Mexico City, August 22nd 2016

MINISTRY OF FINANCE UPDATES 2016 GDP PROJECTION AND ANNOUNCES IMPROVEMENTS TO TRANSPARENCY AND THE PSBRs

- **2016 GDP growth estimate is set at 2.0-2.6%.**
- **Twelve indicators with updated projections for the close of the year will be periodically published as part of the sustained effort to improve fiscal transparency.**
- **Public Sector Borrowing Requirements for 2016 are revised down from 3.5% to 3.0% of GDP.**

Today, the National Institute of Statistics and Geography (INEGI) published the real gross domestic product (GDP) annual rate of 2.5% for the second quarter of 2016. Accordingly, GDP proxy increased at an annual rate of 2.2% in June.

GDP growth showed the largest increase for a second quarter since 2012 and placed above the advanced estimate of 2.4% released by INEGI on July 29th. As for the first quarter, GDP annual growth was 2.5% in non-seasonally adjusted figures.

Amid an adverse external environment, the performance of the Mexican economy is mainly explained by the dynamism of the domestic market.

Between January and May, private consumption increased 3.6% annually in real terms, showing the largest increase for a similar period since 2012. Between January and July, total sales of the National Association of Supermarkets and Department Stores (ANTAD) recorded a real annual growth of 7.8%, the largest growth for this period since 2008. Similarly, automobiles domestic sales increased 18.3% annually in this period.

Based on recent economic trends, the Ministry of Finance sets its estimate for 2016 GDP real growth at 2.0%-2.6%.

As part of the sustained effort to improve fiscal transparency, the Ministry of Finance announces the regular publication of twelve indicators and projections to facilitate monitoring the trajectory of public finances.

In this context, the 2016 Public Sector Borrowing Requirements (PSBRs), the broadest measure of deficit, is estimated to close at 3.0% of GDP, which represents a reduction of 1.1 percentage points of GDP relative to 2015 and 0.5 percentage points of GDP with respect to the 2016 Economic Program.

Current economic conditions

Today, INEGI published 2016 GDP annual rate in the second quarter. The results show that the Mexican economy expanded at an annual rate of 2.5% during this period. The annual rate by sectors showed a 3.8% increase in the primary sector, 1.0% in industrial production and 3.2% in services.

GDP expansion of 2.5% in the second quarter of 2016 was larger than the 2.3% growth registered during the second quarter of 2015, the largest increase for a second quarter since 2012 and placed above the advance estimate of 2.4% reported by INEGI on July 29.

Seasonally adjusted, GDP increased at an annual rate of 1.5% and at a quarterly rate of -0.2% in the second quarter of 2016. It should be noted that in this particular year we had an Easter holiday where Monday (March 21), as well as Thursday and Friday, were days off. Additionally, 2016 was also a leap year. In this sense, it is convenient to observe the growth for the first half of 2016, where the effect of Easter is not so relevant. In the first half, GDP increased 2.5% in non-seasonally adjusted figures and 2.0% in seasonally adjusted ones.

INEGI revised down the annual rate of change in GDP for the first quarter of 2016 from 2.6% to 2.4%. In addition, GDP proxy increased at an annual rate of 2.2% and at a monthly rate of 0.6% in June, both in seasonally adjusted terms. Within, the primary sector grew 15.1% year over year, industrial production expanded at an annual rate of 0.3%, while services increased 2.6% annually.

Growth figures presented by the INEGI must be understood in the context of two factors: the external environment and the domestic sources of growth. The expansion of GDP in the second quarter is given in an adverse external environment. In particular, there has been observed high volatility as a result of the materialization and rise of some risks such as the deterioration in global growth prospects, the divergence in monetary policy among advanced economies, geopolitical tensions and the United Kingdom decision to leave the European Union.

Despite the uncertain global environment, the International Monetary Fund (IMF) revised up their growth outlook for Mexico in 2016 from 2.4% in April to 2.5% in July. In contrast, the IMF revised down again their growth prospects for the global economy, by decreasing them from 3.2% in April to 3.1% in July.

Regarding emerging economies, IMF's growth prospects for 2016 remained at 4.1% between April and July, while the outlook for Latin America partially recovered, from a 0.5% contraction to one of 0.4%. However, downside risks remain for emerging economies in the face of a prolonged slowdown in China and the possibility of a worse than expected recession in Russia and Brazil. Also, the uncertainty generated by the exit of the United Kingdom from the European Union represents a risk for European economies.

Likewise, oil prices have registered high volatility in the face of the existing imbalance between supply and demand of crude oil. The average price of the Mexican Oil Mix was 36.7 dollars per barrel in the second quarter of 2016. Although this price represents an increase of 41.8% with respect to the first quarter of 2016, the figure still implies a reduction of 15.6% compared to 2015 average.

GDP growth in the United States registered an annual rate of 1.2% in the second quarter of 2016, below the 2.5% market consensus and driven by consumption. In addition, a deterioration of the industrial production expectations for 2016 was observed, decreasing from 3.3% in January of 2015 to -0.9% in August of 2016.

In this context, Mexico's GDP annual rate in the second quarter of 2016 compares favorably against other economies in the region, being higher than the ones observed in the main economies of Latin America. This trend is expected to continue throughout 2016.

Non-seasonally adjusted Mexico's GDP grew 2.5% annually, above the 1.5% registered in Chile, and the expectations of -2.5% for Argentina and -3.8% for Brazil for the second quarter. The latter accumulated 8 quarters in contraction. In addition, it is estimated that GDP in Latin America, excluding Mexico, will increase at an annual rate of 2.4% in the second quarter of 2016.

Another factor to consider in order to contextualize the GDP data has to do with the strength of domestic market and the sources of growth. In the second quarter of 2016, the Mexican economy moderated its growth, at the same time positive growth was observed in the three sectors of the economy.

The annual rate in the primary sector showed a 3.8% increase, due to larger production of crops such as corn, rice, sorghum, apple, orange, and avocado. This performance is consistent with the positive behavior of agricultural exports, which expanded 6.8% in the second quarter of 2016.

Industrial production grew 1.0% annually. Within, a 1.6% growth was observed in manufacturing and 3.1% in construction, despite a decrease of 4.3% in mining, whereas oil activities decreased 4.6%.

Regarding industrial production, the following factors, mainly external and related to the oil sector, explain its performance in the second quarter of 2016.

Firstly, Mexico's industrial production growth was affected by weak industrial production performance in the United States, which recorded a decrease of 1.3% in annual terms between January and June, its largest fall since the second half of 2009. This performance mainly affected the manufacturing production in Mexico.

Secondly, the decrease of 2.4% observed in the oil platform between the first and the second quarters of 2016 (-54 thousand barrels per day) still affects GDP growth. Excluding oil production and related activities, Mexico's industrial production annual growth was 2.3%. This figure contrasts with the 1.0% increase recorded in annual terms when these activities are included.

Consequently, observed GDP annual growth, excluding oil related activities, was 3.0% during the second quarter 2016. Considering this, the average growth of non-oil GDP during the last eight quarters on annual basis is 3.1%.

Services increased at an annual rate of 3.2% in the second quartes, due to an 8.4% growth in mass media, 7.8% in professional services and 7.2% in financial services. All of them, activities related to the domestic sector.

Additionally, consumption determinants have shown a sound evolution, which has led to a positive performance of the domestic market.

- Unemployment rate reduction, standing at 3.9% of the economically active population in the April-June period, compared with the 4.4% registered during the same period of last year.

- Formal jobs creation, which increased 3.6% annually during July. In fact, during the current administration the average annual growth rate of employment has been 3.8%, representing a cumulative growth of 12.6% and the creation of 2.1 million jobs.
- Inflation at minimum historic levels. In July, annual inflation was 2.65%, the lowest for a similar period in history.
- Real increase of the contractual wages, which in the first seven months of the year grew 1.6%, the largest increase for a similar period since 2001.
- The real annual expansion of 12.7% in the credit granted by commercial banks to the private sector during June, the largest for this month since 2008.

As a result of the positive development of these variables, private consumption increased 3.1% in annual terms between April and May.

Moreover, the real value of the total sales of the National Association of Supermarkets and Department Stores (ANTAD), increased at an annual rate of 7.8% between January and July, the largest increase for this period since 2008. In the case of stores operating for more than a year, there was an expansion of 4.8% in real annual terms during this period, the largest in history for a similar one. Likewise, automobile sales registered an annual rate of 18.3% between January and July.

Between April and May, gross fixed investment grew 1.3% in real annual terms. Within, stands out the 2.5% growth in machinery and equipment and the 0.5% growth in construction. Between January and June of 2016, USD 14.4 billion in Foreign Direct Investment were received, which represents an increase of 4.6% with respect to the same period of the last year. During the current administration, Foreign Direct Investment amounts to USD 120.3 billion, a 51.8% increase with respect to the same period of the previous administration.

Range Update

In spite of the domestic dynamics, that show a sound consumption evolution, and considering the adverse external environment, as well as the decline in the oil production platform and United States industrial production that has moderated the dynamism of the domestic manufacturing industry, the Ministry of Finance sets its estimate for 2016 GDP real growth at 2.0%-2.6%..

Transparency Improvement

During the current administration continuous efforts have been made to improve the transparency of public finances. Among these it is worth noting:

- An adjustment in the definition of the PSBRs in 2014, according to international best practices in order to achieve a more accurate and transparent indicator.
- Reforms to the Federal Budget and Fiscal Responsibility Law, such as the 2015 amendment, which incorporated the importance of PSBRs by making mandatory the inclusion of its annual target in the General Economic Policy Guidelines. Moreover, a specific destiny was given to the revenue derived from Banco de Mexico´s operating surplus, thus transforming a non-recurring revenue into a permanent benefit.
- The commitment of the Ministry of Finance, established in the Preliminary General Economic Policy Guidelines 2014, to present, if required, modifications to the GDP forecast in pre-established dates in order to provide certainty to financial markets and the public in general.
- In addition, in 2014 the new website on fiscal transparency was presented, which allows to query in detail the timely use, destiny and results of public expenditure, aiming to promote accountability.

In this regard, as part of the sustained effort to improve fiscal transparency:

- The Ministry of Finance announces the regular publication of twelve indicators and projections to facilitate monitoring the trajectory of public finances.
- In addition, estimates will be updated on a quarterly basis, within the quarterly reports of public finances.
- With the compilation of these indicators, and the publication of the Ministry of Finance's projections for all of them, the aim is to establish a more sound and clear framework for the analysis of public finances.
- The Ministry of Finance, when preparing the 2016 Economic Program that was approved by the Congress, estimated that the PSBRs for this year will be 3.5% of GDP.
- During 2016 there have been several factors that were previously communicated to the public. These include the receipt of Banco de Mexico's operating surplus and the support given to Pemex to pay down their accounts payable.
- Today, based on the evolution of public revenues, programmable and non-programmable expenditure, as well as the factors mentioned above, the Ministry of Finance estimates that the PSBRs will stand at 3.0% of GDP by the end of 2016. This implies a decrease of 1.1 percentage points of GDP with respect to the end of 2015 and 0.5 percentage points of GDP with respect to the 2016 Economic Program.

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