



MEXICO

2017 ARTICLE IV CONSULTATION—PRESS RELEASE; AND STAFF REPORT

November 2017

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2017 Article IV consultation with Mexico, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its November 8, 2017 consideration of the staff report that concluded the Article IV consultation with Mexico.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 8, 2017, following discussions that ended on October 6, 2017, with the officials of Mexico on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 23, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Staff Statement** updating information on recent developments.

The documents listed below have been or will be separately released.

Selected Issues

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International Monetary Fund
Washington, D.C.



INTERNATIONAL MONETARY FUND



Press Release No. 17/435
FOR IMMEDIATE RELEASE
November 13, 2017

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes the 2017 Article IV Consultation with Mexico

On November 8, 2017, the Executive Board of the International Monetary Fund (IMF) Concluded the Article IV consultation with Mexico.¹

The Mexican economy has exhibited resilience in the face of a complex external environment. Output has continued to grow at a moderate pace while inflation has temporarily risen above the central bank's target. The flexible exchange rate is playing a key role in helping the economy adjust to external shocks. Fiscal consolidation is on track, monetary policy has maintained a tight stance, and financial supervision and regulation remain strong. The ambitious program of structural reforms is starting to bear fruit, although its full impact will take time to materialize.

The economy is projected to grow by 2.1 percent in 2017. Private consumption remains the main driver of activity, supported by manufacturing exports, while investment has remained weak amid uncertainty about Mexico's future trade relationship with the United States. Growth is expected to slow slightly in 2018 before picking up speed as the uncertainty is resolved. Year-on-year headline inflation has accelerated to more than 6 percent (with core inflation at almost 5 percent), reflecting mainly the recent liberalization of gasoline prices. Both headline and core inflation are expected to gradually converge toward the target by end-2018 as medium-term inflation expectations remain well anchored.

The authorities have taken a more restrictive macroeconomic policy stance with the central bank proactively tightening monetary policy by increasing the policy rate by a cumulative 400 basis points since December 2015 and the government adhering to its fiscal consolidation plan. The public sector borrowing requirement is projected to fall to 1.4 percent of GDP this year, as the government has indicated that it will save the entirety of a 1.5-percent-of-GDP one-off profit transfer from the central bank. For the first time since 2010, the structural primary balance is projected to show a surplus. Moreover, the public debt-to-GDP ratio is projected to decline to 54 percent this year amid both the fiscal consolidation and the peso's appreciation, from 58 percent in 2016.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

Mexico's external position remains broadly consistent with medium-term fundamentals and desirable policy settings. The current account deficit is projected to narrow to 1.8 percent of GDP this year, on the heels of an improvement of the non-oil trade balance driven by very robust and broad-based manufacturing export growth, and continued strong remittances. The net international investment position is projected to continue to strengthen in 2017 and to remain just below 40 percent of GDP over the medium term.

Executive Board Assessment²

Directors highlighted the resilience of the Mexican economy in the context of a challenging external environment. At the same time, they noted that Mexico continues to face external risks, given its strong financial and trade linkages with the rest of the world. Directors expressed confidence that Mexico's very strong policies and institutional policy frameworks will continue to underpin the economy's resilience, while the Flexible Credit Line arrangement provides additional insurance against tail risks. Directors emphasized that reinvigorating the structural reform agenda with a focus on strengthening the rule of law, fighting corruption, and reducing informality would help boost potential output and foster inclusiveness.

Directors commended the authorities for adhering to their fiscal consolidation plan. They encouraged continued efforts to ensure that the public debt-to-GDP ratio is on a firmly downward trajectory. Directors highlighted the need to strengthen non-oil tax collections, with emphasis on reducing the VAT compliance gap, improving the effectiveness of public administration and the efficiency of education and health spending, and consolidating and better targeting social assistance programs. They also underscored the importance of continued improvements in PEMEX's profitability and efficiency.

Directors recommended further strengthening the fiscal framework, including by giving more emphasis on the desired level of debt, and limiting the use of exceptional circumstance clauses. They also suggested that one-off profit transfers from the Bank of Mexico to the budget should be entirely used to reduce the public sector borrowing requirement and public debt.

Directors considered the current pause in monetary tightening to be appropriate. They broadly noted that monetary policy could be eased when inflation is firmly on a downward path and inflation expectations are well anchored, but urged the authorities to carefully weigh the risks and ensure that policy decisions remain data-driven. They recommended continued improvements in monetary policy communication. Directors agreed that the flexible exchange rate should continue to play a key role in helping the economy adjust to external shocks.

Directors welcomed the financial sector's resilience and recommended that it be further strengthened through regulatory reform. They agreed that the new national strategy for financial

² At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: <http://www.imf.org/external/np/sec/misc/qualifiers.htm>.

inclusion would help improve access to financial services for low-income households and small enterprises, although further efforts are needed to deepen the financial sector.

Directors recommended perseverance in implementing the authorities' structural reform agenda. They highlighted the need to prioritize reforms targeting governance, security, the rule of law, and informality. They noted the importance of enhancing the efficiency of judicial institutions, and urged implementation of the National Anti-Corruption System. Directors stressed that strengthening the rule of law and improving the enforcement of anti-discrimination laws could help reduce gender imbalances and raise female labor force participation. Directors urged the authorities to address any shortcomings that may be identified in the evaluation of the AML/CFT framework.

Mexico: Selected Economic and Financial Indicators 1/

	2013	2014	2015	2016	2017 ^{2/}
(Annual percentage changes, unless otherwise indicated)					
National accounts and prices					
Real GDP	1.4	2.3	2.6	2.3	2.1
GDP per capita in U.S. dollars 3/	10,659	10,846	9,522	8,562	...
Gross domestic investment (in percent of GDP)	21.7	21.6	22.9	23.3	22.7
Gross domestic savings (in percent of GDP)	19.2	19.8	20.4	21.1	20.9
Consumer price index (end of period)	4.0	4.1	2.1	3.4	6.1
External sector					
Exports, f.o.b.	2.5	4.4	-4.2	-1.8	8.7
Imports, f.o.b.	2.8	4.9	-1.2	-2.1	7.9
External current account balance (in percent of GDP)	-2.5	-1.8	-2.5	-2.2	-1.8
Change in net international reserves (end of period, billions of U.S. dollars)	13.2	15.5	-18.1	0.4	-0.3
Outstanding external debt (in percent of GDP)	31.4	32.9	36.3	39.4	38.3
Nonfinancial public sector (in percent of GDP)					
Government Revenue	24.2	23.3	23.1	23.2	22.6
Government Expenditure	28.0	27.9	27.2	26.0	24.0
Augmented overall balance	-3.7	-4.6	-4.1	-2.8	-1.4
Money and credit					
Financial system credit to the non-financial private sector	9.2	8.7	14.6	16.5	10.8
Broad money (M2a)	8.3	10.2	7.9	10.6	12.3

1/ Methodological differences mean that the figures in this table may differ from those published by the authorities.

2/ Staff projections.

3/ IMF staff estimates.



MEXICO

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION

October 23, 2017

KEY ISSUES

Context: The Mexican economy has exhibited resilience in the face of a complex external environment. However, the country still faces significant challenges, namely to preserve macro-economic stability, and foster stronger and inclusive growth. These challenges are complicated by the uncertainty associated with the future economic relations with the United States and the future political landscape in Mexico. Prospects hinge on steadfast implementation of the structural reform agenda that would boost growth and improve living standards, supported by continued fiscal consolidation that would put the public debt ratio on a sustainable downward path.

Outlook and Risks: Output growth is projected to slow to 2.1 percent in 2017 and further to 1.9 percent in 2018, and to gradually rise towards 2.7 percent over the medium term. Inflation is projected to decline rapidly next year and to approach the central bank's target of 3 percent as the one-off impact of the sharp increase in domestic fuel prices in January 2017 dissipates. The main risks to the growth outlook include prolonged and heightened uncertainty regarding the pace and outcome of the negotiations on the North American Free Trade Agreement (NAFTA), weaker-than-projected U.S. growth, and renewed volatility in global financial markets. The main domestic risk comes from uncertainty about the political landscape following Mexico's July 2018 general elections, which could adversely affect the investment climate.

Macroeconomic Policies: Policies and policy frameworks remain very strong. The government is expected to meet its fiscal target again in 2017, for the third consecutive year, and the public debt-to-GDP ratio is projected to stabilize over the medium term. Closing the tax compliance gap, further strengthening the fiscal framework, and improving the efficiency of public spending would enhance the long-term credibility and counter-cyclicality of fiscal policy, while also helping build stronger fiscal buffers. The authorities should stand ready to ease monetary policy to support activity as soon as inflation is firmly on a downward path and as long as inflation expectations remain in check. Continued clear communication would further enhance policy credibility and guide market expectations. On the structural front, re-invigorating the structural reform agenda with emphasis on strengthening the rule of law, fighting corruption, and reducing informality would help boost potential output and foster inclusiveness.

Advice from previous Article IV Consultations: Consistent with past Fund advice, the authorities have adhered to their commitment to the fiscal consolidation path until 2018. As recommended in the 2016 Article IV consultation, they have committed to save the entirety of the one-off transfer from the central bank this year. The authorities also continued the liberalization of fuel prices, started in January 2017, and the implementation of the energy sector reform. The National System of Anticorruption became operational in July 2017, although the appointment of a special prosecutor is still pending.

Approved By
Robert Rennhack
(WHD) and
Tamin Bayoumi (SPR)

Discussions were held in Mexico City during September 25–October 6, 2017. The mission comprised Costas Christou (head), Frederic Lambert and Christian Saborowski (WHD), Charlotte Lundgren (SPR), Hui Miao (MCM), Florian Misch (FAD), and Richard Berkhout (LEG). Robert Rennhack (WHD) joined the concluding meetings. Messrs. Hurtado and Zuñiga-Villaseñor (OED) also participated in the meetings. The mission met with Bank of Mexico Governor Carstens, Secretary of Finance and Public Credit Meade, Economy Secretary Guajardo, other senior officials, and representatives of the business community, other IFIs, and academics. Carolina Correa Caro and Patricia Delgado (WHD) contributed to the preparation of this report.

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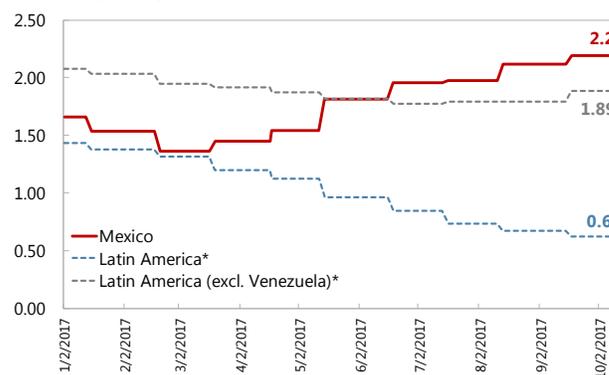
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POLICYMAKING UNDER HEIGHTENED UNCERTAINTY

1. Very strong policies and policy frameworks have helped the Mexican economy navigate successfully a complex external environment. The authorities responded appropriately to the recent external shocks and demonstrated their commitment to macroeconomic stability. They met their fiscal target for the past two years and are on track to meet it in 2017 as well, even excluding the profit transfer from the Bank of Mexico. Monetary policy has maintained a tight stance, while the flexible exchange rate has been playing a key role in helping the economy adjust to external shocks. Financial sector supervision and regulation remain strong. Mexico's resilience is to a large extent the result of very strong policies and policy frameworks. This resilience has been reflected in better-than-expected growth in the first half of 2017, on the back of robust private consumption and manufacturing exports, as well as in the recovery in asset prices since January 2017.

2017 Real GDP Growth Consensus Forecasts
(Percentage change)



Sources: Consensus Forecast.

2. However, Mexico continues to face important challenges. Fiscal space remains constrained by large tax compliance gaps and spending inefficiencies, as well as the need to reduce public debt in relation to GDP. Oil production from aging oil fields and associated tax revenues have continued to decrease, and private investment has been slowing since 2015. While some of the structural reforms are showing early signs of success, they have not yet resulted in a significant boost to growth. In addition, perceived high corruption and a weak rule of law continue to hamstring Mexico's growth prospects.

3. These challenges need to be addressed amid a complex external environment and domestic political uncertainty. NAFTA negotiations began in August and initially envisaged seven rounds of discussions to be completed by end-2017. Protracted negotiations could prolong uncertainty regarding Mexico's future economic relations with the U.S. Moreover, political uncertainty is expected to remain elevated in the run-up to the July 2018 general elections, in which Mexico will elect a new president (to be decided in one round, while, for the first time, independent candidates are allowed to run), new congress and senate, and local congresses. Meanwhile, the political landscape has changed since the 2012 presidential election. The political left has split as Mr. Lopez Obrador left the PRD to create his own party, Morena. The center-right party PAN has formed an alliance with the PRD, which prompted one of its leaders, Ms. Zavala, to resign and run as an independent candidate. Except for the Morena party that has nominated Mr. Lopez Obrador, the political parties are yet to announce their presidential candidates.

RECENT DEVELOPMENTS

4. Growth has remained resilient and inflation has accelerated. Real GDP growth reached 2.5 percent y-o-y in 2017:H1 despite heightened uncertainty about the future economic relationship between Mexico and the U.S. (Figure 1). Economic activity in the past 18 months has been driven by robust private consumption and manufacturing exports, while private investment has remained sluggish and public investment contracted. On the supply side, the strong performance of the services sector and manufacturing growth have offset the contraction in mining and construction. Unemployment declined to 3.3 percent in September 2017 without evidence of growing wage pressures so far (Figure 2). Headline inflation stood at 6.4 percent y-o-y in September, reflecting mainly the increase in gasoline prices liberalized in January 2017 but also the delayed pass-through effect of the significant peso depreciation until January 2017 as well as, more recently, a substantial increase in some agricultural prices (Figure 3).¹ Core inflation reached 4.8 percent during the same month, compared with 3.4 percent at end-2016.

5. The current account has improved. The current account deficit shrank from 2.2 percent of GDP in 2016 to 1.6 percent in 2017:H1, on the heels of an improvement of the non-oil trade balance driven by very robust and broad-based manufacturing export growth, and continued strong remittances (Figure 4). Remarkably, the non-oil goods balance was robustly positive for three quarters, but again became slightly negative in July and August. Net FDI flows contracted to 2.2 percent of GDP in 2017:H1, in line with the general slowdown in investment.

6. Asset prices recovered from the sharp losses following the U.S. elections, but have been under pressure again recently owing to NAFTA-related uncertainties (Figure 7). The peso strengthened substantially from January 2017 and until mid-September as the perceived tail risks receded. However, it weakened somewhat recently as a result of renewed uncertainty regarding NAFTA. Equity markets reached record highs, and the spread between the 10-year Mexican government bond and U.S. Treasury bond yields has approached a multi-year low, although it widened slightly recently.² The improved market outlook reflects both lessened external risks and strong domestic economic fundamentals. Capital inflows have been robust and foreign ownership of government debt has remained broadly stable. In April 2017 Moody's affirmed its A3 sovereign rating for Mexico; and S&P and Fitch raised their outlooks on Mexico sovereign ratings BBB+ to stable from negative in July and August, respectively.

7. The financial sector has weathered the heightened market volatility well amid a deceleration of credit growth. The banking sector remains well capitalized and highly profitable (Table 6). As of July 2017, the sector's Tier-1 capital ratio stood at 14.3 percent and the return on equity at 19.7 percent, while the NPL ratio hit a record low of 2.1 percent. Banks' results were helped

¹ Staff estimates show an exchange rate pass-through to CPI of 0.5 percent after one year, below the import content of consumption (see: 2016 Staff Report). Although the pass-through is small, given the large nominal depreciation, the impact on inflation was sizeable.

² The authorities continue to successfully manage public debt, further improving its structure. In early October, they placed a new US\$1.88 billion 30-year bond to repay a bond maturing in 2020.

by robust economic growth and the expansion of the net income margin associated with the sharp hikes of the policy interest rate.³ The moderation of credit growth has continued given high borrowing costs and a cautious underwriting stance of some banks. Corporate credit quality has improved amid robust corporate profitability, while consumer loan delinquency rates are broadly stable.

8. The central bank proactively tightened its monetary policy stance. In the context of heightened uncertainty, and with inflation on the rise and the peso depreciating until January 2017, monetary policy was tightened considerably starting in December 2015. The tightening cycle entailed a cumulative 400-basis point increase in the policy interest rate to 7 percent. This monetary stance was successful in keeping medium- and long-term inflation expectations anchored: the median inflation expectation at a one-to-four-year horizon is stable at 3.5 percent.

9. The government has adhered to its fiscal consolidation plan. The 2017 public sector borrowing requirements (PSBR) is projected to fall to 1.4 percent of GDP, as the government will save the entirety of a 1.5-percent-of-GDP one-off transfer from the central bank.⁴ Expenditures are projected to contract by 2 percentage points of GDP while revenues would shrink by 0.6 percentage points, after some exceptional increase in 2016 partly related to the 2013 income tax reform. In addition, for the first time since 2010, the structural primary balance is projected to show a surplus, while the public debt-to-GDP ratio is projected to decline to 53.8 percent from 58.4 percent in 2016 (Figure 6).

10. The implementation of a broad range of structural reforms is ongoing. The authorities have been implementing a broad structural reform agenda since the *Pacto por México* was adopted in 2012 in a coordinated effort to lift potential growth. Important progress has been made in liberalizing gasoline prices and progressing with licensing rounds and farm-out contracts for crude oil and natural gas production. In July 2017, a first successful discovery was announced by an international consortium, which constitutes one of the largest oil finds in recent years and the first major find by foreign firms in Mexico. A constitutional reform created the National Anti-Corruption System, but the appointment of a special prosecutor for anti-corruption is still pending. In an effort to stimulate investment in less-developed regions, the government announced in September the creation of three new special economic zones.

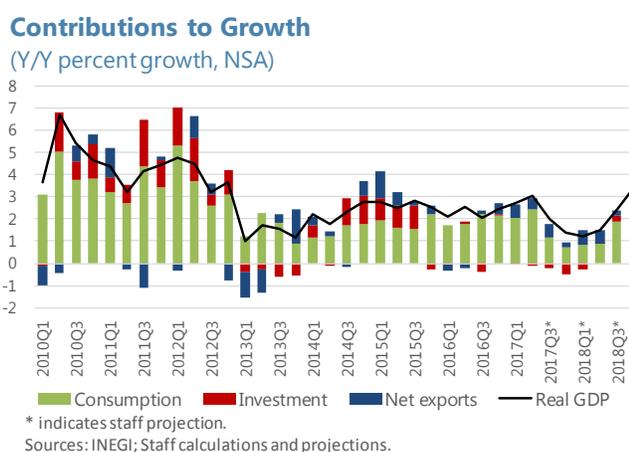
³ Funding costs of the large Mexican banks with high reliance on demand deposits have remained contained despite rising interest rates, while variable rate commercial loans have quickly repriced.

⁴ 70 percent of the transfer is to be used to reduce public debt. In early-October, over half of that amount had already been used in debt buy-back operations, with further operations expected by end-2017.

OUTLOOK AND RISKS

11. Near-term growth prospects are projected to remain subdued, while inflation would gradually return to target.

Prolonged NAFTA-related uncertainty along with political uncertainty and tighter monetary conditions will increasingly weigh on private consumption and investment, particularly in the export-oriented manufacturing sector. These factors would more than offset the positive contribution from external demand. The two earthquakes that shook Mexico in September are expected to have a limited effect on overall growth this year, as the negative impact on economic activity in 2017:Q3 would be broadly offset by the reconstruction process to begin in 2017:Q4. Staff projects output growth to slow to 2.1 and 1.9 percent in 2017 and 2018, respectively. With uncertainty being resolved with a mutually-beneficial NAFTA outcome, growth would gradually converge to 2.7 percent over the medium term. Like staff, the authorities expected the economy to gain speed during 2018:H2, but they were more optimistic regarding near- and medium-term growth which they believe will benefit significantly from the structural reform efforts. As for inflation, there was agreement that its increasing trend has reversed in August and that inflation would drop sharply in early-2018, as the effects of domestic fuel price increases and the depreciation until early-2017 dissipate, and the monetary tightening continues to take effect. Headline and core inflation is thus expected to converge toward the 3-percent target by end-2018.



Mexico: Key Macroeconomic Indicators, 2014-22 (Percent of GDP, unless otherwise indicated)

	2014	2015	2016	Projections					
				2017	2018	2019	2020	2021	2022
Real GDP growth (percent)	2.3	2.6	2.3	2.1	1.9	2.3	2.7	2.7	2.7
Inflation (period average, percent)	4.0	2.7	2.8	5.8	3.5	3.0	3.0	3.0	3.0
General government overall balance (Net lending/borrowing)	-4.6	-4.1	-2.8	-1.4	-2.5	-2.5	-2.5	-2.5	-2.5
General government gross debt	49.5	53.7	58.4	53.8	53.3	53.3	53.3	53.2	53.2
Current account	-1.8	-2.5	-2.2	-1.8	-2.4	-2.5	-2.5	-2.3	-2.1

Sources: Bank of Mexico, Ministry of Finance and Public Credit, and Fund staff estimates.

12. Despite a projected slowdown, credit growth will remain healthy. Major commercial banks can support continued modest credit expansion as they remain well-capitalized, liquid, and profitable. The financial reform has led to greater competition (e.g., in the mortgages market), although there is room to strengthen competition further. Reflecting tighter financing conditions but, at the same time, the underlying process of financial deepening, credit growth is projected to slow down somewhat but remain healthy at above 10 percent (Box 1). Policy uncertainty and more

risky bank lending practices (e.g., associated with SME and consumer lending) could weigh on credit risk. Moreover, credit quality could be affected by firms' exposure to the NAFTA negotiations, while high interest rates could negatively impact repayment capacity.

13. Mexico's external position remains broadly consistent with medium-term fundamentals and desirable policy settings (Annex II). The current account deficit is projected to narrow to 1.8 percent of GDP this year and to hover just above 2 percent by 2022. At these levels, it is broadly in line with medium-term fundamentals and desirable policy settings. The peso was 10 percent stronger in real effective terms relative to its 2016 average at end-August 2017. In staff's assessment, the peso is currently broadly in line with levels suggested by fundamentals. The net international investment position would continue to strengthen in 2017 and remain negative at just below 40 percent of GDP over the medium term. Foreign exchange reserves are adequate according to a range of indicators and established minimum benchmarks (Figure 5). In addition, the FCL arrangement continues to provide an effective complement in reducing risks. External financing needs would be lower in 2017–18, mainly due to lower public sector amortization. Nevertheless, the strong presence of foreign investors leaves Mexico exposed to greater risk in terms of capital flows reversal and increased risk premia. Reserves levels above minimum benchmarks are therefore warranted.

14. Both the authorities and staff saw the balance of risks tilted to the downside (Risk Assessment Matrix). They agreed that prolonged uncertainty regarding the pace and outcome of the NAFTA negotiations could weigh on growth. Since Mexico is particularly vulnerable to changes in its trade regime with the U.S. (Box 2), a materialization of this risk could have a significant impact on consumer sentiment, capital flows, and bilateral trade. Moreover, the risk of renewed volatility in global financial markets, increased risk premia, and a sharp pull-back of capital from emerging markets remains, and Mexico is particularly exposed to this risk due to its high share of non-resident holdings of government paper. The authorities also highlighted that emerging geopolitical risks had the potential to significantly disrupt growth as well as risk sentiment towards emerging markets. On the domestic front, perceived weak governance and rule of law, and, as the elections approach, political uncertainty may adversely affect confidence and investment. There was agreement with the authorities that a modernization of NAFTA and perseverance with structural reforms would provide upside risks to investment and growth.

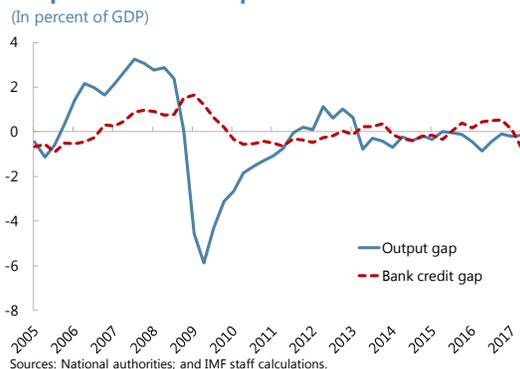
Box 1. Recent Credit Developments

The credit cycle is decelerating. Solid credit growth, stimulated in part by financial reforms, supported economic activity in 2015-16. However, real bank credit has started decelerating since end-2016, in particular as regards payroll and corporate loans, and the bank credit gap has turned negative. This slowdown reflects both a weakening of credit demand due to higher interest rates and a tightening of lending standards by banks in response to heightened uncertainty.

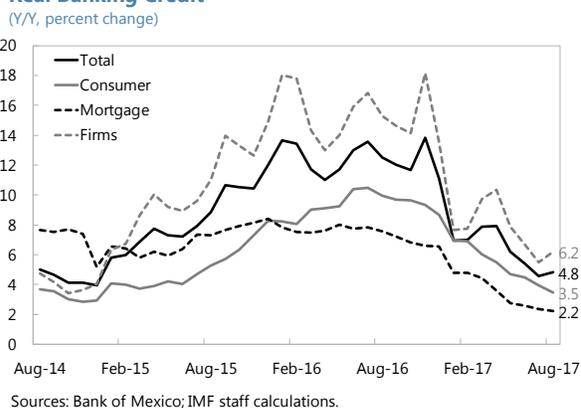
Yet risks to financial stability remain contained.

The fast growth of consumer credit in the past few years, was partly driven by increasing financial inclusion and competition, reflecting a welcome process of credit deepening. While the NPL ratio of banks' consumer portfolio is likely to rise modestly due to high real interest rates and slow income growth, household leverage is still low, with the household credit-to-GDP ratio at 16 percent compared to 37 percent on average for other emerging economies, according to BIS data. The NPL ratio for residential mortgages, which account for half of consumer lending, remained steady at 2.4 percent, and the low loan-to-value ratio of around 70 percent will likely cap mortgage delinquency rates going forward. Moreover, the NPL ratio for corporate loans continued to fall to 1.6 percent in August. Corporate credit indicators such as the debt-to-equity ratio and the EBIT-interest coverage ratio have also improved in 2017. Moreover, the high loan loss provision (155 percent), ample net-interest margin and robust fee income would help the banking sector absorb significantly higher credit losses due to severe shocks on growth, interest rate or the exchange rate.

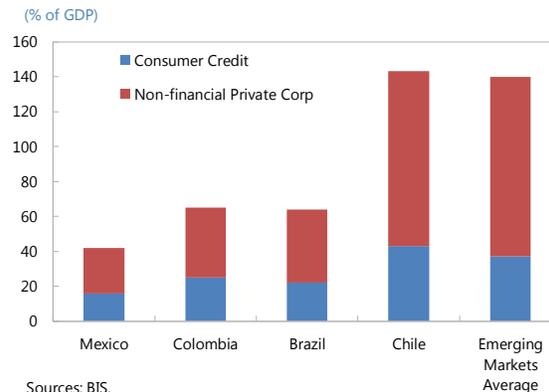
Output and Credit Gaps



Real Banking Credit



Private Credit Balance



Box 2. Mexico’s Trade Linkages with the United States¹

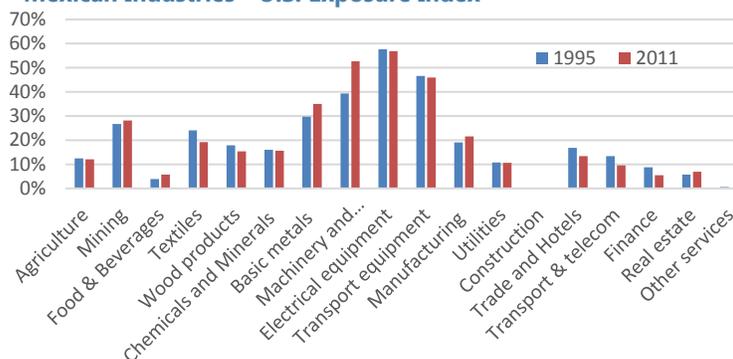
The extent and nature of trade links between the three NAFTA countries, are analyzed using insights from both traditional gross trade statistics and trade in value added (VA) data from OECD’s TiVA database, which covers the period between 1995 and 2011.

Mexico remains highly connected to the U.S. On the export side, the U.S. remains the top export market (70 percent of exports in 2011), followed by Canada (8 percent in 2011). On the import side, the U.S. remains the top importer, although its share has been shrinking substantially and continuously since the early 2000s, mainly due to the rise of China’s share.

Mexico’s exports are still concentrated in a small number of core industries. The sectoral

distribution of exports has changed little since 1995. Machinery, electrical and optical equipment, transport equipment, mining, as well as trade and tourism-related activities (such as hotel and restaurants) still account for most of the value added exported to NAFTA countries. In 2011, these 4 sectors accounted for 60 percent of the valued-added exported to the U.S.

Mexican Industries - U.S. Exposure Index

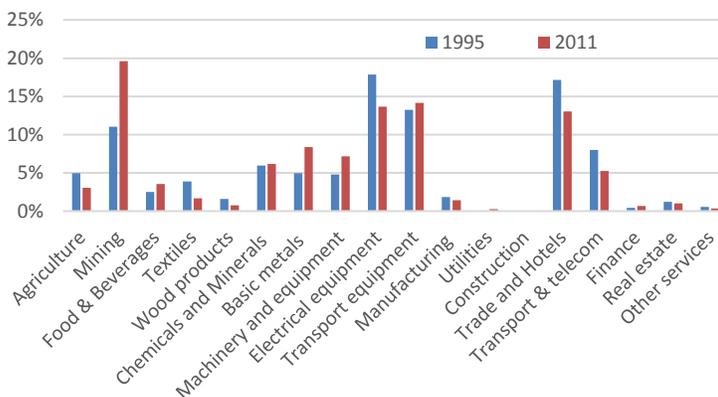


In value-added terms, Mexico’s exposure to NAFTA has been stable. Although gross trade flows have increased significantly between 1995 and 2011, the macro exposure of Mexico to NAFTA has changed very little. In 2011, roughly 14 percent of Mexico’s GDP ended up being consumed by the U.S. (and around 1 percent in Canada); the same figure as in 1995.

Several Mexican industries are highly dependent on final U.S.

demand. In 2011, three sectors had roughly half of each one’s total value added exported and consumed in the U.S (Machinery, Electrical Equipment and Transport Equipment). On the other hand, other important contributors to Mexican exports, such as mining and trade and tourism industries, are much less reliant on U.S. final consumption.

Sectoral Distribution of Exports to the U.S.



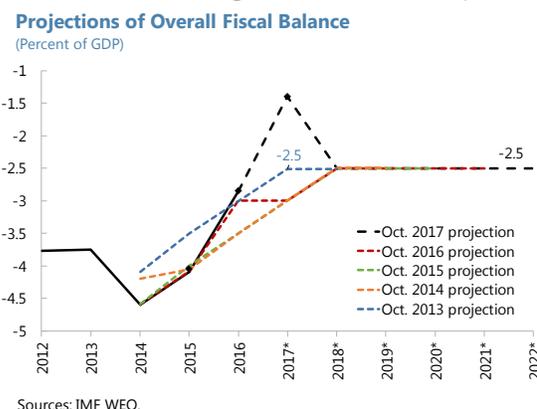
¹ Prepared by Damien Puy (RES).

SETTING THE STAGE FOR STRONGER, SUSTAINABLE, AND INCLUSIVE GROWTH

A. Fiscal Policy: Underpinning Consolidation with an Enhanced Fiscal Framework and Structural Fiscal Reforms

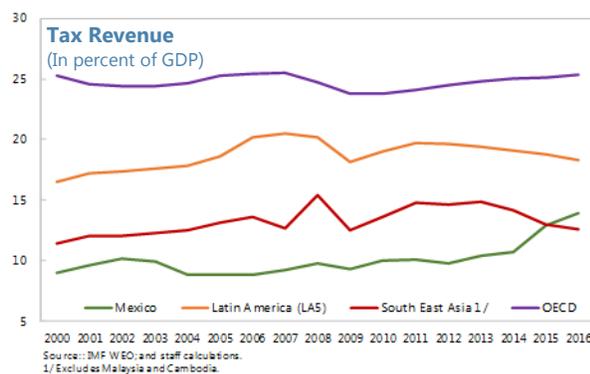
15. There was agreement that fiscal policy should continue to aim at keeping the public debt-to-GDP ratio on a downward trajectory. The trajectory of Mexico's public debt and gross financing needs is overall robust to standard shocks (Box 3 and Annex III), while medium- and long-term adjustment needs are manageable. However, continued reduction in public debt in relation to GDP would create room to address the medium-term needs for social and infrastructure spending. Given these considerations, although Mexico has some fiscal space, it should not be used to stimulate the economy under current conditions.

16. To this end, staff welcomed the authorities' commitment to the fiscal consolidation plan. The draft 2018 budget aims at a PSBR of 2.5 percent of GDP, resulting in a reduction in public debt to 53.3 percent of GDP. Staff estimates that keeping the PSBR at 2.5 percent over the medium term would stabilize debt at around that level. In staff's view, a slightly more ambitious medium-term fiscal target beyond 2018 would help ensure continued market confidence, rebuild fiscal buffers, and ensure that Mexico preserves and expands its fiscal space to respond to negative shocks going forward. To this end, a primary surplus slightly above the debt-stabilizing level of 0.9 percent of GDP over the medium term would put the public debt-to-GDP ratio on a downward path and ensure with a high probability that it would remain below 50 percent over the long term. The authorities noted that the current PSBR target both attains the government's objective to ensure that public debt remains on downward path and creates sufficient space to address the country's infrastructure needs.



17. A strengthening of non-oil tax collection beyond what has already been achieved would help ensure that consolidation gains are not reversed and bolster fiscal space.

The revenue gains from the 2013 tax reform partially compensated the sharp decline in oil revenues, but the tax revenue-to-GDP ratio is among the lowest in the OECD. The authorities shared the view that VAT revenue performance is especially weak, in part because of a large compliance gap amounting to a significant share of VAT revenue currently collected. Staff



recommended to narrow the scope for VAT exemptions and intensify efforts to reduce tax evasion and broaden the tax base. Increasing revenues from property taxes would also be important to bolster local governments' resources over the medium term. Finally, staff welcomed the authorities' due attention to the potential impact on Mexico of the contemplated reform of the U.S. corporate income tax and encouraged them to stand ready to adjust their corporate income tax policy, if needed, to mitigate potential risks to revenues.

Box 3. Rethinking Mexico's Fiscal Objective¹

The fiscal consolidation plan announced by the authorities in 2014 is nearly completed. Considering significant macroeconomic changes since the time when the current medium-term target of 2.5 percent of GDP for the PSBR was chosen, a re-calibration of the medium-term fiscal stance is warranted. To this end, stochastic simulations have been used to estimate different levels of a PSBR ceiling that would keep the public-debt-to-GDP ratio below certain thresholds.

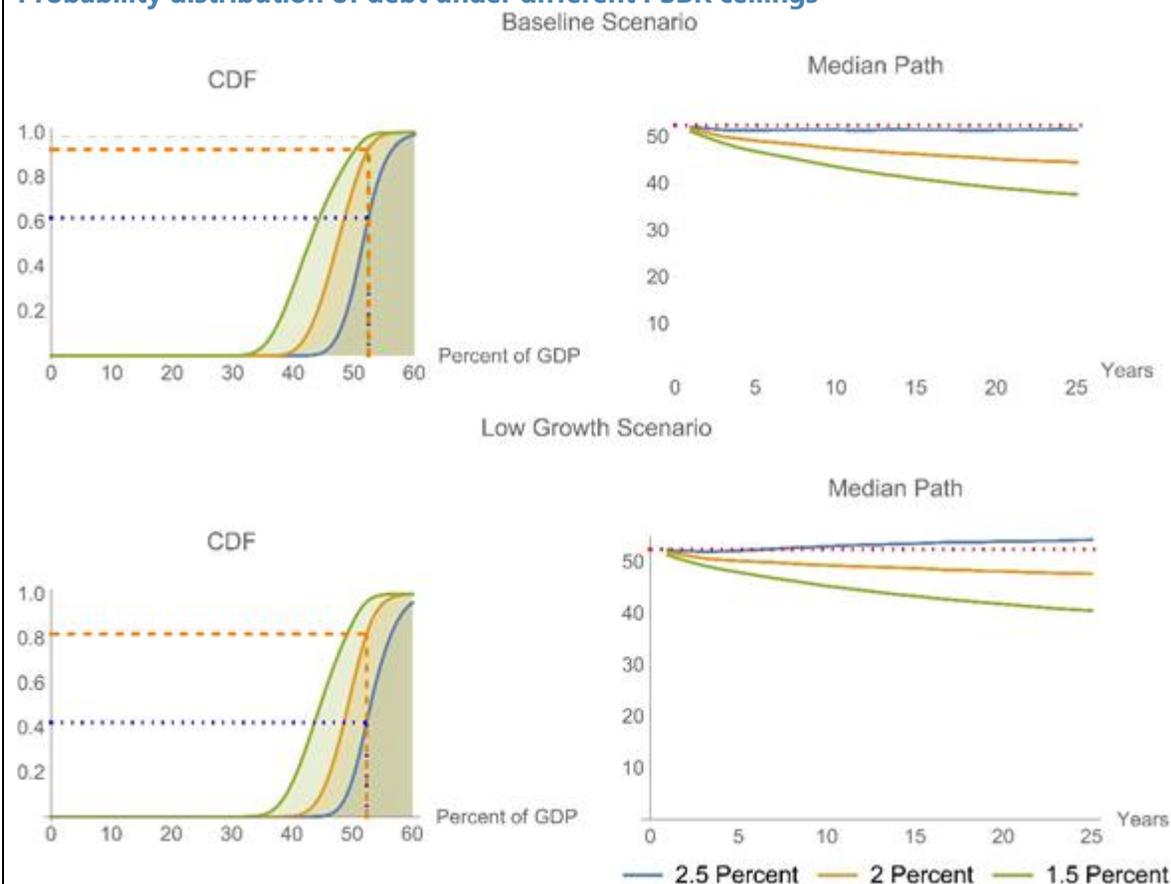
The simulations embed growth and fiscal revenues shocks as well as a more restricted use of exceptional circumstances clauses.² They impose a PSBR ceiling of 2.5, 2.0, and 1.5 percent of GDP, under two scenarios for growth: a baseline in which potential growth stays at 2.7 percent over the long term—corresponding to staff's medium-term projections—and one in which it is only 2.3 percent, which corresponds to staff's estimated potential growth for 2017. In line with staff advice on restricting the use of exceptional circumstances, the simulations also assume that the PSBR ceiling can be relaxed up to 2 percentage points of GDP but it is brought down to below the ceiling within 3 years. These assumptions help derive implications for public debt not only from imposing a permanent ceiling but also from limiting the use of the exceptional circumstances clause.

A permanent PSBR ceiling of 2.5 percent of GDP would keep public debt below 53.2 percent of GDP with 71 percent probability in the baseline scenario. The reference debt level of 53.2 percent of GDP corresponds to the projected medium-term debt level under staff's baseline scenario. Under the baseline scenario, a PSBR ceiling of 2.5 percent of GDP would keep public debt below 53.2 percent of GDP with 71 percent probability over a 25-year period. Setting the ceiling at 2 or 1.5 percent of GDP would increase this probability to 95 and 99 percent respectively. These probabilities correspond to the entire path of the public debt-to-GDP ratio remaining below 53.2 percent.

Under pessimistic potential growth assumptions, only a ceiling of up to 2 percent of GDP for the PSBR would keep the public debt ratio below 53.2 percent with high probability. A PSBR ceiling of 2.5 percent of GDP would imply a 52-percent probability of public debt remaining below 53.2 percent of GDP over the 25-year simulation period. Moreover, the median debt path shows a slightly upward trend. However, a PSBR ceiling of 2 percent or lower would keep public debt below 53.2 percent with 88 percent probability or higher.

Box 3. Rethinking Mexico's Fiscal Objective (Concluded)

Probability distribution of debt under different PSBR ceilings



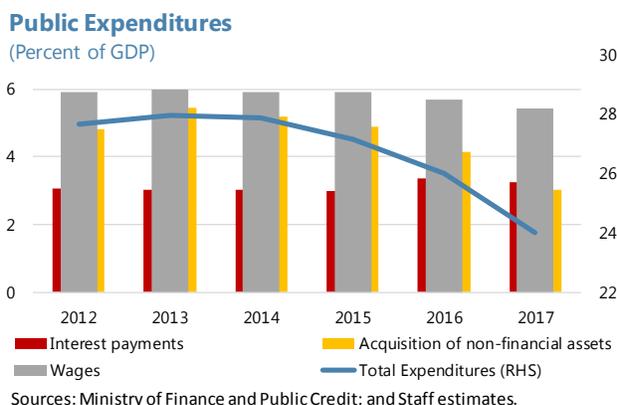
Sources: National authorities; and IMF staff calculations.

¹ Prepared by Fabian Valencia (WHD).

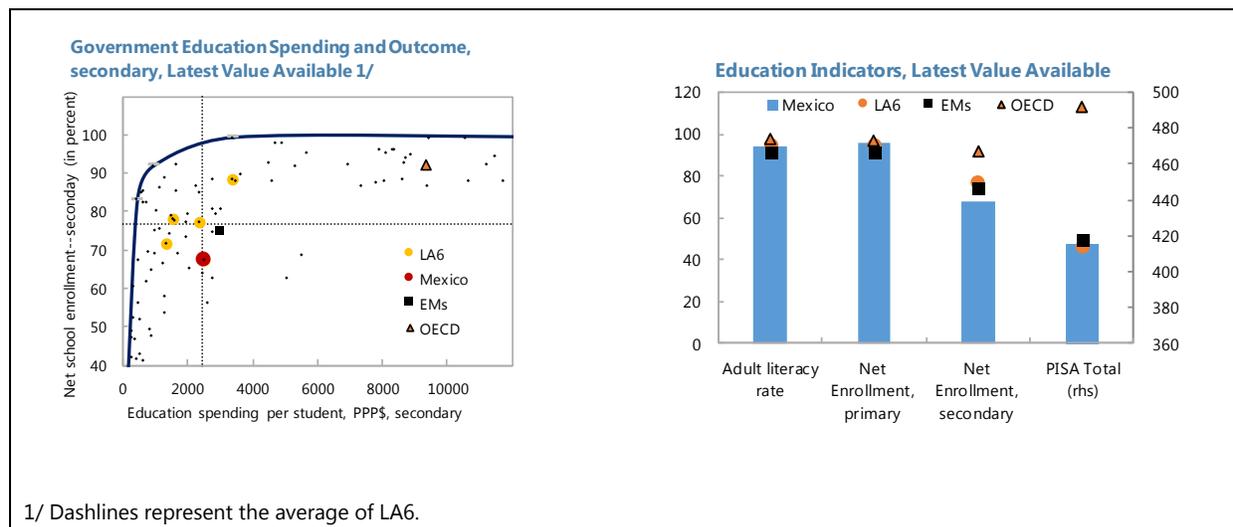
² See: "Strengthening Mexico's Fiscal Framework", IMF Country Report No. 15/314.

18. There was agreement on the need to improve the efficiency and quality of public expenditure to create space for spending on much-needed infrastructure. Public investment has been compressed substantially in recent years, and is projected to fall to 2.6 percent of GDP in 2018, with PEMEX accounting for 1.6 percent of GDP. In 2013-14 total public investment amounted to 5.3 percent of GDP, with PEMEX investing 2 percent of GDP.

- Staff welcomed the authorities' efforts to contain the **wage bill**, which is projected to fall by 0.5 percentage point of GDP between 2015 and 2017, owing to a combination of low wage increases and job cuts. Going forward, consideration should be given to stricter standards and improved transparency in the use of temporary personnel, consistent application of merit-based recruitment, and establishing a centralized payroll system, in line with the recommendations of the Public Expenditure Review by the World Bank.



- Education and health spending efficiency** can also be improved so that a larger share of the population could be served with the same resources. Relative to total spending and GDP, the level of education expenditure is above and at the OECD average, respectively. Educational attainment is significantly below that of advanced economies and at best at the average level of regional peers. Staff welcomed steps taken in the context of the education reform and noted that further progress could be made by: (i) rebalancing the composition of education spending towards investment in equipment and facilities; (ii) more careful auditing of the payroll to better identify ghost workers and curb teacher absenteeism; and (iii) improving teaching quality. There is also scope for improving public health spending efficiency, including by: (i) consolidating procurement of pharmaceuticals and of other goods and services; (ii) eliminating beneficiary duplication between insurance schemes; and (iii) promulgating best practices that would reduce disparities in service quality across insurance schemes and states.



- **Social assistance programs** could be consolidated and better targeted. Given the large number of programs across various levels of government, which often overlap, there is significant scope for efficiency gains by eliminating programs that show no impact on poverty or inequality, and by consolidating programs with similar objectives. To this end, staff welcomed progress in creating a single database that would help curb duplication of social benefits.

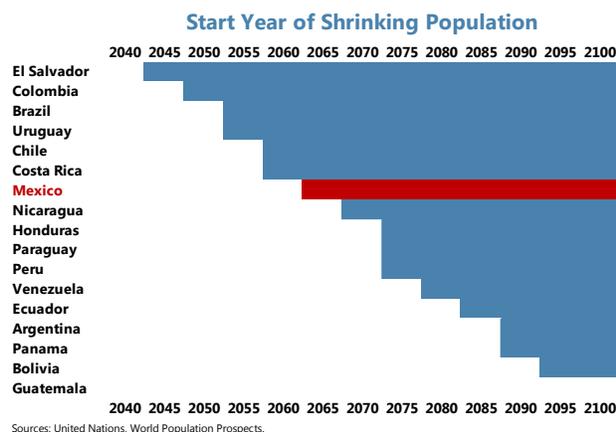
19. Continued improvements in PEMEX’s profitability and efficiency are essential to strengthen public finances and maintain market confidence. PEMEX’s financial situation has stabilized since the record-high losses of 2015. In 2016:Q4, PEMEX posted its first quarterly profits since 2010, met its annual production target, and is on track to meet this year’s target. While the efforts to turn PEMEX into a profitable and efficient company are welcome, the steadfast implementation of PEMEX’s multi-year business plan, including continuing to make efficiency improvements, divesting non-core assets and subsidiaries, and entering into joint ventures with the private sector is needed to ensure PEMEX’s long-term financial soundness.

20. A gradual reduction in public debt would provide a buffer for addressing long-term demographic pressures. The increasing fiscal costs of the pension system have been putting upward pressure on social spending. The federal pension deficit is projected to increase by a third, to 2 percent of GDP by 2030, as a result of extensive grandfathering in the reform toward a defined-contribution system (Box 4). Besides, the very low replacement rates projected under the new system and the extreme inequities between participants who contributed before and after the cutoff dates may add social pressures for government intervention.

Box 4. Mexico’s Long-Term Fiscal Gaps¹

Mexico’s population is aging. The median age reached 28 years in 2015 and is expected to rise to 42 years by 2050. As a consequence of aging, the Mexican population is expected to start declining in 2065. These demographic changes have important implications for Mexico’s pension and healthcare system.

The adoption of a defined-contribution pension system limits in principle the direct fiscal cost of pensions. Mexico replaced the traditional pay-as-you-go defined-benefit (DB) pension system by a defined-contribution (DC) system. The new DC system is mostly self-funded, except for a minimum pension for individuals having a minimum number of years of contributions. However, individuals who were already participants in the DB system prior to the reform were grandfathered, retaining the entitlements already accumulated at the time of the reform and continuing to accumulate entitlements thereafter. Hence the federal pension deficit is projected to increase from 1.5 percent in 2015 to 2 percent in 2030.²

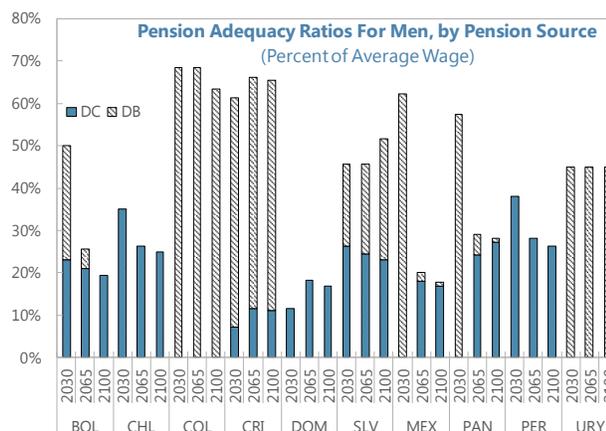


Box 4. Mexico's Long Term Fiscal Gaps (Concluded)

However, the reform has created extreme inequities in the system between individuals grandfathered in the previous DB system and participants in the new DC system. Specifically, replacement rates are 80-100 percent for those grandfathered under the DB system, but expected to be about 30 percent for those entitled to a defined-contribution pension. Pension adequacy ratios are thus projected to drop dramatically between 2030 and 2065. The issue is compounded by the very large labor market informality.

Staff estimates suggest that raising the retirement age to 67 years and contribution rates to 17 percent would allow to boost replacement rates to around 50 percent. Such a large increase in contribution rates would have to be managed carefully to avoid discouraging formal employment. Moreover, to reduce inequities, the DB could be closed for all future accumulation of rights, honoring only entitlements already earned and leaving affected individuals with a mixture of a DB and DC pension. This would allow pension levels to decline gradually with the number of years worked after the reform.

Population aging will also increase healthcare costs. Based on demographic developments and rising expectations about the quality of healthcare, public healthcare spending is projected to rise significantly in the coming decades from 3.3 percent of GDP in 2015 to 8.7 percent by 2065.



Source: "Mind the Gap. Are Latin American Countries Prepared for the Policy Challenges of Population Aging?" WHD Departmental Paper, *forthcoming*. Adequacy ratios are computed as the ratio of pensions received by the average wage earner at the time of retirement over the average earnings of the working population. The estimates vary over time, reflecting changes in pension systems, depend on actual past rates of return, and assume a contribution density of 75 percent in the baseline scenario. DC: defined contribution system; DB: defined benefit system.

¹ This box summarizes the results for Mexico of: "Mind the Gap. Are Latin American Countries Prepared for the Policy Challenges of Population Aging?" WHD Departmental Paper, *forthcoming*.

² Excluding special regimes, such as for the armed forces, state-owned enterprises, state-level public institutions.

21. Enhancements of the fiscal framework would further strengthen the credibility of fiscal policy. The current framework still leaves excessive discretion to the government, once "exceptional circumstances" are invoked, in terms of when and how much the fiscal stance can deteriorate and how it should be brought back to equilibrium. It would be desirable to have a tighter link between the desired level of public debt and PSBR targets, to limit the exceptional circumstances clauses to cases of large output or oil price shocks, and to have explicit guidance on the return path after such clause is invoked. One-off transfers from the Bank of Mexico to the budget should be entirely used to reduce the PSBR and public debt.

22. A non-partisan, adequately-resourced, fiscal council with a formal mandate to provide an independent evaluation of fiscal policy would support the government's commitment to fiscal responsibility. By reviewing macroeconomic forecasts, monitoring public finances, assessing compliance with fiscal rules and informing the public on the sustainability of public finances, including those of the sub-national governments, such an institution would

strengthen the fiscal policy debate and increase accountability. The authorities responded that the government had already demonstrated its credibility by consistently delivering on its fiscal commitments and disputed the need for additional external scrutiny given the large number of banks, credit rating agencies, and other academic and non-academic institutions already analyzing Mexico's public finances. In their view, it would be more important to strengthen the capacity of the Centre for Public Finance Studies of Congress while ensuring that it is non-partisan in its assessments.

23. Prudent debt management remains important to promote market liquidity and reduce financial vulnerabilities. Continued liability management transactions have helped to improve the debt maturity profile and minimize borrowing costs. The inclusion of new Collective Action Clauses in international sovereign debt issuances has also been gradually contributing to strengthening debt contracts.

B. Monetary and Exchange Rate Policies: Supporting the Economy While Ensuring Stability

24. The pause in the monetary policy tightening cycle was appropriate. The Bank of Mexico (Banxico) has kept its policy rate at 7.0 percent since July, and noted in its latest quarterly report that the balance of risks to inflation had turned neutral. While acknowledging that the 400-basis point tightening was successful in keeping medium- and long-term inflation expectations well anchored, staff noted that, with inflation projected to soon enter a downward trajectory, the pause in the monetary policy tightening cycle was warranted.

25. Conditional on inflation expectations remaining well-anchored, the Bank of Mexico should ease monetary policy as soon as inflation is firmly on a downward path. Staff estimates that the current monetary stance is tight given that the ex-ante real policy rate exceeds 3 percent, close to the upper bound of Banxico's estimated fluctuation range for the neutral rate. In 2016, staff estimated the real neutral rate at 1-1.5 percent. With inflation projected to decline rapidly in early-2018 and with fiscal policy set to remain contractionary, and given a negative, albeit small, output gap, staff recommended a reduction in the policy rate as soon as inflation is firmly on a downward path, and as long as inflation expectations remain well anchored. The authorities highlighted the need for continued tight monetary policy in the presence of significant external risks facing the economy. They considered that the current stance was adequate to bring inflation back to the 3-percent target by end-2018 although they noted that the recent earthquakes could lift inflation slightly at end-2017.

26. Continued clear communication by the Bank of Mexico would further enhance the effectiveness of monetary policy. As expected in an inflation targeting regime, the Bank has kept its communication strategy centered on the need to keep inflation expectations anchored amidst heightened uncertainty and rising inflationary pressures. Its communication as elaborated in the minutes of policy meetings, however, suggests lengthy discussions with repeated focus on exchange rate movements and U.S. policies (Box 5). The Bank has for instance frequently referred to the relative monetary stance compared to the U.S. as one element determining monetary policy

decisions, along with the NAFTA-related uncertainty, potential pass-through from exchange rate changes, and the output gap. This suggests that further Fed tightening could be an obstacle to monetary easing in Mexico. Staff thus encouraged Banxico to continue enhancing its communication of future monetary policy decisions, while linking them to U.S. monetary policy and the exchange rate only insofar as they could affect the central bank's ability to achieve the inflation target. The authorities agreed that their monetary policy written communication was on the longer side but felt that more detailed elaboration about the board's thinking and considerations in reaching its decisions was warranted at the current juncture. They also highlighted that the exchange rate remained an important channel for anchoring inflation expectations. They noted that the communications, as well as the monetary policy actions, had preserved the credibility of Banxico.

27. There was agreement that exchange rate flexibility should remain the key shock absorber. A flexible adjustment of the exchange rate is indispensable to restore equilibrium in response to shocks. FX interventions in the spot market or through non-deliverable forwards (NDFs) settled in local currency are better suited to respond to disorderly market conditions associated with excessive volatility.⁵ Staff and the authorities agreed that a mix of exchange rate adjustment and intervention, along with the buffer provided by the FCL, could be used to address the materialization of risks, taking into account the nature of the shock. The authorities highlighted that intervention this year was limited to two instances in which they perceived disorderly market conditions in FX markets. They also felt that intervention via NDFs is a good substitute for spot intervention and can be relatively more useful in situations in which liquidity in forward markets dries up. Finally, there was agreement that efforts to diversify trading partners and the steadfast implementation of structural reforms to enhance competitiveness would reduce Mexico's vulnerability to shocks, although these efforts would bear fruit only in the medium- and long-term.

⁵ In March, the Foreign Exchange Commission introduced a framework for auctions of up to US\$20 billion of non-deliverable forwards (NDF), to be settled in pesos, but only US\$1 billion have been auctioned so far.

Box 5. Monetary Policy Communication¹

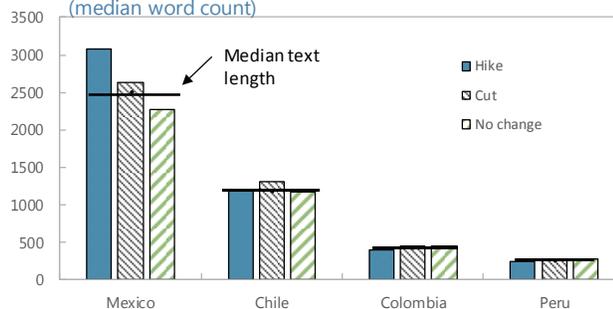
The Bank of Mexico communicates its decisions and the rationale behind them through three main channels: a press release the day of its board meeting, the publication of the minutes of its policy meetings, and quarterly inflation reports. These outlets provide analysts and market participants with a wealth of information about the factors influencing the monetary policy decision. This box focus on the minutes of the Bank's monetary policy meetings.

Banxico is one of the few central banks that publish minutes from policy meetings. These minutes provide a more complete and nuanced explanation of the reasons for the board's decisions and view of the risks to the outlook. The minutes' length is a quantifiable characteristic that may reflect both the level of detail that a central bank wants to transmit to the public and its effort to increase transparency. Banxico's minutes have become longer over time, and are longer after meetings when the policy rate was changed.

The topics covered in the minutes have also evolved. In the minutes published since early 2016, terms related to "inflation", "policy", and "interest rates" have become more prevalent in the discussions. It is also notable that the use of terms related to currency and U.S. developments have become an important factor in the board discussions. Following the 2016 U.S. elections, mentions of U.S. developments have reached levels only seen during the U.S. taper tantrum and have broadly stayed at those levels throughout 2017.

The tone of the discussion in the minutes appears to provide some indication of future policy changes. Recent staff work analyzes the effects of the information content of the minutes published by central banks in the region on future policy decisions.² Results suggest that information in the minutes is useful for predicting future policy, but surprisingly less so in the case of Mexico. In this context, a stronger communication and transparency framework could better anchor expectations and further increase the effectiveness of monetary policy.

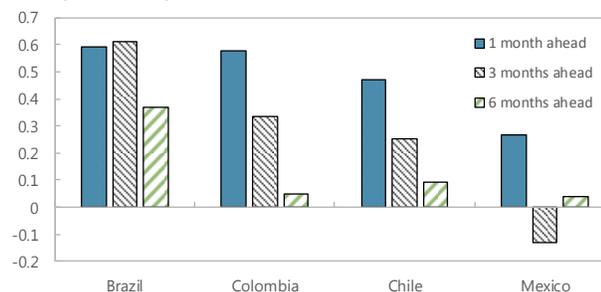
Text Length in Central Bank Minutes, 2010-2017
(median word count)



Frequency of Terms Related to the United States in Minutes
(number of words)



Tone in Minutes and Future Policy Changes
(correlation)



¹ Prepared by Juan Yopez (WHD).

² See Barbosa and others (forthcoming) for details. The "tone" index is constructed by applying computational linguistics models to central bank minutes. The words in the minutes are scored into "hawkish" (+1) and "dovish" (-1) words and aggregated for each minute.

C. Macro-Financial Policies: Ensuring Stability While Fostering Growth

28. Balance sheet analysis suggests that the financial sector is resilient to various risks, but close monitoring should continue. Last year's FSAP found that the balance sheets of financial institutions would be resilient to severe shocks to growth, exchange rates, and interest rates. Recent stress tests of the banking sector by Banxico have also confirmed the sector's resilience. Moreover, a sensitivity analysis of the 50 largest non-financial corporations suggests that major Mexican corporates will be able to weather very severe shocks given their low leverage, high FX hedges and robust income growth.⁶ Stress tests suggest that debt-at-risk could increase from 0.4 to 0.6-0.9 percent of GDP, depending on the level of FX hedges. Even a full default of this debt-at-risk could lead to an increase in gross NPL ratio by 0.7-0.9 percentage point, which is manageable. There is hardly any FX risk on household loans which are generally peso-denominated. Foreign currency loans account for about 13 percent of total bank credit and are largely matched by FX deposits. Overall asset quality is expected to remain stable although developments in short-term household and SME lending warrant close monitoring. High interest rates and slow income growth would likely hurt repayment capacity and lead to rising NPLs in these two segments. The authorities continue to monitor closely developments in corporate lending and advise firms to strengthen their balance sheets as needed. There was also agreement that strong supervision and regulation should continue, especially at the current juncture of heightened uncertainty.

29. Further efforts are needed to increase financial deepening and inclusion. Staff welcomed progress on the implementation of the 2016 National Strategy for Financial Inclusion and efforts to promote technological innovation or "fintech" as a tool for inclusion. Recent labor market, telecom and financial sector reforms have underpinned the momentum in improving financial inclusion. However, with domestic credit to the private sector still low compared with other economies, additional steps would be needed to promote financial deepening, including developing the domestic private capital market. Moreover, it would be important to strengthen the legal framework for enforcement of collateral. To this end, the planned establishment of special courts to administer the bankruptcy process should increase the recovery value and reduce legal delays. Staff also reiterated the FSAP recommendation to change the incentive structure in development banks and focus their lending efforts toward sectors lacking access to market financing.

30. Further reforms of the regulatory framework would help enhance financial sector resilience. Last year's FSAP noted that banking supervision was effective and recommended to close gaps in governance, including by increasing the operational independence, budget autonomy, and legal protection of the banking and securities supervisor. The banking sector is largely compliant with Basel III risk-based capital standard and liquidity requirements. The ongoing implementation of Net Stable Funding Ratio will further enhance the liquidity risk management of banks. Finally, given the large foreign ownership of the domestic banking sector, the cross-border resolution regime needs to be enhanced, while formal contingency plans and simulation exercises would help improve the crisis preparedness framework.

⁶ Nevertheless, the rollover risk of some of the market hedges depends on market liquidity, while the potential concentration of these hedges might raise counterparty risks.

D. Macro-Structural Policies: Re-invigorating the Reform Agenda to Lift Growth and Make It More Inclusive

31. The authorities have been implementing an ambitious reform agenda.⁷ In the face of disappointing GDP growth in recent decades, stakeholders across the political spectrum agreed that lifting productivity growth would necessitate decisive action on structural reforms. The *Pacto por México* thus aimed at boosting competition and increasing access to services across a range of industries while addressing current and future pressures from declining oil revenues and population aging, and exploiting synergies between the broad range of reforms.

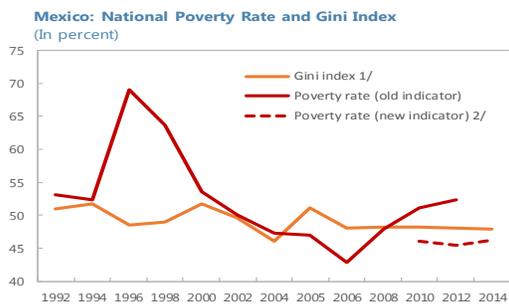
32. Five years after the approval of *Pacto por México*, a major growth acceleration is not yet in sight. While the implementation of the energy and telecom reforms, the tax policy reform and the financial sector liberalization are well advanced, the implementation of the education, labor market and judicial process reforms have yet to be completed. In 2012-13, the authorities estimated that growth would be boosted from an annual average of 2¾ percent over the past 20 years to 4-5 percent per year. Staff projections were more conservative with medium-term annual growth being revised up by about ¾-1 percent to 3½-4 percent. Such growth rates have yet to materialize, and staff has since revised medium-term growth down to 2.7 percent, assessing that more action will be needed on additional reforms to achieve the previously projected growth rates.

33. There was agreement that external headwinds and declining oil production masked positive impulses from the reforms, and that they would take time to exert their full impact on the economy. While initial estimates of the prospective reform impact may have been optimistic, recent research suggests that it is common for major structural reforms to require three years to show results and seven years to exert their full impact on the economy.⁸ Moreover, some reforms (e.g., the liberalization of gasoline prices) would have had important short-term costs. Nevertheless, the reforms do appear to have contributed to increased economic activity, including by boosting investment, reducing prices, and improving access to services: e.g., electricity and telecommunications prices have fallen while the reforms boosted investment in both sectors as well access to telecommunication services.

34. Poverty and income inequality remain high. Mexico implemented several programs to tackle poverty during 1997–2014. However, the national poverty rate has kept increasing in recent years. Moreover, although the poverty headcount at \$3.10 per day declined from 18 to 12 percent of the population during 2005-14, it is still above the LAC6 average (8 percent). Limited progress has been made in reducing income inequality, with Mexico's Gini index hovering at around 48 percent. Regional inequalities remain high.

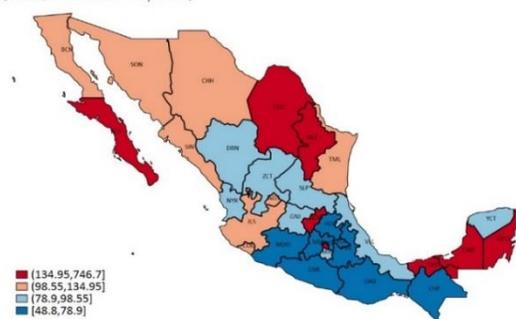
⁷ See "Mexico's Structural Reform Agenda: Early Signs of Success" Accompanying Selected Issues Paper.

⁸ See Duval and Furceri (2016), and IMF (2016)



Sources: CONEVAL, World Bank, World Development Indicators database, SEDLAC (CECLAS and The World Bank); and IMF staff calculations.
 1/ A Gini index of 0 represents perfect equality, 100 implies perfect inequality. For 2014 the SEDLAC estimate was used as reference.
 2/ The new poverty indicator was introduced in 2010 and uses a multi-dimensional approach to measuring poverty based on a "social deprivation index," which takes into account the level of income, education, access to health services, to social security, to food, and quality, size, and access to basic services in the dwelling.

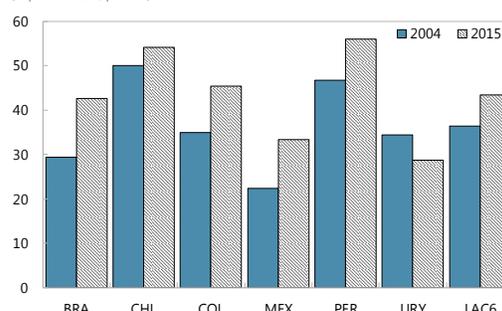
GDP per capita
 (2010, thousand of pesos)



Sources: INEGI; IMF staff calculations.

35. Other social development indicators paint a mixed picture (Figure 10). Access to education, healthcare, and basic services has increased significantly, but in some outcomes Mexico lags its peers. Infant mortality remains above the LAC6 average. The number of intentional homicides per 100,000 people (16.3 in 2015) is three times the world average. Only about a third of the population aged over 25 has completed secondary education, and close to 20 percent of the youth population remain excluded from education, training or employment.

Educational attainment, completed at least upper secondary
 (Population 25+, percent)



Sources: World Development Indicators

36. Informality remains high. The share of informal employment dropped by 2 ppts during 2012–16, but remains high, at around 57 percent. Staff analysis suggests that, on average, the productivity of informal firms is substantially below that of formal firms, even after controlling for other differences between firms, which is in line with evidence from other countries. Productivity in Mexico is also constrained by other distortions that give rise to misallocation of resources among otherwise similar firms. Removing all distortions could increase TFP by more than 70 percent. Interestingly, these estimates mask considerable heterogeneity across sectors and states. Regional differences in resource misallocation arise in part from differences in the incidence of informality, corruption and crime and uneven access to services. While there are also differences in the sectoral composition of the regional economies, these effects

Level of Resource Misallocation by State



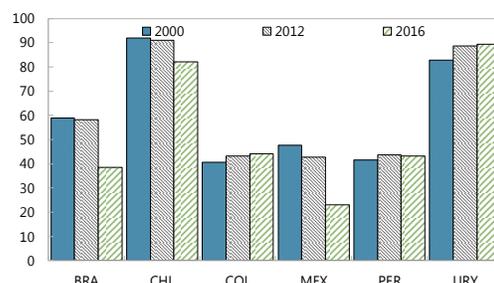
Sources: Data from Mexico's Economic census and staff calculation. The data was accessed through the INEGI's Microdata Laboratory. All results and shown are not part of INEGI's official statistics.

are likely to be of second order given that more than two thirds of all considered sectors are spread across at least 30 states.⁹

37. There was agreement that perseverance with the full implementation of the structural reform agenda would help lift potential growth, reduce poverty, and improve inclusiveness.

Priority should be given to reforms targeting corruption, security, the rule of law, and informality which are widely perceived as important obstacles to investment and growth. Weaknesses in these areas may also impede the broader reform effort from exerting its full impact on the economy. For example, strengthening bankruptcy procedures would not boost credit sufficiently if enforcement remains weak. The authorities agreed that continued reform implementation would be crucial. They highlighted both the rule of law and corruption as important impediments to economic prosperity. They agreed that enhancing the efficiency and quality of law enforcement and judicial institutions would be critical to improve security and strengthen the rule of law.

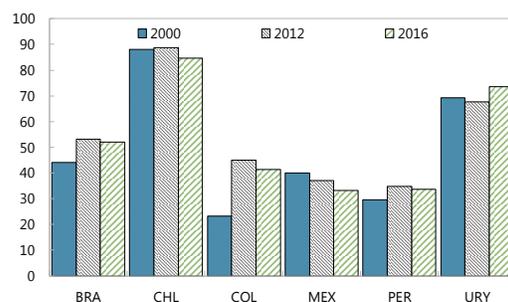
Control of Corruption 1/



Sources: Worldwide Governance Indicators
1/Percentile rank among all countries (ranges from 0 (lowest) to 100 (highest) rank)

38. Corruption is perceived as high and widespread. Mexico stands at the 25th and 38th percentiles in corruption and the rule-of-law, respectively, in the 2016 World Bank Governance Indicators. Moreover, results of surveys conducted by INEGI suggest that both the perception and incidence of corruption have increased since 2011 (Box 6). On average, in 2015, close to 89 percent of each state's population considered corruption to be frequent or very frequent. Based on estimates in the literature, a reduction in the perception of

Rule of Law 1/



Sources: Worldwide Governance Indicators
1/Percentile rank among all countries (ranges from 0 (lowest) to 100 (highest) rank)

corruption could have very large economic effects.¹⁰ Ugur and Dasgupta (2011) find that a one-unit improvement in the perceived corruption index is associated with an increase of 0.59-0.86 percentage point in per capita GDP growth. In this vein, the perception of corruption might have mitigated to some extent the impact of past reforms on growth, although it would be difficult to estimate the precise effect.

39. Efforts to strengthen the anti-corruption framework are under way, but the authorities along with the civil society agree that much remains to be done. This has resulted in the creation of the National Anti-Corruption System (NACS) (Box 6), as well as an increase in corruption investigations and prosecutions against high government officials, such as state governors. Civil society and the general public have supported and in some instances contributed to

⁹ See "Structural Weaknesses and Resource Misallocation in Mexico," accompanying Selected Issues Paper.

¹⁰ See [Corruption in Latin America: Taking Stock, IMF Blog, September 2017](#).

an enhancement of government efforts. The NACS is a major step forward and showcases institutional strength and the strength of civil society. Implementation of the NACS is critical to ending the corruption trap where existing incentives are self-perpetuating, to improve economic efficiency and to increase productivity by reducing resource misallocation and rent-seeking behavior.

40. Mexico has a mature AML/CFT regime, with a technically well-developed legal and institutional framework and a good understanding of money laundering risks. There is an understanding that the use of shell companies is a major method to hide corrupt assets and launder money. This involves shell companies, set-up in Mexico through illicit intermediaries, using Mexican legal entities, created by Mexican notaries, with bank accounts with Mexican banks. This complex typology, *inter alia* used to illicitly divert government funds, needs to be addressed, with a focus to enhance company creation and registration to ensure up-to-date basic and beneficial ownership information, and have banks and notaries strengthen due diligence measures (including with respect to politically-exposed persons and companies linked to the public sector), and intensified repression to counter abuse. Separately, the authorities also need to address any other key effectiveness shortcomings that will be identified in the soon-to-be-published Financial Action Task Force comprehensive AML/CFT assessment.

41. There is significant scope to reduce informality and increase labor market participation. The constitutional reform of the labor dispute resolution system should be fully implemented, with additional means given to courts. A proposal introducing unemployment insurance, still-pending in the Senate, would provide protection to workers and allow for a reduction in severance payments, thereby reducing informality and facilitating mobility within the formal sector. Staff welcomed the increase in female labor force participation, but with the gender gap still close to 35 percent, strong efforts would be needed to reduce it further and to also better target labor training programs. Female labor force participation should be supported by improving child-care services and, above all, better enforcement of anti-discrimination laws.

Box 6. The National Anti-Corruption System (NACS)

The enactment of the NACS constitutes an important step forward. It is a coordinating mechanism that connects existing and new anti-corruption entities, some with new powers. To create NACS, a constitutional amendment (in 2015) and seven laws were passed (in 2016) by the Federal Congress. The creation and enactment of the NACS was made possible by strong civil society involvement, including the drafting of some of the legal proposals by civil society groups. There was also strong support from the general public, which provided the signatures necessary to table and discuss these draft bills in Congress. NACS has the potential to widen the scope of current anti-corruption efforts to also include private sector corruption to have a broader positive effect on efforts against organized crime and improve the rule of law.

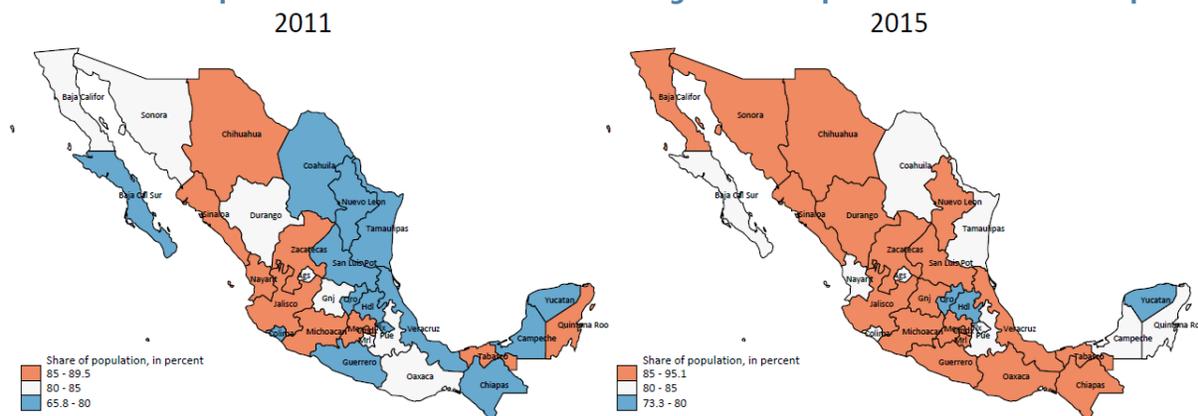
The NACS is led by a Citizen Participation Committee (CPC), consisting of five representatives from civil society. In addition to the CPC, the NACS consists of the Federal Court of Administrative Justice, the Federal Judiciary Council, the Secretariat of the Public Administration, the National Audit Office, the National Institute of Transparency, and the new Anti-Corruption Prosecution Office. Although NACS is a coordination mechanism, the legislative changes include new preventive and repressive measures, and provides new powers to existing and new bodies. Swift implementation of all elements of the NACS is now essential. Priorities include:

- appointment of an operationally independent anti-corruption prosecutor (in line with international conventions and best practices)
- appointments of judges to fill the new anti-corruption chambers at administrative courts
- implementation of new transparency requirements for public officials
- drafting of a national anti-corruption policy
- creation and implementation of the National Digital Platform, to provide access to important data, such as procurement information.
- for every bribe accepted, one must be offered, and it is important that the authorities broaden their focus on public sector corruption to include prevention and repression of private sector corruption.

A unique feature of NACS is the requirement for the 32 States to create State Anti-Corruption Systems (SACS). Some of these have already been created, others are in the process of being established. Although the creation of SACS is generally supported, there are some concerns that not all SACS will be able to operate independently from state legislatures and the state executive branches. As data from INEGI suggest (see below), the perception and experience of corruption have grown especially at the state level. These concerns are compounded by ongoing corruption investigations at the state level: at least 10 state governors have been investigated for corruption, arrested or have fled the country since 2010. The authorities are to be commended for pursuing these corruption cases, even if this negatively impacts the corruption perception in the short term. All of this supports the need to ensure that SACS are effectively implemented.

Box 6. The National Anti-Corruption System (NACS) (concluded)

Share of the Population of a Given State Considering that Corruption in that State is Frequent



Sources: INEGI; and staff calculations.

Incidence of Corruption in the Relations with the Federal, State, and Municipal Governments

Regions	Prevalence of corruption in administrative procedures ¹	Prevalence of corruption in relations with the federal government ^{1,2}	Prevalence of corruption in relations with state governments ^{1,3}	Prevalence of corruption in relations with municipal governments ^{1,4}
Mexico (all states)	12.6	2.7	17.3	12.6
Central states ⁵	13.9	3.7	19.3	11.9
North-Eastern states ⁶	9.5	1.9	13.1	10.8
North-Western states ⁷	15.7	2.3	21.1	18.4
Western states ⁸	11.6	1.9	15.6	12.5
South-Eastern states ⁹	10.2	2.5	14.1	9.6

Note: Geographical regions defined by the National Commission for Public Security.

¹ Computed as the ratio of victims of corruption in administrative procedures to total population aged 18 and above in urban areas and having been in touch with the administration.

² Administrative relations involving the federal government include: electricity payment, tax reports and payments, medical treatments (planned or emergencies), payment of housing or social benefits, passport delivery.

³ Administrative relations involving state administrations include: vehicle registration and tax payment, civil registrar, building permits, judicial procedures, relations with the police and public security authorities, business registration, and public

⁴ Administrative relations involving municipal governments include: drinking water provision, property tax payment, municipal services, building permits, local administrative procedures, relations with the municipal police and public security authorities.

⁵ Includes Mexico City, Guerrero, Hidalgo, Estado de México, Morelos, Puebla, and Tlaxcala.

⁶ Includes Coahuila de Zaragoza, Durango, Nuevo León, San Luis Potosí, and Tamaulipas.

⁷ Includes Baja California, Baja California Sur, Chihuahua, Sinaloa, and Sonora.

⁸ Includes Aguascalientes, Colima, Guanajuato, Jalisco, Michoacán de Ocampo, Nayarit, Querétaro, and Zacatecas.

⁹ Includes Campeche, Chiapas, Oaxaca, Quintana Roo, Tabasco, Veracruz de Ignacio de la Llave, and Yucatán.

Source: INEGI. *Encuesta Nacional de Calidad e Impacto Gubernamental*, 2015.

STAFF APPRAISAL

42. Very strong policies and policy frameworks have served Mexico well. The flexible exchange rate is playing a key role in helping the economy adjust to external shocks. Fiscal consolidation is on track, monetary policy maintains a cautious stance, and financial supervision and regulation are strong. Mexico's external position is broadly in line with macroeconomic fundamentals and desirable policy settings. The ambitious program of structural reforms is starting to bear fruit, although its full impact may take time to materialize.

43. Growth is projected to slow down in the near-term and inflation to gradually return to target. Heightened and prolonged uncertainty about the future economic relationship with the United States, and tighter monetary conditions would weigh on the economy, thus slowing GDP growth to 2.1 and 1.9 percent in 2017 and 2018, respectively. With uncertainty been resolved and continued implementation of structural reforms, growth would gradually converge to 2.7 percent over the medium term. Headline and core inflation would start declining and converge toward the central bank's target by end-2018. The flexible exchange rate and Mexico's strong fundamentals and policy buffers, provide resilience against adverse shocks. The Flexible Credit Line remains an important complement to reserve buffers, providing insurance against tail risks.

44. Mexico continues to face substantial external risks. As the country is particularly vulnerable to changes in its trade regime with the United States, substantial impediments to bilateral trade could have a significant impact on financial markets, investment and growth. Moreover, the risk of renewed global financial market volatility, increased risk premia, and a pull-back of capital from emerging markets remains, and Mexico is exposed to this risk especially due to the high share of non-resident holdings of government paper.

45. The authorities' adherence to their fiscal consolidation plan is commendable and would bring public debt down. This year's expected fiscal outcome would result in a welcome reduction in public debt to about 53 percent of GDP. Keeping the PSBR at 2½ percent of GDP over the medium term would stabilize debt around that level. The authorities share the goal of keeping debt on a downward path. To this end, it would be important to build on their efforts and consider a slightly more ambitious medium-term target that would put the public debt-to-GDP ratio on a downward trajectory. Such a target would help ensure continued market confidence, strengthen Mexico's ability to respond to adverse shocks, and prepare the country to better deal with long-term demographics-related spending pressures.

46. Improving the efficiency of public expenditure and tax revenue collection would help create space for much-needed infrastructure spending. Priority should be given to improving the effectiveness of public administration. Education and health efficiency can also be improved so that a larger share of the population could be served with the same resources. Moreover, social assistance programs could be consolidated and better targeted. On the revenue side, a further strengthening of non-oil tax collections, with emphasis on reducing the large VAT compliance gap, would help build fiscal space. Continued improvements in PEMEX's profitability and efficiency is also essential for the fiscal outlook.

47. Enhancements to the fiscal framework would further strengthen fiscal policy credibility. It would be desirable to have a tighter link between the desired level of public debt and medium-term PSBR targets, and to limit exceptional circumstance clauses only to cases of large output or oil price shocks. One-off profit transfers from the Bank of Mexico to the budget should be entirely used to reduce the PSBR and public debt. Finally, establishing a non-partisan, adequately-resourced fiscal council would improve accountability and strengthen the fiscal policy debate.

48. Conditional on inflation expectations remaining well-anchored, the Bank of Mexico should ease monetary policy as soon as inflation is firmly on a downward path. The pause in the monetary tightening cycle is appropriate. The current monetary stance is tight and inflation is projected to decline rapidly in early-2018. Moreover, fiscal policy is set to remain contractionary, and the output gap is negative, albeit small. Therefore, a reduction in the policy rate as soon as inflation is firmly on a downward trend and as long as inflation expectations remain well-anchored would be appropriate to support the economy.

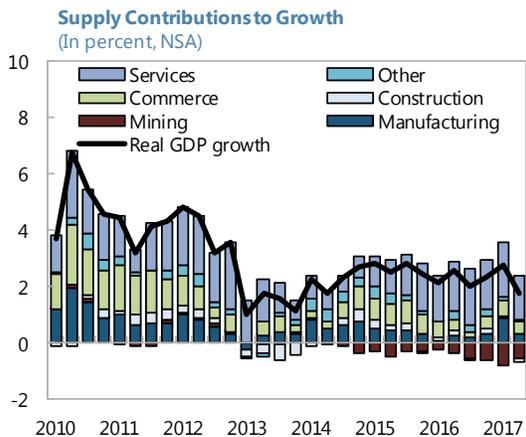
49. The financial sector could withstand various shocks. The banking sector is well capitalized and resilient to market, liquidity, and credit risks thanks to high capital buffers. Non-financial corporates would be able to weather further large shocks to the exchange rate or interest rates. The implementation of the new national strategy for financial inclusion would improve access to financial services for low-income households and small enterprises, but further efforts would be needed to increase financial deepening. Moreover, further reforms of the regulatory framework would help enhance financial sector resilience.

50. Despite significant progress, perseverance will be needed with the implementation of the structural reform agenda. Priority should be given to reforms targeting governance, security, the rule of law, and informality as weaknesses in these areas may impede the reform effort from exerting its full impact on the economy. Implementation of the National Anti-Corruption System is critical to end the corruption trap, improve economic efficiency, and increase productivity by reducing misallocation of resources and rent-seeking behavior. Enhancing the efficiency and quality of law enforcement and judicial institutions would be critical to improve security and strengthen the rule of law. Finally, better enforcement of anti-discrimination laws can help reduce gender imbalances and raise female labor force participation.

51. It is proposed that the next Article IV Consultation with Mexico take place on the standard 12-month cycle.

Figure 1. Mexico: Real Sector

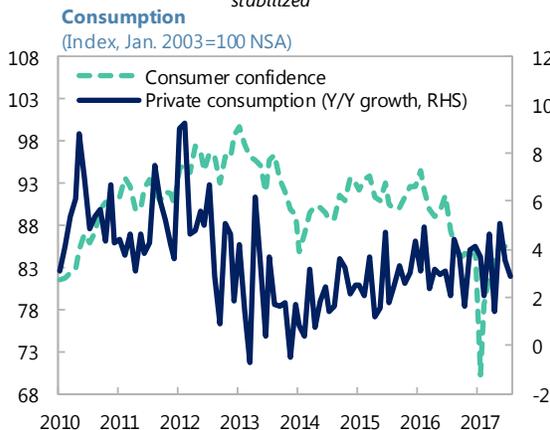
Growth has been supported by strong services and some growth in manufacturing amid falling oil production.



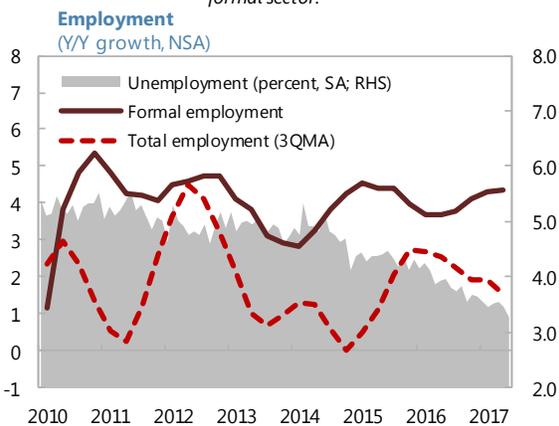
Non-oil exports have recovered, in part due to strengthening U.S. external demand.



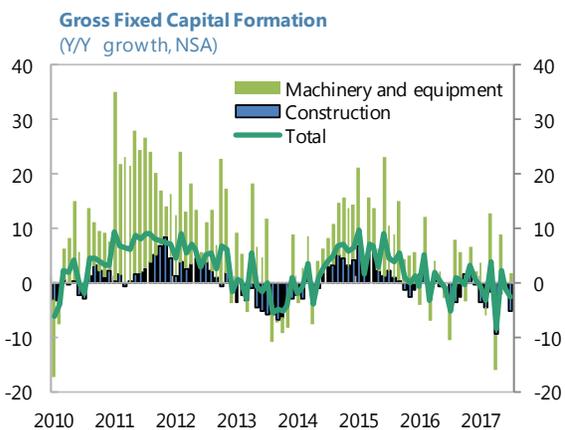
Private consumption has held up as sentiment recently stabilized



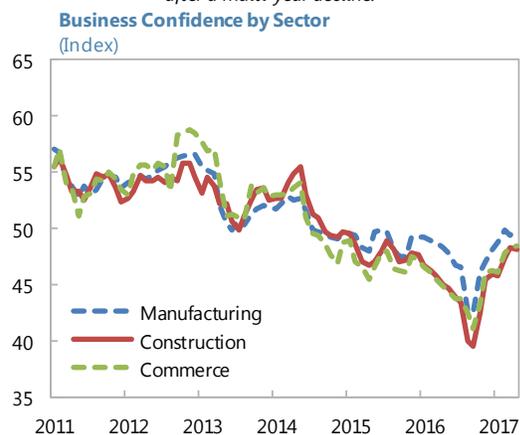
...supported by strong job creation, particularly in the formal sector.



Gross fixed capital formation, however, has remained weak...



... as business confidence has strengthened from low levels after a multi-year decline.

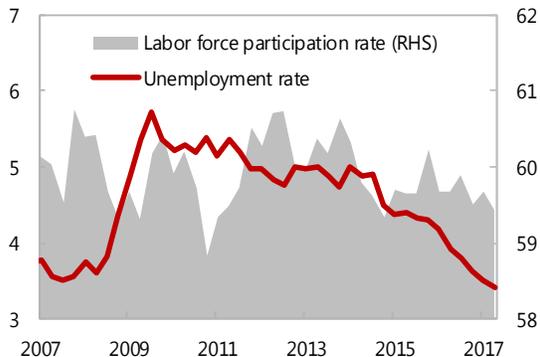


Sources: National authorities, Haver Analytics, and Fund staff estimates.

Figure 2. Mexico: Labor Market Indicators

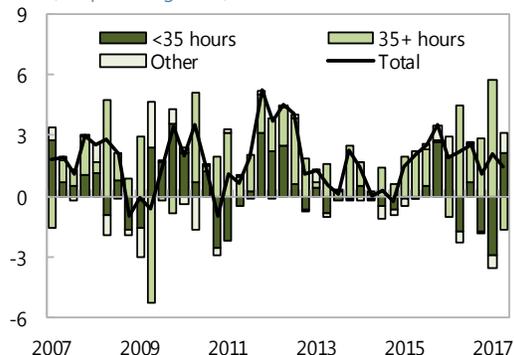
The unemployment rate has continued to decline, falling to the lowest level in a decade.

Unemployment Rate
(In percent, SA)



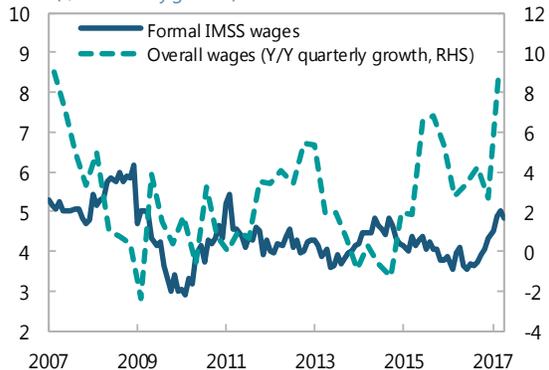
...with robust creation of full-time jobs...

Contributions to Employment Growth
(Y/Y percent growth)



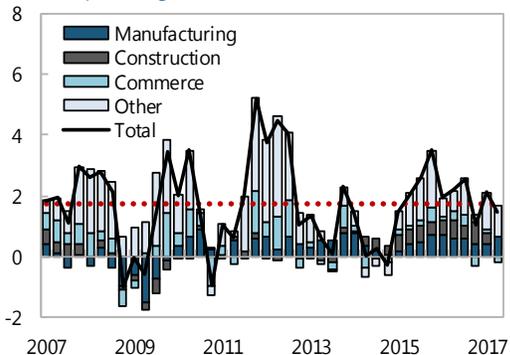
Nominal wage growth is picking up...

Average Nominal Wages
(Y/Y monthly growth)



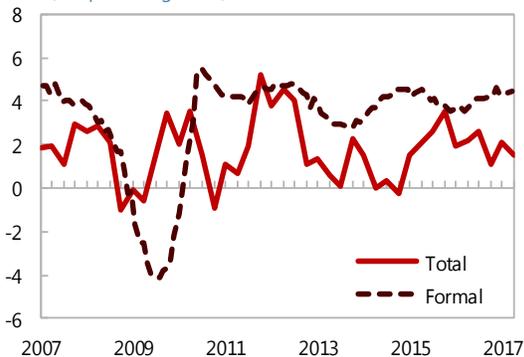
Job creation has slowed but remains close to the historical average.

Contributions to Employment Growth
(Y/Y percent growth)



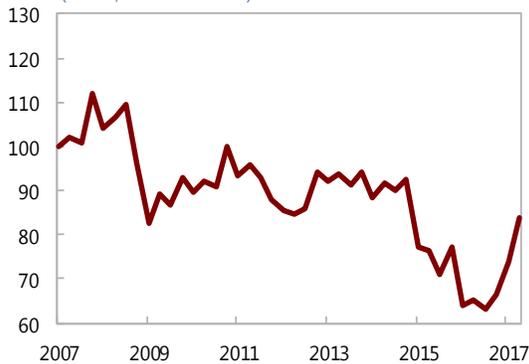
...and of formal employment.

Total and Formal Employment
(Y/Y percent growth)



... and the ULC based REER has begun to recover from low levels.

Unit Labor Cost Real Effective Exchange Rate
(Index, Jan. 2007=100)

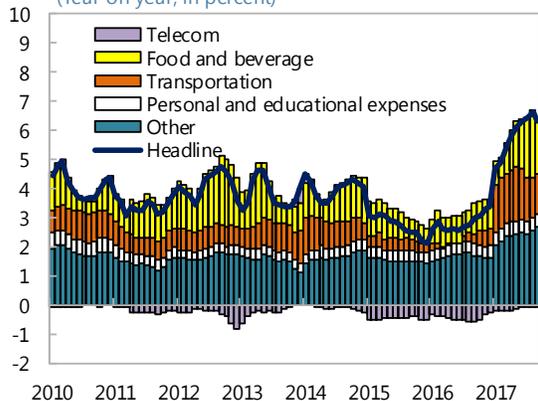


Sources: National authorities, Haver Analytics, and Fund staff estimates.

Figure 3. Mexico: Prices and Inflation

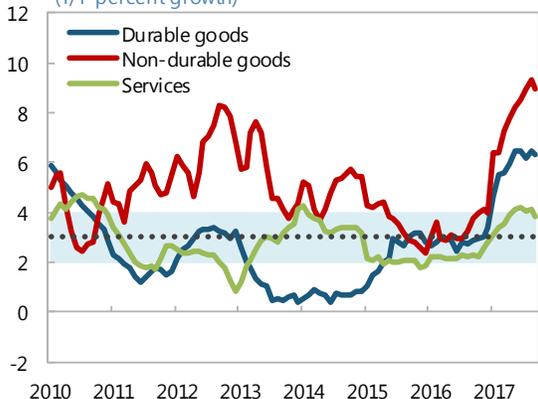
Headline inflation has been increasing largely on account of increases in domestic fuel prices....

Contributions to Headline Inflation
(Year on year, in percent)



Services price inflation is still close to the target.

Inflation
(Y/Y percent growth)



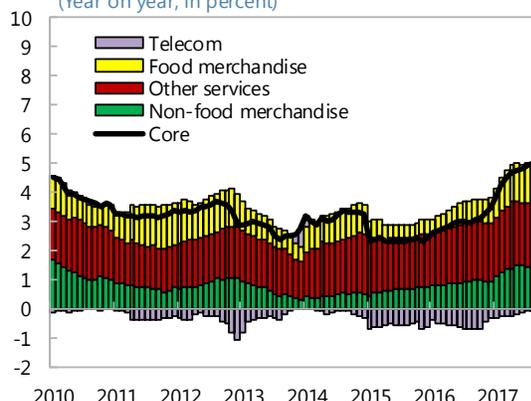
...keeping medium-term inflation expectations anchored close to the target.

Survey-based Inflation Expectations
(In percent)



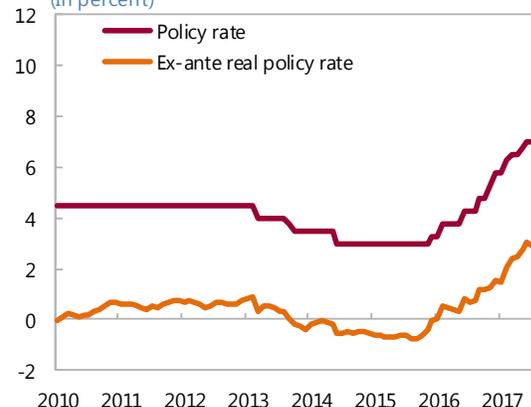
...while core inflation was lifted by falling telecoms price deflation, the pass-through from the currency depreciation as well as modest second-round effects from the fuel price rise.

Contributions to Core Inflation
(Year on year, in percent)



Policy rate hikes have helped contain second-round effects from the depreciation...

Policy Rates
(In percent)



Real wage growth has turned negative.

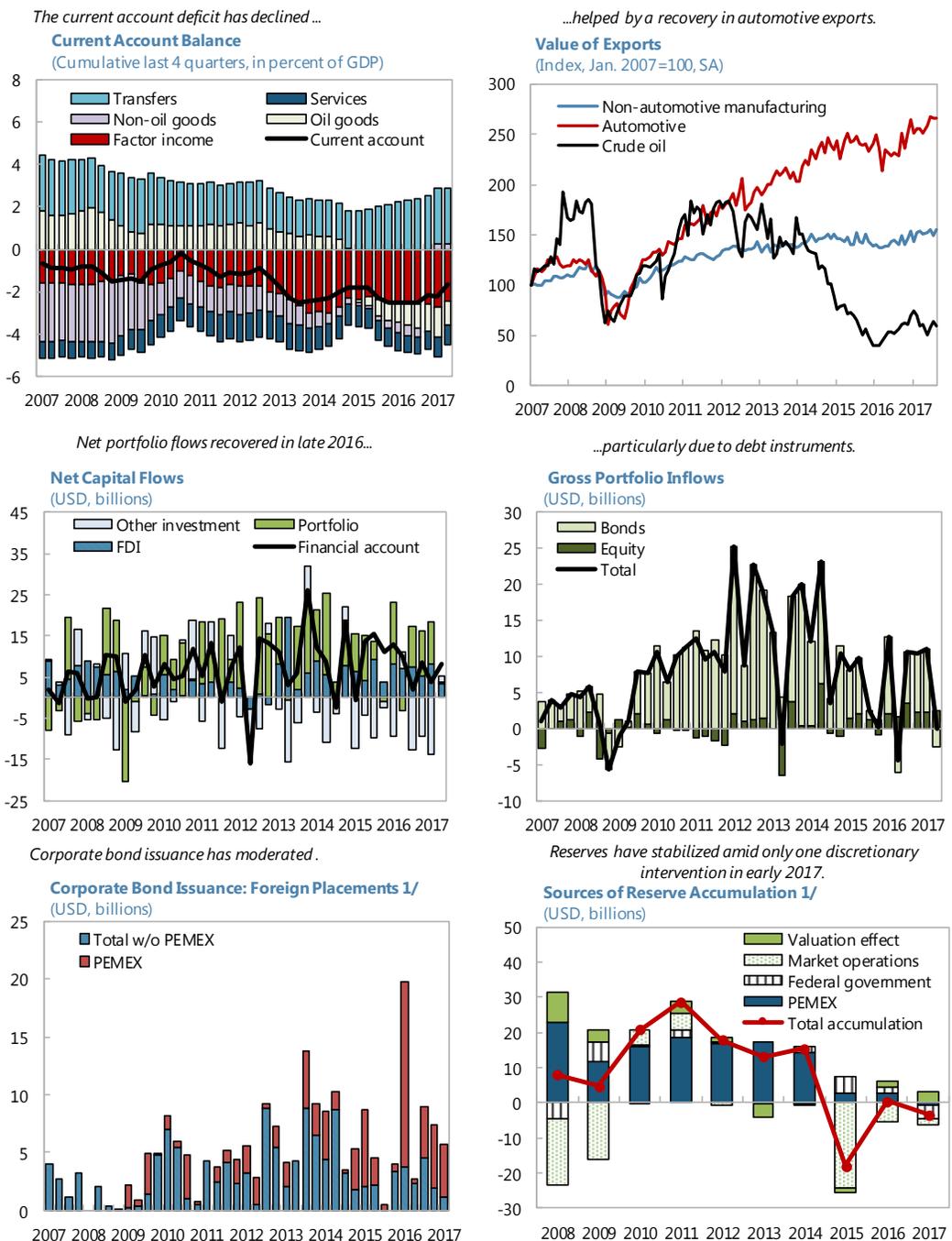
Real Wages and Labor Productivity
(Y/Y percent growth)



Sources: National authorities, and Haver Analytics.

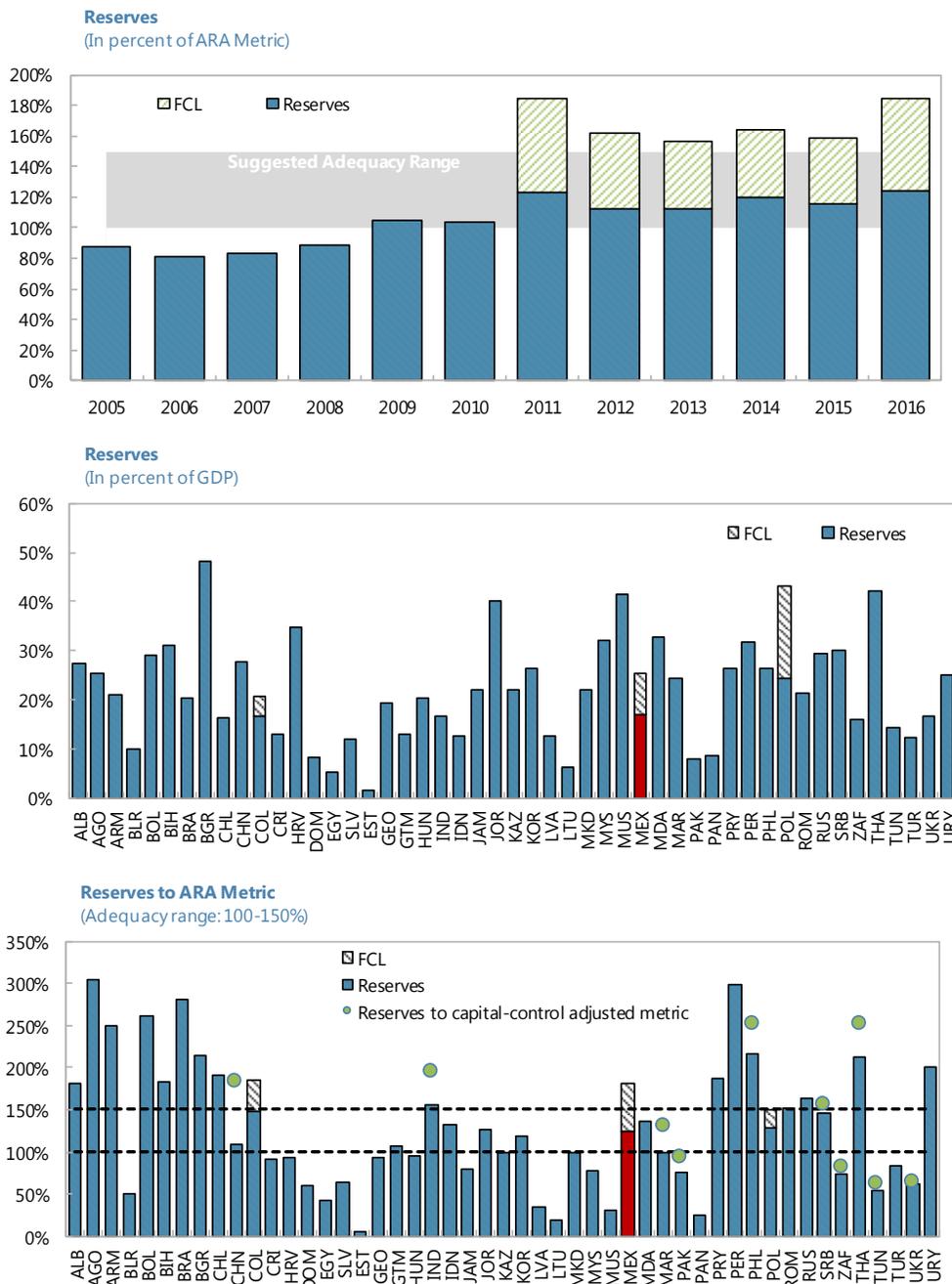
1/ Based on hours worked.

Figure 4. Mexico: External Sector



Sources: National authorities, Haver Analytics, Dealogic, and Fund staff estimates.
1/ Data through March 2017.

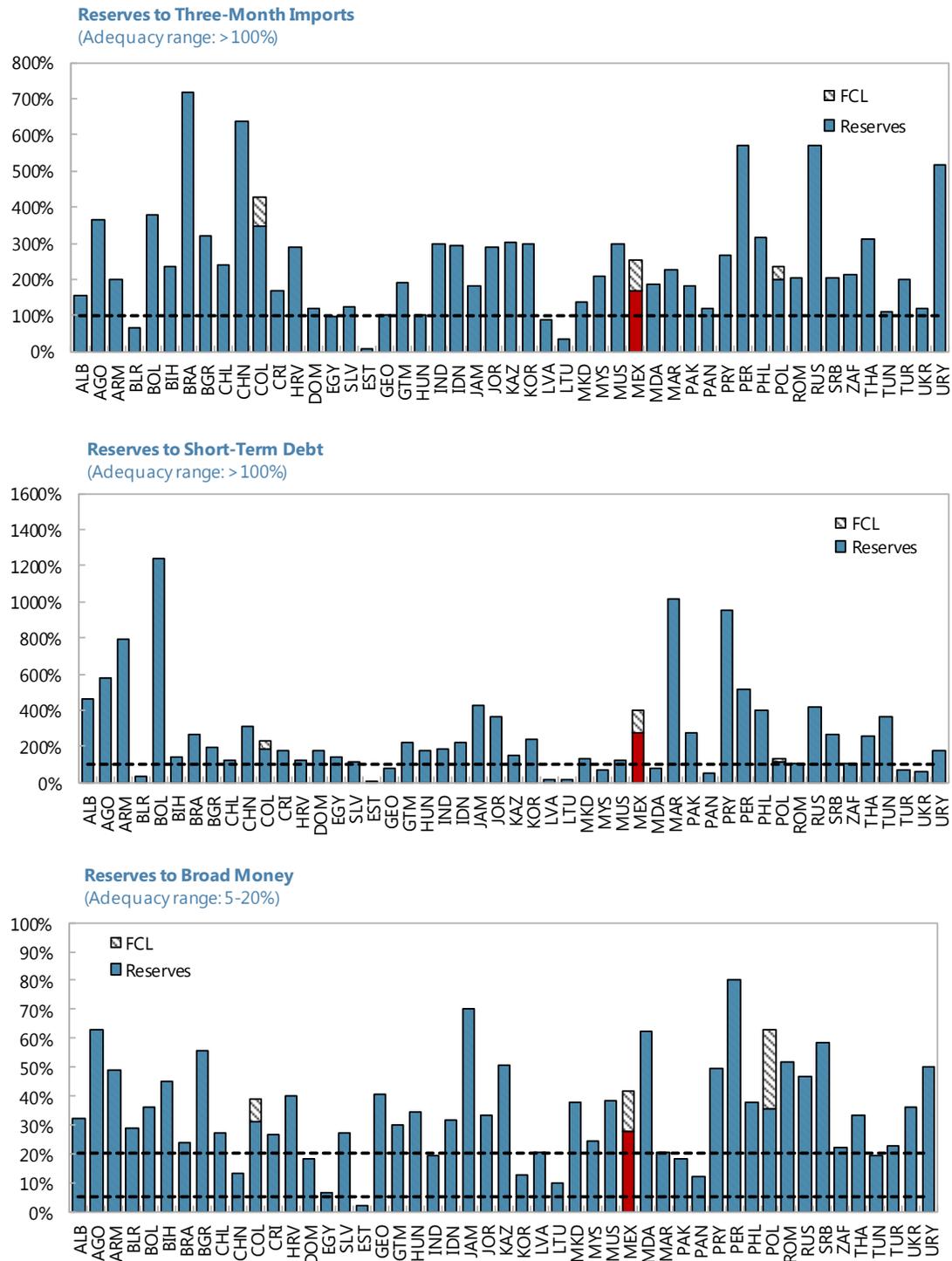
Figure 5. Mexico: Reserve Coverage in an International Perspective, 2016 1/



Sources: World Economic Outlook, Balance of Payments Statistics Database, and IMF staff estimates.

1/ The assessing reserve adequacy (ARA) metric for emerging markets comprises four components reflecting potential balance of payment drains: (i) export income, (ii) broad money, (iii) short-term debt, and (iv) other liabilities. The weight for each component is based on the 10th percentile of observed outflows from emerging markets during exchange market pressure episodes, distinguishing between fixed and flexible exchange rate regimes.

Figure 5. Mexico: Reserve Coverage in an International Perspective, 2016 (Concluded)

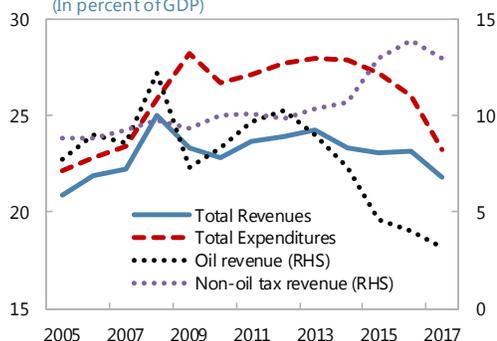


Sources: World Economic Outlook, and IMF staff estimates.

Figure 6. Mexico: Fiscal Sector

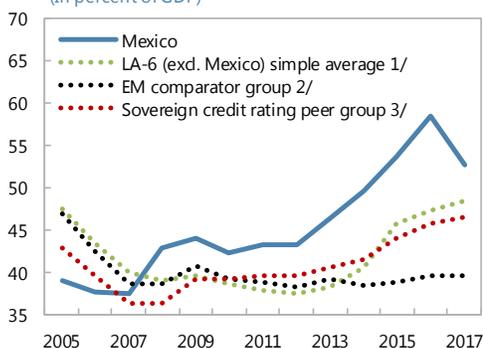
The 2013 tax reform and lower oil prices and production have reduced fiscal dependence on oil...

Public Sector Revenues and Expenditures
(In percent of GDP)



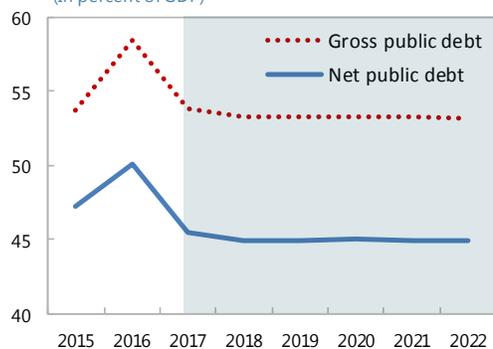
However, public debt has continued to increase, though it is projected to fall in 2017 in part due to currency appreciation.

Gross Public Sector Debt
(In percent of GDP)



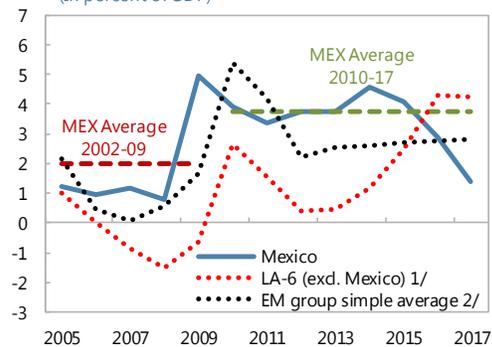
...would stabilize the debt-to-GDP ratio.

Public Sector Debt Path
(In percent of GDP)



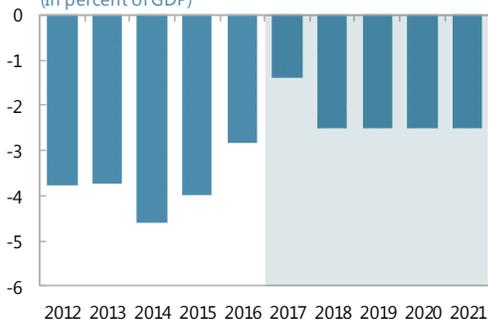
...and narrowed the public sector deficit, together with declining expenditure.

Overall Public Sector Deficit
(In percent of GDP)



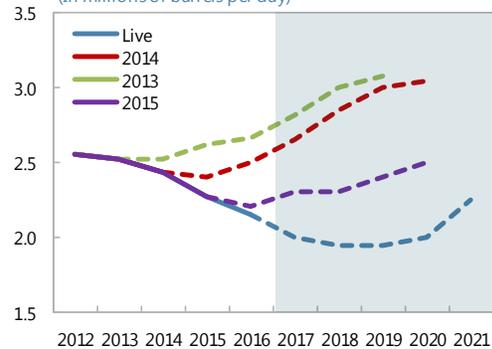
Stabilizing the PSBR at 2.5 percent of GDP...

Fiscal Balance
(In percent of GDP)



Further declines in oil production, however, remain a relevant fiscal risk.

Oil Production Forecasts Vintages
(In millions of barrels per day)



Source: National authorities, World Economic Outlook, Fitch Ratings, and Fund staff estimates.

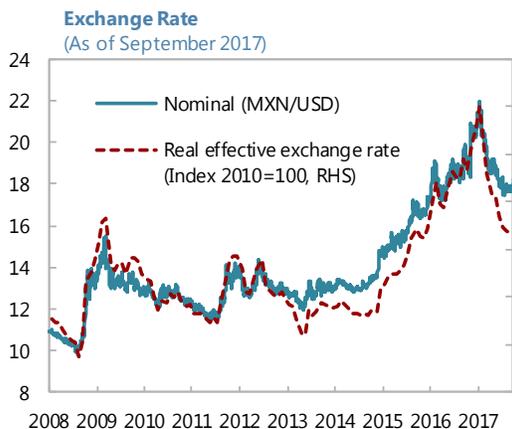
1/ LA-6 excluding Mexico is comprised of Brazil, Chile, Colombia, Peru, and Uruguay.

2/ EM comparator group is comprised of India, Indonesia, Poland, Russia, Thailand, and Turkey.

3/ Fitch sovereign credit rating peer group includes Brazil, Chile, Colombia, India, Poland, Russia, South Africa, Thailand, and Turkey.

Figure 7. Mexico: Financial Sector

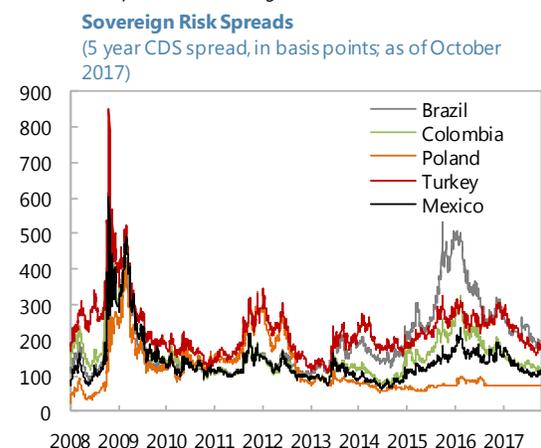
After falling in late 2016/early 2017, the peso appreciated on improved sentiment regarding US related risks.



...with the share of foreign holdings in local-currency sovereign debt falling only modestly amid financial market volatility.

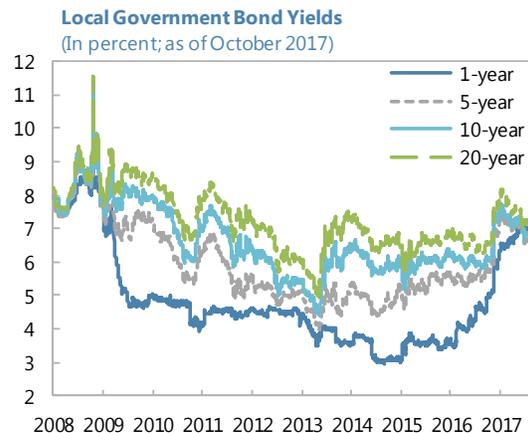


Risk credit spreads on sovereign dollar-denominated debt...

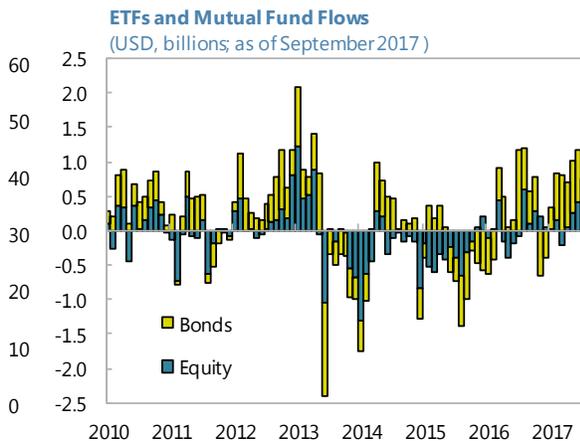


Sources: Bloomberg, National authorities, and Haver Analytics.

Long-term and government bond yields in local currency have also decreased ...



ETF and mutual funds' inflows have recovered since the decline in late 2016.



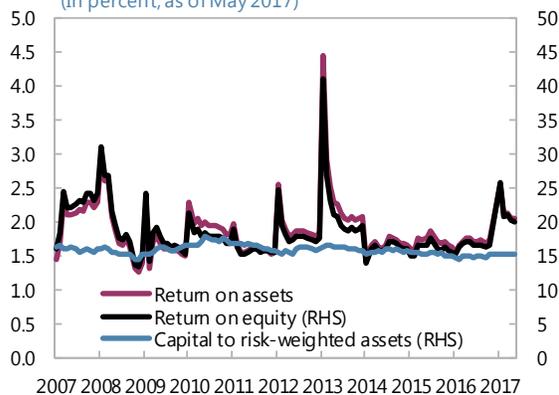
...and on corporate debt have also declined in recent months.



Figure 8. Mexico: Banking System

The banking sector remains profitable...

Commercial and Development Banking Sector
(In percent; as of May 2017)



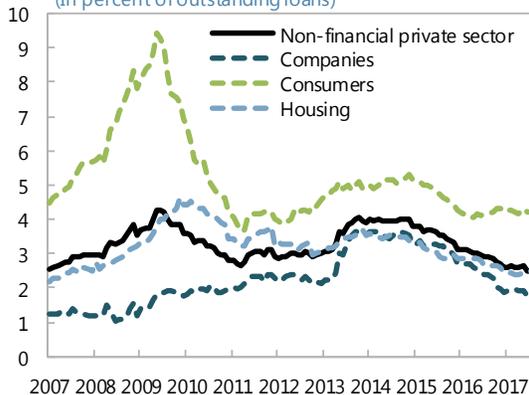
2007 2008 2009 2010 2011 2012 2013 2014 2015 2016 2017
After picking up in late, commercial bank credit growth has moderated...

Commercial Bank Credit Growth by Sector
(Y/Y monthly growth, nominal)



Non-performing loans at commercial banks...

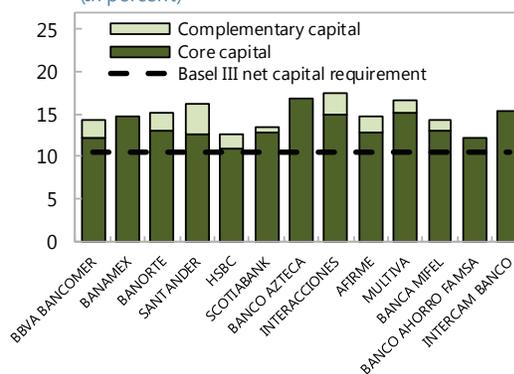
Total Commercial Bank NPLs
(In percent of outstanding loans)



Sources: National authorities, Haver Analytics, Dealogic, Bloomberg, and Fund staff estimates.
1/ As of July 2017.

...and well capitalized.

Capital to Risk-Weighted Assets 1/
(In percent)



...while development bank consumer credit growth remains strong.

Development Bank Credit Growth by Sector
(Y/Y monthly growth, nominal)



...and development banks are low.

Total Development Bank NPLs
(In percent of outstanding loans)

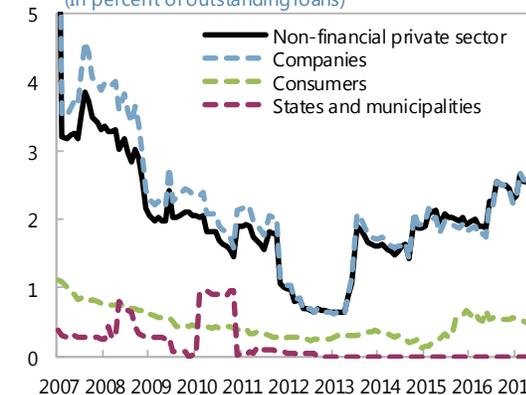
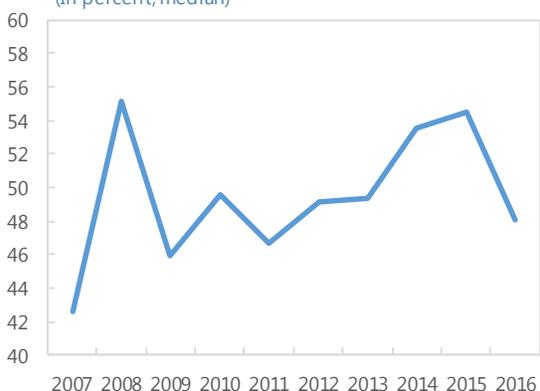


Figure 9. Mexico: Nonfinancial Corporate Sector

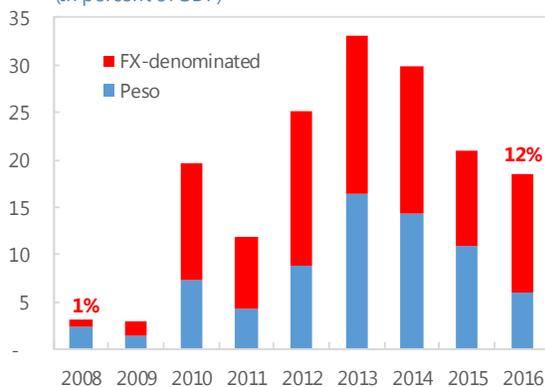
Corporate leverage is declining...

Total Debt to Total Equity
(In percent, median)



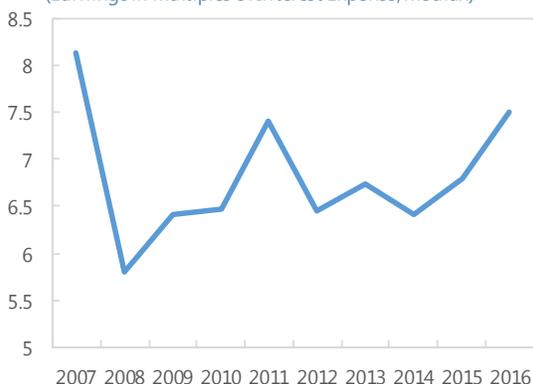
...as bond issuance has moderated.

Nonfinancial Corporate Debt Issuance
(In percent of GDP)



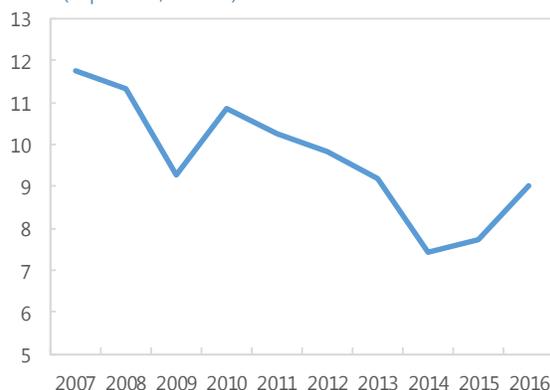
Debt servicing capacity remains strong...

Interest Coverage Ratio
(Earnings in multiples of Interest Expense, median)



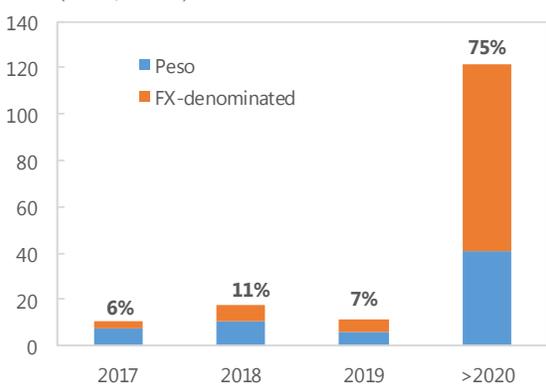
...as profitability has improved.

Return on Equity
(In percent, median)

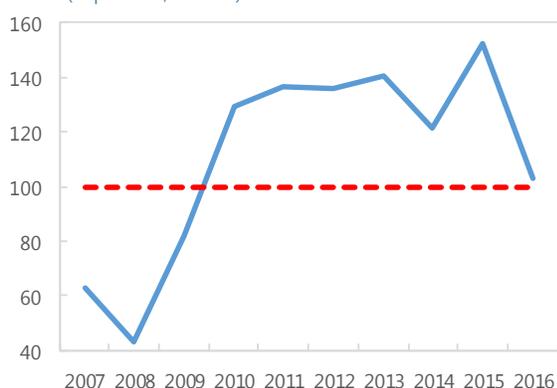


The maturity structure of borrowing has largely been termed out...

Nonfinancial Corporate Bond Maturity Profile
(In US\$ billion)



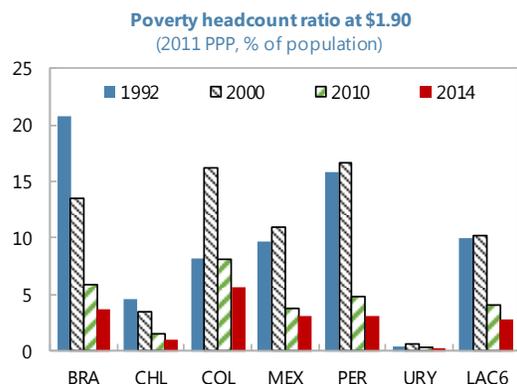
Cash and Cash Equivalent to Short Term Debt
(In percent, median)



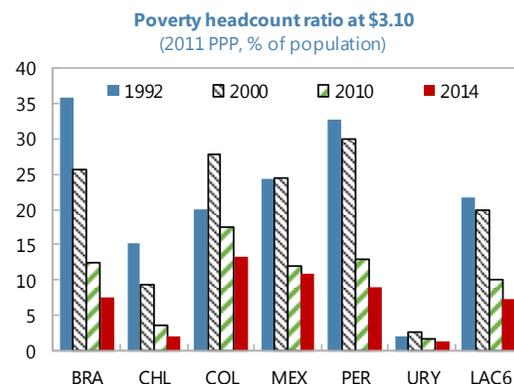
Sources: Bloomberg, External Debt Statistics, Financial Soundness Indicators, and Fund staff estimates.

Figure 10. Mexico: Social Development Indicators

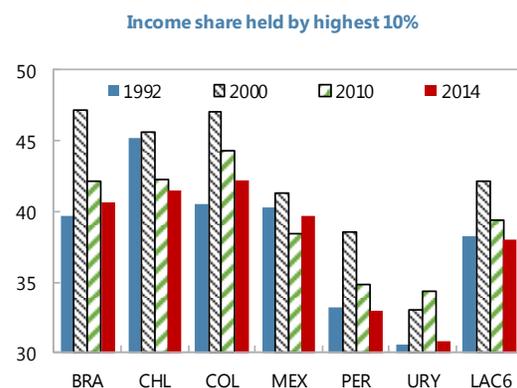
Extreme poverty has declined over the past 25 years.



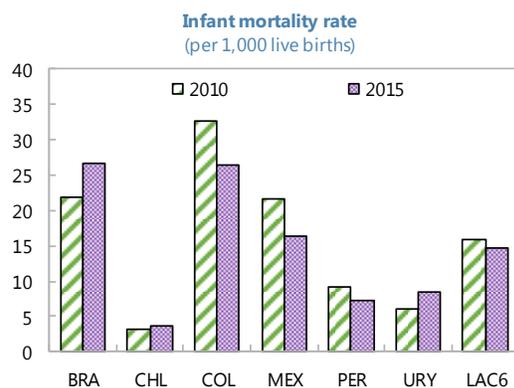
Still, poverty in Mexico remains higher than the LAC6 average.



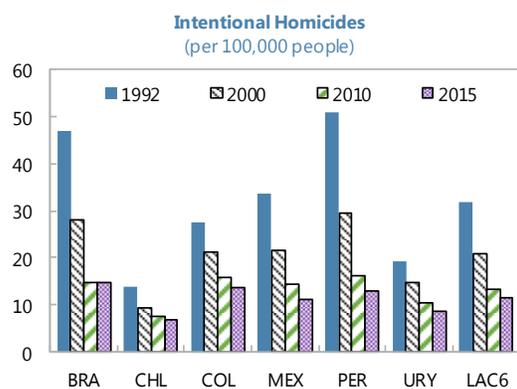
Income inequality is also higher than the regional average.



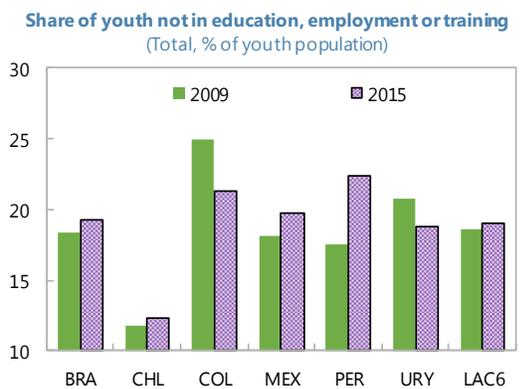
High poverty and inequality go along with higher than average infant mortality rates.



The homicide rate remains high but close to the regional average.



A large share of youth is excluded from education or employment.



Source: World Development Indicators.

Table 1. Mexico: Selected Economic, Financial, and Social Indicators

I. Social and Demographic Indicators						
GDP per capita (U.S. dollars, 2016)	8,562	Poverty headcount ratio (% of population, 2016) 1/	43.6			
Population (millions, 2016)	122.3	Income share of highest 20 percent / lowest 20 percent (2014)	10.8			
Life expectancy at birth (years, 2015)	76.9	Adult illiteracy rate (2015)	5.5			
Infant mortality rate (per thousand, 2015)	11.3	Gross primary education enrollment rate (2014) 2/	103.4			
II. Economic Indicators						
	2013	2014	2015	2016	Projections	
					2017	2018
(Annual percentage change, unless otherwise indicated)						
National accounts (in real terms)						
GDP	1.4	2.3	2.6	2.3	2.1	1.9
Consumption	2.0	1.9	2.3	2.5	2.1	1.9
Private	2.1	1.8	2.3	2.7	2.3	1.9
Public	1.0	2.1	2.3	1.2	0.3	2.0
Investment	-2.0	3.3	3.1	-0.3	-1.6	1.0
Fixed	-1.6	3.0	4.3	0.1	-1.5	1.0
Private	-1.6	5.0	8.0	1.9	0.3	2.2
Public	-1.3	-5.0	-11.8	-9.0	-12.2	-6.8
Inventories 3/	-0.1	0.1	-0.2	-0.1	0.0	0.0
Exports of goods and services	2.4	7.0	10.4	1.2	6.1	3.1
Imports of goods and services	2.6	6.0	8.6	1.1	5.6	2.8
GDP per capita	0.2	1.1	1.6	1.2	1.0	0.9
External sector						
External current account balance (in percent of GDP)	-2.5	-1.8	-2.5	-2.2	-1.8	-2.4
Exports of goods, f.o.b.	2.5	4.4	-4.2	-1.8	8.7	2.8
Export volume	1.7	7.1	9.6	0.1	6.9	6.2
Imports of goods, f.o.b.	2.8	4.9	-1.2	-2.1	7.9	5.8
Import volume	2.5	6.2	9.1	1.3	2.5	4.4
Net capital inflows (in percent of GDP)	-5.1	-4.1	-2.1	-3.2	-1.8	-2.7
Terms of trade (improvement +)	0.4	-1.3	-3.4	1.5	0.5	-3.0
Exchange rates						
Real effective exchange rate (CPI based, IFS) (average, appreciation +)	6.1	-1.0	-10.1	-13.3	-0.3	...
Nominal exchange rate (MXN/USD) (average, appreciation +)	-0.5	-12.6	-16.9	-20.5	9.7	-0.7
Employment and inflation						
Consumer prices (end-of-period)	4.0	4.1	2.1	3.4	6.1	3.0
Core consumer prices (end-of-period)	2.8	3.2	2.4	3.4	4.6	3.1
Formal sector employment, IMSS-insured workers (average)	3.5	3.5	4.3	3.8	4.4	...
National unemployment rate (annual average)	4.9	4.8	4.4	3.9	3.6	3.6
Unit labor costs: manufacturing (real terms, average)	1.0	-1.2	1.5	3.6	0.7	...
Money and credit						
Financial system credit to non-financial private sector 4/	9.2	8.7	14.6	16.5	10.8	10.2
Broad money (M2a) 5/	8.3	10.2	7.9	10.6	12.3	10.4
Public sector finances (in percent of GDP) 6/						
General government revenue	24.2	23.3	23.1	23.2	22.6	20.7
General government expenditure	28.0	27.9	27.2	26.0	24.0	23.2
Overall fiscal balance	-3.7	-4.6	-4.1	-2.8	-1.4	-2.5
Gross public sector debt	46.4	49.5	53.7	58.4	53.8	53.3
Memorandum items						
Nominal GDP (billions of pesos)	16,118	17,260	18,261	19,540	21,363	22,947
Output gap	-0.3	-0.4	-0.2	-0.2	-0.3	-0.5

Sources: World Bank Development Indicators, CONEVAL, National Institute of Statistics and Geography, National Council of Population, Bank of Mexico, Secretariat of Finance and Public Credit, and Fund staff estimates.

1/ CONEVAL uses a multi-dimensional approach to measuring poverty based on a "social deprivation index," which takes into account the level of income; education; access to health services; to social security; to food; and quality, size, and access to basic services in the dwelling.

2/ Percent of population enrolled in primary school regardless of age as a share of the population of official primary education age.

3/ Contribution to growth. Excludes statistical discrepancy.

4/ Includes domestic credit by banks, nonbank intermediaries, and social housing funds.

5/ Includes public sector deposits.

6/ Data exclude state and local governments and include state-owned enterprises and public development banks.

Table 2. Mexico: Statement of Operations of the Public Sector, Authorities' Presentation 1/
(In percent of GDP)

	2013	2014	2015	2016	Projections					
					2017	2018	2019	2020	2021	2022
Budgetary revenue, by type	23.6	23.1	23.4	24.8	22.6	20.7	20.5	20.5	20.7	20.7
Oil revenue	8.3	7.1	4.6	4.0	3.9	3.6	3.3	3.3	3.5	3.4
Non-oil tax revenue	9.7	10.5	12.9	13.9	13.0	13.0	13.1	13.1	13.1	13.1
Non-oil non-tax revenue 2/	5.5	5.5	5.8	6.9	5.8	4.1	4.1	4.1	4.1	4.1
Budgetary revenue, by entity	23.6	23.1	23.4	24.8	22.6	20.7	20.5	20.5	20.7	20.7
Federal government revenue	16.8	16.7	17.4	18.3	17.3	15.5	15.3	15.3	15.5	15.4
Tax revenue, of which:	9.7	10.5	12.9	13.9	13.0	13.0	13.1	13.1	13.1	13.1
Excises (including fuel)	0.0	0.6	1.9	2.1	1.7	1.8	1.9	1.9	1.9	2.0
Nontax revenue	7.1	6.3	4.5	4.4	4.4	2.5	2.2	2.2	2.3	2.3
Public enterprises	6.8	6.3	6.0	6.5	5.3	5.2	5.2	5.2	5.3	5.3
PEMEX	3.0	2.6	2.4	2.5	1.9	1.8	1.8	1.8	1.8	1.8
Other	3.8	3.8	3.6	4.1	3.4	3.4	3.4	3.4	3.4	3.4
Budgetary expenditure	25.9	26.2	26.8	27.4	23.9	22.7	22.5	22.5	22.7	22.7
Primary	24.0	24.2	24.6	24.9	21.2	19.9	19.9	19.9	19.9	19.9
Programmable	20.6	20.7	21.0	21.3	17.5	16.2	16.2	16.2	16.2	16.2
Current	15.1	15.5	15.8	15.2	14.2	13.6	13.6	13.6	13.6	13.6
Wages	6.0	5.9	5.9	5.7	5.4	5.4	5.4	5.4	5.4	5.4
Pensions 3/	2.9	3.0	3.2	3.3	3.4	3.5	3.5	3.5	3.5	3.5
Subsidies and transfers	3.3	3.6	3.7	3.5	2.8	2.6	2.6	2.6	2.6	2.6
Other	3.0	3.0	3.0	2.7	2.6	2.2	2.2	2.2	2.2	2.2
Capital	5.4	5.2	5.1	6.0	3.3	2.6	2.6	2.6	2.6	2.6
Physical capital	4.6	4.8	4.2	3.7	2.9	2.5	2.5	2.5	2.5	2.5
Financial capital 4/	0.9	0.4	0.9	2.3	0.5	0.1	0.1	0.1	0.1	0.1
Nonprogrammable	3.4	3.5	3.6	3.7	3.7	3.7	3.7	3.7	3.7	3.7
Of which: revenue sharing	3.3	3.4	3.4	3.6	3.6	3.5	3.5	3.6	3.6	3.6
Interest payments	2.0	2.0	2.2	2.4	2.7	2.9	3.0	3.0	3.0	3.1
Traditional balance	-2.3	-3.1	-3.5	-2.6	-1.2	-2.0	-2.0	-2.0	-2.0	-2.0
Adjustments to the traditional balance	-1.4	-1.4	-0.6	-0.3	-0.2	-0.5	-0.5	-0.5	-0.5	-0.5
Public Sector Borrowing Requirements	3.7	4.6	4.1	2.8	1.4	2.5	2.5	2.5	2.5	2.5
Memorandum items										
Structural current spending 5/	11.6	12.1	12.2	11.4						
Structural current spending real growth (y/y, in percent)	3.3	6.7	3.0	-4.3						

Sources: Mexican authorities and IMF staff estimates.

1/ Data exclude state and local governments, and include state-owned enterprises and public development banks.

2/ Includes revenues from the oil-price hedge for 0.6 percent of GDP in 2015 and 0.3 percent of GDP in 2016; and Bank of Mexico's operating surplus transferred to the federal government for 0.2 percent of GDP in 2015, 1.2 percent of GDP in 2016, and 1.5 percent of GDP in 2017.

3/ Includes social assistance benefits.

4/ Due to lack of disaggregated data this item includes both financing and capital transfers.

5/ The 2014 amendment to the FRL introduced a cap on the real growth rate of structural current spending set at 2.0 percent for 2015 and 2016, and equal to potential growth thereafter. Structural current spending is defined as total budgetary expenditure, excluding: (i) interest payments; (ii) non-programmable spending; (iii) cost of fuels for electricity generation; (iv) public sector pensions; (v) direct physical and financial investment of the federal government; and (vi) expenditure by state productive enterprises and their subsidiaries.

Table 3. Mexico: Statement of Operations of the Public Sector, GFSM 2001 Presentation 1/
(In percent of GDP)

	2013	2014	2015	2016	Projections					
					2017	2018	2019	2020	2021	2022
Revenue	24.2	23.3	23.1	23.2	22.6	20.7	20.5	20.5	20.7	20.7
Taxes	10.3	10.7	12.9	13.9	13.0	13.0	13.1	13.1	13.1	13.1
Taxes on income, profits and capital gains	5.9	5.6	6.7	7.3	6.8	6.8	6.8	6.8	6.8	6.8
Taxes on goods and services	4.1	4.7	5.8	6.2	5.7	5.8	5.9	5.9	5.9	5.9
Value added tax	3.5	3.9	3.9	4.1	4.0	4.0	4.0	4.0	4.0	4.0
Excises	0.6	0.9	1.9	2.1	1.7	1.8	1.9	1.9	1.9	2.0
Taxes on international trade and transactions	0.2	0.2	0.2	0.3	0.2	0.2	0.2	0.2	0.2	0.2
Other taxes	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social contributions	1.7	1.7	1.7	1.7	1.5	1.5	1.5	1.5	1.5	1.5
Other revenue	12.2	10.9	8.4	7.6	8.1	6.2	5.8	5.9	6.1	6.0
Property income 2/	7.0	6.2	4.4	4.3	4.3	2.5	2.2	2.2	2.3	2.3
Other	5.1	4.6	4.0	3.2	3.8	3.6	3.6	3.7	3.7	3.7
Total expenditure	28.0	27.9	27.2	26.0	24.0	23.2	23.0	23.0	23.2	23.2
Expense	22.5	22.7	22.3	21.9	21.0	20.6	20.3	20.4	20.6	20.6
Compensation of employees	6.0	5.9	5.9	5.7	5.4	5.4	5.4	5.4	5.4	5.4
Purchases of goods and services	3.0	3.0	3.0	2.7	2.6	2.2	2.2	2.2	2.2	2.2
Interest 3/	3.0	3.0	3.0	3.4	3.3	3.1	3.2	3.3	3.5	3.6
Subsidies	4.0	3.8	3.7	3.5	2.8	2.6	2.6	2.6	2.6	2.6
o/w fuel subsidy	0.7	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants 4/	3.3	3.4	3.4	3.6	3.6	3.5	3.5	3.6	3.6	3.6
Social benefits 5/	2.9	3.0	3.2	3.3	3.4	3.5	3.5	3.5	3.5	3.5
Other expense 6/	0.4	0.5	0.0	-0.3	0.0	0.3	-0.1	-0.1	-0.1	-0.3
Net acquisition of nonfinancial assets 7/	5.4	5.2	4.9	4.2	3.0	2.6	2.7	2.7	2.7	2.7
Gross Operating Balance	1.7	0.6	0.8	1.3	1.6	0.1	0.2	0.2	0.2	0.2
Overall Fiscal Balance (Net lending/borrowing)	-3.7	-4.6	-4.1	-2.8	-1.4	-2.5	-2.5	-2.5	-2.5	-2.5
Primary net lending/borrowing	-0.7	-1.6	-1.1	0.5	1.9	0.6	0.7	0.8	1.0	1.1
Memo items:										
Primary expenditure	24.9	24.8	24.2	22.7	20.8	20.1	19.8	19.7	19.8	19.7
Current expenditure	22.5	22.7	22.3	21.9	21.0	20.6	20.3	20.4	20.6	20.6
Structural fiscal balance	-4.3	-4.8	-4.5	-4.1	-2.8	-2.4	-2.4	-2.5	-2.5	-2.5
Structural primary balance 8/	-1.3	-1.8	-1.5	-0.7	0.5	0.7	0.8	0.8	0.9	1.1
Fiscal impulse 9/	-0.2	0.5	-0.2	-0.8	-1.2	-0.3	0.0	-0.1	-0.1	-0.1
Gross public sector debt 10/	46.4	49.5	53.7	58.4	53.8	53.3	53.3	53.3	53.2	53.2
In domestic currency (percentage of total debt)	75.8	74.0	70.9	66.3	67.3	66.6	66.2	66.2	65.9	66.0
In foreign currency (percentage of total debt)	24.2	26.0	29.1	33.7	32.7	33.4	33.8	33.8	34.1	34.0
Net public sector debt 11/	40.4	43.1	47.3	50.1	45.5	45.0	45.0	45.0	44.9	44.9

Sources: Mexico authorities; and Fund staff estimates and projections.

1/ Data exclude state and local governments, and include state-owned enterprises and public development banks.

2/ Includes revenues from the oil-price hedge for 0.6 percent of GDP in 2015 and 0.3 percent of GDP in 2016, treated as revenues from an insurance claim. It includes also Bank of Mexico's operating surplus transferred to the federal government for 0.2 percent of GDP in 2015, 1.2 percent of GDP in 2016, and 1.5 percent of GDP in 2017.

3/ Interest payments differ from official data due to adjustments to account for changes in valuation and interest rates.

4/ Includes transfers to state and local governments under revenue-sharing agreements with the federal government.

5/ Includes pensions and social assistance benefits.

6/ Includes Adefas and other expenses, as well as the adjustments to the "traditional" balance not classified elsewhere.

7/ This category differs from official data on physical capital spending due to adjustments to account for Pidieregas amortizations included in budget figures.

8/ Adjusting revenues for the economic and oil-price cycles and excluding one-off items (e.g. oil hedge income and Bank of Mexico transfers).

9/ Negative of the change in the structural primary fiscal balance.

10/ Corresponds to the gross stock of PSBR, calculated as the net stock of PSBR as published by the authorities plus public sector financial assets.

11/ Corresponds to the net stock of public sector borrowing requirements (i.e., net of public sector financial assets) as published by the authorities.

Table 4. Mexico: Public Sector Financial Balance Sheet

(In billions of pesos)

	2013			2014			2015			2016			2017
	Opening balance	Trans.	Other flows 1/	Opening balance	Trans.	Other flows 1/	Opening balance	Trans.	Other flows 1/	Opening balance	Trans.	Other flows 1/	Opening balance
Net worth													
Nonfinancial assets													
Net financial assets	-5890.8	-603.4	-13.4	-6504.3	-792.9	-148.7	-7446.1	-742.0	-445.1	-8633.5	-556.6	-607.3	-9797.4
Financial assets	855.4	133.6	-22.3	966.7	56.1	72.7	1095.5	214.4	-141.4	1168.2	397.1	55.4	1620.6
Liabilities	6746.3	737.0	-9.0	7471.0	848.9	221.4	8541.5	956.4	303.7	9801.6	953.7	662.7	11418.0
Memorandum items													
Net financial worth (in % GDP)	-37.70			-40.35			-43.14			-47.28			-50.14
Financial assets (in % GDP)	5.47			6.00			6.35			6.40			8.29
Liabilities (in % GDP)	43.17			46.35			49.49			53.67			58.43
GDP nominal prices (previous year)	15,627			16,118			17,260			18,261			19,540

Sources: Mexico authorities; and Fund staff estimates and projections.

1/ Includes exchange rate and various accounting adjustments.

Table 5. Mexico: Summary Balance of Payments 1/
(In billions of U.S. dollars, unless otherwise indicated)

	2013	2014	2015	2016	Projections					
					2017	2018	2019	2020	2021	2022
Current account	-31.1	-23.1	-28.8	-23.0	-20.5	-28.7	-32.5	-33.4	-33.6	-32.3
Merchandise goods trade balance	-0.9	-2.8	-14.6	-13.1	-11.2	-23.7	-21.9	-21.0	-22.1	-22.0
Exports	380.7	397.6	381.0	374.3	406.9	418.4	441.5	472.9	505.4	534.5
o/w Manufactures	314.6	337.3	340.0	336.1	363.9	375.4	396.8	424.7	452.5	477.1
o/w Petroleum and derivatives 2/	49.5	42.4	23.1	18.8	20.3	20.1	21.2	23.0	26.6	29.4
Imports	381.6	400.4	395.6	387.4	418.0	442.1	463.4	493.9	527.4	556.5
o/w Petroleum and derivatives 2/	40.9	41.5	33.3	31.6	34.8	32.9	33.5	34.4	35.6	36.4
Services, net	-14.1	-13.3	-9.8	-9.0	-8.7	-9.2	-9.9	-10.6	-11.3	-11.9
Primary income, net	-37.6	-29.8	-28.6	-27.5	-30.3	-29.1	-37.5	-42.2	-44.5	-46.7
Secondary income (mostly remittances), net	21.5	22.8	24.1	26.5	29.7	33.3	36.9	40.5	44.2	48.3
Capital Account, net	2.3	0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Financial Account (Net lending +)/Net borrowing (-)	-46.0	-37.3	-40.1	-33.5	-20.5	-28.9	-32.6	-33.4	-33.6	-32.4
Foreign direct investment, net	-35.5	-21.6	-23.9	-28.4	-21.5	-25.2	-28.7	-32.6	-35.3	-38.2
Net acquisition of financial assets	11.6	8.5	12.3	5.5	6.5	6.8	7.1	7.3	7.6	7.9
Net incurrence of liabilities	47.1	30.1	36.2	33.9	28.0	32.0	35.8	40.0	42.9	46.1
Portfolio investment, net	-42.9	-46.8	-23.6	-32.1	-9.5	-20.1	-20.3	-19.4	-17.4	-18.2
Net acquisition of financial assets	6.7	2.5	-3.1	-2.5	2.2	1.6	1.0	0.5	0.5	0.5
Net incurrence of liabilities	49.6	49.3	20.5	29.6	11.7	21.7	21.3	19.9	17.9	18.7
Public Sector	33.2	36.0	16.9	21.4	8.4	18.2	16.1	14.7	12.7	13.5
o/w Securities issued abroad	11.2	13.0	15.7	22.9	4.9	9.2	7.6	7.5	6.5	7.0
o/w Local currency domestic-issued bonds	22.0	23.1	1.3	-1.5	3.5	9.0	8.5	7.2	6.2	6.5
Private sector	16.4	13.3	3.6	8.2	3.3	3.5	5.2	5.2	0.0	0.0
Securities issued abroad	18.9	8.4	0.0	-1.3	1.3	1.5	3.7	3.7	3.7	3.7
Equity	-2.4	4.8	3.6	9.5	0.0	0.0	0.0	0.0	0.0	0.0
Pidiregas	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Financial derivatives, net	0.5	0.8	-4.8	-0.4	0.0	0.0	0.0	0.0	0.0	0.0
Other investments, net	14.2	13.9	27.9	27.6	10.8	12.3	9.8	12.0	11.7	14.5
Net acquisition of financial assets	18.7	15.7	26.5	25.9	13.3	15.5	12.8	15.0	14.7	16.5
Net incurrence of liabilities	4.6	1.7	-1.4	-1.7	2.5	3.2	3.0	3.0	3.0	2.0
Public sector	-2.6	2.9	0.1	-2.7	1.0	0.5	0.0	0.0	0.0	0.0
Non-banking sector	-3.0	2.3	1.0	-2.4	1.0	0.5	0.0	0.0	0.0	0.0
Banco de Mexico	0.0	-0.3	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Development banks	0.4	0.9	-0.7	-0.2	0.0	0.0	0.0	0.0	0.0	0.0
Private sector	7.1	-1.1	-1.5	1.0	1.5	2.7	3.0	3.0	3.0	3.0
Commercial banks	5.2	-4.9	-2.2	0.0	1.0	1.0	1.0	1.0	1.0	1.0
Non-banking sector	1.9	3.8	0.7	1.0	0.5	1.7	2.0	2.0	2.0	2.0
Pidiregas	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Change in Reserves Assets	17.8	16.3	-15.7	-0.1	-0.3	4.1	6.6	6.6	7.4	9.6
Total change in gross reserves assets	13.2	15.5	-18.1	0.4	-0.3	4.1	6.6	6.6	7.4	9.6
Valuation change	4.6	0.8	2.4	-0.6	0.0	0.0	0.0	0.0	0.0	0.0
Errors and Omissions	-17.3	-14.2	-11.1	-10.4	0.0	0.0	0.0	0.0	0.0	0.0
					(In percent of GDP)					
Current account balance	-2.5	-1.8	-2.5	-2.2	-1.8	-2.4	-2.5	-2.5	-2.3	-2.1
o/w Hydrocarbons trade balance 1/	0.7	0.1	-0.9	-1.2	-1.3	-1.0	-0.9	-0.8	-0.6	-0.5
o/w Petroleum and derivatives exports	3.9	3.3	2.0	1.8	1.8	1.6	1.6	1.7	1.8	1.9
o/w Non-hydrocarbons trade balance (goods)	-0.8	-0.3	-0.4	0.0	0.3	-0.9	-0.8	-0.7	-0.9	-1.0
o/w Manufactures exports	24.9	26.0	29.5	32.1	32.5	30.7	30.8	31.2	31.5	31.5
o/w Services trade balance	-1.1	-1.0	-0.8	-0.9	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8
Net capital inflows	-5.1	-4.2	-1.7	-3.1	-1.8	-2.7	-3.0	-2.9	-2.9	-2.8
Net FDI inflows	-2.8	-1.7	-2.1	-2.7	-1.9	-2.1	-2.2	-2.4	-2.5	-2.5
Net portfolio inflows	-3.4	-3.6	-2.0	-3.1	-0.8	-1.6	-1.6	-1.4	-1.2	-1.2
Net other investment inflows	1.1	1.1	2.4	2.6	1.0	1.0	0.8	0.9	0.8	1.0
International Investment Position, net	-45.3	-41.8	-46.3	-44.1	-40.0	-39.0	-39.5	-39.9	-40.1	-40.2
Memorandum items										
Hydrocarbons exports volume growth (in percent)	-1.2	-4.3	2.7	2.0	-10.4	-2.6	5.1	7.5	14.6	11.5
Non-hydrocarbons exports volume growth (in percent)	1.8	7.5	9.8	0.1	6.4	3.2	3.6	4.9	5.0	5.1
Hydrocarbons imports volume growth (in percent)	3.4	-4.3	16.0	15.5	-1.0	-1.6	2.2	2.2	2.9	2.5
Non-hydrocarbons imports volume growth (in percent)	2.5	6.5	9.0	1.0	5.8	2.9	3.9	5.0	5.1	5.0
Crude oil export volume (in millions of bbl/day)	1.2	1.1	1.2	1.2	1.0	1.0	1.0	1.1	1.3	1.5
Gross international reserves (in billions of U.S. dollars)	180.2	195.7	177.6	178.1	177.8	181.9	188.5	195.2	202.5	212.1
Gross domestic product (in billions of U.S. dollars)	1,262.0	1,298.5	1,152.3	1,046.9	1,119.9	1,221.4	1,289.8	1,360.5	1,436.9	1,516.8

Sources: Bank of Mexico, Ministry of Finance and Public Credit, and Fund staff estimates.

1/ Since May 2017, Mexico's authorities publish balance of payment data in accordance with the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6).

2/ Crude oil, oil derivatives, petrochemicals, and natural gas.

Table 6. Mexico: Financial Soundness Indicators
(In percent)

	2013	2014	2015	2016	2017	Latest available data
Capital Adequacy						
Regulatory capital to risk-weighted assets	15.6	15.8	15.0	15.2	15.6	July
Regulatory Tier 1 capital to risk-weighted assets	13.4	13.8	13.3	13.5	14.3	July
Capital to assets	10.4	10.8	10.4	10.7	10.8	July
Gross asset position in financial derivatives to capital	73.5	56.0	61.1	64.1	61.2	July
Gross liability position in financial derivatives to capital	72.7	59.6	65.1	68.6	63.7	July
Asset Quality						
Nonperforming loans to total gross loans	3.2	3.0	2.5	2.2	2.1	July
Provisions to Nonperforming loans	147.5	132.7	140.5	153.5	159.3	July
Earnings and Profitability						
Return on assets	2.1	1.7	1.6	1.7	2.0	July
Return on equity	19.3	15.9	15.4	16.5	19.7	July
Liquidity						
Liquid assets to short-term liabilities	47.7	47.1	45.5	43.6	41.8	July
Liquid assets to total assets	36.0	36.0	34.6	32.7	31.7	July
Customer deposits to total (noninterbank) loans	88.7	89.5	87.7	87.1	90.1	July
Trading income to total income	7.4	4.0	3.3	4.8	6.1	July

Sources: Financial Soundness Indicators

Table 7. Mexico: Financial Indicators and Measures of External Vulnerabilities

	2013	2014	2015	2016	2017	Latest available data
Financial market indicators						
Exchange rate (per U.S. dollar, average)	13.1	14.7	17.2	20.7	18.8	August
(year-to-date percent change, + appreciation)	-0.5	-12.6	-16.9	-20.5	-3.1	August
28-day treasury auction rate (percent; period average)	3.8	3.0	3.0	4.1	6.5	August
EMBIG Mexico spread (basis points; period average)	188.7	182.5	250.9	303.5	258.4	October
Sovereign 10-year local currency bond yield (period average)	5.6	6.0	6.0	6.2	7.1	October
Stock exchange index (period average, year on year percent change)	5.6	1.4	3.1	3.8	8.0	October
Financial system						
Financial system credit on non-financial private sector (year on year percent change)	9.2	8.7	14.6	16.5	11.9	June
Nonperforming loans to total gross loans	3.2	3.0	2.5	2.2	2.1	October
External vulnerability indicators						
Gross financing needs (billions of US\$)	142.1	150.9	121.3	123.5	89.8	Proj.
Gross international reserves (end-year, billions of US\$) 1/	180.2	195.7	177.6	178.1	174.7	August
Change (billions of US\$)	13.2	15.5	-18.1	0.4	-3.3	August
Months of imports of goods and services	5.2	5.4	5.0	5.1	4.7	Proj.
Months of imports plus interest payments	5.0	5.2	4.8	4.9	4.5	Proj.
Percent of broad money	23.3	25.9	25.4	27.8	24.3	August
Percent of portfolio liabilities	38.0	40.6	38.9	39.8	46.1	Proj.
Percent of short-term debt (by residual maturity)	169.2	183.3	182.8	269.9	267.3	Proj.
Percent of ARA Metric 2/	111.8	120.3	115.8	123.7	118.1	Proj.
Percent of GDP	14.3	15.1	15.4	17.0	16.3	June
Gross total external debt (in percent of GDP)	31.4	32.9	36.3	39.4	40.9	June
Of which: In local currency	11.1	11.1	10.7	9.8	11.2	June
Of which: Public debt	21.4	22.1	24.4	26.6	28.3	June
Of which: Private debt	10.0	10.8	11.9	12.7	12.6	June
Financial sector	1.3	1.4	1.3	1.3	1.3	June
Nonfinancial sector	8.7	9.4	10.6	11.4	11.2	June
Gross total external debt (billions of US\$)	396.8	427.3	417.9	412.0	438.3	June
Of which: In local currency	140.3	143.9	123.3	102.1	119.8	June
Of which: Public debt	270.1	287.3	281.0	278.7	303.4	June
Of which: Private debt	126.6	139.9	136.9	133.4	134.9	June
Financial sector	17.3	19.6	16.3	15.5	14.3	June
Nonfinancial sector	109.4	120.3	120.7	117.9	120.6	June
External debt service (in percent of GDP)	8.9	9.8	11.0	11.2	7.7	Proj.

Sources: Bank of Mexico, National Banking and Securities Commission, National Institute of Statistics and Geography, Secretary of Finance and Public Credit, and Fund staff estimates.

1/ Excludes balances under bilateral payments accounts. For 2009, includes the allocation of SDR 2.337 billion in the general allocation implemented on August 28, 2009, and another SDR 0.224 billion in the special allocation on September 9.

2/ The ARA metric was developed by the Strategy and Policy Review Department at the IMF to assess reserve adequacy. Weights to individual components were revised in December 2014 for the whole time series.

Table 8. Mexico: Baseline Medium-Term Projections

	2013	2014	2015	2016	Projections					
					2017	2018	2019	2020	2021	2022
(Annual percentage change, unless otherwise indicated)										
National accounts (in real terms)										
GDP	1.4	2.3	2.6	2.3	2.1	1.9	2.3	2.7	2.7	2.7
Consumption	2.0	1.9	2.3	2.5	2.1	1.9	1.9	2.2	2.1	1.9
Private	2.1	1.8	2.3	2.7	2.3	1.9	2.2	2.4	2.5	2.6
Public	1.0	2.1	2.3	1.2	0.3	2.0	0.1	0.4	-0.7	-2.5
Investment	-2.0	3.3	3.1	-0.3	-1.6	1.0	4.0	4.4	4.5	4.7
Fixed	-1.6	3.0	4.3	0.1	-1.5	1.0	4.0	4.4	4.6	4.8
Private	-1.6	5.0	8.0	1.9	0.3	2.2	5.1	5.6	5.4	5.9
Public	-1.3	-5.0	-11.8	-9.0	-12.2	-6.8	-3.9	-5.3	-2.7	-6.5
Inventories 1/	-0.1	0.1	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	2.4	7.0	10.4	1.2	6.1	3.1	3.6	4.9	5.3	5.2
Oil exports	-1.2	-4.3	2.7	2.0	-10.4	-2.6	5.1	7.5	14.6	11.5
Non-oil exports	2.5	7.3	10.6	1.2	6.6	3.2	3.6	4.9	5.0	5.1
Imports of goods and services	2.6	6.0	8.6	1.1	5.6	2.8	3.9	4.9	5.0	4.9
Oil imports	3.4	-4.3	16.0	15.5	-1.0	-1.6	2.2	2.2	2.9	2.5
Non-oil imports	2.6	6.3	8.5	0.7	5.8	2.9	3.9	5.0	5.1	5.0
Net exports 1/	-0.1	0.3	0.6	0.1	0.2	0.1	-0.1	0.0	0.1	0.2
Consumer prices										
End of period	4.0	4.1	2.1	3.4	6.1	3.0	3.0	3.0	3.0	3.0
Average	3.8	4.0	2.7	2.8	5.8	3.5	3.0	3.0	3.0	3.0
External sector										
Current account balance (in percent of GDP)	-2.5	-1.8	-2.5	-2.2	-1.8	-2.4	-2.5	-2.5	-2.3	-2.1
Non-hydrocarbon current account balance (in percent of GDP)	-3.1	-1.8	-1.6	-1.0	-0.5	-1.3	-1.6	-1.6	-1.7	-1.7
Exports of goods, f.o.b.	2.5	4.4	-4.2	-1.8	8.7	2.8	5.5	7.1	6.9	5.8
Imports of goods, f.o.b.	2.8	4.9	-1.2	-2.1	7.9	5.8	4.8	6.6	6.8	5.5
Terms of trade (improvement +)	0.4	-1.3	-3.4	1.5	0.5	-3.0	0.9	0.5	-0.2	0.0
Crude oil export price, Mexican mix (US\$/bbl)	98.8	87.7	44.3	35.8	43.6	44.0	44.3	44.8	45.5	45.5
(In percent of GDP)										
Non-financial public sector										
Overall balance	-3.7	-4.6	-4.1	-2.8	-1.4	-2.5	-2.5	-2.5	-2.5	-2.5
Primary balance	-0.7	-1.6	-1.1	0.5	1.9	0.6	0.7	0.8	1.0	1.1
Saving and investment 2/										
Gross domestic investment	21.7	21.6	22.9	23.3	22.7	22.5	23.2	23.9	24.6	25.3
Fixed investment	21.1	21.0	22.5	22.9	22.4	22.3	22.9	23.6	24.3	25.0
Public	4.5	4.1	3.6	3.3	2.9	2.7	2.5	2.4	2.3	2.1
Private	16.6	16.9	18.9	19.5	19.5	19.6	20.4	21.2	22.0	23.0
Inventories	0.6	0.6	0.4	0.4	0.3	0.3	0.3	0.3	0.3	0.3
Gross domestic saving	19.2	19.8	20.4	21.1	20.9	20.6	20.8	21.2	21.8	22.5
Public	0.8	-0.5	-0.5	0.5	1.5	0.1	0.0	-0.2	-0.3	-0.5
Private	18.4	20.3	20.9	20.6	19.4	20.5	20.8	21.4	22.1	23.0
(Percent growth, unless otherwise indicated)										
Memorandum items										
Financial system credit to non-financial private sector	9.2	8.7	14.6	16.5	10.8	10.2	10.2	10.4	10.9	10.9
Output gap (in percent of potential GDP)	-0.3	-0.4	-0.2	-0.2	-0.3	-0.5	-0.3	0.0	0.0	0.0
Total population	1.1	1.1	1.1	1.0	1.0	1.0	1.0	0.9	0.9	0.9
Working-age population 3/	1.9	1.9	1.8	1.6	1.6	1.5	1.4	1.3	1.3	1.2

Sources: Bank of Mexico, National Institute of Statistics and Geography, Secretary of Finance and Public Credit, and IMF staff projections.

1/ Contribution to growth. Excludes statistical discrepancy.

2/ Reported numbers may differ from authorities' due to rounding.

3/ Based on United Nations population projections.

Annex I. Risk Assessment Matrix

Potential Deviations from Baseline

Source of Risk	Up/ Downside	Relative Likelihood ^{1,2}	Impact ²	Policy Response
<p>Significant further strengthening of the US dollar and/or higher rates. As investors reassess policy fundamentals, as term premia decompress, or if there is a more rapid Fed normalization, leveraged firms, lower-rated sovereigns and those with un-hedged dollar exposures could come under stress. Could also result in capital account pressures for some economies.</p>	↓	H	H	Exchange rate flexibility and provision of liquidity to mitigate disorderly market conditions.
<p>Policy uncertainty and divergence. Two-sided risks to U.S. growth with difficult-to-predict policies and global spillovers. In Europe, uncertainty associated with negotiating post-Brexit arrangements and with upcoming major elections. Policy divergence could lead to rising global imbalances and exacerbate exchange rate and capital flow volatility.</p>	↓	H	H	Exchange rate flexibility would be critical to restore equilibrium. Temporary FX interventions and liquidity provision could help smooth extreme volatility.
<p>Retreat from cross-border integration. A fraying consensus about the benefits of globalization could lead to protectionism and economic isolationism, leading to reduced global and regional policy collaboration with negative consequences for trade, capital and labor flows, sentiment, and growth.</p>	↓	H	H	Exchange rate flexibility would be critical to restore equilibrium. Temporary FX interventions and liquidity provision could help smooth extreme volatility. Steadfast implementation of structural reforms to boost growth and raise competitiveness.
<p>Termination of NAFTA. An immediate return to most-favored nation (MFN) or even higher tariffs would be disruptive for Mexico's trade with its most important trading partner and could weaken growth, dampen capital inflows and raise risk premia.</p>	↓	H	H	Exchange rate flexibility would be critical to restore equilibrium. Temporary FX interventions and liquidity provision could help smooth extreme volatility. Steadfast

				implementation of structural reforms and efforts to diversify trading relationships would increase competitiveness and boost growth over the medium term.
Structurally weak growth in key advanced and emerging economies.	↓	H/M	H	Steadfast implementation of structural reforms to increase competitiveness.
Lower energy prices. They would lead to lower fiscal revenues and prospects for energy sector investments.	↓	L	L	Exchange rate flexibility and fiscal adjustment.
Further declines in oil production at PEMEX.	↓	L	M	Implement joint ventures to benefit from technology transfer.
Slower-than-anticipated fiscal consolidation in the context of the forthcoming electoral cycle, leading to further steady increase in public debt and an increase in country risk premiums.	↓	M/L	M	Maintain the consolidation effort. Use positive revenue surprises to reduce the deficit faster.
<p>1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.</p> <p>2/ Low (L), Medium (M), High (H).</p>				

Annex II. External Sector Assessment

Updated as of September 30, 2017

	Mexico	Overall Assessment
Foreign asset and liability position and trajectory	<p>Background. Mexico's NIIP reached -44.0 percent of GDP in 2016 (gross foreign assets and liabilities were 61.3 percent and 105.3 percent of GDP, respectively), a slight increase relative to -41 percent in 2010. Portfolio liabilities stood at 42.7 percent of GDP, of which around ¼ one fourth were local-currency government bonds. Of the estimated outstanding federal government FX liabilities in 2016 (8 percent of GDP), about ¾ was denominated in US-dollars, and the remainder in euro, yen, and pound sterling. A predominantly large share of private sector external liabilities is denominated in US-dollars. The ratio of NIIP to GDP is projected to improve to -40 percent of GDP in 2017 and stay at around that level over the medium term.</p> <p>Assessment. While the NIIP is sustainable, the large gross foreign portfolio liabilities holdings could be a source of vulnerability to global financial volatility. Although Mexico showed remarkable resilience to the weakening of the peso in 2016 and early 2017, an even stronger depreciation could complicate policy making through balance sheet exposures.</p>	<p>Overall Assessment:</p> <p><i>Developments so far in 2017 indicate that Mexico's external sector position remains broadly consistent with medium-term fundamentals and desirable policies. The depreciation of the peso in 2016 and January 2017, which largely reflected risks of rising protectionism in key trading partners, led to a REER that was moderately weaker than suggested by fundamentals. This implied a temporary divergence vis-à-vis the CA, which remained broadly in line with medium-term fundamentals and desirable policies. Staff assessment at that time was that, when uncertainty would recede, the CA and the REER positions would converge. The appreciation of the peso during February – mid-September 2017 in staff's assessment indeed brought the REER back to a level broadly in line with fundamentals, similar to the position of the current account. Lingering protectionism risks may, however, put renewed downward pressure on the exchange rate.</i></p> <p>Potential policy responses:</p> <p>The external sector position is broadly consistent with medium-term fundamentals and desirable policies. However, further structural reforms to improve competitiveness and strengthen non-oil exports will be essential for boosting growth while maintaining external sustainability. This will be all the more important should risk of rising protectionism re-appear or materialize.</p> <p>The authorities have committed to reducing the public sector borrowing requirement from 4.6 percent of GDP in 2014 to 2.5 percent of GDP in 2018, have met the corresponding 2015 and 2016 targets, and are on track to meet the target for 2017.</p> <p>The central bank sets monetary policy to ensure that the inflation remains close to the 3-percent target. The authorities have a free-floating exchange rate policy, and use foreign exchange intervention occasionally to prevent disorderly market conditions.</p> <p>The FCL provides an added buffer against global tail risks.</p>
Current account	<p>Background. After narrowing to 2.2 percent of GDP in 2016, the current account (CA) deficit has decreased further to 1.6 percent of GDP in the first half of 2017. The continued strengthening of the non-hydrocarbon goods and services balances and increased inflow of remittances more than compensating for the deterioration of the hydrocarbons balance is expected to bring the CA balance to -1.8 percent of GDP in 2017. The cyclically-adjusted CA deficit for 2017 is estimated at 1.6 percent of GDP.</p> <p>Assessment. Mexico's CA deficit remains broadly in line with the level consistent with medium-term fundamentals and desirable policies. The EBA model estimates a cyclically-adjusted current account norm of -2.0 percent in 2017, implying a CA gap of 0.4 percent of GDP in 2017. The staff assessment is similar, with a gap between -1 and 1 percent of GDP./1</p>	
Real exchange rate	<p>Background. The average REER in 2016 was 13 percent weaker than the 2015 average, reflecting a reduction in net oil exports, weaker medium-term growth prospects, and global uncertainties, in particular risks of rising protectionism in key trading partners. The free-floating exchange rate has been a key shock absorber in an unsettled global environment. As of August 2017, the REER had appreciated by 10 percent relative to the 2016 average, driven by increased non-oil export demand and a perceived reduction of protectionism risks.</p> <p>Assessment. The EBA level REER regression estimates an undervaluation of 10.6 percent in 2017. The index approach yields higher undervaluation (25.3 percent). Staff puts less weight on the index approach as it has shown the peso to be persistently undervalued for the last 9 years. The external sustainability approach suggests a very marginal overvaluation by 0.2 percent. Considering all estimates for 2017 and the uncertainties around them, as well as the considerable real appreciation so far in 2017, staff assesses Mexico's real effective exchange rate to now be in a position broadly in line with fundamentals.</p>	
Capital and financial accounts: flows and policy measures	<p>Background. During 2010-14, a large share of capital inflows went into purchases of locally-issued government paper and other portfolio investments. In 2015-16 gross portfolio inflows slowed markedly, and there were net outflows from local currency government papers in the first half of 2016, which were reversed during the second half of the year. A small net reduction of long term liabilities reoccurred in the second quarter of 2017 but this reflected a re-positioning between maturities due to the shifting yield curve and not a decrease in appetite for peso bonds more generally. The authorities have continued to successfully conduct debt management operations to further improve the federal debt profile. Going forward, structural reforms are expected to lead to higher FDI, while portfolio inflows are unlikely to return to the previous high growth rates.</p> <p>Assessment. The long duration of sovereign debt and the high share of local currency financing reduce the exposure of government finances to depreciation risks. The banking sector is well capitalized and liquid and assessed to be resilient to large shocks. Non-financial corporate debt levels are low and foreign exchange risks well covered by natural and financial hedges. Nonetheless, the strong presence of foreign investors leaves Mexico exposed to greater risk of capital flow reversals and risk premium increases. The authorities have refrained from capital flow management measures, in line with their view that an open capital account reduces policy uncertainty and supports long-term growth. Capital flow risks are also mitigated by prudent macroeconomic policies.</p>	
FX intervention and reserves level	<p>Background. The central bank remains committed to a free-floating exchange rate, using discretionary intervention only to prevent disorderly market conditions.^{2/} The central bank usually builds up reserves through purchases of the net foreign currency proceeds of the state oil company, but at current oil prices this is minimal. At end-2016, FX reserves were unchanged at US\$178 billion (17.0 percent of GDP), declining very marginally to US\$175 billion in late September, 2017. In February 2017, the Foreign Exchange Commission announced a new FX hedging program, with the Central Bank of Mexico able to offer up to US\$20 billion of non-deliverable forwards with a maturity of up to 12 months and settled in pesos. The new program can help reduce short-term volatility of the peso vis-à-vis the U.S. dollar and adds to the authorities' toolkit to counter disorderly market conditions. A first</p>	

	<p>auction of US\$1billion was completed in early March 2017. As of late September 2017, no further auctions had taken place, with only the outstanding stock being rolled over.</p> <p>Assessment. At 124 percent of the ARA metric at end-2016 (expected to decline only slightly in 2017) and 270 percent of short-term debt (at remaining maturity), the current level of foreign reserves remains adequate for normal times. The FCL arrangement has been an effective complement to international reserves, providing protection against global tail risks.</p>	
<p>Technical Background Notes</p>	<p>1/Mexico's transition to BPM6 in May 2017 resulted in the 2016 current account deficit being ½ percentage point of GDP smaller than previously estimated. This, however, did not affect the external sector assessment of the current account being broadly in line with fundamentals.</p> <p>2/ Rules-based intervention mechanisms were in place between December 8, 2014 and February 17, 2016. During this time, pre-announced amounts were automatically offered for auction when the exchange rate depreciated by more than a threshold (1 or 1.5 percent) on a given day. Regular auctions with no minimum price were also used. Since February 17, 2016, the authorities moved to discretionary intervention and used it only once in 2016 and once in 2017 (through early September). Data on intervention amounts are published weekly.</p>	

Annex III. Debt Sustainability Analysis

Mexico's public debt is expected to remain sustainable in the medium term with high probability. Under the baseline scenario, public debt¹ is expected to stabilize over the medium term. After peaking up at 58.4 percent of GDP at end-2016, due mainly to the depreciation of the exchange rate, the public debt-to-GDP ratio is projected to decline to 53.3 percent by 2018 and remain around this level in the medium term. Gross financing needs (projected at 9.1 percent of GDP in 2018) are expected to remain contained around 10 percent over the medium term. The long average maturity and favorable currency composition of the debt mitigate short-term financing risks coming from a high foreign ownership of the debt.

Public Debt Sustainability

Baseline and Realism of Projections

- **Debt levels.** Given the ongoing fiscal consolidation, gross debt levels are projected to decline very slightly from 53.8 percent of GDP in 2017 to 53.2 percent of GDP by 2022.² Gross financing needs over the medium-term are projected to average around 10 percent of GDP.
- **Fiscal adjustment.** The structural primary balance (adjusted by the business cycle and oil prices) is projected to increase from 0.5 percent of GDP in 2017 to 1.1 percent in 2022. On the revenue side, the decline in one-offs would lead to lower revenues in 2018, which would then stabilize at a similar level over the medium term. On the spending side, projections assume compliance with the consolidation plan spelled out in the 2018 budget documents, which envisages a public sector borrowing requirement (PSBR) of 2.5 percent of GDP in 2018 and over the medium term. Compared to the distribution of fiscal adjustment episodes provided in the DSA template, the maximum projected 3-year adjustment of the cyclically-adjusted primary balance of around 1.9 percent of GDP seems feasible.
- **Growth assumptions.** Past projections of growth outcomes suggest moderate forecast errors, with the median forecast error in line with other emerging markets. There seems to be no evidence of a systematic projection bias in the baseline assumption for growth that could undermine the DSA assessment. Medium-term growth is expected to pick up gradually as the effects from structural reforms take hold, stabilizing at 2.7 percent of GDP in the second half of the projection horizon.

¹ Public debt reported in this annex excludes state and local governments, but includes central government, social security, state-owned enterprises and public development banks. At end-June 2017, the debt stock of subnational entities reached 561 billion pesos, or about 2.6 percent of GDP, and therefore does not pose a systemic risk to debt sustainability.

² A sizeable share of the fall in the public debt-to-GDP ratio in 2017 comes from the appreciation of the peso since the end of last year.

- **Sovereign yields.** Mexico's sovereign yields surged last January but have since declined significantly, with the 10-year local-currency bond yield remaining stable around 6.9 percent in September. The EMBIG spread has remained on average at 251 basis points for the last three months. Taking into account the upward projections for the medium-term U.S. Libor rates, the effective nominal interest rate on Mexico's sovereign debt is projected to rise from 6.7 percent in 2016 to 7.1 percent by 2022.³

Debt profile

- **Rollover and exchange rate risks.** The long maturity structure of the debt reduces rollover risks, including for the part of public debt held by non-residents that is relatively high for Mexico.⁴ The real interest rate and real exchange rate shocks have a moderate impact on the debt stock, given the low direct interest pass-through to the budget and the large share of debt denominated in local currency (more than 65 percent).

Stochastic Simulations

- **Fan charts.** The fan charts illustrate the possible evolution of the debt ratio over the medium term and are based on both the symmetric and asymmetric distributions of risk. Under the symmetric distribution of risk, there is more than a 75 percent probability that debt will be below 60 percent of GDP over the medium term. If restrictions are imposed on the primary balance (i.e., the asymmetric scenario, where it is assumed that there are no positive shocks to the primary balance), there is still at least 70 percent chance that the debt path will remain below 60 percent of GDP over the projection horizon.

Stress Tests

- **Individual shocks.** The debt ratio would remain below 60 percent of GDP under all scenarios. A permanent real exchange rate depreciation of 25 percent increases debt by around 3 percentage points of GDP.⁵ This would also result in an increase of gross financing needs by 0.5 percentage point of GDP in the first year.
- **Combined shock.** A combined shock incorporates the largest effect of individual shocks on all relevant variables (real GDP growth, inflation, primary balance, exchange rate and interest rate). Under this scenario, debt would increase to 66.9 percent of GDP. Gross financing needs would reach 14 percent of GDP in 2022.

³ The projections for interest rates on newly issued debt assume a constant spread vis-à-vis U.S. Libor rates.

⁴ The federal government debt denominated in pesos has an average maturity of about 8 years. The average maturity of FX bonds is 20.7 years.

⁵ This shock uses a pass-through elasticity of 7 percent (staff estimate) rather than the default value of 25 percent.

Net Public Debt

- In their communication on public debt, the authorities focus on the concept of Historical Balance of the Public Sector Borrowing Requirements (HBPSBR), which is analogous to a net debt concept.⁶ On the basis on the present public debt stability analysis, staff estimates that net public debt (defined as gross debt minus public assets) would decline from 50.1 percent in 2016 to around 45 percent in the medium term.

Authorities' views

- The authorities reiterated their goal to stabilize the public debt-to-GDP ratio at a relatively low level for an emerging market economy. They considered that the current medium term budget prospects were consistent with a downward trend for the debt-to-GDP ratio. They highlighted that non-residents did not reduce their holdings of public debt even in a context of heightened uncertainty.

External Debt Sustainability

- Mexico's external debt as share of GDP increased by 6.5 percentage points between 2014 and 2016, mainly due to price and exchange rate changes (5.8 percentage points), to 39.4 percent of GDP. However, at this level, Mexico's external debt is not very high compared to other emerging markets in the region and globally. Under the current baseline projections, the external debt is expected to remain stable just below 40 percent of GDP in the medium term.
- A relatively large share of Mexico's external debt, 26.6 percent of GDP is owed by the public sector, of which 17.8 percentage points by the federal government. Despite a significant share of the debt being denominated in Mexican peso (9.8 percent of GDP), a depreciation of the exchange rate remains the most significant risk to external debt sustainability; a 30 percent depreciation is estimated to lead to an increase in the external debt to up to 55 percent of GDP. However, rollover risks for federal government debt are mitigated by a very favorable maturity structure and continuous prudent debt management by the government. The banking sector is well capitalized and liquid, and assessed to be resilient to large shocks. Non-financial corporate debt levels are low and foreign exchange risks well covered by natural and financial hedges.

⁶ Consistently with their focus on the HBPSBR, the authorities also compute a "debt-stabilizing primary balance" that includes changes in assets and is therefore different from the debt-stabilizing primary balance presented here.

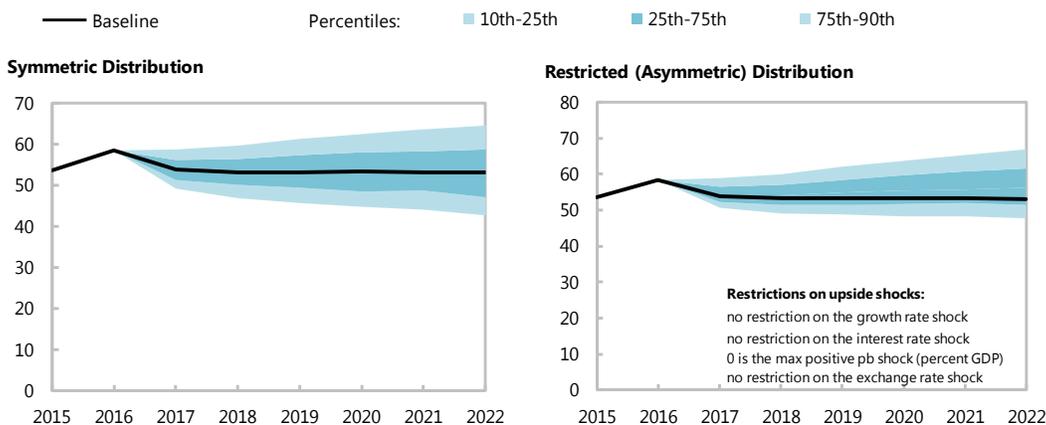
Mexico Public DSA Risk Assessment

Heat Map

Debt level ^{1/}	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability shock
Gross financing needs ^{2/}	Real GDP Growth Shock	Primary Balance Shock	Real Interest Rate Shock	Exchange Rate Shock	Contingent Liability Shock
Debt profile ^{3/}	Market Perception	External Financing Requirements	Change in the Share of Short-Term Debt	Public Debt Held by Non-Residents	Foreign Currency Debt

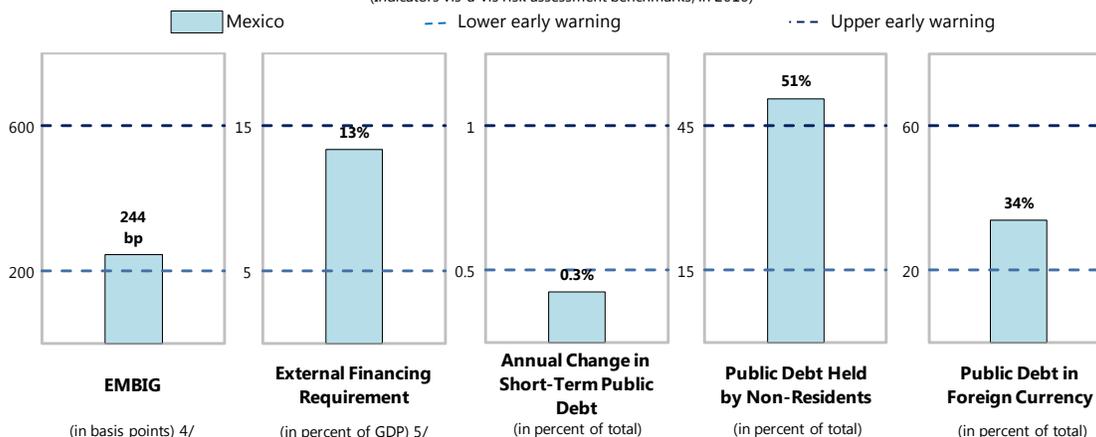
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)



Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white. Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ EMBIG, an average over the last 3 months, 04-Jul-17 through 02-Oct-17.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

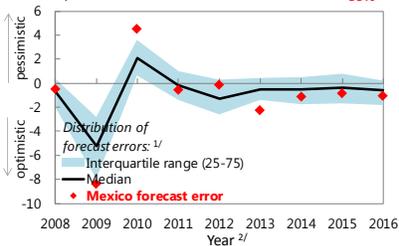
Mexico Public DSA - Realism of Baseline Assumptions

Forecast Track Record, versus all countries

Real GDP Growth

(in percent, actual-projection)

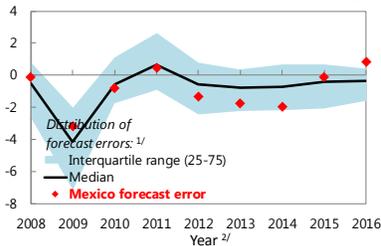
Mexico median forecast error, 2008-2016: **-0.86**
 Has a percentile rank of: **35%**



Primary Balance

(in percent of GDP, actual-projection)

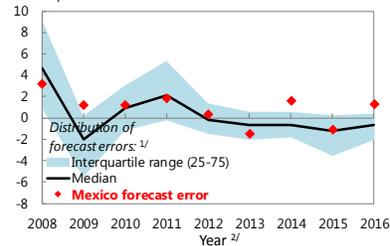
Mexico median forecast error, 2008-2016: **-0.81**
 Has a percentile rank of: **47%**



Inflation (Deflator)

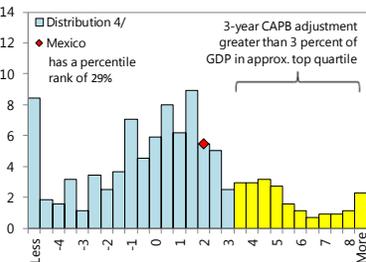
(in percent, actual-projection)

Mexico median forecast error, 2008-2016: **1.21**
 Has a percentile rank of: **83%**

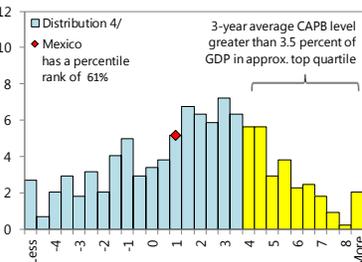


Assessing the Realism of Projected Fiscal Adjustment

3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)
 (Percent of GDP)

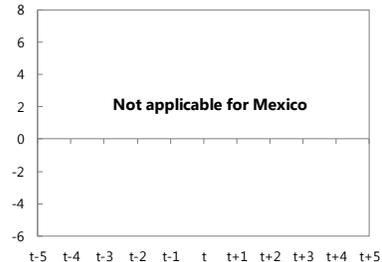


3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)
 (Percent of GDP)



Boom-Bust Analysis^{3/}

Real GDP growth
 (in percent)



Source : IMF Staff.

1/ Plotted distribution includes all countries, percentile rank refers to all countries.

2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Mexico, as it meets neither the positive output gap criterion nor the private credit growth criterion.

4/ Data cover annual observations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

Mexico Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

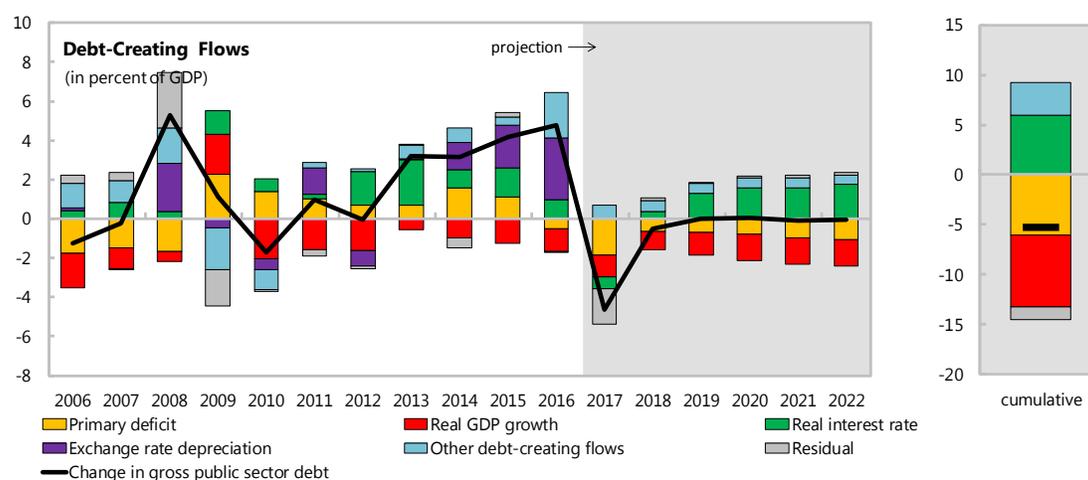
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators ^{1/}

	Actual			Projections						As of October 02, 2017		
	2006-2014 ^{2/}	2015	2016	2017	2018	2019	2020	2021	2022	Sovereign Spreads		
Nominal gross public debt	42.9	53.7	58.4	53.8	53.3	53.3	53.3	53.2	53.2	EMBIG (bp) ^{3/} 251		
Public gross financing needs	11.0	12.7	14.0	8.8	9.1	10.3	10.0	10.5	10.3	5Y CDS (bp) 107		
Real GDP growth (in percent)	2.4	2.6	2.3	2.1	1.9	2.3	2.7	2.7	2.7	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	4.5	3.1	4.6	7.1	5.4	3.7	3.3	3.6	3.5	Moody's	A3	A3
Nominal GDP growth (in percent)	7.0	5.8	7.0	9.3	7.4	6.0	6.1	6.4	6.3	S&Ps	BBB+	A
Effective interest rate (in percent) ^{4/}	7.0	6.4	6.7	6.1	6.3	6.4	6.6	6.9	7.1	Fitch	BBB+	A-

Contribution to Changes in Public Debt

	Actual			Projections						cumulative	debt-stabilizing balance ^{9/}
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022		
Change in gross public sector debt	1.2	4.2	4.8	-4.6	-0.5	0.0	0.1	-0.1	0.0	-5.3	primary
Identified debt-creating flows	1.1	3.9	4.8	-2.9	-0.6	-0.1	-0.1	-0.2	-0.2	-4.0	balance ^{9/}
Primary deficit	0.3	1.1	-0.5	-1.9	-0.6	-0.7	-0.8	-1.0	-1.1	-6.0	0.9
Primary (noninterest) revenue and gra	23.4	23.1	23.2	22.6	20.7	20.5	20.5	20.7	20.7	125.8	
Primary (noninterest) expenditure	23.7	24.2	22.7	20.8	20.1	19.8	19.7	19.8	19.7	119.8	
Automatic debt dynamics ^{5/}	0.5	2.4	3.0	-1.7	-0.6	0.2	0.2	0.2	0.4	-1.2	
Interest rate/growth differential ^{6/}	0.1	0.3	-0.2	-1.7	-0.6	0.2	0.2	0.2	0.4	-1.2	
Of which: real interest rate	1.0	1.5	1.0	-0.6	0.4	1.3	1.6	1.6	1.7	6.0	
Of which: real GDP growth	-0.9	-1.2	-1.1	-1.1	-0.9	-1.1	-1.3	-1.4	-1.3	-7.2	
Exchange rate depreciation ^{7/}	0.4	2.2	3.1	...	...	...	...	...	...	...
Other identified debt-creating flows	0.3	0.4	2.3	0.7	0.6	0.5	0.5	0.5	0.5	3.2	
Please specify (1) (e.g., drawdown of	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Change in assets	0.3	0.4	2.3	0.7	0.6	0.5	0.5	0.5	0.5	3.2	
Residual ^{8/}	0.1	0.2	0.0	-1.8	0.1	0.1	0.1	0.1	0.1	-1.2	



Source: IMF staff.

1/ Public sector is defined as the Central government, state-owned enterprises, public sector development banks, and social security funds. Excludes local governments.

2/ Based on available data.

3/ EMBIG.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)] / (1+g+\pi+g\pi)$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; a = share of foreign-currency denominated debt; and e = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Includes interest revenues (if any). For projections, includes exchange rate changes during the projection period.

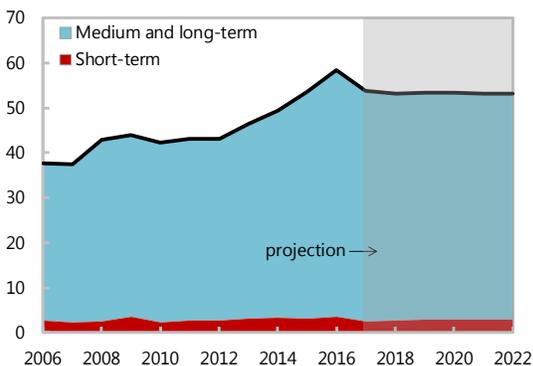
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Mexico Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

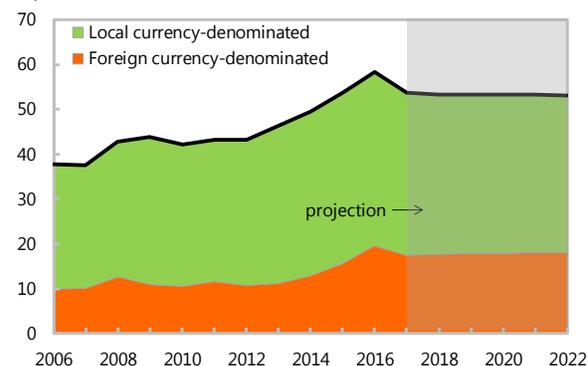
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)



Alternative Scenarios

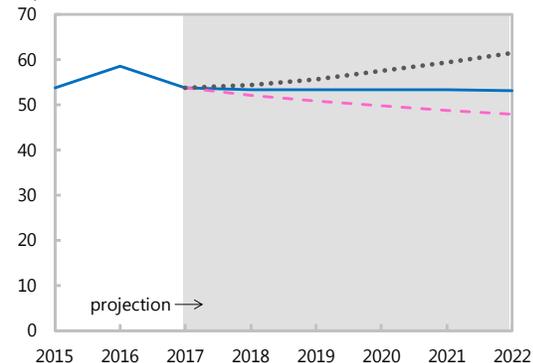
— Baseline

..... Historical

- - - Constant Primary Balance

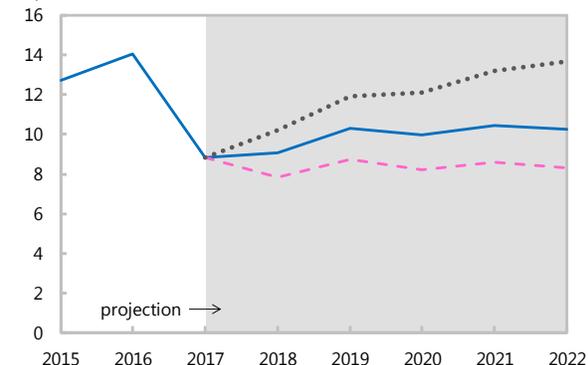
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario

	2017	2018	2019	2020	2021	2022
Real GDP growth	2.1	1.9	2.3	2.7	2.7	2.7
Inflation	7.1	5.4	3.7	3.3	3.6	3.5
Primary Balance	1.9	0.6	0.7	0.8	1.0	1.1
Effective interest rate	6.1	6.3	6.4	6.6	6.9	7.1

Historical Scenario

	2017	2018	2019	2020	2021	2022
Real GDP growth	2.1	2.2	2.2	2.2	2.2	2.2
Inflation	7.1	5.4	3.7	3.3	3.6	3.5
Primary Balance	1.9	-0.5	-0.5	-0.5	-0.5	-0.5
Effective interest rate	6.1	6.3	6.5	6.8	7.2	7.5

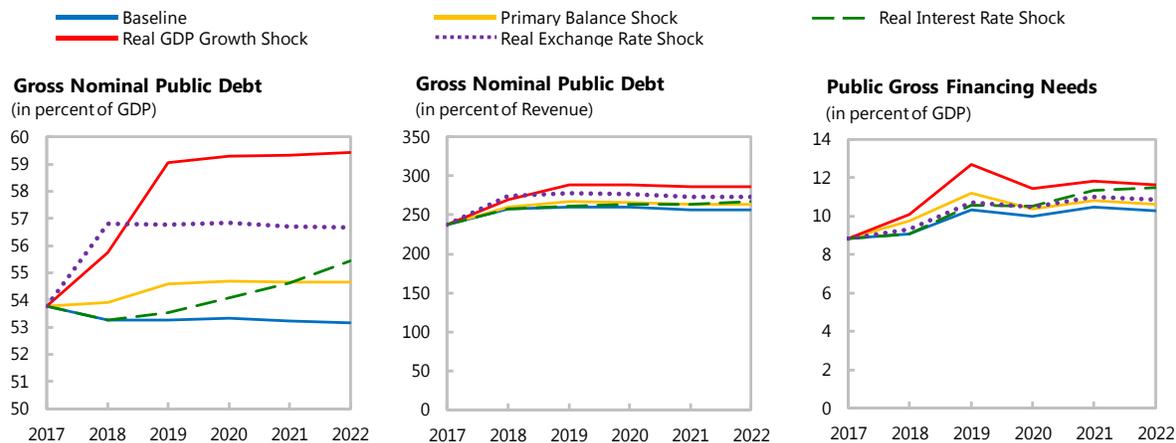
Constant Primary Balance Scenario

	2017	2018	2019	2020	2021	2022
Real GDP growth	2.1	1.9	2.3	2.7	2.7	2.7
Inflation	7.1	5.4	3.7	3.3	3.6	3.5
Primary Balance	1.9	1.9	1.9	1.9	1.9	1.9
Effective interest rate	6.1	6.3	6.3	6.5	6.8	7.0

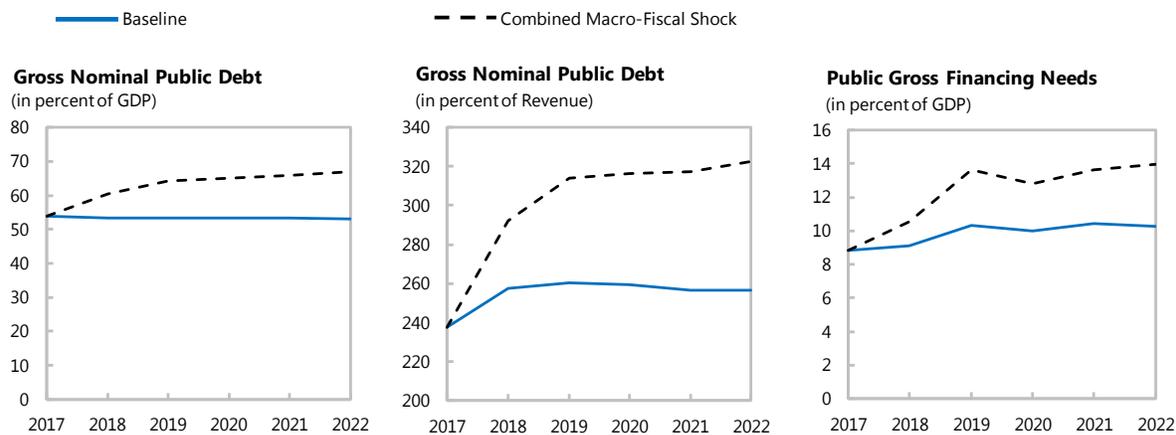
Source: IMF staff.

Mexico Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



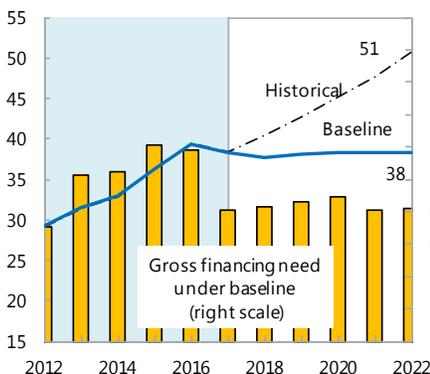
Underlying Assumptions (in percent)

	2017	2018	2019	2020	2021	2022
Primary Balance Shock						
Real GDP growth	2.1	1.9	2.3	2.7	2.7	2.7
Inflation	7.1	5.4	3.7	3.3	3.6	3.5
Primary balance	1.9	0.0	0.0	0.8	1.0	1.1
Effective interest rate	6.1	6.3	6.4	6.7	7.0	7.2
Real Interest Rate Shock						
Real GDP growth	2.1	1.9	2.3	2.7	2.7	2.7
Inflation	7.1	5.4	3.7	3.3	3.6	3.5
Primary balance	1.9	0.6	0.7	0.8	1.0	1.1
Effective interest rate	6.1	6.3	6.9	7.5	8.2	8.7
Combined Shock						
Real GDP growth	2.1	-0.8	-0.4	2.7	2.7	2.7
Inflation	7.1	4.8	3.0	3.3	3.6	3.5
Primary balance	1.9	0.0	-0.7	0.8	1.0	1.1
Effective interest rate	6.1	6.7	6.8	7.5	8.2	8.7
Real GDP Growth Shock						
Real GDP growth	2.1	-0.8	-0.4	2.7	2.7	2.7
Inflation	7.1	4.8	3.0	3.3	3.6	3.5
Primary balance	1.9	0.0	-0.7	0.8	1.0	1.1
Effective interest rate	6.1	6.3	6.4	6.7	7.0	7.2
Real Exchange Rate Shock						
Real GDP growth	2.1	1.9	2.3	2.7	2.7	2.7
Inflation	7.1	7.3	3.7	3.3	3.6	3.5
Primary balance	1.9	0.6	0.7	0.8	1.0	1.1
Effective interest rate	6.1	6.7	6.3	6.5	6.8	7.0

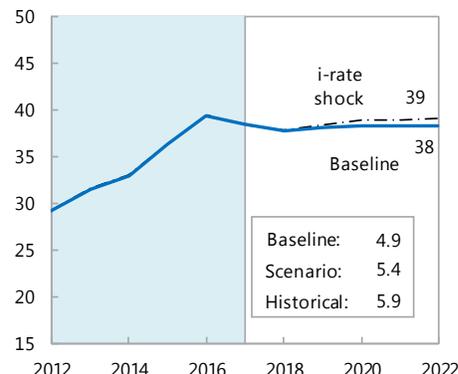
Source: IMF staff.

Mexico: External Debt Sustainability: Bound Tests 1/ 2/ (External debt in percent of GDP)

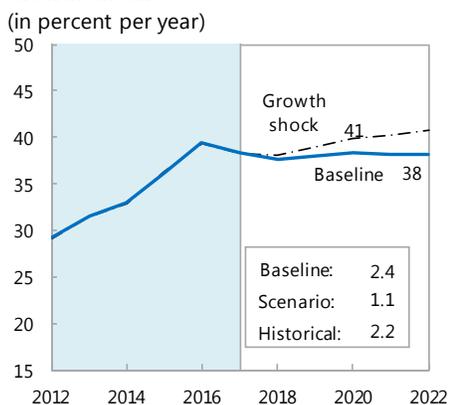
Baseline and historical scenarios



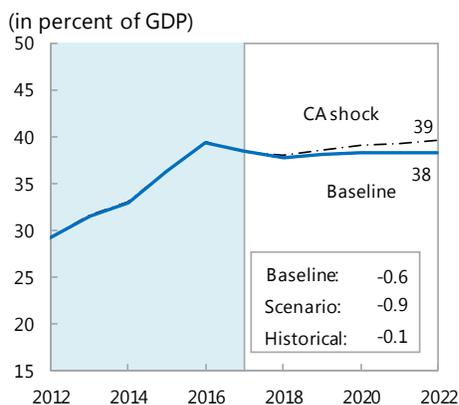
Interest rate shock (in percent)



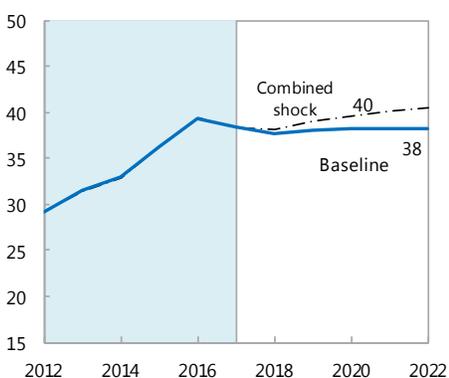
Growth shock



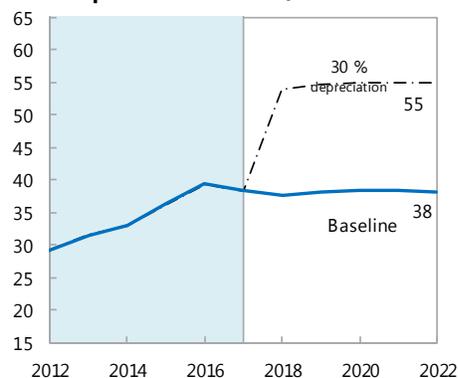
Non-interest current account shock



Combined shock 3/



Real depreciation shock 4/



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

4/ One-time real depreciation of 30 percent occurs in 2016.

Mexico: External Debt Sustainability Framework

(In percent of GDP, unless otherwise indicated)

	Actual					Projections						Debt-stabilizing non-interest current account 6/ -2.7	
	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022		
1 Baseline: External debt	29.2	31.4	32.9	36.3	39.4	38.3	37.6	38.0	38.3	38.2	38.2		
2 Change in external debt	5.1	2.3	1.5	3.4	3.1	-1.0	-0.7	0.4	0.2	0.0	0.0		
3 Identified external debt-creating flows (4+8+9)	-1.1	-1.9	-1.6	2.1	1.2	-1.2	-0.5	-0.6	-0.9	-1.1	-1.3		
4 Current account deficit, excluding interest payments	-0.1	0.9	0.2	0.8	0.3	0.0	0.9	0.8	0.6	0.5	0.3		
5 Deficit in balance of goods and services	-66.6	-64.4	-65.7	-72.2	-78.3	-79.3	-75.9	-75.7	-76.7	-77.5	-77.7		
6 Exports	32.7	31.6	32.3	35.1	38.1	38.8	36.6	36.6	37.2	37.6	37.7		
7 Imports	-33.9	-32.8	-33.5	-37.2	-40.2	-40.5	-39.3	-39.1	-39.5	-39.9	-40.0		
8 Net non-debt creating capital inflows (negative)	-1.7	-3.0	-2.1	-2.5	-2.8	-2.2	-2.2	-2.3	-2.4	-2.4	-2.5		
9 Automatic debt dynamics 1/	0.8	0.1	0.3	3.8	3.7	1.1	0.8	1.0	0.9	0.9	0.9		
10 Contribution from nominal interest rate	1.5	1.5	1.6	1.7	1.9	1.9	1.4	1.8	1.9	1.9	1.8		
11 Contribution from real GDP growth	-1.0	-0.4	-0.7	-1.0	-0.9	-0.8	-0.7	-0.8	-1.0	-1.0	-1.0		
12 Contribution from price and exchange rate changes 2/	0.3	-1.1	-0.6	3.1	2.7	...	...	...	...	...	...
13 Residual, incl. change in gross foreign assets (2-3) 3/	6.2	4.2	3.1	1.3	1.9	0.1	-0.2	1.0	1.2	1.1	1.3		
External debt-to-exports ratio (in percent)	89.2	99.5	102.0	103.5	103.3	98.9	102.8	103.9	103.0	101.7	101.3		
Gross external financing needs (in billions of US dollars) 4/	84.1	129.0	135.4	139.4	123.1	90.1	101.6	110.6	121.1	117.0	123.7		
in percent of GDP	7.1	10.2	10.4	12.1	11.8	10-Year	10-Year	8.0	8.3	8.6	8.9	8.1	8.2
Scenario with key variables at their historical averages 5/						38.3	40.5	42.7	45.1	47.7	50.8	0.1	
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation						
Real GDP growth (in percent)	4.0	1.4	2.3	2.6	2.3	2.2	2.7	2.1	1.9	2.3	2.7	2.7	
GDP deflator in US dollars (change in percent)	-2.6	4.9	0.6	-13.6	-11.2	-0.9	9.3	4.8	7.0	3.3	2.7	2.8	
Nominal external interest rate (in percent)	6.2	5.6	5.2	4.7	4.8	5.9	0.9	5.0	4.1	5.0	5.2	5.1	
Growth of exports (US dollar terms, in percent)	6.0	2.8	5.0	-3.6	-1.2	4.9	12.8	8.9	3.0	5.5	7.1	6.9	
Growth of imports (US dollar terms, in percent)	5.2	2.8	5.1	-1.5	-1.7	4.9	12.8	7.9	5.8	4.9	6.6	6.8	
Current account balance, excluding interest payments	0.1	-0.9	-0.2	-0.8	-0.3	-0.1	0.5	0.0	-0.9	-0.8	-0.6	-0.5	
Net non-debt creating capital inflows	1.7	3.0	2.1	2.5	2.8	2.2	0.6	2.2	2.2	2.3	2.4	2.5	

1/ Derived as $[r - g - r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as $[-r(1+g) + ea(1+r)] / (1+g+r+gr)$ times previous period debt stock. r increases with an appreciating domestic currency ($e > 0$) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period, excluding reserve accumulation.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.



MEXICO

STAFF REPORT FOR THE 2017 ARTICLE IV CONSULTATION— INFORMATIONAL ANNEX

October 23, 2017

Prepared By

The Western Hemisphere Department
(in consultation with other departments)

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FUND RELATIONS

(As of September 30, 2017)

The 2017 Article IV discussions were held in Mexico City during September 25-October 6. The mission comprised Costas Christou (head), Frederic Lambert and Christian Saborowski (WHD), Charlotte Lundgren (SPR), Hui Miao (MCM), Florian Misch (FAD), and Richard Berkhout (LEG). Robert Rennhack (WHD) joined the concluding meetings. Messrs. Hurtado and Zuñiga-Villaseñor (OED) also participated in the meetings. The mission met with Bank of Mexico Governor Carstens, Secretary of Finance and Public Credit Meade, Economy Secretary Guajardo, other senior officials, and representatives of the business community, other IFIs, and academics. Carolina Correa Caro, Patricia Delgado and Andrea Herrera (WHD) contributed to the preparation of this report.

Mexico has accepted the obligations of Article VIII, sections 2, 3, and 4. Comprehensive economic data are available for Mexico on a timely basis. It subscribes to the SDDS, and economic data are adequate to conduct surveillance.

Membership Status: Joined December 31, 1945

General Resources Account:	SDR Million	Percent of Quota
Quota	8,912.70	100.00
Fund holdings of currency	7,988.15	89.63
Reserve position in Fund	924.59	10.37
New Arrangement to Borrow	370,60	

SDR Department:	SDR Million	Percent of Allocation
Net cumulative allocation	2,851.20	100.00
Holdings	2,606.88	91.43

Outstanding Purchases and Loans: None

Latest Financial Arrangements

Type	Arrangement Date	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
FCL	May 27, 2016	May 26, 2018	62,388.90	0.00
FCL	Nov 26, 2014	May 26, 2016	47,292.00	0.00
FCL	Nov 30, 2012	Nov. 25, 2014	47,292.00	0.00
FCL	Jan 10, 2011	Nov 29, 2012	47,292.00	0.00
FCL	Mar 25, 2010	Jan 09, 2011	31,528.00	0.00
FCL	Apr 17, 2009	Mar 24, 2010	31,528.00	0.00

Projected Payments to the Fund (SDR million):

	2017	2018	Forthcoming 2019	2020	2021
Principal					
Charges / Interest	0.34	1.40	1.40	1.40	1.40
Total	0.34	1.40	1.40	1.40	1.40

Exchange Rate Arrangement: Mexico has a free-floating exchange rate, although it temporarily shifted to a floating arrangement between May and November 2015. Mexico maintains an exchange system that is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation: The last Article IV consultation was concluded by the Executive Board on November 16, 2016. The staff report was published as IMF Country Report No. 16/359.

Technical Assistance

Year	Dept.	Purpose
2017	STA	Government Financial Statistics
2017	FAD	Tax policy
2017	MCM	Central Securities Depositories
2017	FAD	Revenue Administration
2016	FAD	Revenue Administration
2015	STA	Balance of Payments
2015	FAD	Supervision of Subnational Finances
2014	FAD	Tax Policy and Compliance
2014	STA	Sectoral Balance Sheets
2014	STA	National Accounts
2014	STA	Balance of Payments
2013	MCM	Post-FSAP Follow Up
2012	FAD	Pension and Health Systems
2012	FAD	Treasury
2012	FAD	Tax Regimes for PEMEX
2011	FAD	Custom Administration
2011	FAD	Tax Policy

Resident Representative: None

RELATIONS WITH THE WORLD BANK

Mexico has had a longstanding partnership with the World Bank Group. The Country Partnership Strategy (CPS) FY14–19—which was jointly prepared with the Government of Mexico—focuses on the World Bank Group’s twin goals (ending extreme poverty and promoting shared prosperity) and is fully aligned with the Mexico’s National Development Plan (NDP) for 2013–18. The four key areas of engagement supported by the CPS are: (i) Unleashing Productivity; (ii) Increasing Social Prosperity; (iii) Strengthening Public Finances and Government Efficiency; and (iv) Promoting Green and Inclusive Growth. It describes the Bank’s engagement with Mexico as a partnership to achieve development results through selective and tailored packages of financial, knowledge, and convening services. The CPS was recently reviewed and updated at its mid-course through the Performance and Learning Report (PLR). The PLR shows that the WBG-supported program is on track and has advanced towards the achievement of the CPS objectives. A deepening of support in the four main areas of WBG engagement was proposed, as part of the PLR. IBRD lending has remained an important part of this engagement throughout the years.

As a member of the OECD and the G20, Mexico has maintained economic stability through times of recent crisis, and increased economic and social well-being over the last two decades. As of August 2017, the IBRD’s exposure was US\$14.8 billion which has positioned Mexico as the World Bank’s third largest IBRD borrower in terms of debt outstanding. The increase of the Single Borrower Limit up to US\$19.0 billion provides the IBRD with further financial space to support Mexico’s efforts in achieving its development agenda, albeit at additional cost.

The active portfolio consists of 17 IBRD projects (including 3 full GEF operations) for a net commitment of US\$2.4 billion and an undisbursed balance of US\$1.4 billion. The Bank has an active trust fund portfolio comprising 43 trust funds for a total net commitment of around US\$353 million. This includes a large Clean Technology Fund implemented in conjunction with the national Urban Transport Program project and a Forest Investment Program (FIP) fund.

In FY15-16, the Mexico Public Expenditure Review (PER) enhanced the Government’s capacity to manage medium-term fiscal challenges at national and subnational levels and was a valued input to the Government’s budget discussion and deepened the policy dialogue in many areas such as subnational borrowing regulations, and improvements in the targeting of social protection programs. The Government has requested the WBG to explore the possibility of providing more technical assistance in this area, specifically on fiscal consolidation policies for highly indebted states and a better use of federal transfers to state level.

In response to the Government’s intention to better link its social protection system to productive programs, the Bank has provided support to the re-design of Mexico’s CCT program—now known as PROSPERA—in further improving investments in human capital for the poor. The Bank has specifically contributed to link the poor to a broader set of income generating programs and to better target the

supply of social programs to areas and beneficiaries with the greatest needs. A new operation supporting PROSPERA is currently under preparation.

At the request of Government, the Bank is supporting the development of the Special Economic Zones (SEZs) which includes among the poorest states in the country (Chiapas, Guerrero, and Oaxaca) caught in a low-productivity, low-growth, and high-poverty cycle. Considered a partner of choice on SEZs, the WBG has been supporting the government on the development of its SEZ regime. Drawing on the WBG's global experience with SEZs, support has been provided for a rapid investor perceptions survey, the drafting of the SEZ law and implementing regulation, and the development of a SEZ roadmap to guide Government implementation.

Other areas of support to Mexico's productivity and inclusive growth agenda include projects to improve the country's agricultural storage and information systems to enhance food security and competitiveness as well as to strengthen the efforts of the Government to launch an Inner-City affordable housing program.

The IFC investment portfolio reached US\$1.22 billion own account and \$0.98 billion resource mobilization at the end of August 2017, representing the second largest portfolio in the Latin America and Caribbean (LAC) region and the 6th largest worldwide. The portfolio represents investments across 50 companies, mostly in the chemicals sector (27 percent), followed by ports (24 percent), telecom (10 percent), oil and gas (9 percent), agribusiness and forestry (7 percent), financial markets (7 percent), and others (16 percent). In terms of products, 73 percent is in loans and guarantees and 27 percent in equity and equity-type products. The outstanding portfolio (including mobilization) represents 86 percent of the total portfolio, with the remaining 14 percent pending disbursement.

IFC's Asset Management Company (AMC) has been selected to manage the China-Mexico Fund (CMF), a \$1.2B private equity fund established in September 2014 of the Chinese government, through the China Investment Corporation (CIC) and the China Development Bank (CDB), with the Mexican government, via the National Infrastructure Fund (FONADIN) and Nacional Financiera (NAFIN). CMF aims to promote the implementation of Mexico's structural reforms and contribute towards further development of the private sector in Mexico. To date, the CMF team has made two high profile investments in the oil and gas and telecom sectors, representing investment commitments of \$320m. CMF has a life of 12 years, including a five-year investment period.

MIGA remains open to explore opportunities to support private sector in the areas of infrastructure and energy via its political risk insurance and credit enhancement products.

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
<p>General: Data provision is adequate for surveillance.</p>
<p>National Accounts: The national accounts statistics generally follow the recommendations of the <i>System of National Accounts, 2008 (2008 SNA)</i>. Source data and statistical techniques are sound and most statistical outputs sufficiently portray reality. A broad range of source data are available, with economic censuses every five years and a vast program of monthly and annual surveys. For most surveys, scientific sampling techniques are used. Nonetheless, most samples exclude a random sample of small enterprises. Some statistical techniques need enhancement. For example, taxes and subsidies on products at constant prices are estimated by applying the GDP growth rate, a deviation from best practice.</p> <p>During 2014 STA conducted a reassessment of the data module of the ROSC that covered national accounts. As compared with the 2010 ROSC, the reassessment was based on the newest (May 2012) vintage of the Data Quality Assessment Framework (DQAF) and against those specified in the Special Data Dissemination Standard (SDDS). The data ROSC reassessment found that national accounts statistics are generally of a high quality, adequate to conduct effective surveillance and adequately meet users' needs. Since 2010, Mexico has made significant improvements on the methodological and dissemination aspects of data quality. Nevertheless, areas for further improvement and refinement exist, in particular, on the resources devoted to collecting state and local government source data and seasonally-adjusted data, explaining data revisions, and on compiling data on changes in inventories and on the volume of taxes on products.</p> <p>INEGI has published annual sectoral accounts and balance sheets following the System of National Accounts 2008 (2008 SNA) classifications of assets and sectors for the period 2003–2012 in November 2013. These accounts were revised recently and published on June 30, 2014. STA conducted a mission during 2014 to assess the possibility for developing quarterly sectoral accounts and balance sheets and agreed with the Mexican authorities on a work plan for developing these accounts. INEGI and Banxico agreed to collaborate in the compilation of quarterly stocks and flows of financial assets and liabilities by institutional sectors.</p>
<p>Prices: The concepts and definitions for both the CPI and PPI meet international standards. The PPI is only compiled by product and not by economic activity. A ROSC mission on prices was conducted in November 2012.</p>
<p>Government finance statistics: The authorities compile fiscal statistics following national concepts, definitions, and classifications that make international comparison difficult. The statistics are comprehensive and timely, except for states and municipalities. The new government accounting law mandates accounting standards that follow international standards for all levels of government, and that take into account the information needs of</p>

international organizations and national accounts. A full adoption of uniform accounting standards at the sub-national level will be crucial to obtain a precise measure of public fixed investment in national accounts, among others.

The authorities have started to report government finance statistics in GFSM 2014 format in 2017. They reported a time series that covers GFS from 2008 to 2016 inclusive, and will be published in the next GFS yearbook.

Monetary and financial statistics: The methodological foundations of monetary statistics are generally sound. Availability of data on other financial intermediaries such as insurance companies and pension funds allow for the construction of a financial corporation's survey with full coverage of the Mexican financial system, which is published on a monthly basis in International Financial Statistics.

Financial sector surveillance: Mexico is reporting Financial Soundness Indicators (FSIs) for Deposit Takers on a monthly basis.

External sector statistics: In 2017, Banco de Mexico migrated balance of payment and international investment statistics to the *sixth edition of the Balance of Payments and International Investment Position Manual (BPM6)* and adopted a structure consistent with *BPM6* in national publications. Several measures to improve external debt statistics have been carried out, including the compilation of data on external liabilities of the private sector and publicly traded companies registered with the Mexican stock exchange (external debt outstanding, annual amortization schedule for the next four years broken down by maturity, and type of instrument). STA conducted two technical assistance missions on external sector statistics (ESS) in 2014 and 2015. The main purpose of the missions was to assist the balance of payment statistics compilers in further strengthening their data collection and compilation system for ESS. In particular, the missions focused on foreign direct investment, financial derivatives, bank accounts used in foreign exchange operations, capital account, financial intermediation services indirectly measured private sector debt, and the migration to the *BPM6*. As a result of the implementation of the missions' recommendations, the quality of ESS has significantly improved. There are ongoing efforts to compile manufacturing services on physical inputs own by others, and to improve the coverage of capital account transactions and nonfinancial private sector transactions and positions.

II. Data Standards and Quality

Mexico observes the Special Data Dissemination Standards (SDDS) and its metadata are posted on the Dissemination Standards Bulletin Board (DSBB). In a number of cases, the periodicity and timeliness of disseminated data exceed SDDS requirements.

A data ROSC update was completed on June 24, 2015 and was published as IMF Country Report No. 15/176.

Mexico: Table of Common Indicators Required for Surveillance								
As of Oct. 10, 2017								
		Date of latest observation	Date received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷	Data Quality-Methodological Soundness ⁸	Data Quality Accuracy and Reliability ⁹
Exchange Rates		Sep. 2017	Oct. 2017	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹		Sep. 2017	Oct. 2017	W	W	W		
Reserve/Base Money		Jul.2017	Sep. 2017	D	D	D	LO, O, O, LO	LO, O, O, O, O
Broad Money		Jul.2017	Sep.2017	M	M	M		
Central Bank Balance Sheet		Jul.2017	Sep. 2017	W	W	W		
Consolidated Balance Sheet of the Banking System		Jul.2017	Sep. 2017	M	M	M		
Interest Rates ²		Jul.2017	Sep. 2017	D	D	D		
Consumer Price Index		Aug.2017	Sep. 2017	Bi-W	Bi-W	Bi-W	O, O, LNO, O	LO, LNO, O, O, LNO
Revenue, Expenditure, Balance and Composition of Financing ³ -Gen. Government ⁴		Aug. 2016	Oct. 2016	M	M	M	LO, LNO, LNO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing ³ -Central Government		Jun 2017	Aug 2017	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt ⁵		Aug. 2016	Oct. 2016	M	NA	M		

Mexico: Table of Common Indicators Required for Surveillance (concluded)

External Current Account Balance		Q2 2017	Sep. 2017	Q	Q	Q	LO, LO, LNO, LO	LO, O, O, O, LO
Exports and Imports of Goods and Services		May 2017	Sep. 2017	M	M	M		
GDP/GNP		Q1 2017	Sep. 2017	Q	Q	Q	O, O, O, LO	LO, O, LO, LO, O
Gross External Debt		Q2 2016	Sep. 2016	Q	Q	Q		
International Investment Position ⁶		Q1 2017	Jul. 2017	Q	Q	Q		

¹ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

² Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

⁷ Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

⁸ Reflects the assessment provided in the data ROSC completed on July, 2014, except consumer prices which is based on the ROSC completed on 2012. For the dataset corresponding to the variable in each row, the assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

⁹ Same as footnote 8, except referring to international standards concerning source data, assessment and validation of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by the Staff Representative on Mexico
November 8, 2017

This statement provides information that has become available since the staff report was finalized. This information does not alter the thrust of the staff appraisal.

1. **The Foreign Exchange Commission announced on October 25 that it would sell non-deliverable forwards (NDFs) settled in local currency for a total of US\$4 billion in seven weekly auctions.** The decision was motivated by the recent increase in peso volatility associated with greater uncertainty regarding the NAFTA negotiations after an inconclusive fourth round of discussions as well as the process of U.S. monetary policy normalization.¹ The first two operations entailed a total of US\$1.5 billion in contracts and were met by strong demand. The contracts will be rolled over at maturity for as long as the Foreign Exchange Commission deems necessary. These auctions are the first since the NDF program was first used in March 2017 with the auctioning of US\$1 billion in NDF contracts.

2. **On October 31, the authorities published revised National Accounts data series along with the 2017:Q3 flash estimate.** Output declined 0.2 percent s.a.a.r in 2017:Q3 following a 0.6 percent expansion in 2017:Q2. In year-on-year terms, the economy grew by 1.6 percent in 2017: Q3, compared with 1.9 percent in 2017:Q2. This is in line with staff's annual growth projection of 2.1 percent for 2017. The authorities also published a revised National Accounts data series with a new base year of 2013. The series reflects a variety of methodological and coverage improvements including most of the recommendations in the 2015 Report on the Observation of Standards and Codes (ROSC). As a result of these revisions, annual average real GDP growth in the years 2013–16 was revised from 2.1 percent to 2.6 percent.

3. **The Financial Action Task Force (FATF) discussed Mexico's AML/CFT assessment at its Plenary meeting last week.** The draft report was approved, pending a final quality and consistency review to take place in the coming weeks ahead of publication. The overall findings of the FATF report are consistent with the staff assessment as reflected in the staff report.

¹ The peso had depreciated almost 8 percent during the preceding three weeks, bid-ask spreads had widened, and implied exchange rate volatility had increased.