Economic Outlook

Mexico

January 2024

BASE

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INTRODUCTION

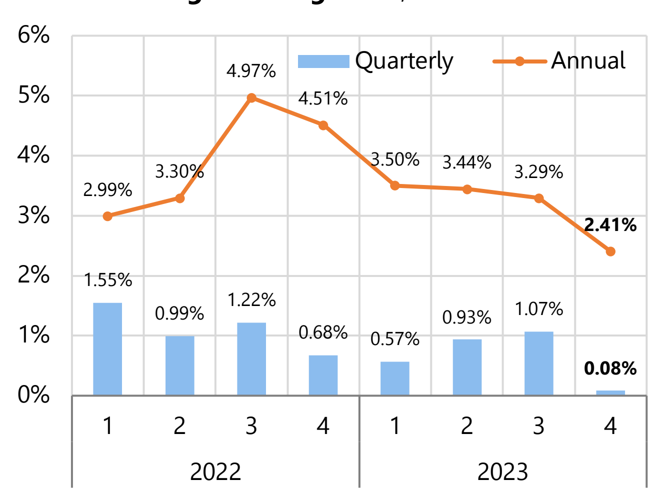
In the fourth quarter of 2023, Mexico's Gross Domestic Product (GDP) registered growth of 0.10% with respect to the previous quarter, according to INEGI's timely estimate (Fig. 1), falling below market expectations and confirming a sharp slowdown in economic activity during the last three months of 2023. This quarterly growth rate is the lowest since the third quarter of 2021, when a sharp drop in tertiary activities was observed due to restrictions on the outsourcing of personnel. Compared to the same quarter of the previous year, GDP showed annual growth of 2.4% in the fourth quarter, marking the lowest growth rate since the fourth quarter of 2021 and a sharp deceleration from the average annual growth of 3.41% in the first three quarters of 2023.

In order to make a comparison with the economic growth rate reported by the United States, which presents quarterly growth on an annualized basis (i.e., as if the quarterly growth were repeated for a consecutive year), Mexico's economy showed an annualized quarterly growth of 0.04% in the fourth quarter, considerably lower than the 3.28% of the U.S. economy.

In cumulative terms for the year 2023, Mexico's GDP registered a growth of 3.10% compared to the previous year, decelerating from a growth of 3.94% in 2022. However, it is important to mention that this figure far exceeds expectations at the beginning of 2023, when a growth of 0.98% was estimated according to Banco de México's survey of private sector specialists.

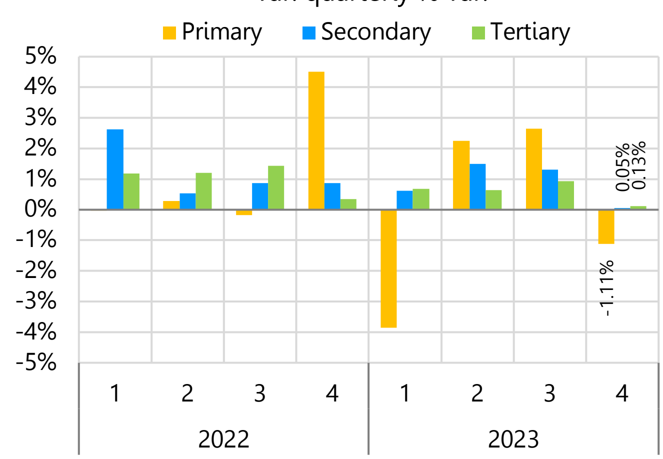
This considerably better-than-expected performance was largely due to: 1) strong growth in fixed investment, particularly in non-residential construction driven by public works spending, as well as private investment motivated by expectations of the benefits that *nearshoring* will have in Mexico and 2) consumption growth, driven by a declining unemployment rate, government transfers, credit granting, slowing inflation and peso appreciation.

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.

Primary activities contracted 1.10% quarter-over-quarter and secondary activities showed no growth with respect to the previous quarter (0.0%), their worst performance since the first quarter of 2021 when the economy was still affected by the pandemic. Finally, tertiary activities grew 0.10% quarter-over-quarter, their lowest growth rate since the third quarter of 2021.

Despite the fact that economic growth in the year exceeded market expectations, at the close of 2023 GDP per capita still stands 1.63% below that observed in 2018.

Growth during the six-year presidential term

Considering the known figures for the first five years of the current six-year term, as well as an estimated growth of 2.5% for the current year, Mexico's economy would be ending the six-year term with an average annual growth[1] of 0.96% with respect to the GDP level with which it ended the previous six-year term (fourth quarter of 2018). Compared to what was observed in previous administrations, the current six-year term of President López Obrador shows the worst performance since the six-year term of Miguel de la Madrid Hurtado (1982-1988), when the economy grew at an average annual rate of 0.51%.[2]

Considering the population growth in the period and that its trend has been downward, the evolution of GDP per capita shows a slightly more favorable outlook for the Lopez Obrador administration. With an estimated population growth of 6.05% during the six-year period, it is estimated that GDP per capita will end the six-year period with a contraction of 0.17%. Although this per capita GDP growth is lower than that observed during Peña Nieto's six-year term (when it grew 4.11%), it would exceed that recorded during Felipe Calderón Hinojosa's six-year term, when it contracted 0.95% after the U.S. financial crisis.

Putting this economic growth in the global context of the recovery from the COVID-19 pandemic, the high rate of growth that Mexico has experienced is not out of the ordinary. In the aftermath of the pandemic crisis, the recovery of global economies has not been uniform. Mexico's recovery has been slow compared to that observed in other countries. Although at the end of the third quarter of 2023 Mexico's GDP was already 4.44% above its 2019 (pre-pandemic) GDP level, in a list of the 45 largest economies in the world, Mexico ranked #31 (see Appendix 1).

Expectations

Grupo Financiero BASE estimates that Mexico's economy will grow between 2.5% and 3% in 2024, and a moderation in the pace of growth is expected for 2025. In fact, a recession scenario is possible in 2025, considering that the uncertainty generated by the change of government at the federal level could lead to caution in consumer spending and a decrease in public spending, particularly in physical investment, is expected. Historically, each six-year term usually begins with very little economic dynamism. Of the seven six-year terms since Miguel de la Madrid, four have shown GDP contractions in the first year, and in six of the seven, the growth rate in the first year of the six-year term has been lower than that of the previous year.

In addition to the aforementioned, other risk factors for Mexico's economic growth stand out, particularly:

- The high budget deficit by 2024, putting upward pressure on inflation and causing the interest rate to remain at restrictive levels for a longer period.
- The dispute settlement panel under the USMCA on the dispute over the use of genetically modified corn, which could rule against Mexico and result in trade sanctions.
- The possibility that the other trade dispute against Mexico, the energy dispute, will also be taken to the panel stage.
- The uncertainty caused by the presidential and congressional elections, both in Mexico and the United States, which tends to cause greater volatility in the exchange rate and a slowdown in investment projects.
- Uncertainty regarding domestic economic policy and possible deterioration of governance, especially in the context of a new administration and Congress.
- The possibility that the lack of infrastructure in the distribution and transmission of electric power and water availability may slow the growth of fixed investment.

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[1] This is the geometric average, which has two important differences with respect to the traditional (arithmetic) average: (1) it takes into account the cumulative or compound nature of economic growth over time and (2) it is only a function of the initial value, the final value and the time elapsed between the two, ignoring everything that happens between the two data. This rate is also known as the "compound annual growth rate" or CAGR. The geometric average provides a more realistic and accurate measure of economic growth than the arithmetic average.

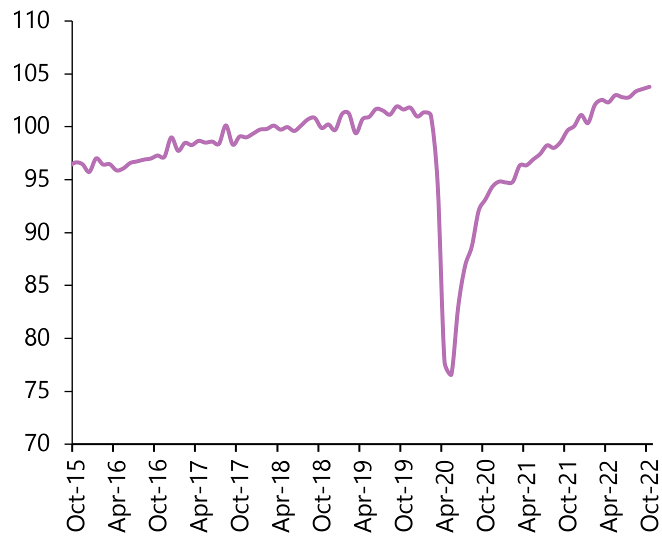
[2] This is considering the GDP at the end of 2024. The presidential succession used to take place on December 1; however, an electoral reform approved in 2014 changed the date of the inauguration of the new president to October 1. Thus, López Obrador's six-year term will be 2 months shorter than that of his predecessors.

- Declines in the non-residential construction sector and in fixed investment, due to the lack of fiscal space in the expenditure budget for new infrastructure works.
- The possibility of the U.S. economy slowing down more than expected or falling into recession, which would be reflected in exports, remittances and foreign direct investment coming into Mexico.
- The possibility of the imposition of stimuli in the United States to encourage companies to return factories to that country, which would take away, in part, Mexico's nearshoring opportunity.

PRIVATE CONSUMPTION

Private consumption represents approximately 70% of Mexico's Gross Domestic Product, and is considered an indirect measure of the well-being of individuals and households, as it reflects their ability to acquire goods and services to satisfy their needs and desires. An increase in consumption generally indicates that households have more disposable income, which comes from an improvement in employment, wages, and general economic conditions of the population.

Fig. 3. Monthly Indicator of Private Consumption, annual % var.



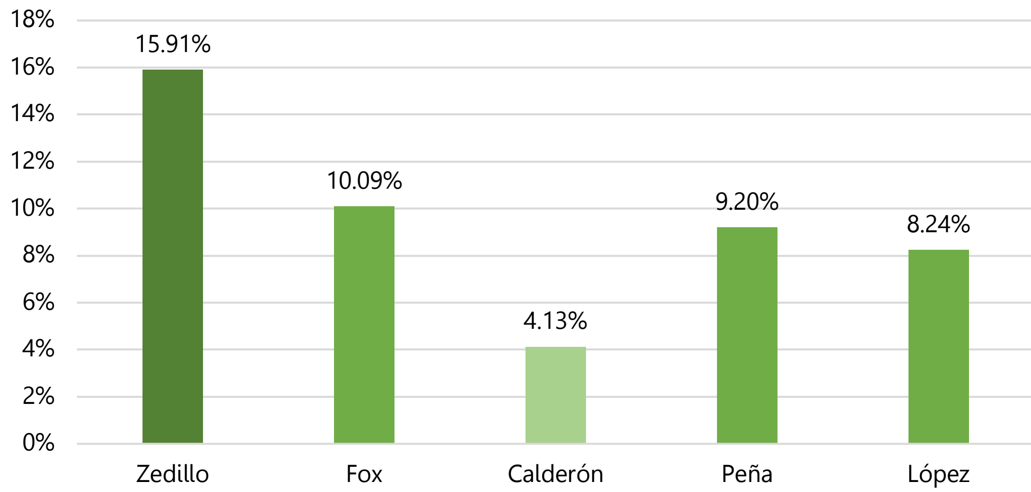
Source: Grupo Financiero BASE with information from INEGI.

In October 2023 (latest available data), the monthly indicator of private consumption in the domestic market, published by INEGI, registered a contraction of 0.25% in the month. However, the annual growth rate of consumption is 4.53%. With this, the consumption indicator accumulates 32 consecutive months registering positive annual rates, something not observed since the period from December 2009 to February 2019. In the first ten months of the year, the accumulated growth of consumption with respect to the same period of the previous year is 4.01%.

In the breakdown by type of consumption and origin of goods, the highest growth has been in imported goods, which in October registered an annual growth of 21.98% and in the first ten months grew by an accumulated 167.21% annually. This type of consumption was largely driven by the appreciation of the peso against the dollar, increasing the purchasing power of the peso relative to the cost of goods in the United States. However, this produces a substitution effect, as consumers opt for foreign goods instead of domestic ones. As a result, consumption of domestic goods showed an increase of only 0.16% in the first 10 months of the year compared to the same period of the previous year. On the other hand, the consumption of domestic services grew 3.37% annually in those 10 months, so that the consumption of goods and services in aggregate registered an annual growth of only 1.62% in that period.

Comparing the performance of the private consumption indicator between the six-year periods with the information available, the growth in consumption so far in the current six-year period (8.24%) is the lowest since the same period in Calderón's six-year term (4.13%) (Fig. 4). The rest of the six-year periods for which comparable information is available show higher growth: Zedillo (15.91%), Fox (10.09%) and Peña (9.20%).

Fig. 4. Cumulative growth of private consumption in the first 59 months of each six-year period.



Source: Grupo Financiero BASE with information from INEGI.

The growth in total private consumption during this six-year period is largely due to the consumption of imported goods, which, as mentioned above, is the result of the strong appreciation of the peso, which has made foreign goods more attractive (Table 1).

Table. 1. Breakdown of cumulative growth in private consumption in the first 59 months of each six-year term

	Total private consumption	Goods and services of national origin	Goods of national origin	Services of national origin	Imported goods
Zedillo	**15.91%**	16.32%	19.27%	12.18%	22.43%
Fox	**10.09%**	9.03%	10.29%	7.87%	24.90%
Calderon	**4.13%**	5.80%	5.97%	5.29%	-9.66%
Peña	**9.20%**	9.55%	5.21%	15.78%	22.04%
López	**8.24%**	4.09%	5.35%	2.55%	40.07%

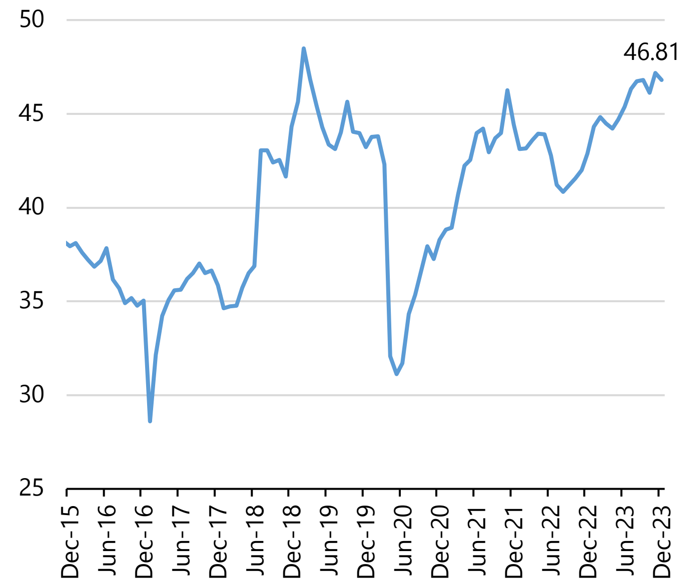
Source: Grupo Financiero BASE with information from INEGI.

Consumer Confidence

Consumer confidence is fundamental to consumption growth, as it reflects how willing people are to spend on goods and services. When consumers feel confident about their economic situation and have positive expectations about the economic future of their household and the country, they are more likely to spend more. Conversely, low confidence can lead to a reduction in spending, which ends up slowing economic growth.

In 2023, the National Survey on Consumer Confidence (ENCO) published by INEGI registered an increase of 3.94 points, the highest annual advance since 2021. With this, the indicator stood at a level of 46.81 points, only 1.68 points below the historical high recorded in February 2019 (Fig. 5). This increase in confidence was mainly due to consumers recognizing that the economic situation of households and the country is considerably better than it was a year ago, with respective increases of 3.91 points and 2.94 points in those survey questions. This improvement in consumers' perception of the economic environment also led to a strong increase in the component of possibilities of purchasing durable goods, which obtained the highest growth of the five components with 6.73 points.

Fig. 5. Consumer Confidence Indicator



Source: Grupo Financiero BASE with information from INEGI.

Remittances

The most recent remittances data published by the Bank of Mexico showed that in November 2023 the country received a total of 4,908.15 million dollars, which represented a drop of 15.54% with respect to October's figure. This reading is considered negative since, historically, falls in November are usually smaller (on average 5.69% in the previous 5 years). On an annual rate, remittances continue to show growth, registering in November an increase of 1.88% over the same month of the previous year, but being the lowest growth rate since April 2020.

With this, cumulative remittances in the first eleven months of 2023 totaled 57,796.39 million dollars, growing 8.73% with respect to the same period of 2022. Likewise, analyzing the accumulated flow of the last 12 months (December 2022 to November 2023), the inflow of remittances totaled 63,149.42 million dollars and registered 43 consecutive months of monthly growth.

It is important to consider that what is relevant for the Mexican consumer is the purchasing power provided by those dollars sent from abroad. For this, it is necessary to convert the flows into Mexican pesos and adjust them for the variation in the price level. From this perspective, the appreciation of the Mexican peso against the dollar is detrimental to those who receive remittances, since they receive fewer pesos for the same amount of dollars. Although the amount of dollars received in November was 1.88% higher than a year ago, when adjusting the flow for accumulated inflation over the last twelve months, as well as the variation in the exchange rate, the flow in real pesos decreased by 12.73%. Thus, the flow of remittances in real pesos has contracted for 13 consecutive months as of November, equaling the historical maximum period of declines in the purchasing power of remittances between August 2012 and August 2013. Given the performance of the peso, which observed a monthly average of 17.19 pesos per dollar in December, and the inflation observed in December of 4.6%, it is estimated that in December remittances measured in real pesos also fell, which would imply a total of 14 consecutive months with a loss of purchasing power, something never seen before in Mexico. With this, it is estimated that 2023 closed with a 9.1% loss in purchasing power of remittances, the first since 2013 and the largest since 2010.

By 2024, it is estimated that remittances will grow 8% and assuming an exchange rate rising to 18.50 pesos as of June and an annual closing inflation of 4.4%, it is projected that remittances will gain 5.8% of purchasing power, which if realized would contribute to the growth of consumption in Mexico.

Labor Market

According to the results of the National Occupation and Employment Survey (ENOE) published by INEGI, the occupied population (or employed) increased by 1,196 thousand people in 2023, reaching a total of 59 million 146 thousand employed people. This increase is equivalent to a 2.06% growth in the employed population, exceeding the 1.77% increase recorded in 2022.

As for the unemployed population (or unemployed), in 2023 there was a decrease of 59 thousand people. With this, the Economically Active Population (EAP), which is made up of all employed people and those who are seeking employment and are unable to find it (unemployed), increased by 1.91% to 60.73 million people. The result of dividing the unemployed population by the EAP is known as the unemployment rate. This rate registered in June 2023 the lowest unemployment rate since the ENOE has been registered, a reading of 2.67%, and since then it has risen slightly to close 2023 at 2.79%. Likewise, the urban unemployment rate, which when considering more formal and organized labor markets offers a more accurate and stable outlook, also reached a historic low of 3.27% in June 2023, and has since risen to close the year at 3.30%.

Table 2. Summary of the National Occupation and Employment Survey (ENOE)

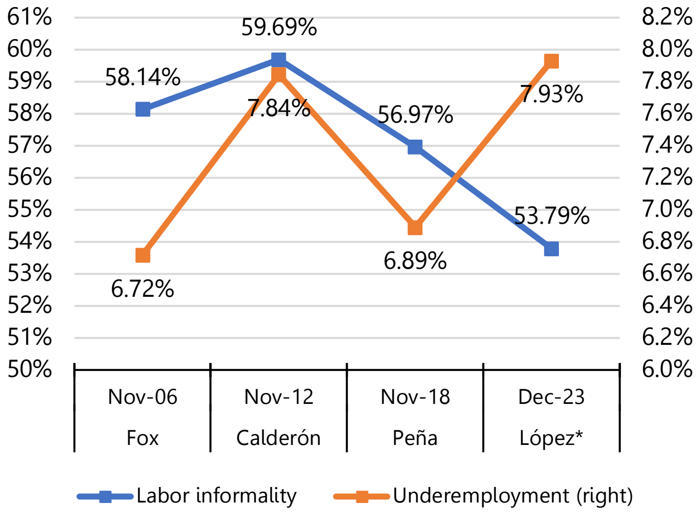
	Pre-COVID-19		COVID-19	Recovery		
	Feb-20	**Mar-20**	**Apr-20**	**Dec-22**	**Nov-23**	**Dec-23**
EAP (millions)	**57.45**	**57.12**	**44.86**	**59.6**	**59.79**	**60.73**
Employed	55.43	55.46	42.76	57.95	58.17	59.15
Unemployed	2.03	1.66	2.1	1.65	1.62	1.59
PNEA (millions)	**38.02**	**38.39**	**50.23**	**40.24**	**38.29**	**40.71**
Available	5.59	5.79	19.94	5.51	5.5	4.91
Not available	32.42	32.59	30.29	34.73	32.79	35.81
National unemployment rate	3.65%	3.31%	4.68%	2.94%	2.80%	2.79%
Urban unemployment rate	4.65%	4.10%	5.13%	3.84%	3.36%	3.30%
Extended unemployment rate	12.09%	11.85%	34.01%	10.99%	10.91%	9.89%
Participation rate	60.56%	60.17%	47.20%	59.97%	60.42%	60.16%
Underemployment rate	8.63%	9.06%	25.40%	7.26%	8.21%	7.63%
Informality rate	56.09%	55.55%	48.01%	55.03%	54.91%	53.79%

Source: Grupo Financiero BASE with information from INEGI.

Despite the low unemployment rate, informality continues to be a relevant issue, since under this scheme there are no legal benefits or social security, which implies vulnerability in the income and quality of life of workers. According to ENOE figures, 53.79% of Mexico's workers are in the informal labor market. Although this rate has decreased since the peak of 61.17% recorded in the ENOE in March 2010, it is still at high levels (Fig 6).

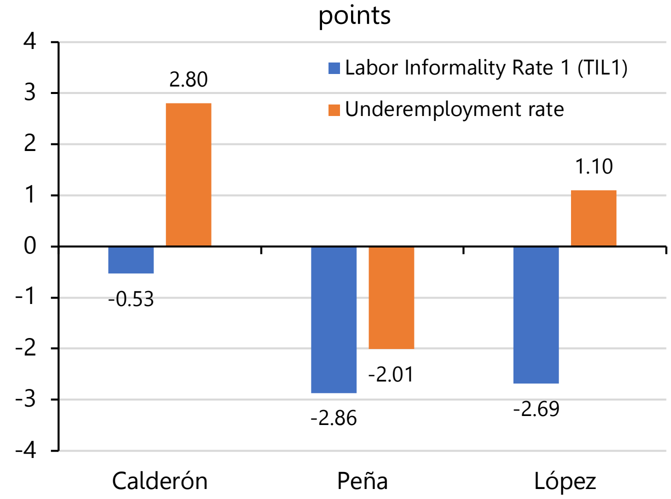
Another vulnerable point in the labor market has to do with the underemployed population, which includes people who have jobs but need a second job. This rate closed 2023 at 7.63%, a high level compared to the average observed in the year prior to the beginning of the current six-year term (6.86%) (Fig. 7), and above the minimum of 5.80% recorded in June 2006.

Fig. 6. Informality and underemployment rates at the end of each six-year period.



* López Obrador's six-year term ends on October 1, 2024.
Source: Grupo Financiero BASE with information from INEGI.

Fig. 7. Changes in informality and underemployment rates in the first 73 months of the six-year term, percentage points



Source: Grupo Financiero BASE with information from INEGI.

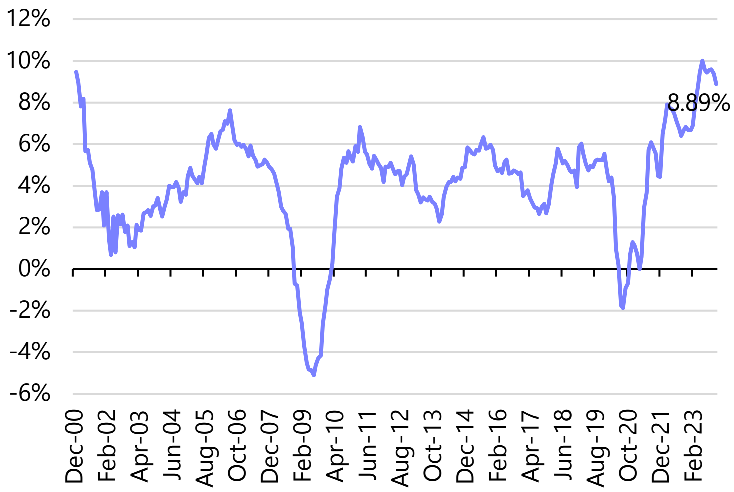
Regarding formal private employment, the Mexican Social Security Institute (IMSS) recorded an increase of 651,490 jobs in 2023, bringing the total number of insured persons to 22,024,386. In percentage terms, the increase was only 3.05%, the lowest annual growth rate since May 2021. However, the fact that employment continues to grow despite the labor market being in a low unemployment environment is a good sign for the economy.

In December 2023, the average base contribution salary was 537.9 pesos per day, which represents a monthly increase of 0.57%. At an annual rate, the increase was 10.53%, the lowest since February 2022. Considering that in December there was an annual inflation rate of 4.60%, the real annual growth of the average contribution base salary was 5.67%.

Multiplying the real average base contribution wage by the total number of jobs affiliated to the IMSS provides an approximation of what is known as the real wage bill, which is a determining factor in the performance of consumption. However, it is crucial to keep in mind that this calculation only considers private formal employment, excluding both formal workers in the public sector, as well as those in the informal sector.

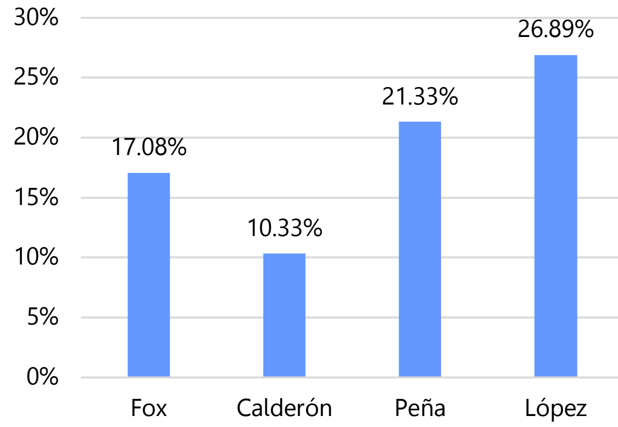
Considering that the number of formal jobs increased by 3.05% during the year and that the base salary contribution increased by 5.61% real, the real wage bill grew by 8.83% annually, marking the lowest annual growth rate since April 2023 (Fig. 8). As mentioned in previous paragraphs, the fact that the wage bill continues to grow in the current environment is a good sign for household consumption. In fact, comparing the first 61 months of each six-year term, we observe that AMLO's term has seen the largest increase in the real wage bill (26.89%) (Fig. 9).

Fig. 8. Real wage mass according to IMSS figures, annual % var.



Source: Grupo Financiero BASE with information from INEGI.

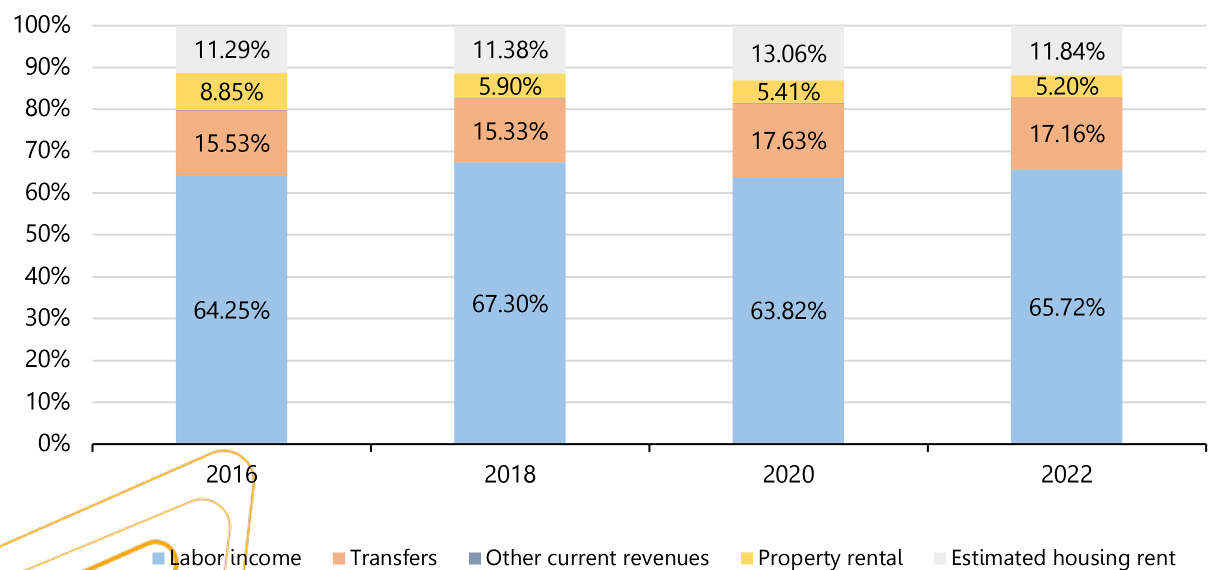
Cumulative growth of the real wage bill in the first 61 months of each six-year period.



Source: Grupo Financiero BASE with information from INEGI.

Despite this increase in the real wage bill, it is noteworthy that in the household income-expenditure survey, published by INEGI with data up to 2022, income from work in households lost participation with respect to 2018, along with an increase in the participation of transfers, where remittances and government transfers or aid to certain population groups are found. This implies that, if the wage bill rose, transfers (remittances and government aid) rose at a higher rate. With the above, households have become more dependent on remittances and government aid, relative to 2018 (Fig. 10).

Fig. 10. Main sources of household income



Source: Grupo Financiero BASE with information from ENIGH-INEGI.

FIXED INVESTMENT

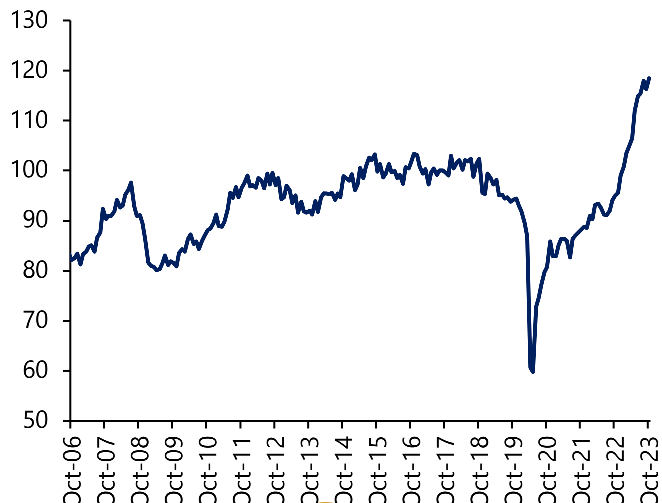
The most recent data of the Gross Fixed Investment (GFI) indicator published by INEGI corresponds to October 2023. In this month, fixed investment showed a monthly growth of 1.91%. With this, the gross fixed investment indicator achieved an annual growth of 24.74% and reached a new historical high, surpassing the previous high recorded in August of the same year (Fig. 11). The gross fixed investment indicator now records 31 consecutive months of positive annual growth rates, something that had not been observed since the period from January 2010 to November 2012.

Gross fixed investment accumulated a growth of 20.21% in the first 10 months of the year, which was mainly due to investment in imported transportation equipment (60.08%), investment in domestic transportation equipment (29.08%) and non-residential construction (38.55%).

The strong growth in investment in transportation equipment is mainly due to a rebound effect, as demand weakened at the beginning of the pandemic and supply chains were disrupted, limiting production in this sector. In addition, investment in imported transportation equipment has also been driven by the appreciation of the Mexican peso against the U.S. dollar. Nevertheless, investment in transportation equipment is still well below its historical highs: that of domestic transportation equipment is 8.29% below its December 2016 peak, while that of imported transportation equipment is 5.40% below its September 2007 peak.

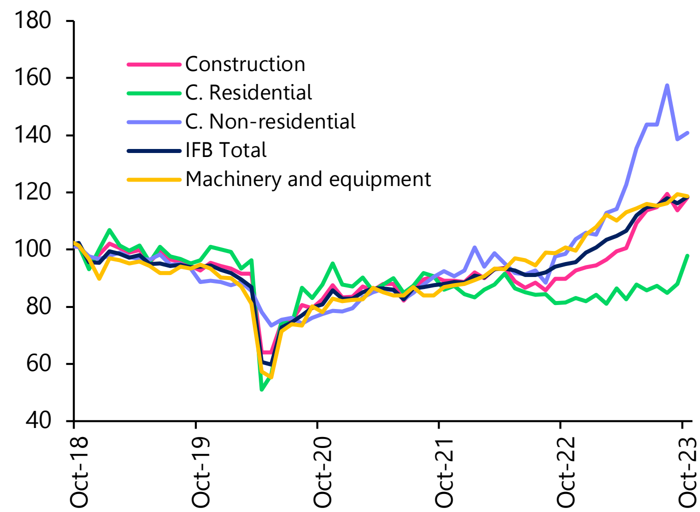
The recovery of investment in transportation equipment was undoubtedly an important driver for the recovery of investment, however, the component that surprised the most and gave the greatest boost to total investment was non-residential construction, which, despite a monthly contraction of 11.25% in September (the largest since May 1995) followed by a rebound of 11.27% in October (the largest since August 2020), registered an annual growth of 42.89% in October and a cumulative annual growth of 38.55% in the January to October 2023 cumulative (Fig. 12).

Fig. 11. Gross Fixed Investment Ratio
Base 2018=100



Source: Grupo Financiero BASE with information from INEGI.

Fig. 12. Components of the IFB
Base 2018=100



Source: Grupo Financiero BASE with information from INEGI.

The monthly industrial activity indicator (IMAI) figures provide a breakdown of the construction sector that shed light on the growth observed in non-residential construction. The "building" subsector showed in November 2023 (most recent data) an annual growth of 9.78%, "specialized works for construction" grew 14.32%; and "construction of civil engineering works" grew 69.01%, the latter subsector being where most public works are accounted for. With this, it is possible to infer that the growth of non-residential construction and fixed investment has been largely due to the infrastructure works carried out by this administration. It is noteworthy that in August 2023, an annual growth rate of 163.31% was recorded, with the construction of civil engineering works reaching its historical maximum.

Figures from the National Survey of Construction Companies (ENEC) also show strong annual growth in the value of public sector construction output: 44.27% in November 2023. With this, the public sector construction indicator accumulates 18 consecutive months of annual growth, something that had not been seen since the beginning of the series in 2006. Within this sector, it is worth noting that the production of "civil engineering construction" according to the ENEC grew 49.14% in November. Likewise, the personnel employed in this subsector showed an annual growth of 15.14%, and one month earlier, in October 2023, it registered an annual growth of 15.47%, a rate not seen since February 2013.

With the growth observed in 2023, López Obrador's six-year term is set to end with the highest growth in gross fixed investment in a six-year term since the series has been recorded (since Zedillo's six-year term). Comparing the first 59 months of each six-year term since Zedillo, the highest growth is under López Obrador, with a cumulative growth of 21.42% (an average annual growth of 4.10%). Likewise, the six-year term of López Obrador leads in cumulative growth in domestic machinery and equipment, total construction and non-residential construction (Table 3).

By 2024, it is estimated that fixed investment will continue to show growth, both in transportation equipment because it has not yet finished recovering, and in non-residential construction, due to nearshoring and to a large extent due to intensive spending to complete the infrastructure works of this administration. This is a positive, but also a risk, since by 2025 there will be no infrastructure works to invest in, as it is the first year of administration and public finances have no room for new investments. In addition, there will be a high base of comparison and with this, fixed investment could start the next six years showing significant drops, unless *nearshoring* investment compensates for the lack of investment in public works.

Table 3. Breakdown of the cumulative growth of gross fixed investment in the first 59 months of each six-year term

	Total IFB	Total machinery and equipment	Domestic machinery and equipment	Domestic transportation equipment	Machinery, equipment and other national assets	Imported machinery and equipment	Imported transportation equipment	Machinery, equipment and other imported goods	Construction	Residential construction	Non-residential construction
Zedillo	4.20%	17.78%	4.60%	-19.22%	23.20%	32.98%	67.83%	33.66%	-1.45%	2.54%	-2.88%
Fox	6.10%	8.37%	5.68%	5.76%	4.70%	11.29%	15.04%	8.72%	4.42%	17.46%	-5.55%
Calderon	17.01%	31.51%	16.97%	34.95%	7.47%	48.40%	-11.82%	62.25%	8.43%	-3.16%	19.48%
Peña	1.12%	6.23%	0.92%	21.75%	-15.49%	9.98%	-7.74%	13.71%	-2.50%	5.84%	-10.89%
López	23.95%	22.62%	17.52%	28.03%	8.64%	24.87%	61.86%	20.96%	23.72%	4.90%	44.20%

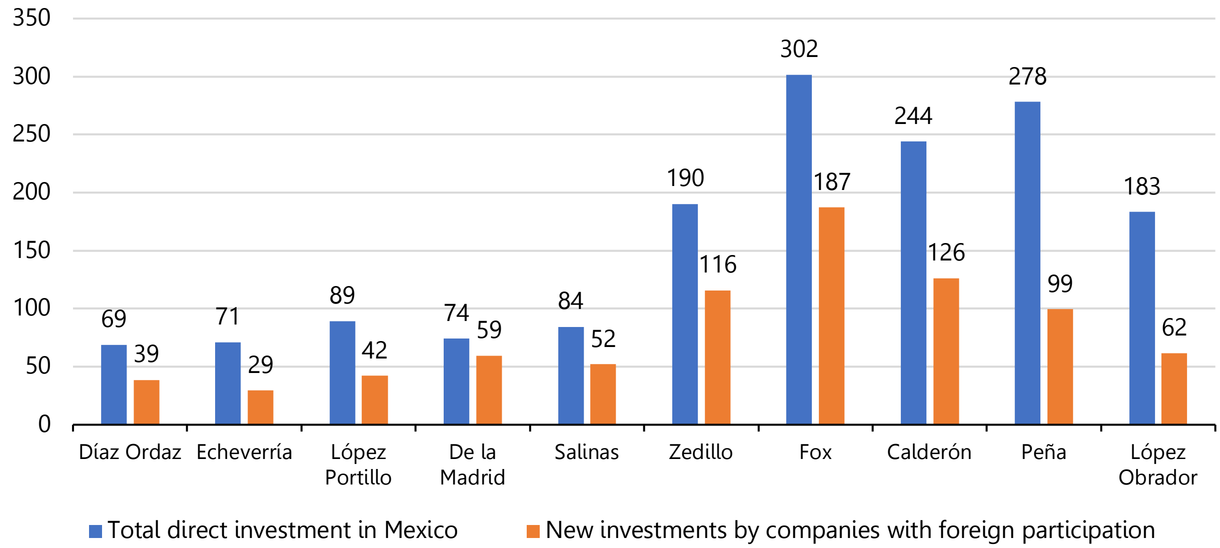
Source: Grupo Financiero BASE with information from INEGI.

Also analyzing real foreign direct investment (FDI)[3] accumulated in the first twenty quarters of each six-year term (due to the availability of data in the current six-year term), it can be observed that during López Obrador's six-year term, foreign direct investment totaled 183 billion dollars, the lowest since Felipe Calderón's six-year term, when 244 billion dollars were received. In the interior, new investments total 62 billion dollars during this six-year term, the lowest figure since the six-year term of Salinas de Gortari, when 52 billion dollars were received (Fig. 13). This is despite the global opportunity of *nearshoring*, which should be generating significant foreign direct investment in Mexico.

To put in context, China received FDI for 320 billion dollars until 2021, but with the trade war with the United States this amount has decreased and by the third quarter of 2023 (latest available data) it registered an outflow of FDI. This implies that the *nearshoring* opportunity amounts to more than 300 billion dollars, of which Mexico received in new investments in 2022 and 2023 a total of 20.95 billion dollars, which implies that Mexico is taking advantage of only about 6.5% of the opportunity, despite sharing a border with the United States and having a trade agreement.

[3] For comparability purposes, dollar amounts are adjusted for inflation according to the U.S. Consumer Price Index (CPI).

Fig. 13. FDI accumulated in the first 20 quarters of each six-year period
Billions of dollars, adjusted for **inflation**



Source: Grupo Financiero BASE with data from Banco de México and the U.S. Bureau of Labor Statistics.

Table 4. Cumulative FDI flows in 2022 and first 3 quarters of 2023
Millions of dollars

	Total direct investment in Mexico	**New investments by companies with foreign participation**	New investments as % of total FDI in Mexico
4 quarters of 2022	36,309.8	**18,145.1**	49.97%
First 3 quarters of 2023	32,926.4	**2,806.2**	8.52%

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

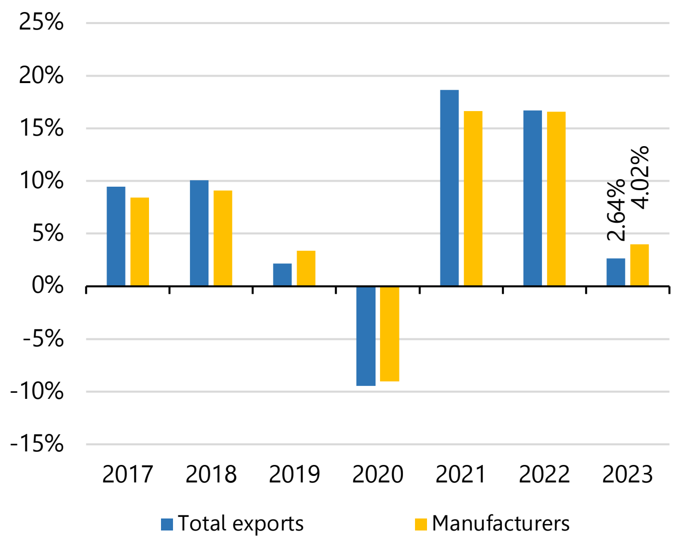
FOREIGN TRADE

In 2023, Mexican exports suffered a sharp deceleration, growing 2.54%, after growing 16.73% in 2022. The slowdown in exports can be explained by the appreciation of the Mexican peso of 12.96% in 2023, the largest appreciation on record for a year since the peso has traded under a free-floating exchange rate regime.

The slowdown in export growth was also related to a deterioration in U.S. manufacturing activity, as although U.S. GDP grew 2.54% in 2023, this growth was largely driven by the public sector through higher spending and additional job creation. In 2023, U.S. industrial production stagnated, showing a cumulative growth of 0.16%, its worst performance since 2020, when it registered a 7.19% drop, while manufacturing production registered a cumulative contraction of 0.61%, its first drop since 2020 when it contracted 6.58%. In fact, analyzing by type of export (with data up to November 2023), exports of consumer goods accumulated a growth of 7.93% with respect to the same period of 2022, exports of capital goods grew 4.23% and those of intermediate goods, i.e. those directed to industrial processes, contracted 0.73%. Exports of intermediate goods have the highest share with 43.09% of the total, according to 2023 data.

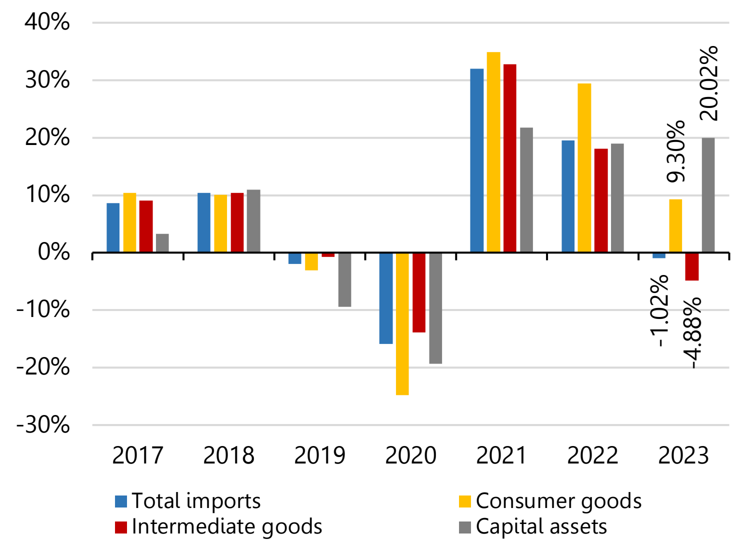
Within the country, oil exports fell by 14.76%, while non-oil exports grew by 3.90%. In non-oil exports, manufacturing exports grew 4.02% (Fig. 14), driven by automotive exports, which grew 14.33% with respect to 2022, allowing total exports to show growth. If automotive exports had not grown with respect to 2022, total exports would have fallen 1.45% in 2023. The growth in automotive exports is due to the fact that the sector was lagging in its recovery from pre-pandemic levels. According to information from the automotive registry, exports measured in number of units grew 15.34% in 2023, on par with a 15.83% growth in production. With this, automotive exports stood at 3,305,192 units, with a lag of 2.57% with respect to 2019 (pre-pandemic). Finally, the appreciation of the peso affected the "other manufacturing exports" component, which registered an accumulated drop of 0.95%.

Fig. 14. Annual growth of total exports and manufacturing exports



Source: Grupo Financiero BASE with information from INEGI.

Fig. 15. Annual growth of total imports and by type of goods



Source: Grupo Financiero BASE with information from INEGI.

On the other hand, imports registered a 1.02% drop with respect to 2022. Within Mexico, imports of consumer goods grew 9.30%, while imports of capital goods grew 20.02%, driven by the appreciation of the peso and the growth of investment in Mexico. However, imports of intermediate goods, related to the productive sector, recorded an annual drop of 4.88%, falling back despite the appreciation of the Mexican peso, evidence of a slowdown in the manufacturing industry other than the automotive sector (Fig. 15).

Consequently, the trade balance (difference between exports and imports) showed a deficit of US$5,464 million, decreasing from a deficit of US$26,879 million in 2022. Internally, the deficit was explained by the oil balance, with a deficit of 18.536 billion dollars, accumulating 9 consecutive years showing a deficit. On the other hand, the non-oil balance showed a surplus of US$13,073 million, the largest since 2021 and accumulating 7 consecutive years showing a surplus.

By 2024, export growth is expected to be around 6%, driven by the expected depreciation of the Mexican peso and by economic growth in the United States, which is expected to continue to be driven by public spending. By 2025, exports are likely to slow down again and a drop cannot be ruled out due to the risk of an economic recession in the United States.

INFLATION AND MONETARY POLICY

The behavior of inflation during 2023 can be divided into two parts. In the first part, between January and July, annual inflation showed a clear downward trend, going from 7.91% annually in January to 4.79% in July. This rapid deceleration in inflation was mainly due to a combination of three factors:

1. **The deceleration in the monthly rate of core merchandise inflation.** In the first seven months of 2023, monthly core inflation averaged 0.46%, down from an average of 0.69% in the same period of 2022. Internally, the slowdown

was due to the merchandise component, as average monthly inflation fell from 0.92% to 0.49%. In contrast, monthly services inflation averaged 0.43%, unchanged from the first seven months of 2022. This was due to the fact that during the second half of 2022 and first half of 2023 the functioning of global supply chains normalized and also stabilized commodity prices, which had increased in the first quarter of 2022 with the start of the war in Ukraine. Services inflation continued at the same pace as the sector saw a slower recovery after the pandemic, so companies delayed passing on higher costs to consumers.

Considering the above, core inflation fell from 8.45% in January 2023 to 6.64% in July, with the merchandise component dropping from 11.00% in January to 7.82% in July. The services component showed little change, falling from 5.51% to 5.24% in the same period.

2. **The fall in prices of the non-core component**, particularly in the subcomponents of livestock products and energy. In the first seven months of 2023, monthly non-core inflation averaged -0.34%, below the average of 0.62% in the same period of 2022. Within, the livestock products subcomponent showed an average monthly inflation of -0.01%, decelerating from an average of 1.54% in the same period of 2022. On the other hand, the energy component registered an average monthly rate of -1.37%, down from 0.20% in the same period of 2022.

   It should be recalled that the non-core component of inflation includes products whose prices are more volatile and do not respond to monetary policy actions. In this regard, in the minutes of the September 28th monetary policy announcement, it was acknowledged that the greatest contribution to the decrease in headline inflation came from the non-core component, adding that it has been "lucky". Annual core inflation fell from 6.32% in January to -0.67% y/y in July. The effect was much more evident in the energy sub-component, as annual inflation fell from 2.52% in January to -7.82% in July, the largest annual drop in prices since May 2020. The drop in energy prices was explained by sustained monthly decreases in consumer prices of LPG and natural gas between January and July.

3. **Effect of high base of comparison**. Due to the deceleration of inflation at the monthly rate, the annual rate, which compares the current price level with the price level 12 months ago, registered a faster decline.

Between August and October 2023, headline inflation continued to decline, but at a slower pace, reaching a minimum rate in October 2023 of 4.26%, not seen since February 2021. Inflation slowed its downward trend due to the fading effect of the high comparison base, as it was between August and October 2022 that inflationary pressures began to diminish.

Additionally, towards the end of 2023, upward pressures began to materialize in prices of the non-core component, i.e., the "luck" that had helped to reduce headline inflation in the first half of 2023 came to an end. In November and December 2023, non-core inflation stood at 1.43% and 3.39%, respectively. Annual agricultural products inflation accelerated to 5.66% y/y in December due to a rebound in fruit and vegetable prices, while energy inflation was close to 0% in December, but was no longer negative.

In the first two weeks of January 2024, inflation continued to rebound. Headline inflation stood at 4.90%, with the core component at an annual rate of 4.78% and the non-core component at 5.24%. Within non-core inflation, the agricultural products component continued to accelerate with an annual inflation rate of 9.73% and the energy component was at 0.16%.

Considering the rebound in inflation, which has exceeded market expectations, the Bank of Mexico should wait at least until the second quarter to make its first interest rate cut.

In its November 9, 2023 monetary policy announcement, Banco de México modified its forward guidance for monetary policy, stating that in order to achieve the convergence of inflation to the 3% target, it will be necessary to maintain the reference rate at 11.25% for "some time", instead of "for an extended period", as had been stated until September. Because of this, the market began to speculate that the first interest rate cut could be at the end of the first quarter, in the March 21 announcement.

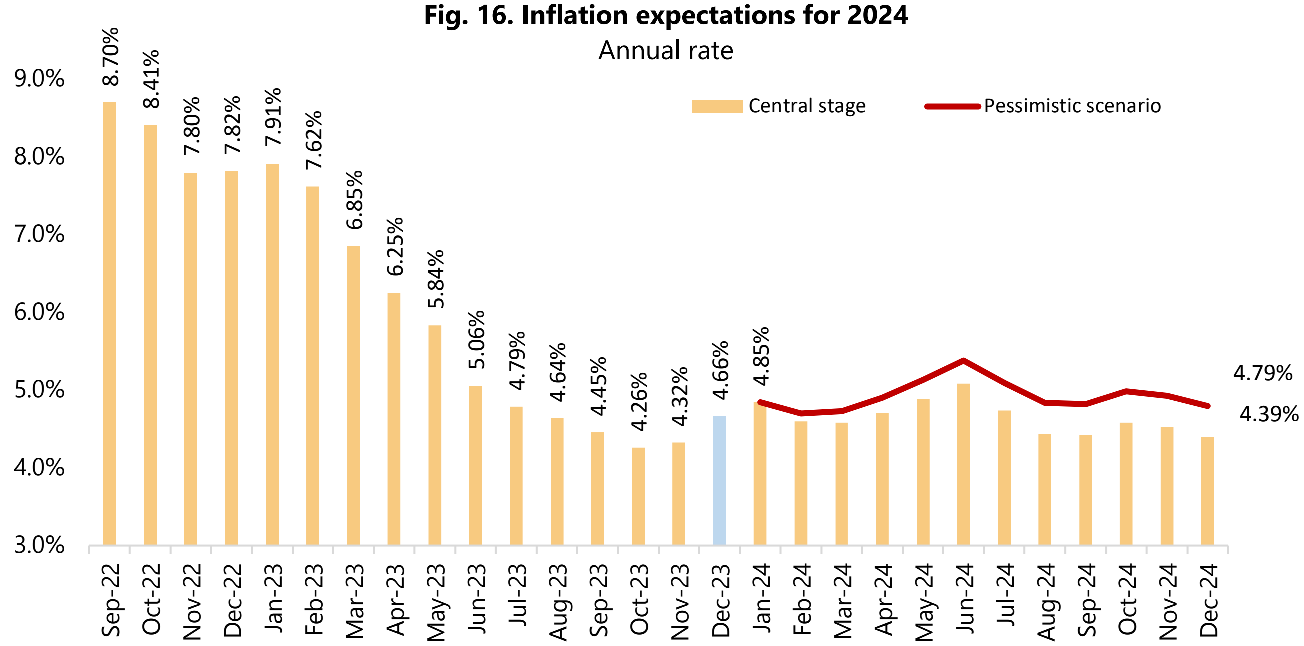
In addition to the rebound in agricultural prices, there are other upside risks to inflation that could materialize. In 2024, there are many risks to inflation, including: the high budget deficit, the increase in the minimum wage and the probable depreciation of the peso due to the electoral processes in the United States and Mexico. There are also external risks, including: the increase in maritime transportation costs (which has begun to materialize since the end of 2023), the possible stagnation of U.S. inflation around 3% and the possibility of new supply shocks.

Considering the above, the inflation projection at the end of 2024 is 4.39% in a central scenario (Fig. 16). A pessimistic scenario cannot be ruled out, in which several of the mentioned risks materialize, which could push headline inflation above 5.0% and close the year at 4.79%, under a pessimistic scenario.

The Bank of Mexico is still expected to cautiously cut its interest rate by a total of 100 basis points during the year, to close 2023 at 10.25%. However, the cuts are expected to be gradual and in movements of 25 basis points.

Fig. 16. Inflation expectations for 2024

Annual rate



Source: Grupo Financiero BASE with information from INEGI.

During the first 61 months of the current six-year term, cumulative headline inflation stood at 29.4%, the highest for the same period since Ernesto Zedillo's six-year term, when cumulative inflation stood at 201.8% (Table 5). The lower accumulated inflation rates in the last four six-year terms (Vicente Fox, Felipe Calderón, Enrique Peña Nieto and López Obrador) is the result of Banco de México's autonomy as of April 1, 1994, which led to the adoption of the inflation targeting scheme in 2001 and an annual inflation target of 3% as of 2003.

The higher cumulative headline inflation so far this six-year period is mainly due to the underlying component, due to upward pressures on prices of goods and services, between 2021 and 2022, when increases in logistics costs were observed after the coronavirus pandemic that began in 2020. It should be recalled that due to the pandemic, the synchronization of supply chains was lost, which increased production costs for manufacturing companies. Ocean freight costs also increased, and in 2022 the start of the war in Ukraine caused upward pressure on energy prices, adding another shock to the prices of production inputs.

As a result, the core component accumulated an inflation rate of 30.3% during the six-year period, 12.3 percentage points above that observed in the same period of the previous six-year period and the highest rate since the Zedillo administration, prior to the adoption of Banco de México's inflation targeting scheme. Within Mexico, the merchandise component accumulated inflation of 37.2%, 16.9 percentage points above that observed in the same period of the previous six-year period, while the services component accumulated inflation of 22.9%, 6.8 percentage points above that observed in the previous six-year period.

Cumulative inflation in services is lower during the current six-year period compared to that of merchandise. This is due to the slow economic recovery of the services sector after the pandemic, which has forced companies in this sector to delay the transfer of higher costs to consumers. As a result, the annual inflation rate for services was 5.33% at the end of 2023, making it 17 consecutive months at a rate above 5.0%, and it is likely that annual inflation for services will continue to be at an elevated level for the rest of 2024.

Table 5. Cumulative inflation in the first 61 months of each six-year period

President	Years	Cumulative inflation first 61 months of each six-year period								
		General	Core	Merchandise	Services	Non-Core	Fruits and vegetables	Livestock	Energetics	Government -authorized rates
Echeverría	1970-1976	82.0%	-	-	-	-	-	-	-	-
López Portillo	1976-1982	188.2%	-	-	-	-	-	-	-	-
De la Madrid	1982-1988	2680.6%	2667.5%	3022.2%	2098.9%	2725.3%	2153.2%	2425.7%	3650.7%	3195.4%
Salinas	1988-1994	128.0%	130.4%	87.9%	209.1%	120.8%	121.1%	75.1%	144.6%	224.7%
Zedillo	1994-2000	201.8%	199.1%	228.3%	169.6%	209.1%	232.8%	170.4%	247.4%	200.6%
Fox	2000-2006	26.1%	23.0%	16.7%	29.7%	37.7%	28.0%	33.1%	46.5%	34.4%
Calderon	2006-2012	24.8%	22.7%	28.1%	18.3%	31.8%	24.0%	40.0%	30.0%	31.7%
Peña	2012-2018	22.3%	18.0%	20.3%	16.1%	36.1%	49.8%	27.5%	40.0%	29.9%
López Obrador	2018-2024	29.4%	30.3%	37.2%	22.9%	26.7%	48.6%	41.6%	10.5%	23.0%

Source: Grupo Financiero BASE with information from INEGI.

The efforts of the Lopez Obrador administration to contain inflation are evident in the non-core component, mainly in the subcomponents of energy and government-authorized tariffs.

Cumulative non-core inflation is 26.7% so far this six-year period, 9.4 percentage points below cumulative inflation for the same period of the previous six-year period and the lowest rate for the same period on record. The energy component stands out, with a cumulative inflation rate of 10.5%, which is 29.5 percentage points lower than the cumulative inflation rate for the same period of the previous six-year period and the lowest on record. This is due to the government's efforts to control LP gas prices, which accumulated a decrease of 11.3% during the six-year period, and to the fact that natural gas prices, despite showing pressure in 2022, corrected downward in 2023, accumulating an increase of 2.9% during the six-year period.

Government-authorized tariffs accumulated inflation of 23.0% during the six-year period, the lowest on record for the same period, while fruit and vegetable prices accumulated an increase of 48.6%, down 1.2 percentage points from the previous six-year period, but above the accumulated inflation of 24.0% during the six-year period of Felipe Calderón.

PUBLIC FINANCES

Budget revenues. In the first eleven months of 2023, public sector revenues increased by 1.1% real over the same period of the previous year despite a 26.6% reduction in oil revenues. The increase was due to the fact that non-oil revenues grew by 8.7% in real terms during the same period. Within non-oil revenues, tax revenues (tax collection, which represents approximately 64% of total budget revenues) grew 10.9% in real terms. This was the result of a 3.9% increase in Income Tax (ISR), a 1.7% increase in Value Added Tax (VAT), and most of all, a 308.9% increase in the collection of the Special Tax on Production and Services (IEPS). The reason for the large increase in STPS revenues is because during 2022 the federal government introduced fiscal stimuli to contain the increase in gasoline and diesel prices (a program that cost hundreds of billions of pesos in uncollected taxes). With the decrease in fuel prices, the Ministry of Finance (SHCP) reduced the stimulus quotas and thus increased the collection of IEPS.

However, the 1.1% increase in budgetary revenues is not enough to meet the program of the Revenue Law, as revenues for the first eleven months were 114 billion pesos lower than expected (a difference of 1.8% with respect to the program).

Expenditures. Net public sector spending in the first eleven months of the year grew 4.0% in real terms compared to the same period in 2022. However, a large part of this increase corresponded to non-programmable spending, which is mainly made up of the items of participations (which are delivered to federal entities according to the formulas defined in the Fiscal Coordination Law) and the financial cost of debt. Participations increased by 2.8% in real terms, which was welcomed by local governments since they correspond to resources that were not earmarked for their spending. However, the financial cost of debt increased by 26.5% in real terms, representing 16.3% of net public sector spending.

Programmable spending, over which the government has the power to decide how to allocate the budget, only showed a real increase of 1.0% with respect to the same period of the previous year. Furthermore, the increase was only in current spending (2.6%), while capital spending decreased by 5.4% (Table 6). Within capital spending, physical investment fell by 2.8% in real terms. This contrasts with the figures for investment and activity in the non-residential construction and public sector construction sectors, which show strong annual increases. One possible explanation is that the increases in the investment and construction indicators are due to the incorporation of public works data from years prior to 2023.

Table 6. Programmable Public Sector Expenditures

Millions of pesos, cumulative figures from January-November 2023

Concept	2022	2023	Real % growth
Total	**4,878,694.1**	**5,201,616.8**	**1.0%**
Current expense	3,874,820.0	4,199,322.5	2.6%
Capital expenditures	1,003,874.1	1,002,294.3	-5.4%
Physical investment	758,880.9	778,302.5	-2.8%
Financial investment and other	244,993.2	223,991.8	-13.4%

Source: Grupo Financiero BASE with information from SHCP

Public debt. In terms of indebtedness, during the years of the current administration there have been no large deficits as a proportion of GDP and a favorable primary balance has been maintained, and in some years a surplus. Apart from the impact of the pandemic crisis, the debt-to-GDP ratio has remained relatively low, something that has undoubtedly been well received by the rating agencies. However, it is important to keep in mind that a considerable part of the spending in the early years came from resources that were saved in trusts, much of which was used prior to the pandemic crisis. Also, by 2024, a historic debt level of 5.4% as a percentage of GDP was proposed[4] . The Secretary of Finance commented that of the 5.4 percentage points, 3.5 points correspond to investment projects, with which the federal government will seek to complete its major emblematic infrastructure works.

However, another major reason for increased spending has to do with the fact that presidential elections will be held this year.

ELECTIONS 2024

On June 2, federal elections will be held in Mexico, in which Mexican citizens will go out to vote to elect the next President of Mexico and the 500 deputies and 128 senators that will make up the Mexican Congress. In addition, more than 19,000 local public offices will also be elected, including 8 governorships and the Mexico City Mayor's Office.

[4] Percentage approved to increase the Public Sector Borrowing Requirements (PSBR) by 2024.

Undoubtedly, every presidential election year brings uncertainty regarding economic policy, especially when a drastic change in power is expected, as happened in 2018 when the MORENA party and the Juntos Haremos Historia coalition, led by current President Andrés Manuel López Obrador, won a victory that allowed them to have enough power in Congress to carry out reforms aligned with their economic agenda. In addition, MORENA's victory also occurred at the local level, winning governorships and local congresses. With the possibility of having a qualified majority in both houses of Congress (two thirds) and the majority of local congresses (17), López Obrador and MORENA were in a position to make changes to the Constitution, and in cases where attempts at constitutional reforms were blocked by the opposition, they had a simple majority to reform federal laws.

The 2018 elections marked a before and after in Mexico's economic history, as they put an end to the so-called "neoliberal" period which, beginning in the 1980s, reformed the institutional framework of the Mexican economy to create an environment of trade openness, encourage private investment, seek a balance of government power with the creation of autonomous administrative and regulatory bodies, reduce the role of the State in some sectors of the economy, among other things, all with the goal of trying to give Mexico greater potential for economic growth and development. While the economic results of "neoliberal" policies are the subject of much discussion, the government that entered in 2018 called it a failed ideology and tried to get rid of some of the policies of previous governments.

In a broad sense, the policies, initiatives and reforms proposed by López Obrador's government seek for the State to play a greater role in the productive activities of the economy, instead of being only a regulator and facilitator of economic activity. This implies drastic changes such as, for example, getting rid of reforms such as the energy reform, which sought to gradually reduce the State's participation in the hydrocarbon sector and cede participation to the private sector.

It was also part of President López Obrador's agenda to concentrate power in the hands of the President of the Republic, downplaying the need for autonomous bodies to carry out the tasks of regulation, oversight, compliance, and to have checks and balances in order to have a balance between the different branches of government. The president's frequent attacks were directed at bodies such as the National Electoral Institute (INE), the National Institute of Transparency, Access to Information and Protection of Personal Data (INAI), the Supreme Court of Justice of the Nation as well as the Judicial Power, or the autonomous bodies that regulate matters of economic competition such as the Energy Regulatory Commission (CRE), the Federal Economic Competition Commission (COFECE) and the Federal Telecommunications Institute (IFT), led to the creation of an environment of distrust in the intentions of the government and the institutions of the economy, discouraging investment by the private sector, which is the basis for economic growth.

In fact, on January 18 of this year, President Lopez Obrador announced in his morning address that in early February he will present before Congress a package of constitutional reforms. No details are yet known about the initiatives that the President promised to present before the end of the six-year term, however, it is believed that this is more of a political campaign strategy, as MORENA and its allies do not have the majority necessary to make changes to the Constitution. In order to do so, they would require the support of PAN and PRI legislators, but these parliamentary groups have already expressed their opposition to the comments made by the President. These initiatives may have the purpose of 1) setting the political agenda for the beginning of the next Legislature, since the current one will most likely not be able to carry it out, and 2) making the opposition look bad, by rejecting proposals that would increase in the short term the welfare of Mexico's workers.

Among the initiatives is the pension initiative, in which it is intended that workers will retire with 100% of their last salary, for which the federal government would have to contribute resources that are not budgeted and which would put pressure on Mexico's public finances. If the reform is implemented, public spending would increase without a counterpart in revenues, which would increase the deficit and the debt.

Another of the reform initiatives to be presented is that of the disappearance of the autonomous agencies of the Federal Public Administration, which serve as an arbiter in the functioning of the economy. The President has said that with the disappearance of the autonomous agencies, there will be sufficient resources to carry out the reform of the pension system. However, even if the resources freed up by the autonomous agencies were sufficient to apply to pensions, the opportunity cost of eliminating the autonomous agencies will be greater, as it will further deteriorate the business environment in Mexico.

Perhaps one of the most important factors of uncertainty in the 2024 elections is regarding the ideology and agenda of the candidate supported by López Obrador to assume the Presidency, the former Head of Government of Mexico City, Claudia Sheinbaum.

Since the beginning of López Obrador's six-year term, Sheinbaum became one of the most important figures in the country's political scene, as it was evident that she would be one of the people the president would consider for the presidential succession. Sheinbaum has been a close collaborator of López Obrador since her days as Chief of Government of the Federal District, where she held the position of Secretary of the Environment and was in charge of the construction of the "Second Floor" of Mexico City's Periferico (one of the most emblematic and controversial projects of López Obrador's presidency in 2000-2006). Likewise, during López Obrador's presidential term, Sheinbaum always showed loyalty to his ideas and projects, becoming one of the main voices in the implementation of MORENA's agenda.

However, despite her closeness to López Obrador's policies, it is not entirely clear whether, if elected as the next president of Mexico, Claudia Sheinbaum would opt to follow the same political-economic line of her mentor or if, on the contrary, she would opt for a more conventional management. This uncertainty adds to the already complex electoral scenario, where her definitive position (still unknown) could be decisive in the direction Mexico will take in the coming years.

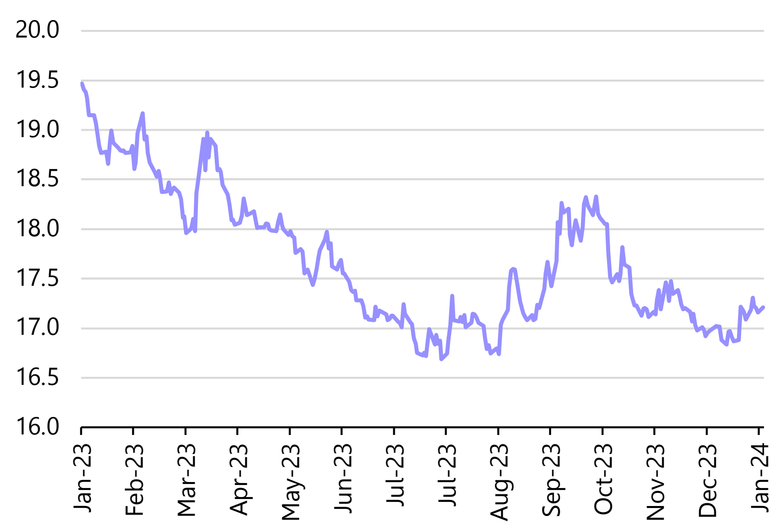
Sheinbaum's closest challenger in the race for the Presidency of Mexico is Xóchitl Gálvez, the candidate of the Fuerza y Corazón por México coalition, formed by the PRI, PAN and PRD parties. Gálvez emerged as an important figure within the opposition bloc after several public comments exchanged with President López Obrador, and proposes a project that leans more towards free market economic policies and an emphasis on institutional strength. Galvez presents herself as a candidate who can appeal to both conservatives and center or even left-leaning voters looking for a more moderate option than *Obradorism.* However, polls show Sheinbaum as the favorite candidate to win the presidential election.

EXPECTATIONS

Exchange rate expectations

Omitting the years 2008 and 2020 when the Mexican peso showed strong depreciations due to the U.S. financial crisis and the pandemic, on average the peso depreciated 2.11% between January and October, in the five U.S. presidential elections since 1996. This implies that, from the 2023 closing level, the exchange rate could be around 17.30 pesos per dollar prior to the Mexican elections and close to 17.45 pesos prior to the U.S. elections. However, this year there are factors that could cause the peso's depreciation to be greater than the historical average observed. In fact, as of January, the exchange rate has already surpassed in one session the level of 17.30 pesos that it would have reached in May. The factors that could cause the peso to depreciate above the historical average are as follows:

Fig. 17. Exchange rate
Pesos per dollar



Source: Grupo Financiero BASE with information from Bloomberg.

1. Donald Trump returns to the political stage as a Republican pre-candidate at a crucial moment of the *nearshoring* opportunity*,* the fentanyl crisis, the immigration crisis and two years before the scheduled review of the USMCA in accordance with the *sunset* clause*,* in July 2026*.* In accordance with this clause, 6 years after the treaty entered into force, the three countries must carry out a joint review and at the end of such review the countries must confirm its continuity for a period of 16 years. In the event that one of the countries does not wish to confirm, joint reviews

must be made annually for a period of 10 years until differences are resolved and if an agreement is not reached within this period, the treaty would terminate at the end of year 10. The above represents a risk for Mexico, as Trump may threaten to use the review of the USMCA in 2026 and force annual reviews during his term, especially now that there are open trade disputes and could promote new disputes and panels. A scenario of termination of the USMCA is not a concern, as was feared in 2016, but rather the annual reviews that could be used as a pressure tool and overshadow the *nearshoring* opportunity, affect investment in Mexico and raise risk aversion about the country.

The risk represented by Trump's figure could push the exchange rate to levels between 18.00 and 18.50 pesos, but it is not excluded that in the face of very aggressive comments and an environment of greater global risk aversion, the exchange rate could reach 20.00 pesos per dollar this year. The Republican National Convention will be held from July 15 to 18, where the presidential candidate will be defined.

2. The possibility that the presidency and the majority in the Mexican Congress will be concentrated in a single political party, which could make changes to the Constitution and further weaken Mexico's institutional framework. The pre-campaign period has concluded and campaigns will officially begin on March 1 and end on May 29. Elections will be held on June 2.

3. The beginning of the cycle of interest rate cuts. One of the factors that led to the appreciation of the peso in 2022 and 2023 was Banco de México's restrictive monetary policy. To date, Mexico's benchmark rate is 6 percentage points higher than that of the United States. This wide differential attracts portfolio capital to the country, which implies a greater supply of dollars and therefore a lower exchange rate. During the year, the Bank of Mexico and the Federal Reserve are expected to initiate the cycle of cuts, but the month each central bank will do so and the total of the cuts is relevant because of the rate differential between Mexico and the United States. The main factor that could put upward pressure on the exchange rate would be the possibility that the Fed is cautious and waits longer to cut the interest rate, decreasing the rate differential and putting upward pressure on the exchange rate. The Fed may be cautious because transportation costs have increased due to the conflicts in the Middle East, which poses an upside risk to inflation.

   According to information from the World Container Index (WCI), as of January 26, the average cost of a 40-foot container stood at $3,964.18, its highest level since September 2022. This rate, composed by the prices of different routes at a global level, accumulates an increase of 182.27% since October 2023, when the conflict in Palestine began, but most of the increase was concentrated in the first three weeks of January 2024, in which it has risen 138.67%.

4. Risk aversion due to global geopolitical conflicts and the economic slowdown in China, the world's second largest economy. The wars between Ukraine and Russia, Israel and Hamas in Palestine and the expansion of the conflict to the Red Sea continue to pose a threat to the global flow of raw materials, mainly grains and energy. There is also the economic slowdown in China and the publication of negative economic indicators increases global fear, which changes investment portfolios that take refuge in safe assets, increasing the demand for dollars or safe haven currencies and affecting other currencies such as the Mexican peso.

Considering these points, it is estimated that the exchange rate will not behave as the historical average in election years. Three scenarios are considered. In the optimistic scenario, which is also the least likely, the exchange rate does not react to U.S. and Mexican monetary policy and shows behavior consistent with other election years, including years in which Donald Trump did not participate. In this scenario, the exchange rate rises during the year to an average level of 17.40 pesos per dollar in the fourth quarter. In the central scenario, upward pressures are considered due to Donald Trump's comments against Mexico, but without specific threats regarding the trade relationship, which could push the exchange rate towards 18.50 pesos per dollar in the third and fourth quarters, being the most likely scenario. Finally, a pessimistic scenario is presented in which the exchange rate could reach 20 pesos per dollar if Trump makes direct threats to Mexico that call into question the future of the trade relationship, in conjunction with greater global risk aversion and the expectation that the Fed will take longer to begin cutting interest rates. We could also see upward pressure on the exchange rate if Mexico's elections result in a single-party majority in Congress, making it easier to carry out constitutional reforms.

Table 7. Exchange rate expectations

Quarter	Exchange rate (average)		
	Optimistic scenario	Central stage	Pessimistic scenario
1T 2024	17.20	17.70	18.00
2T 2024	17.30	17.80	18.50
3T 2024	17.35	18.50	19.20
4T 2024	17.40	18.50	20.00

Source: Grupo Financiero BASE

Growth expectations for 2024-2025

Grupo Financiero BASE estimates that the Mexican economy will continue to grow during 2024, but at a slower pace than it did in 2023. After growth of 3.10% in 2023, growth is expected to decelerate to a rate of 2.5% under a baseline scenario. With 2.5% growth in 2024, BASE estimates GDP per capita to end the year 0.12% lower than in 2018. However, depending on the events that unfold over the course of the year, as well as the previously mentioned risks that may materialize, BASE estimates a range in which growth could be between 1.5% and 3.0%.

The pessimistic scenario is based primarily on an economic slowdown in the United States, which would cause a reduction in demand for Mexican export goods. Also, by 2025, a sharp reduction in government spending is expected, particularly in the area of physical investment, as the incoming government will face the common challenges of the transition, as well as limited fiscal space. In addition, economic stagnation in the United States, or even a recession, is expected to materialize by 2025. Under these assumptions, it is estimated that Mexico's economy would grow between 0.8% and 1.0% in 2025.

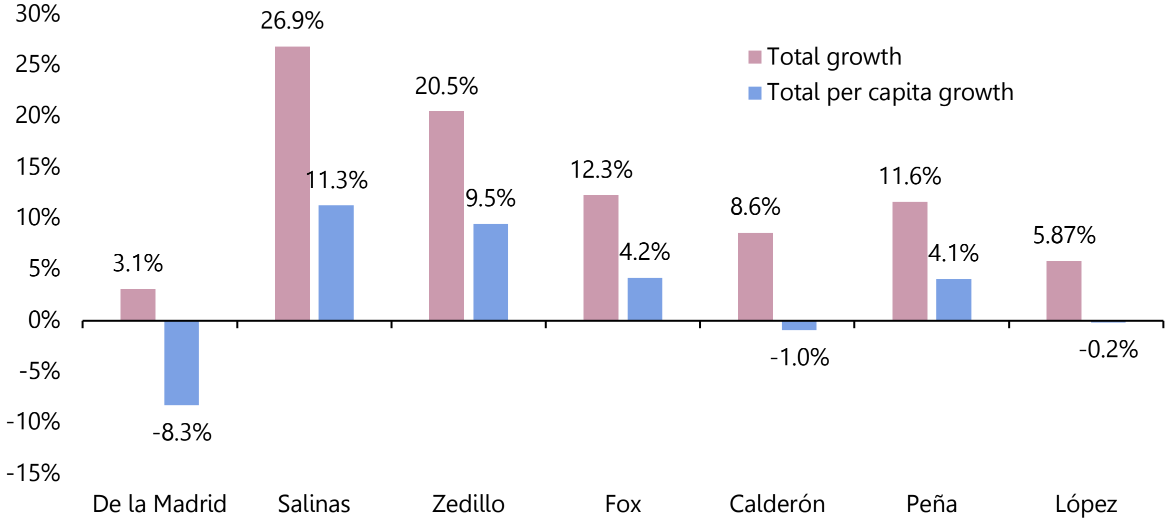
Table 8. Grupo Financiero BASE's Expectations for the Mexico's economic growth

Year	Expected growth	GDP per capita vs. 2018
2024	2.5%	-0.12%
2025	0.8%	-0.27%

Source: Grupo Financiero BASE

As previously mentioned, using these economic and population growth assumptions, the six-year term of López Obrador would end with a variation in GDP per capita of -0.17% with respect to the close of the previous six-year term (fourth quarter of 2018) (Fig. 18).

Fig. 18. Economic growth by six-year period



Growth between the GDPs of the last quarters of each six-year period, using Grupo Financiero BASE's growth forecast for 2024.

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	Q2 2023	Q3 2023	Q4 2023	2022	Q2 2023	Q3 2023	Q4 2023
Vietnam*	2.57%	42.06%	8.17%	106.52%	53.13%	39.60%	57.61%	28.24%	96.37%	174.12%
China*	2.24%	20.76%	2.99%	6.60%	5.83%	9.40%	27.15%	28.83%	36.34%	49.16%
Ireland	5.82%	14.75%	9.55%	-0.36%	-1.91%		33.03%	31.50%	28.98%	-
Turkey	1.67%	11.80%	5.31%	3.30%	0.27%		19.70%	25.18%	25.52%	-
Israel	-1.82%	9.67%	6.49%	0.79%	0.66%	-	14.66%	18.20%	18.98%	-
India	-4.97%	9.54%	6.34%	-5.16%	1.45%	-	10.69%	15.06%	16.73%	-
Taiwan	3.39%	6.62%	2.59%	1.82%	1.90%	-	13.08%	13.48%	15.63%	-
Indonesia	-2.07%	3.70%	5.31%	3.86%	1.60%	-	6.95%	12.37%	14.16%	-
Poland	-2.03%	6.84%	5.51%	0.30%	1.49%	-	10.44%	10.19%	11.83%	-
Malaysia	-5.46%	3.30%	8.65%	-0.79%	5.19%	-	6.11%	6.17%	11.68%	-
Colombia	-7.25%	11.02%	7.26%	-0.99%	0.24%	-	10.44%	11.27%	11.53%	-
Singapore	-3.81%	8.87%	3.63%	0.06%	1.36%	-	8.52%	8.65%	10.13%	-
Romania	-3.51%	5.69%	4.56%	1.55%	0.89%	-	6.63%	8.77%	9.74%	-
Philippines	-9.33%	5.51%	7.62%	-0.71%	3.33%	-	2.96%	6.04%	9.58%	-
Australia	-2.13%	5.56%	3.79%	0.44%	0.21%	-	7.22%	9.28%	9.51%	-
Russia*	-2.25%	6.14%	-1.27%	9.15%	7.89%	-	2.43%	1.45%	9.45%	-
United States	-2.21%	5.80%	1.94%	0.51%	1.19%	0.81%	5.46%	7.41%	8.69%	9.57%
Brazil	-3.58%	5.10%	3.13%	0.98%	0.15%	-	4.50%	7.86%	8.02%	-
South Korea	-0.71%	4.30%	2.61%	0.61%	0.62%	0.63%	6.27%	7.35%	8.01%	8.69%
Chile	-6.39%	11.94%	2.49%	-0.35%	0.33%	-	7.40%	7.01%	7.37%	-
Denmark	-2.42%	6.84%	2.73%	-0.70%	-0.65%	-	7.10%	8.02%	7.32%	-
Switzerland	-2.28%	5.39%	2.67%	-0.13%	0.27%	-	5.74%	6.30%	6.59%	-
Netherlands	-3.88%	6.19%	4.39%	-0.44%	-0.31%	-	6.54%	6.62%	6.30%	-
Belgium	-5.26%	6.85%	3.01%	0.33%	0.38%	-	4.28%	5.59%	6.00%	-
Sweden	-2.33%	5.94%	3.00%	-0.81%	-0.29%	-	6.58%	6.21%	5.89%	-
Saudi Arabia	-4.34%	4.47%	9.09%	-0.51%	-3.18%	-	9.01%	9.16%	5.69%	-
Portugal	-8.30%	5.74%	6.83%	0.13%	-0.24%	-	3.58%	5.92%	5.66%	-
Norway	-1.83%	4.02%	2.96%	-0.51%	-0.52%	-	5.14%	5.57%	5.02%	-
Canada	-5.04%	5.29%	3.82%	0.34%	-0.27%	-	3.80%	5.10%	4.82%	-
Argentina	-9.90%	10.72%	4.96%	-2.73%	2.72%	-	4.70%	1.97%	4.75%	-
Mexico	**-8.82%**	**5.96%**	**3.94%**	**0.93%**	**1.07%**	**0.10%**	**0.43%**	**3.33%**	**4.44%**	**4.54%**
Italy	-9.04%	8.29%	3.89%	-0.38%	0.10%	-	2.33%	2.91%	3.02%	-
Spain	-11.17%	6.40%	5.77%	0.44%	0.30%	0.60%	-0.02%	2.24%	2.55%	3.26%
Peru	-10.93%	13.36%	2.73%	4.99%	-2.14%	-	3.71%	4.45%	2.22%	-
United Kingdom	-10.36%	8.67%	4.35%	0.04%	-0.13%	-	1.65%	2.01%	1.88%	-
France	-7.68%	6.36%	2.53%	0.61%	-0.11%	0.00%	0.68%	1.70%	1.59%	1.59%
Finland	-2.36%	2.84%	1.63%	0.35%	-0.86%	-	2.05%	2.16%	1.28%	-
Hong Kong	-6.55%	7.17%	-3.48%	-2.29%	5.93%	-	-3.32%	-4.60%	1.05%	-
Japan	-4.20%	2.65%	0.94%	0.88%	-0.73%	-	-0.74%	1.78%	1.04%	-
South Africa	-6.17%	4.84%	1.90%	0.66%	-0.07%	-	0.24%	0.94%	0.87%	-
Austria	-6.72%	4.36%	4.84%	-1.11%	-0.52%	0.20%	2.05%	1.31%	0.78%	0.98%
Thailand	-3.43%	2.45%	2.10%	-2.69%	-	-	1.01%	2.94%	0.73%	-
Germany	-4.20%	3.12%	1.88%	0.14%	-0.13%	-0.30%	0.65%	0.64%	0.51%	0.20%
Nigeria	-1.79%	3.65%	3.25%	-0.30%	0.00%	-	5.10%	-0.46%	-0.46%	-
Czech Republic	-5.52%	3.50%	2.35%	0.08%	-0.63%	0.20%	0.08%	-0.07%	-0.70%	-0.50%

* Figures without seasonal adjustment

Source: BASE Financial Group with information from the statistical offices of each country.