Economic update: consumers´ walk beats their talk

According to a various indicators, confidence about Mexico´s economy is sceptical at best and downright pessimistic at worst. Indeed, according to the National Institute of Statistics and Geography (INEGI by its Spanish acronym), the Consumer Confidence Index decreased from 85.8 in March to 82.7 in April.

What´s striking about this bearish stance is that what consumers are saying directly contradicts with how they´re actually behaving. According to the Mexico´s National Association of Retail Stores, sales grew 4.9 per cent month on month during April. In fact the average monthly growth in retail sales during the first four months of 2015 averaged 4 per cent, which makes a stark contrast with an average of -2.1 per cent during the first four months of 2014 as the economy adapted to President Enrique Peña Nieto´s fiscal reform.

Furthermore, there was also a monthly decrease from 85.8 to 82.7 in the component of the index related to the intention of consumers to purchase durable goods such as furniture or electronic devices compared to a year ago. Although the contradiction in this case might be slightly extrapolated, it is plausible nonetheless, in light of the fact that automobile sales grew by 22.2 per cent during January-April this year, reaching close to half a million vehicles -a historic figure for the country.

Low inflation levels have prompt up consumers' real income, which partly explains why consumption has taken over from exports as the economy´s most important driver.

However, the pessimistic outlook revealed by recent confidence and expectations indicators is not, of course, completely without basis. The full effects of recently announced cuts to public spending are yet to be felt. Moreover, stalled progress in Mexico´s security situation continues to act as a significant headwind. Insecurity has been quoted as the main obstacle for growth in the country for 17 months straight in Mexico´s Central Bank´s (Banxico) survey of economic analysts from the private sector. In line with this, the head of the National Chamber for Industry and Transformation (Canacintra as known by its Spanish acronym), Rodrigo Alpizar, stated this week that three in ten investors are withholding investments until the country´s security situation improves.

There is also sustained uncertainty regarding the peso´s fate once the Fed increases rates. This week´s news that jobless claims fell by 1000 is yet another sign of a healthier labour market, which in turn has put pressure on Banxico to

pre-emptively raise its own rates, something which its board agreed this week would not be a prudent move.

Despite increased strength in labour market, the U.S. economy is still far from out of the woods, given that in March it actually contracted by 1 per cent according to private forecasting firm Macroeconomic Advisers. This is also likely to explain why industrial production in Mexico remains weak, given that it grew 1.4% year on year in March -the third consecutive month it has grown below 2 per cent- and presented no change from the month prior.

Energy reform update: third phase of Round: the low hanging fruit?

The National Hydrocarbons Commission approved the call made by the Secretariat of Energy for the third phase of Round One of bidding, as the implementation of Mexico's reform moves forward. The Secretariat of Energy expects this new phase to generate 620 million USD of investment during the next five years.

The two most important differences regarding the said phase and its predecessors are that it will use license contracts and that it is comprised of onshore extraction blocks.

The 26 blocks up for tender have an estimated 2.5 billion BOE (barrel of oil equivalent) and are located across five different states; namely, eight in Nuevo Leon, six in Veracruz, five in Chiapas, five in Tabasco and two in Tamaulipas.

Furthermore, unlike the first two phases of Round One, this phase is designed so as to allow for Mexican companies to climb up the learning curve of E & P and become competitive players within Mexico's energy sector.

Most of the blocks of the third phase are small and shallow, which are much more easily accessible and thus require less technical expertise. In fact, unlike the previous phases, the one in discussion is that the technical experience requirement applies to employed personnel and not to the company as a whole.

Moreover, whereas the capital requirements for the first phase reached levels as high as 1 billion USD, for the third phase participants should have a minimum of 5 million USD.

Many of the blocks in this phase have good levels of infrastructure, which in turn reduces the financial burden on operators looking to develop them.

Finally, the decision to use license contracts was made with the idea of benefitting smaller firms, since this type of contract is far less onerous in terms of accounting work.

In light of this and the fact that the average cost per barrel of these blocks ascends to 15 USD, the third phase would seem to represent the low hanging fruit of Round One.

Notwithstanding the technical and regulatory advantages it offers, the third phase will also represent the encounter of E & P operators with some of the risk factors of the energy reform that are frequently mentioned –yet rarely discussed thoroughly. More specifically and depending on which state is under discussion, risks arising from violence due to organized crime groups, land ownership issues and social risks will now have to be inevitably dealt with by new players coming into the market, in order to make sure that the low hanging fruit doesn't turn out to be the fruit from the forbidden tree.