2023) to 48.8% in 2024 and the financial cost of debt will rise to 11.8%. The budget will also be constrained by higher pension spending, which will reach 22% of total spending. With the above, GDP is likely to continue growing, but driven by an expansionary fiscal policy, which may deteriorate Mexico's credit profile at the beginning of the next six-year term.

Fig. 14. Variation in government securities holdings by foreign residents



Source: Grupo Financiero BASE with information from Banxico.

Following the publication of the Economic Package at the beginning of September, the decrease in M-Bond holdings by foreign residents has continued. In September, there was an outflow of capital from M Bonds for 20,172 million pesos and in October it accumulated a decrease of 2,837 million pesos. In contrast, flows to Cetes continued in September for 7,485 million pesos and in October accumulated an inflow of 277 million pesos. Considering the above, it is likely that capital outflows from Mexican government securities will continue.

Table 2. Variation in the holding of government securities by foreign residents, by type of instrument. Figures in millions of pesos.

Year	Udibonos	Bondes F	MS Bonds	Cetes	Bondes D	Bonds M	Total
2019	-5,960	0	0	-27,021	742	50,758	18,519
2020	-6,619	0	0	-98,874	48,039	-199,785	-257,239
2021	20,810	0	0	-32,469	-8,082	-237,865	-257,601
2022	72,467	211	0	26,495	-7,110	-18,533	73,530
2023	**-4,569**	**325**	**10,757**	**50,270**	**-32,324**	**-61,354**	**-36,896**

Note: the change in government securities holdings in 2023 was estimated with data through October 17.
As of July 24, 2023 there is a balance in the holding of MS Bonds, issued this year. Their characteristic is that they are bonds aligned with environmental, social and corporate governance criteria.
Source: Grupo Financiero BASE with information from Banxico.

Public Sector

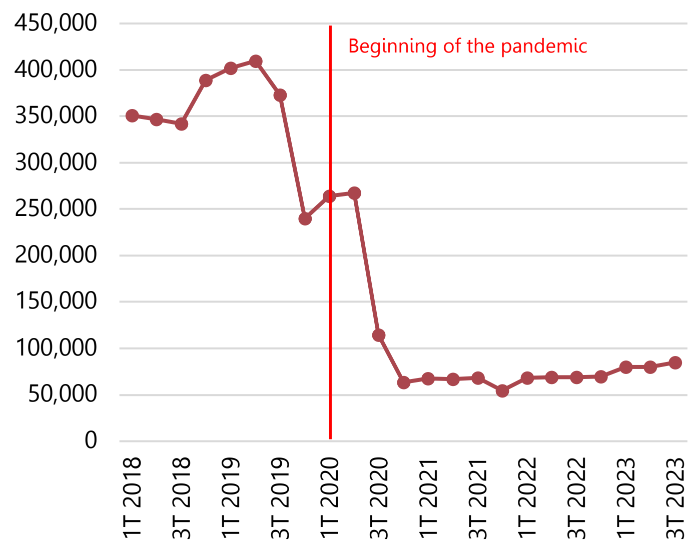
At the end of the third quarter of 2023, Public Sector budget revenues amounted to Ps. 5.195 trillion, 2.9% below the program for the period. This is because non-oil revenues were 21.6% below the program due to the fall in fuel prices and the appreciation of the Mexican peso. This is equivalent to a shortfall of Ps. 216.8 billion. However, non-oil revenues were

1.4% above program, resulting in a surplus of 59.1 billion pesos. Non-oil revenues include tax revenues, which are mainly composed of income tax, VAT and STPS. VAT revenues for the period were 11.4% lower than programmed, equivalent to a gap of 122.4 billion pesos. However, income tax collection 2.2% higher than programmed, equivalent to 40.5 billion pesos, compensated for part of this shortfall.

On the expenditure side, total net public sector spending in the first nine months of the year amounted to 5.860 trillion pesos. Of this, 4.179 trillion pesos corresponded to Programmable Spending, showing an increase of 2.5% in real terms with respect to the same period of the previous year. However, with respect to the program, there was an under-expenditure of 128.5 billion pesos. This is partly explained by lower-than-expected budgetary revenues.

With the quarterly publication, the balances of public trusts were made public: the Budgetary Income Stabilization Fund (FEIP), the Federal Entities' Income Stabilization Fund (FEIEF) and the Mexican Petroleum Fund (FMP). The three funds together totaled a balance of 84 billion pesos, an increase of 23% over the same quarter of the previous year. However, despite this growth, the amount is still 78.18% lower than it was at the close of 2018, at the beginning of the current six-year term. In order to achieve the balance at the end of 2018, resources would have to grow 258%. It is also important to remember that much of the decline occurred during 2019, prior to the COVID-19 pandemic crisis (Fig. 15).

Fig. 15. Use of resources of FEIP, FEIEF and FMP. Combined balance of the three funds, in pesos at the end of each quarter.



EFSF: Budget Revenue Stabilization Fund
FEIEF: Fondo de Estabilización de los Ingresos de las Entidades Federativas (Federal Entities Income Stabilization Fund).
FMP: Mexican Petroleum Fund
Source: Grupo Financiero BASE with information from SHCP.

2024 Economic Package

On October 20, the Chamber of Deputies approved the Federal Income Law (LIF), which was passed to the Senate, which has until October 31 to approve it.

In September 2023, the Executive Branch, through the Ministry of Finance and Public Credit (SHCP), submitted to the Mexican Congress the Economic Package 2024, which contains the Federal Expenditure Bill (PPEF), the Federal Revenue Law Initiative (ILIF) and the General Economic Policy Criteria (CGPE) for Fiscal Year 2024, among other documents. The CGPE 2024 are macroeconomic assumptions that serve as the basis for the SHCP's proposals to prepare the revenue and expenditure policy for the coming year.

It is important that these assumptions or estimates be realistic for several reasons; not only to ensure that the management of finances is as close as possible to what has been approved by Congress, but also to foster investor confidence, improve institutional credibility and promote transparency and accountability.

With respect to economic growth expectations, there is not much to question. The SHCP estimates that, both in 2023 and 2024, Mexico's GDP will grow between 2.5% and 3.5%. This outlook is not so far from what the most recent survey by the Bank of Mexico shows: a 3.2% growth for 2023 and a 1.90% growth for 2024. There is no doubt that strong economic growth will generate higher revenues. The ILIF 2024 proposes a 6.1% real increase in tax revenues with respect to what is estimated to close 2023. However, the Ministry of Finance is proposing to increase indebtedness as a percentage of GDP considerably. The Economic Package proposes that in 2024 the Public Sector Borrowing Requirements (PSBR) will be 5.4% of GDP and a budget deficit of 4.9% of GDP, which would imply the largest budget deficit since 1988. With this, rating agencies could be more vigilant about public finances, with the possibility of cuts in Mexico's sovereign debt credit rating.

This increase in PSBR as a percentage of GDP is because the government now has a greater capacity to borrow without the Historical PSBR Balance exceeding the level of 50% of GDP. This is because the debt-to-GDP ratio is expected to close 2023 at 46.5%, when it was originally expected to close at 48.5%. There are several factors behind this decrease:

1. Economic growth will be significantly higher than expected at the beginning of the year. Banxico's January survey showed an expectation of 0.98% and now stands at 3.2%.

2. The new GDP series (after the change in methodology and base year by INEGI) shows a larger economy than the previous methodology.

3. The appreciation of the peso, which caused a decrease in the peso value of external debt, contributing to a decrease in the numerator of the debt-to-GDP ratio.

With this, instead of keeping the debt ratio low, the Ministry of Finance decided to bring it back to 48.8% to finance higher spending. There is an important risk here, as the decrease due to the exchange rate fluctuation is not under the government's control and is an effect that can suddenly reverse, especially with the uncertainty expected for 2024 and the possibility of a recession in 2025. A high deficit, like any debt, will have to be repaid in the future. With this, the next administration will have to raise revenue and/or lower public spending. This implies that the next administration will have to consider a fiscal reform from the beginning of the six-year term to return the deficit to manageable levels.

In fact, Mexico's twin deficits (current and fiscal account) can only be financed in two ways: 1) higher domestic savings and lower private investment or 2) foreign financing.

Higher national savings would imply a decrease in current consumption and lower economic growth. That is, the government's greater contribution to the economy is offset by declines in private consumption.

On the other hand, foreign financing can be provided through debt issued internally (in pesos) or externally (in foreign currency). It is worth noting that in 3 of the last 4 years there have been capital outflows by foreigners who have opted to leave domestically issued Mexican government instruments, so that foreign financing through domestic debt would have to be encouraged with a higher interest rate, which would imply a higher financing cost for the government. On the other hand, the issuance of foreign debt would imply a higher foreign exchange risk for public finances and greater scrutiny of the way in which domestic economic policy is carried out. The increase in the interest rate to encourage the purchase of Mexican instruments would attract more capital, which in turn would appreciate the peso and discourage Mexican exports. Thus, once again, higher public spending is offset by lower exports, in an environment where interest rates are also higher.

Education spending is the second largest, second only to pension spending. For education spending, the PPEF proposes an increase of 2.7% over 2023, so in absolute terms it proposes the highest education spending since 2016 (historic high). However, much of this increase goes to higher labor benefits and personal services, not on investment to improve education quality or coverage. However, as a percentage of total spending, a decrease is proposed, from an estimated 12.27% by 2023 to 12.10% in 2024. Likewise, as a percentage of GDP, it would be 3.19%, a level considerably lower than the 4% to 6% recommendation proposed by the Inter-American Development Bank (IDB).

The PPEF shows that in 2024, in general, priority is being given to spending on pensions (an unavoidable expense because they are labor obligations or constitutional rights), flagship programs and projects of this administration, and support for PEMEX and IMSS, but there is a larger gap in spending on education and health with respect to the recommendations of international organizations, as well as a decrease in spending on physical investment.

To finance the increase in spending, a primary deficit of 1.2% of GDP is contemplated, which means that the government's operating spending cannot be financed with revenues and will require more debt. This may have been expected since this is an election year, as the government will be focused on increasing social support to achieve greater approval, but this does not diminish the concern that 19% of total public sector spending will have to come from debt. By 2024, the financial cost of the debt is expected to increase by 11.8%, which would represent 3.7% of GDP.

By 2025, spending is expected to decrease to 23.2%. While this could be the result of high GDP growth, it is more likely to be caused by a decrease in spending due to a lack of resources. This would be because the government will most likely be forced to cut spending after 2024 to return to healthy levels in the primary balance.

In the horizon shown by the General Economic Policy Criteria towards 2029, programmable spending as a percentage of GDP is expected to decrease by 2 percentage points, while the financial cost will only decrease by 1.2 percentage points.

It is worth noting that the current government had been characterized by achieving its goals of closing fiscal years with primary surpluses[6] . This is important because, if spending excluding the cost of debt is lower than revenues, the government can use that surplus to cover interest payments and thus reduce the debt burden in the long term.

Beyond the management of public finances, which undoubtedly presents one of the most important challenges for the next government, the role of the state in other aspects of the economy, such as industrial and institutional policy and governance, must also be considered. In the coming quarters, a high degree of political and economic uncertainty is expected, as federal elections will be held not only in Mexico, but also in the United States.

Here it is important to mention that, although there will be uncertainty, it does not represent a risk similar to that perceived during the 2018 election period. For the time being, markets seem to be calm in the face of the range of possible scenarios for 2024 in Mexico.

The greatest risk related to Mexico's elections is that a single party obtains the presidency and a majority in Congress, as it could make changes to the Constitution, generating instability in the economy and distrust in the markets. For the next administration, the main risks remain focused on the possible weakening of institutions, the deterioration of governance, the management of public finances and the change of economic model towards a GDP growth driven by government transfers to certain groups of the population. Financial markets will be attentive to free market economic policies, Bank of Mexico autonomy, sound public finances and governance.

In the U.S. elections, Donald Trump could run again for the presidency. Unlike in 2016, Trump no longer represents such a big threat to Mexico, as he has already signed the TMEC, which explicitly chose Mexico as a trading partner, while he started a trade war with China. However, the Make America Great Again (MAGA) rhetoric could be taken up again by trying to bring manufacturing companies back to the United States, taking away Mexico's nearshoring opportunity. Even though President Joe Biden has a low approval rating, he will most likely win the U.S. elections, as few presidents have failed to be reelected. In addition, the U.S. economy has avoided the dreaded recession this year, accelerating its economic growth, and in elections where the U.S. has been involved, directly or indirectly, in war conflicts around the world, people have chosen to reelect the president in an attempt to close ranks and prioritize the stability of the country. To make matters worse, the independent candidacy of Robert F. Kennedy Jr. is taking voters away from the Republicans[7] .

Other risks to economic growth

According to Banco de México's most recent survey, in which they ask private sector economic specialists about the factors that most slow down the growth of the Mexican economy, the factors of most concern are:

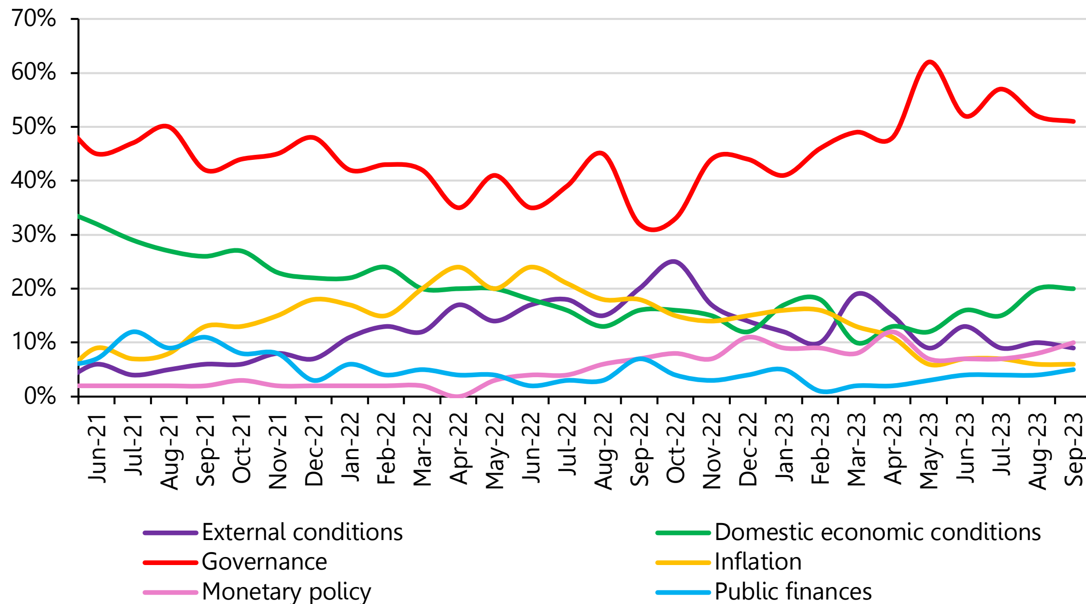
- **#1. Governance** (with 51% of the responses), in which the problems of public insecurity, rule of law, internal political uncertainty and impunity stand out.
- **#2. Domestic economic conditions** (with 20% of the responses), where the absence of structural change stands out. This is probably related to the fact that Mexico's economy is not updating its institutional framework to encourage more investment and private sector participation in key sectors such as energy.

[6] A primary surplus implies that total government revenues are greater than total government expenditures, excluding interest payments.

[7] For further reference see Banco BASE's report on the U.S. Economic Outlook for the third quarter of 2023.

- **#3. Monetary policy** (with 10% of the responses), with specialists concerned that the monetary policy currently being applied in the country may be hindering investment by remaining at restrictive levels. However, this does not necessarily mean that they consider it a problem for the economy, since the intention of the restrictive monetary policy is precisely to cool it down to lower inflation.

Fig. 16. Main factors hindering Mexico's economic growth (% of respondents)



Source: Grupo Financiero BASE with data from Banco de México.

Other important factors:

- **Sustainability of public finances**. Mexico faces the challenge of carrying out a comprehensive fiscal reform that guarantees the sustainability of public finances in the long term. Currently, government revenues are not sufficient to cover public spending needs, resulting in a fiscal deficit that jeopardizes economic stability. A fiscal reform should contribute to broaden the tax base, improve the efficiency of tax collection and focus on solving the problem of the large debts and labor liabilities of PEMEX and CFE.

- PEMEX's results for the third quarter of 2023 showed that the state-owned oil company obtained a net loss of 79 billion pesos. This came in the face of a 26.8% decrease in sales, with sales in Mexico falling 21.0% and foreign sales 25.9%. As a result, gross yield decreased 42.0% versus the previous quarter, and gross margin on sales dropped from 23.40% to 18.55%. After other operating and administrative expenses, where "other expenses" increased 577.8%, PEMEX obtained an operating income of 31.662 billion pesos (72.7% lower than the previous quarter). As a result, PEMEX's operating margin on sales dropped from 18.40% to 6.86%. Despite the contributions and aid from the federal government, the oil company's financial debt stands at 105.836 billion dollars or 1.8 billion pesos. As long as PEMEX's business model does not change, it will continue to be a heavy burden for Mexico's public finances and a latent risk for Mexico's sovereign debt credit rating. If PEMEX were a private company, it would have sold part of its assets to pay off debt, in addition to streamlining the organization, lowering operating costs. On the contrary, PEMEX has increased assets with the purchase of Deer Park and the construction of the Dos Bocas refinery, while at the same time costs have risen, especially in the so-called "other expenses" of which the details are not specified.

- With respect to the Federal Electricity Commission (CFE), the state-owned company in charge of electricity supply continues to leave much to be desired in terms of infrastructure and security of supply. It is important to remember

that, although the Mexican legal framework allows for private sector participation in power generation, the transmission and distribution segments are the exclusive monopoly of the CFE.

- Also of concern is the increase observed in the overdue portfolio of the Instituto del Fondo Nacional de la Vivienda para los Trabajadores (INFONAVIT), which in August 2023 amounted to 316 billion pesos, equivalent to 18.34% of the total portfolio. In the same month last year, the overdue portfolio index stood at 17.99% and in August 2018, the overdue portfolio was only 7.88%.

Credit rating

At the end of October, the three main rating agencies maintained a stable outlook for Mexico's sovereign debt rating. However, the risk of revisions to the outlook has been raised in light of an expected deterioration in Mexico's public finances as of 2024. Specifically, three things are of concern:

1. The proposed high budget deficit of 4.9% of GDP by 2024.

2. The expected growth of debt as a proportion of GDP from an estimated 46.5% in 2023 to 48.8% in 2024, as a result of the high deficit.

3. Government support for PEMEX, which has been included in the 2024 budget. It is worth mentioning that, in 2023 up to the third quarter, PEMEX's profits stand at only 3,025 million pesos, falling 98.5% with respect to the same period in 2022 and the total financial debt stands at 1,864,778 million pesos, which is equivalent to 6.03% of GDP or 20.57% of the 2024 expenditure budget.

On June 16, Fitch Ratings ratified the credit rating for the long-term sovereign debt at BBB- with a stable outlook, but anticipating a fiscal deficit of 3.5% of GDP in 2023 and 3.2% in 2024, well below what was contemplated in the 2024 Economic Package published in September, so the debt outlook on which Fitch's ratification is based has deteriorated.

On August 17, Fitch Ratings warned that government support for PEMEX could raise the deficit and debt, which would have a negative effect on debt as a proportion of GDP and the sovereign rating. Specifically, they point out that support for PEMEX would be negative for the rating if the government's fiscal priorities are modified. This is worrisome because during the six-year term, although spending has not been efficiently allocated to key needs in education, health and investment other than star projects, they did seek stability in debt as a proportion of GDP and a relatively stable budget deficit (1.6% of GDP in 2019, 2.8% in 2020, 2.8% in 2021 and 3.2% in 2022). By 2024 this changes, raising the risk of a downward revision of the sovereign debt outlook.

On September 27, Moody's announced that it will review the 2024 credit rating until after the elections scheduled for June 2, once more information is available on the elected candidate's proposals and the outcome of the congressional elections.

Finally, the rating agency S&P Global maintains a more optimistic stance for the credit rating. On July 6, 2022, the rating agency revised Mexico's outlook from negative to stable. In the outlook revision, they point out that they expect moderate fiscal deficits in 2024 and 2025 of 2.7% and 2.6% of GDP, something that is no longer met if what is contemplated in the 2024 budget is carried out.

Considering the above and the fact that elections will be held in Mexico in 2024, the risk of rating outlook revisions next year and rating downgrades in the second half of 2024 and in 2025 has been raised. One factor that could delay rating downgrades is higher economic growth driven by *nearshoring*.

Table 3. Mexico's sovereign debt credit rating, latest change

Rating Agency	Rating	Last Change
Moody's	Baa2 with stable outlook	8-Jul-22
S&P Global	BBB with stable outlook	26-Mar-20
Fitch Ratings	BBB- with stable outlook	15-Apr-20

Source: Grupo Financiero BASE with information from Moody's, S&P Global and Fitch Ratings.

Table 4. Credit rating scale and variation during the six-year period

Quality Grade	Moody's	S&P Global	Fitch Ratings
Principal	Aaa	AAA	AAA
High Grade	Aa1	AA+	AA+
	Aa2	AA	AA
	Aa3	AA-	AA-
Upper Middle Grade	A1	A+	A+
	A2	A	A
	A3 ▼	A-	A-
Lower Middle Grade	Baa1	BBB+ ▼	BBB+ ▼
	Baa2 ▽	BBB ▽	BBB
	Baa3	BBB-	BBB- ▽
Non-investment grade - Speculative	Ba1	BB+	BB+
	Ba2	BB	BB
	Ba3	BB-	BB-
Highly Speculative	B1	B+	B+
	B2	B	B
	B3	B-	B-
Substantial Risk	Caa1	CCC+	CCC+
	Caa2	CCC	CCC
	Caa3	CCC-	CCC-
Extremely Speculative	Ca	CC	CC
			C
Noncompliance	C	D	D

▼ Beginning of the six-year term
▽ Current (October 2023)

Source: Grupo Financiero BASE with information from Moody's, S&P Global and Fitch Ratings.

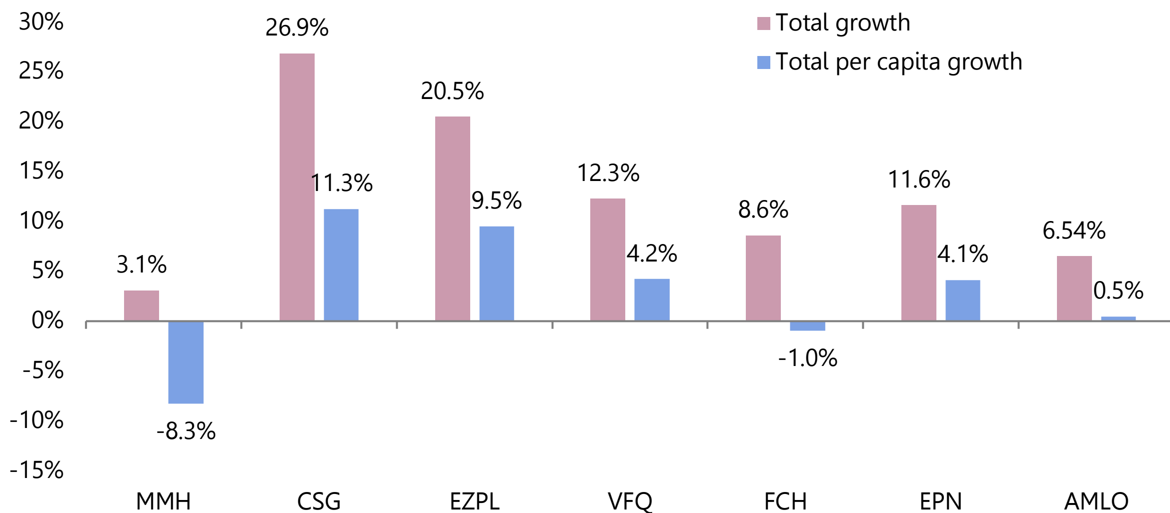
Expected growth

For this year, Grupo Financiero BASE estimates that Mexico's GDP will grow around 3.5%, while for 2024 growth is expected to be between 2.5% and 3.0%. For 2025, growth is expected to be between 0.8% and 1.0%, as a result of 1) economic slowdown in the United States, 2) lower public spending in Mexico and 3) accumulation of consumer debt. If the recession materializes in 2025, this administration will have started with a recession and will have inherited one to the next administration.

Finally, if Grupo Financiero BASE's forecasts materialize, GDP would be closing the six-year term with an accumulated growth of 6.54%, the lowest since the six-year term of Miguel de la Madrid (1982-1988). However, taking into account population growth, at the end of 2023 Mexico's GDP per capita would show a growth of 0.47% with respect to 2018. This growth would be lower than the 4.1% recorded in the six-year term of Enrique Peña Nieto, but higher than the 1.0% contraction observed in the six-year term of Felipe Calderón (Fig. 17).

Mexico's GDP growth, although it has accelerated, is not sustainable in the long term.

Fig. 17. Economic growth by six-year period



GDP growth in the last quarters of each six-year period, using Grupo Financiero BASE growth forecasts.
Source: Grupo Financiero BASE with information from INEGI.

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ANNEX 1. Recovery of the 45 largest economies in the world.
Actual changes in local currency, seasonally adjusted

Country	Variations									
	Annual			Quarterly				vs. 2019		
	2020	2021	2022	4T 2022	1T 2024	2T 2023	3T 2023	2022	2T 2023	3T 2023
Poland	2.1%	12.6%	16.6%	11.7%	-8.4%	2.1%		34.0%	42.8%	
Ireland	5.8%	14.8%	9.5%	-0.9%	-2.6%	0.5%		33.0%	31.5%	
China *	2.2%	20.8%	3.0%	0.8%	2.3%	0.5%	1.3%	27.2%	28.8%	36.4%
Vietnam *	2.6%	42.1%	8.2%	38.4%	-76.2%	106.5%	53.1%	57.6%	28.2%	96.4%
Turkey	1.7%	11.8%	5.3%	1.1%	-0.1%	3.5%		19.8%	25.6%	
Nigeria	-1.8%	3.6%	3.3%	11.0%				5.1%	18.9%	
Israel	-1.8%	9.7%	6.5%	1.1%	0.7%	0.8%		14.6%	18.1%	
India	-5.0%	9.5%	6.3%	4.4%	6.9%	-5.2%		10.7%	15.1%	
Taiwan	3.4%	6.5%	2.4%	-0.5%	-0.7%	1.4%		12.7%	12.9%	
Indonesia	-2.1%	3.7%	5.3%	0.4%	-0.9%	3.9%		7.0%	12.4%	
Colombia	-7.3%	11.0%	7.3%	-1.7%	2.2%	-1.0%		10.4%	11.2%	
Australia	-1.8%	5.2%	3.7%	0.7%	0.4%	0.4%		7.1%	9.0%	
Romania	-3.5%	5.7%	4.6%	1.1%	-1.0%	1.7%		6.6%	8.7%	
Singapore	-3.8%	8.9%	3.6%	0.1%	-0.4%	0.1%		8.5%	8.6%	
Saudi Arabia	-4.3%	3.6%	9.1%	1.3%	-1.4%	-0.2%		8.1%	8.3%	
Denmark	-2.4%	6.8%	2.7%	0.6%	0.8%	-0.3%		7.1%	8.3%	
Brazil	-3.6%	5.3%	3.0%	0.1%	1.8%	0.9%		4.6%	8.1%	
United States	-2.2%	5.8%	1.9%	0.6%	0.6%	0.5%	1.2%	5.5%	7.4%	8.7%
South Korea	-0.7%	4.3%	2.6%	-0.3%	0.3%	0.6%	0.6%	6.3%	7.4%	8.0%
Netherlands	-3.9%	6.2%	4.4%	0.9%	-0.4%	-0.2%		6.5%	6.9%	
Chile	-6.4%	11.9%	2.5%	0.0%	0.4%	-0.3%		7.4%	6.8%	
Norway	-1.9%	4.0%	3.2%	-0.1%	0.3%	0.0%		5.3%	6.6%	
Switzerland	-2.3%	5.4%	2.7%	0.0%	0.3%	0.0%		5.7%	6.4%	
Malaysia	-5.5%	3.3%	8.7%	3.4%	-4.3%	-0.8%		6.1%	6.2%	
Philippines	-9.3%	5.5%	7.6%	2.0%	1.0%	-0.9%		3.0%	6.1%	
Sweden	-2.3%	5.9%	2.9%	-0.8%	0.4%	-0.8%		6.5%	5.8%	
Belgium	-5.3%	6.9%	3.0%	0.2%	0.4%	0.3%		4.3%	5.6%	
Portugal	-8.3%	5.5%	6.7%	0.3%	1.6%	0.0%		3.2%	5.4%	
Peru	-10.9%	13.4%	2.7%	3.4%	-6.8%	5.0%		3.8%	4.5%	
Canada	-5.1%	5.0%	3.4%	0.0%	0.6%	0.0%		3.1%	4.2%	
Mexico	-8.8%	6.1%	3.9%	0.6%	0.8%	0.8%	0.9%	0.5%	3.5%	4.4%
Italy	-9.1%	8.3%	3.9%	-0.2%	0.6%	-0.4%		2.3%	2.9%	
Thailand	-3.4%	2.4%	2.1%	3.7%	2.9%	-2.8%		1.0%	2.8%	
Finland	-2.4%	3.2%	1.6%	-0.6%	0.3%	0.6%		2.4%	2.8%	
United Kingdom	-10.4%	8.7%	4.3%	0.1%	0.3%	0.2%		1.7%	2.2%	
Spain	-11.2%	6.4%	5.8%	0.4%	0.6%	0.4%	0.4%	0.0%	2.2%	2.5%
Argentina	-9.9%	10.7%	5.0%	-1.8%	0.9%	-2.8%		4.7%	1.9%	
Austria	-6.7%	4.4%	4.8%	0.0%	0.1%	-0.8%		2.0%	1.6%	
France	-7.7%	6.4%	2.5%	0.1%	0.0%	0.5%		0.7%	1.6%	
Russia *	-2.2%	6.1%	-1.3%	10.3%	-19.0%	9.2%		2.4%	1.4%	
Japan	-4.3%	2.3%	1.0%	0.1%	0.8%	1.2%		-1.1%	1.1%	
South Africa	-6.2%	4.8%	1.9%	-1.1%	0.3%	0.6%		0.2%	0.9%	
Germany	-4.2%	3.1%	1.9%	-0.4%	-0.1%	0.0%		0.7%	0.4%	
Czech Republic	-5.5%	3.5%	2.4%	-0.4%	0.1%	0.0%		0.1%	-0.2%	
Hong Kong	-6.5%	7.2%	-3.5%	3.7%	-3.0%	-2.3%		-3.3%	-4.6%	

* Figures without seasonal adjustment
Source: BASE Financial Group with information from the statistical offices of each country.