Mexico:
2016 IMF ARTICLE IV CONSULTATION

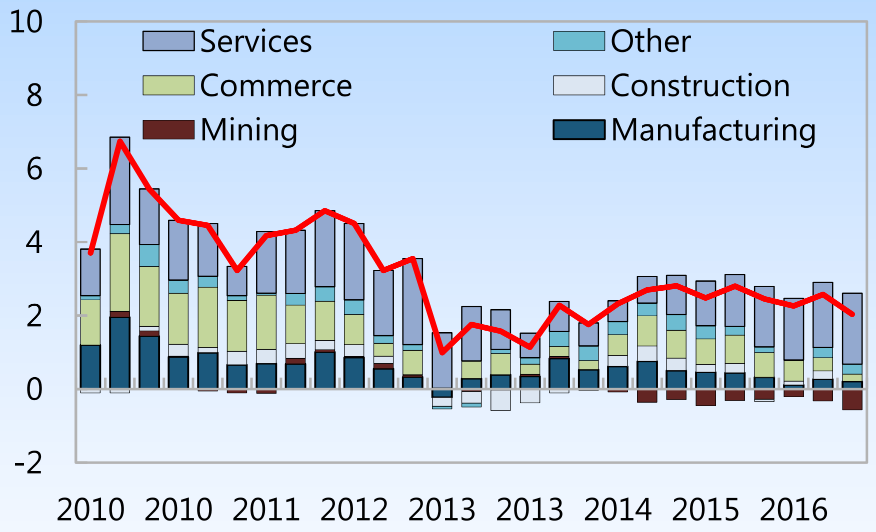
Wilson Center, January 9, 2017

Western Hemisphere Department
International Monetary Fund

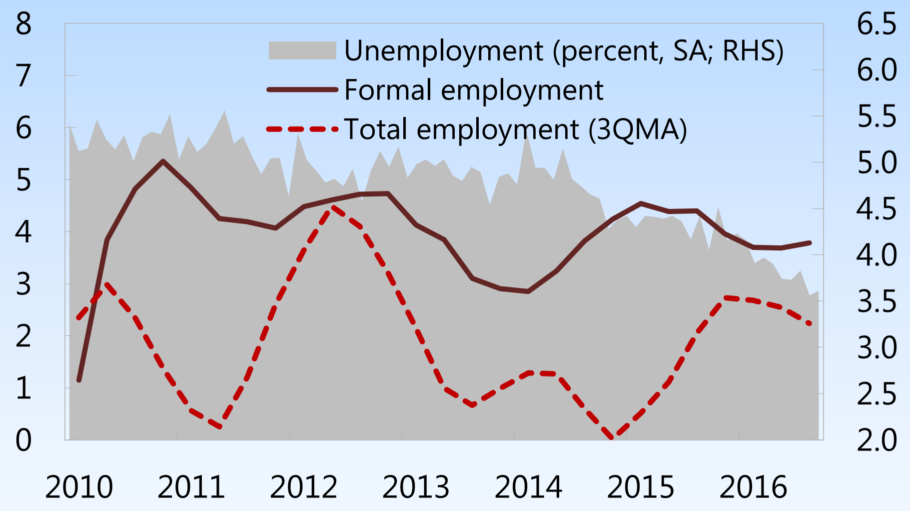
BACKGROUND

Growth in Economic Activity and Employment Have Remained Stable

Real GDP Growth and Contributions
(In percent, NSA)

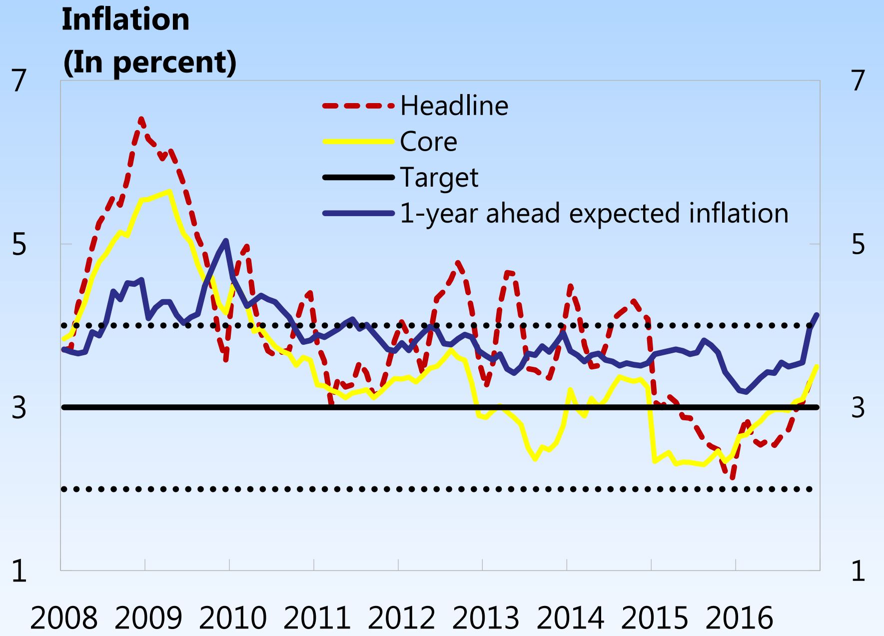


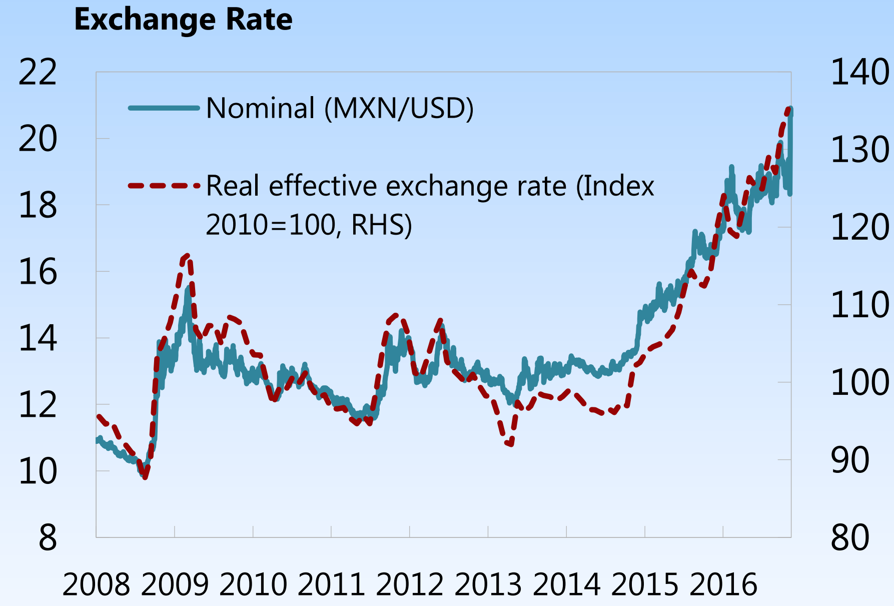
Employment
(Y/Y growth, NSA)



Source: National Authorities.

Inflation Has Remained Close to the Target

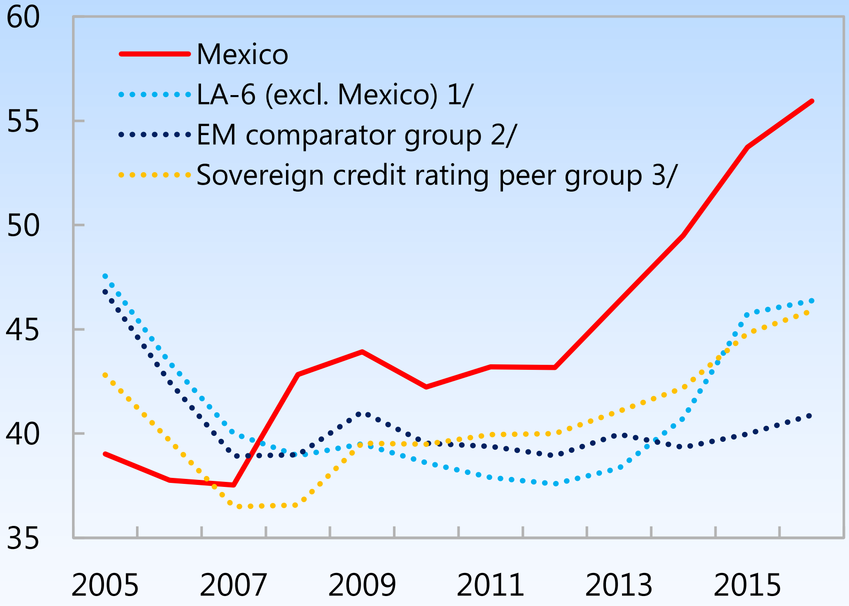




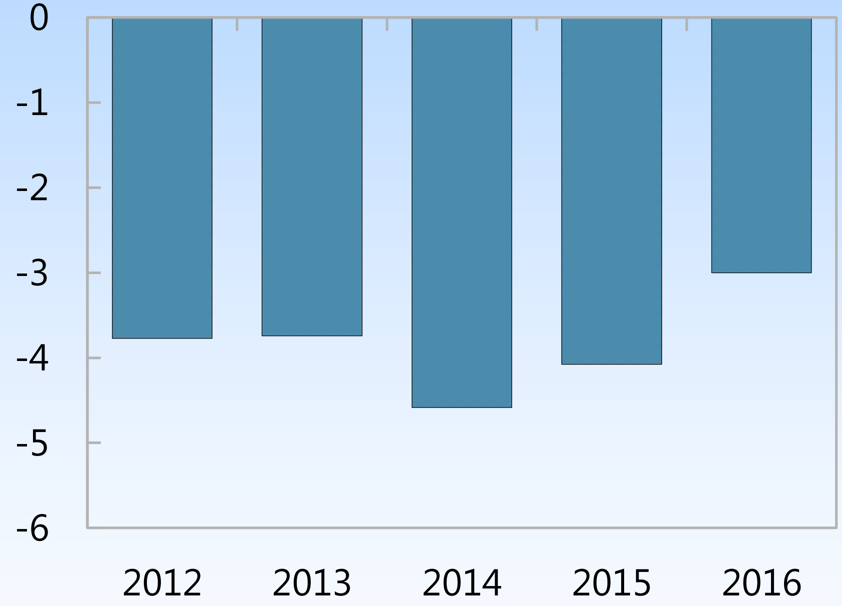
Source: National Authorities.

Public Debt has Steadily Increased, but Fiscal Consolidation Has Begun

Gross Public Sector Debt
(In percent of GDP)



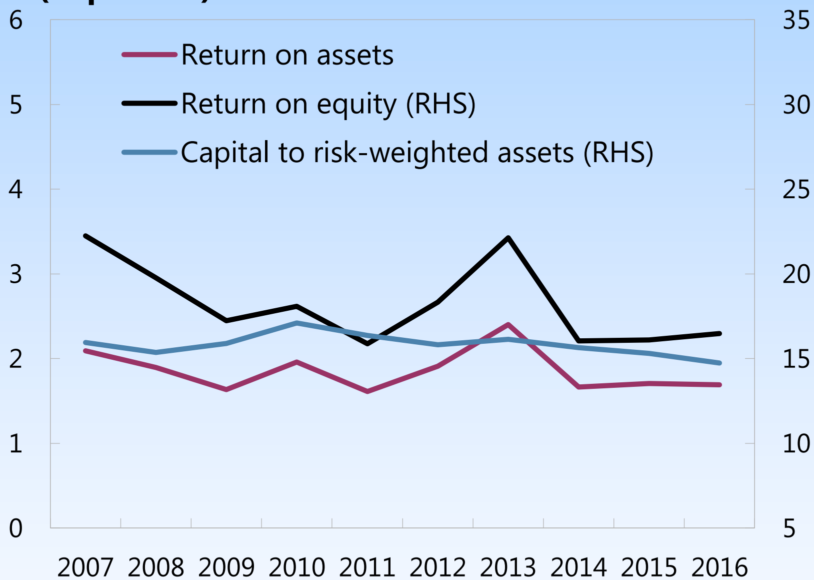
Fiscal Balance
(In percent of GDP)



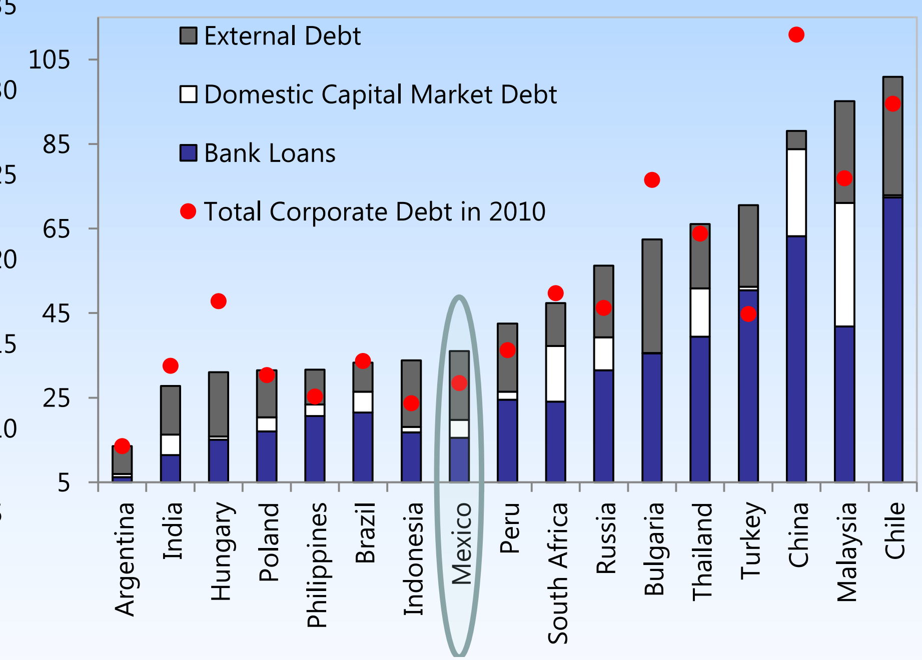
Source: National authorities; World Economic Outlook; Fitch Ratings; and IMF staff calculations.
1/ LA-6 excluding Mexico is comprised of Brazil, Chile, Colombia, Peru, and Uruguay.
2/ EM comparator group is comprised of India, Indonesia, Poland, Russia, Thailand, and Turkey.
3/ Fitch sovereign credit rating peer group includes Brazil, Chile, Colombia, India, Poland, Russia, South Africa, Thailand, and Turkey.

Low Financial Vulnerabilities

Commercial and Development Banking Sector 1/
(In percent)



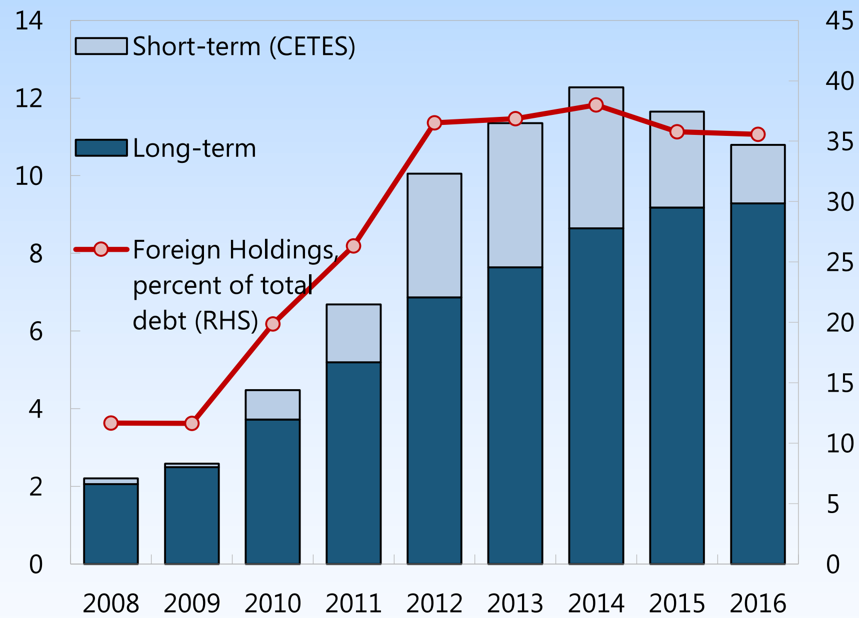
Total Nonfinancial Corporate Debt in 2015
(In percent of GDP)



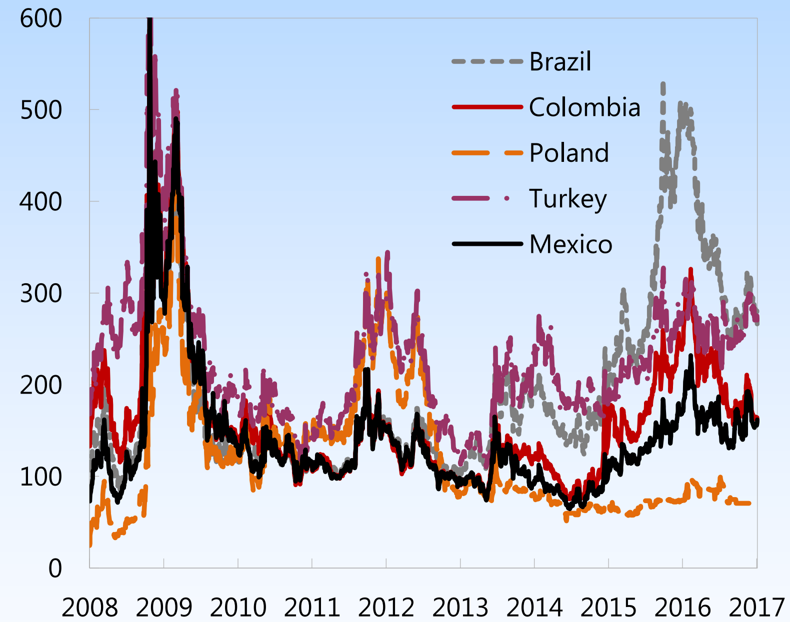
Source: National Authorities, Bloomberg.
1/ as of July 2016

Solid Appetite for Mexico's Financial Assets

Non-Residents' Holdings of Local Sovereign Debt
(In percent of GDP: as of December 2016)



Sovereign Risk Spreads
(5 year CDS spread, in basis points as of Jan. 6, 2017)



Source: National Authorities, Bloomberg.

OUTLOOK AND RISKS

Downside Risks are Mostly External

Outlook (as of October, 2016):

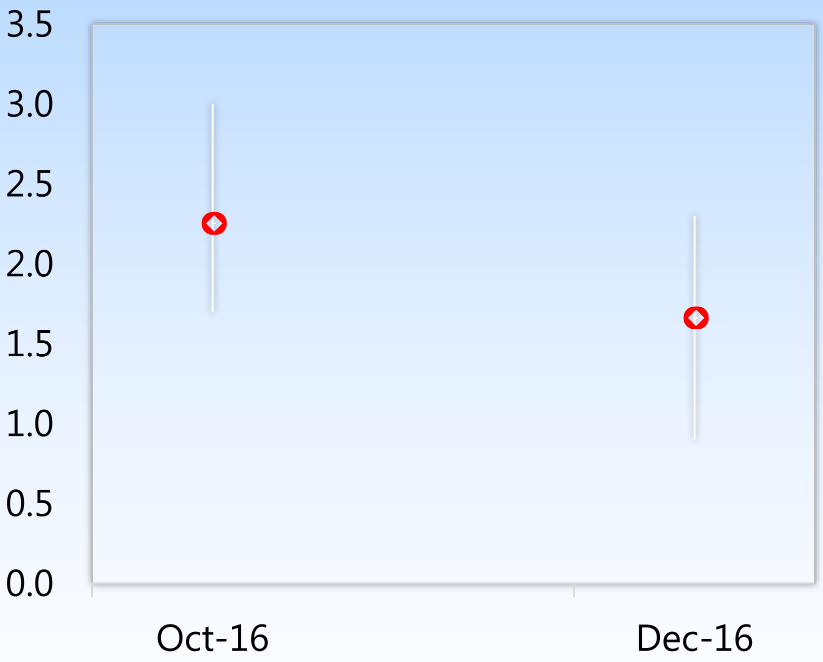
- Growth expected to pick up on the back of stronger US growth in the near term and the effect of structural reforms in the medium term.

Main downside risks:

- Rise in protectionism.
- Weaker-than-expected global growth, and particularly U.S. growth.
- Renewed volatility in global financial markets.
- A lower-than-expected path for oil prices or domestic oil production.

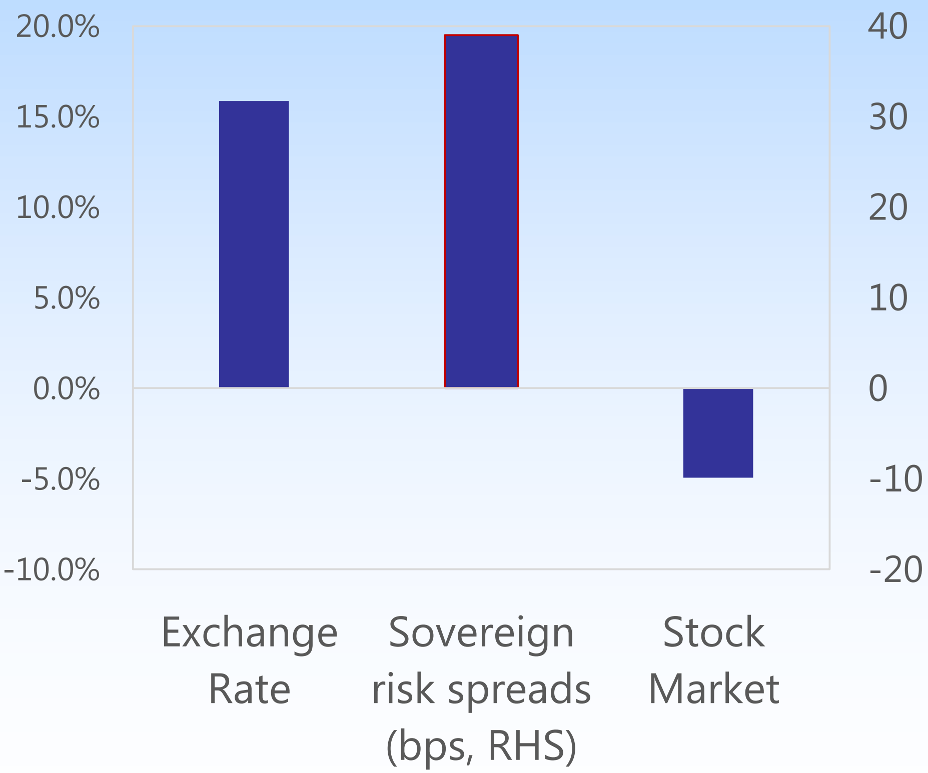
Downside risks have increased

Consensus Forecast for 2017 Real GDP growth
(In percent)



Source: Bloomberg.

Change between Nov. 8, 2016 and Jan. 6, 2017
(In percent and bps)

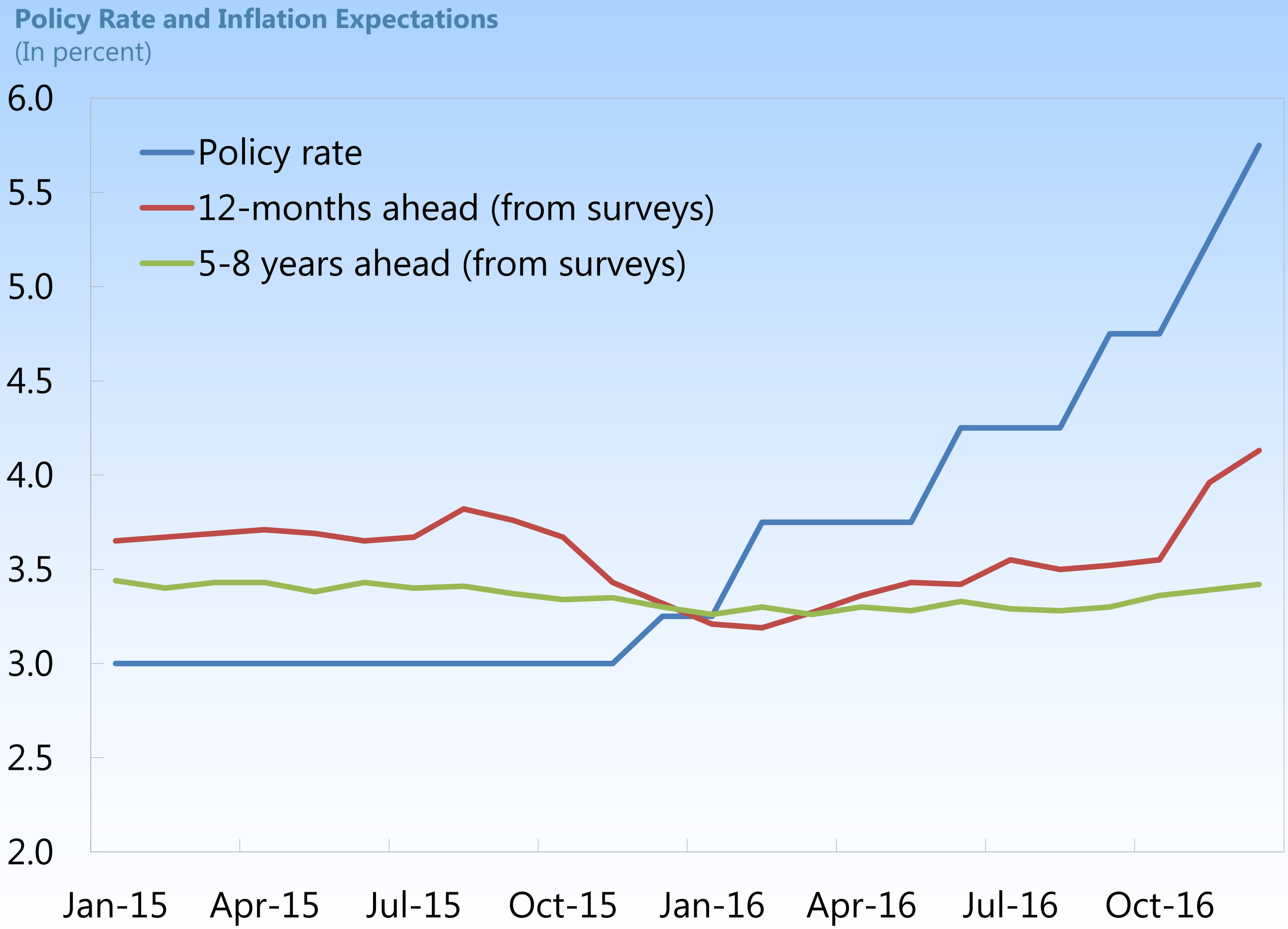


POLICY PRIORITIES

Fiscal Policy: Rebuild Buffers and Strengthen Fiscal Framework

- Adhere to plan of reducing fiscal deficit (PSBR) to 2.5 percent of GDP by 2018.
  - If revenue surprises materialize, reduce PSBR faster.
  - Consider more ambitious target beyond 2018 to reduce public debt faster.
- PEMEX reform critical for market confidence.
- Credibility enhancements to the fiscal framework:
  - Creation of a non-partisan fiscal council
  - Tighter link between the desired level of public debt and PSBR targets
  - Tighter triggers for exceptional circumstances clause
  - Explicit rules to return to targets following a deviation

Monetary Policy: Anchored Expectations Reduce the Need for Tightening



Source: National Authorities.

Exchange Rate Policies

- Flexible exchange rate key shock absorber
- Interventions to address disorderly market conditions
- Shift from rules-based to (sparing) discretionary intervention (in line with 2015 AIV advice)

FX interventions (USD, billions)

	Total	Rules based	Other
2014	0.2	0.2	0.0
2015	24.5	24.5	0.0
2016	5.6	3.6	2.0

Source: Banxico.

- Going forward, discretionary intervention remains a tool. Point: ensure functional markets, prevent build-up of one-sided bets, no specific exchange rate target.

Financial Sector Assessment Program

- Balance sheets of financial and non-financial institutions resilient to severe shocks
- Financial sector prudential oversight has been strengthened, but further enhancement are recommended:
  - Strengthen the independence of supervisors. Financial soundness should be primary mandate. Consolidate supervisors.
  - Strengthen the role of the Financial System Stability Council (CESF) in the assessment of financial stability risks.
  - Develop formal contingency plans and simulation exercises.
  - Strengthen deposit insurance (remove legacy debt).
  - Align incentives of development banks more closely with developmental objectives (and eliminate credit targets).

Structural Issues

- Impressive set of reforms in 2013/14
  - energy, telecommunications, financial, labor, education…
  - Impact: telecom reform reduced prices, energy reform coincided with falling oil prices, but nevertheless proceeding.
  - Expected to boost potential growth over the medium term.
  - Continued implementation crucial
- Major structural bottlenecks remain:
  - Security and rule of law need to be strengthened (with particularly severe problems in some parts of the country)
  - Efficiency and quality of judicial institutions should be further strengthened
  - Female labor supply weak compared to peers
  - High rates of poverty and inequality

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