MEXICO

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION

November 1, 2012

KEY ISSUES

Background. Mexico's growth has remained resilient, supported by both external and domestic demand, nearly closing the output gap opened during the global crisis. Mexico's strong economic performance, despite the sluggish U.S. recovery and persistent global uncertainty associated with Europe, attests to its strong fundamentals and sound policy management. Economic activity is expected to moderate towards potential growth. Inflationary pressures have been contained and inflation expectations remain anchored, despite the recent uptick in headline inflation due to higher food prices. The exchange rate has fluctuated significantly, related to bouts of global risk aversion, but with no major balance sheet or pass-through effects. The authorities' policies have aimed to balance supporting the recovery and gradually rebuilding policy space, given heightened global risks.

Risks. Short-term risks are mainly associated with unsettled external conditions, with longer-term risks linked principally to domestic structural challenges. A significant U.S. slowdown or renewed global financial turmoil from Europe would affect Mexico, given its close integration with the U.S. economy and international capital markets. Longer-term issues include the need to advance reforms to boost growth and to address fiscal challenges associated with diminishing oil revenues and spending pressures from health and pensions.

Policy Challenges. With Mexico operating close to potential but external risks looming large, discussions focused on the importance of: (i) maintaining an appropriate policy stance (from a cyclical perspective) and policy mix (to continue rebuilding fiscal policy buffers); and (ii) weighing contingent policy responses to global downside risks. The ongoing fiscal consolidation is welcome, but stepping up consolidation efforts would be important to restore Mexico's fiscal buffers to pre-crisis levels. The end of oil windfalls would pose challenges for fiscal policy, making this more difficult. The monetary authorities' vigilance over recent supply shocks and cyclical conditions is warranted at the current juncture.

Overall, current and incoming authorities emphasized policy continuity, stressing that it is underpinned by the strong consensus in Mexico about macroeconomic stability.

Were downside risks to materialize, exchange rate flexibility should continue to play a key buffering role. The policy room to contain the fallout would greatly depend on the extent to which global financial stresses spill over to Mexico. In the event of a significant U.S. slowdown, monetary policy and automatic stabilizers could be used to cushion the impact of the real spillover. In the event of a surge in global risk aversion and consequent general pullback from emerging markets, the policy space to contain the fallout would be more constrained. However, Mexico has significant foreign exchange buffers to deploy if necessary to limit overshooting and dysfunctional market conditions.

Addressing Mexico's longer-term challenges would require decisive action on structural reforms. Tax and subsidy reforms, including revenue mobilization efforts, would be essential to address future pressures from declining oil revenues and population aging. Structural reforms to unleash Mexico's growth potential would benefit from a broad approach, whereby energy reform is accompanied by, inter alia, competition, labor and education reforms to ensure that productivity gains accrue to all sectors.

Approved By
Adrienne Cheasty and Lorenzo Giorgianni

Discussions took place in Mexico, D.F., during September 18–27, 2012. The team comprised: Martin Kaufman (head), Herman Kamil, Esteban Vesperoni (all WHD); Pamela Madrid Angers (MCM); Santiago Acosta Ormaechea (FAD); and Gilda Fernandez (SPR). Adrienne Cheasty (WHD) participated in the concluding meetings.

CONTENTS

RECENT DEVELOPMENTS

1. **Mexico's strong economic performance, despite the sluggish recovery in U.S. GDP and persistent uncertainty from Europe, attests to its strong fundamentals and sound policy management**. The strength and resilience of the recovery after the global crisis have been underpinned by Mexico's sound balance sheets, strong policy frameworks, and skillful macroeconomic management. Mexico's recognition as a predictable and prudently managed economy, as well as its open capital and current accounts, market-friendly and transparent regulations for foreign investment, and deep and liquid financial markets, have bolstered large foreign investment in recent years. Amid persistent global financial uncertainty, the successive Flexible Credit Line (FCL) arrangements have supported Mexico's economic policies by providing a significant buffer against tail risks. The Executive Board commended Mexico's very strong policy track record and frameworks in the 2011 Article IV consultation and the last review of the FCL arrangement.

2. **Mexico's growth has been resilient, supported by both external and domestic demand, helping to close the output gap**. Growth in 2011 and 2012 has remained above potential and is expected to help close the output gap that opened during the global crisis (Figure 1). Since the crisis, Mexico has benefited from the relatively good performance of the U.S. manufacturing sector (which has grown faster than U.S. GDP) and achieved a strong recovery of its market share in that market, particularly vis-à-vis China (see Chapter 2 of the Selected Issues paper). The gain in market share in the U.S. has come in part from improved relative unit labor costs (ULCs) and a continued flow of foreign direct investment into manufacturing, especially in the automotive sector.[1] In turn, domestic demand has been supported by sustained growth in employment and credit, underpinned by investors' and consumers' recognition of Mexico's resilience.

3. **Inflationary pressures have remained contained thus far, despite the recent uptick in headline inflation associated with higher food prices**. The increase in agricultural prices has driven headline inflation above the 4 percent ceiling of the inflation targeting range (Figure 2). While core inflation has also risen slightly, it remains within the target range, particularly in services, suggesting limited demand pressures so far.[2] Amid relatively slack labor market conditions until now, wage pressures have remained subdued.[3] Headline inflation developments are broadly viewed as temporary and supply-driven, with medium-term inflation expectations remaining firmly anchored, albeit slightly above the mid-level of the target range.

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[1] ULC in Mexico measured in pesos have shown a declining trend since early 2009. This is related to the containment of wage increases due to lower migration to the U.S. since the mid-2000s and a strong increase in manufacturing sector productivity. Other factors explaining the recouping of U.S. market share include the reemergence of a location advantage due to higher oil prices and transport costs, and a reassessment of additional benefits from relocating to Mexico (including the protection of proprietary technologies).

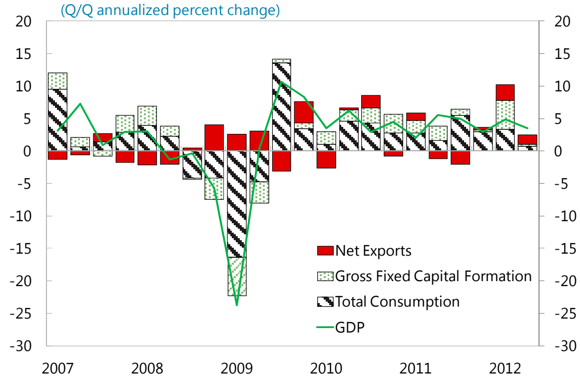
[2] The spike in non-core inflation has been driven by both external factors (international corn prices) as well as domestic factors (eggs and poultry prices linked to a bird flu outbreak, and vegetable prices linked to a drought).

[3] Following the global crisis, employment has experienced a significant and sustained recovery, but with the increase in labor participation from lower migration to the U.S., the urban unemployment rate (at about 5¾ percent) has remained somewhat above its pre-crisis level (4½ percent at end-2007). See Chapter 5 of the Selected Issues paper.

Figure 1. Mexico: Real Sector, 2007–2012

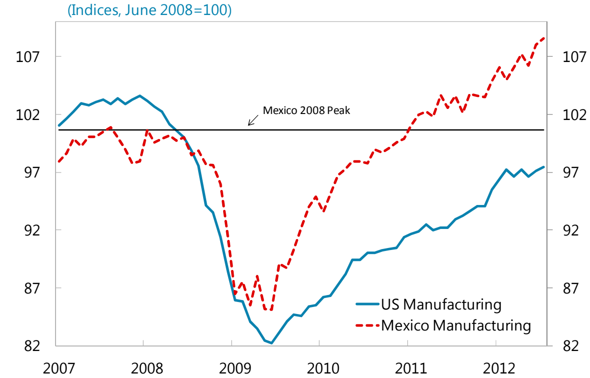
Growth has been resilient...

Contributions to GDP Growth
(Q/Q annualized percent change)



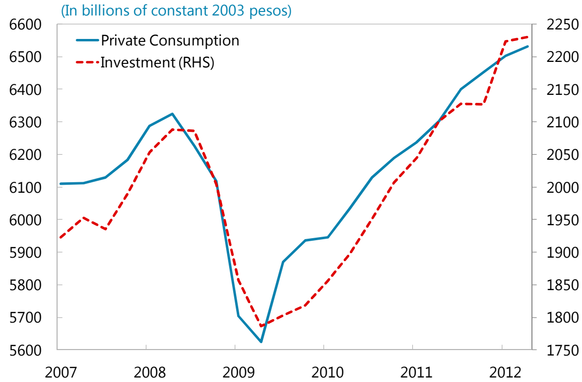
...supported by both external demand...

External Demand
(Indices, June 2008=100)



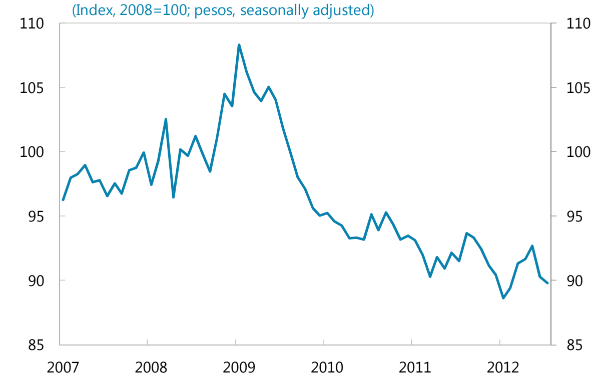
... and vibrant domestic demand.

Domestic Demand
(In billions of constant 2003 pesos)



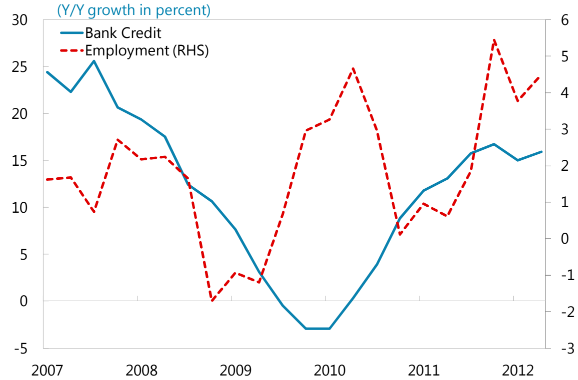
Exports have been underpinned by subdued ULC, amid lower migration to the US and higher labor participation...

Unit Labor Costs in Manufacturing
(Index, 2008=100; pesos, seasonally adjusted)



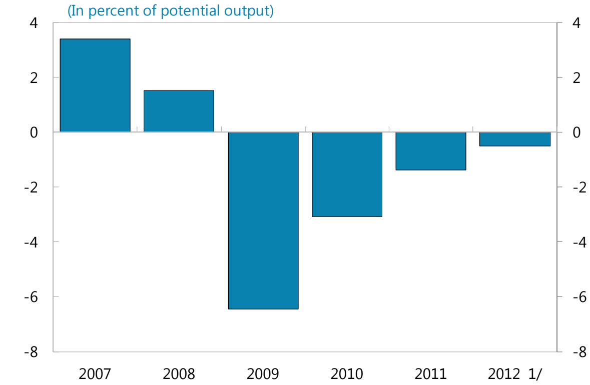
... while buoyant domestic demand has been supported by improving credit and employment conditions.

Employment and Credit
(Y/Y growth in percent)



Hence, the output gap has been gradually closing.

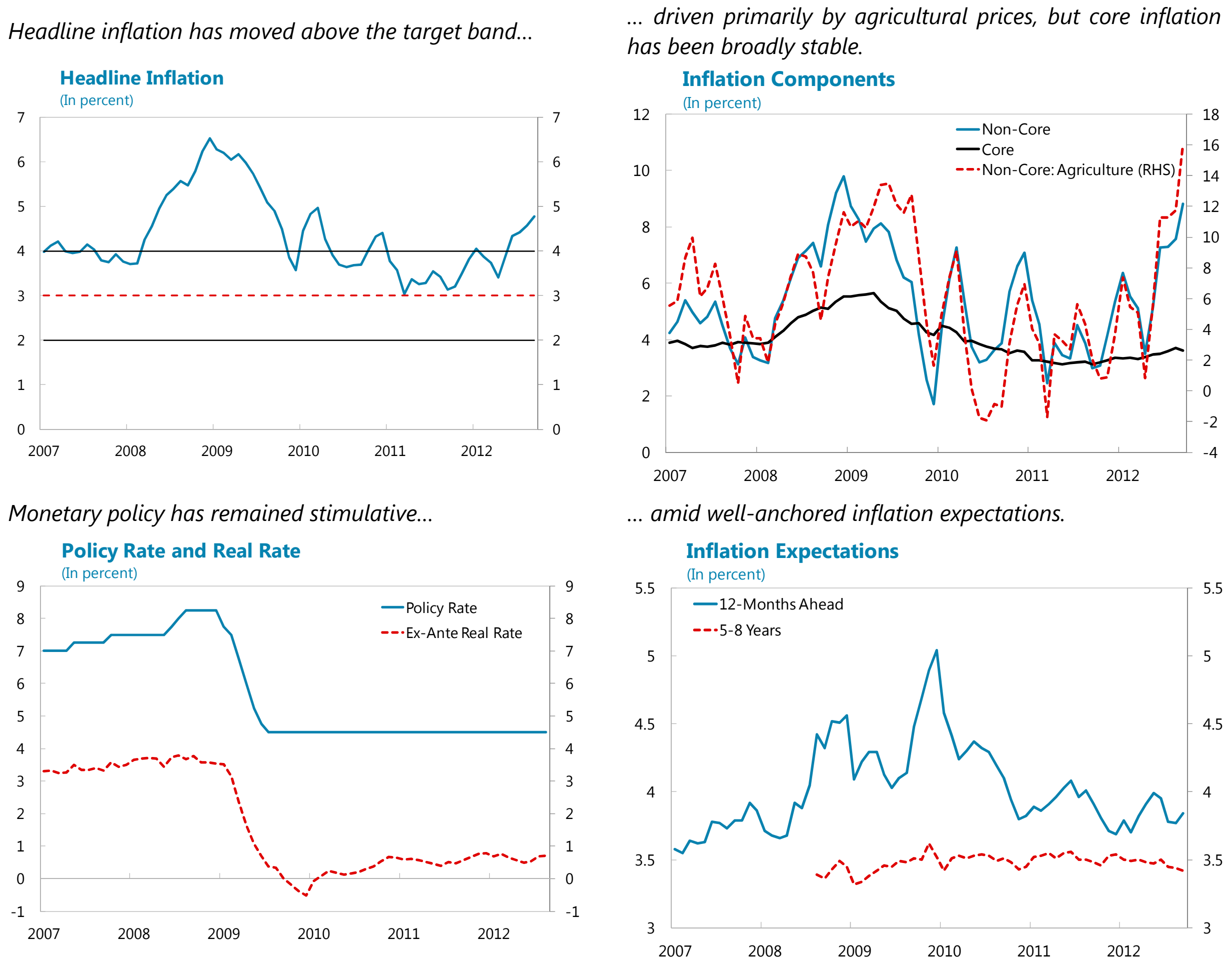
Output Gap
(In percent of potential output)



Sources: INEGI, Haver Analytics, Banxico, CNBV, and IMF staff calculations.

1/ Projection for 2012.

Figure 2. Mexico: Prices and Monetary Policy, 2007–2012



Sources: INEGI, Haver Analytics, Banxico, and Bloomberg.

4. **The exchange rate has fluctuated substantially, linked to the recurrent bouts of global risk aversion, but without major balance sheet or pass-through effects**. Exchange rate flexibility has been a key shock absorber, while sovereign and financial markets have remained stable, including the banking sector and domestic subsidiaries of Spanish banks. Capital inflows have continued, from an increasingly diversified investor base, particularly into local-currency sovereign paper and across the whole yield curve.[4] During the periods of high global uncertainty in 2011 and 2012, foreign investors responded mainly by covering currency exposures rather than divesting from government paper (Figure 3). These shifts to cover currency positions induced significant exchange rate volatility, but interest rates on government bonds remained stable through this period. To try to

[4] In 2012, foreign investment into short-term government paper (CETES) has increased by US$13 billion and into longer-duration government bonds by US$18 billion. In all, foreign investors currently hold about one third of the outstanding stock of local-currency government bonds.

reduce excessive daily currency volatility, the authorities introduced a new FX rule last November, selling U.S. dollars when the peso depreciates more than 2 percent in any given day; this is considered to have had an important signaling effect but has been used only sporadically.[5]

5. Mexico's external position has remained sound. The Fund's current account models and a range of exchange rate metrics suggest that the external position and real exchange rate are consistent with underlying fundamentals and desirable policy settings (see Annex 1). The balanced recovery in activity has meant that the current account deficit has remained moderate at about 1 percent of GDP (Figure 4). Given Mexico's rule-based reserve accumulation policy, the central bank bought US$16 billion in the first three quarters of 2012, with the bulk coming from Pemex's net FX balance; international reserves now amount to US$166 billion. At the same time, capital inflows have increased the stock of foreign portfolio liabilities by US$48 billion in the first half of 2012, to US$355 billion (30 percent of GDP).

6. Credit conditions have remained supportive of domestic demand. The banking system, including the domestic subsidiaries of Spanish banks, has been shielded so far from unsettled external conditions. Underpinned by strong capital and liquidity ratios, bank credit has continued to expand at a healthy pace (about 10 percent in real terms), sustaining the recovery that started in 2010, particularly through consumer and corporate lending.[6] Market access conditions for corporates have remained favorable, with spreads near historic lows. Despite some concerns from the large presence of Spanish banks in Mexico, lending by these institutions has continued unabated; any potential future divestment by these banks is expected to have limited effects in Mexico, as other financial institutions are anticipated to fill the space left.[7]

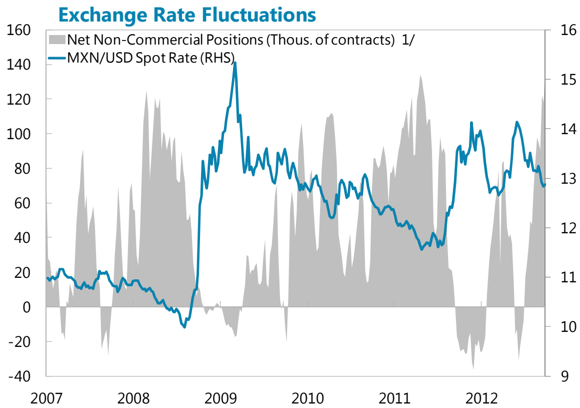
[5] The new rule stipulates that the Central Bank stands ready to sell up to US$400 million on any day that the peso depreciates more than 2 percent from the previous closing. At the same time, the authorities stopped their monthly auctioning of options to buy foreign exchange (for an equivalent to US$600 million per month), which had been established in February 2010.

[6] Bank NPLs have remained broadly stable at about 2 percent of assets for the system as a whole.

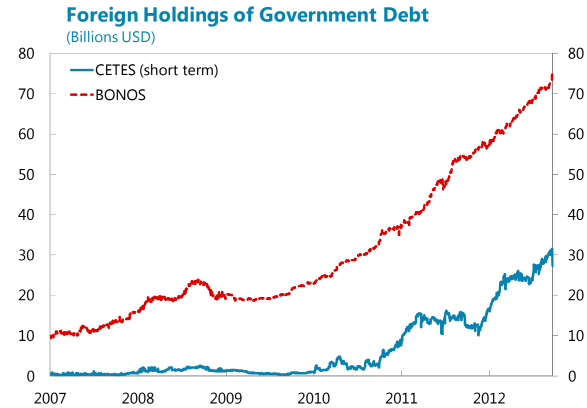
[7] Santander, the fourth largest bank in Mexico, recently conducted a successful IPO equivalent to 25 percent of the capital of its local subsidiary (about US$4 billion) and BBVA, the second largest bank, has announced plans to sell its stake in the pension administration business.

Figure 3. Mexico: Financial Sector, 2007–2012

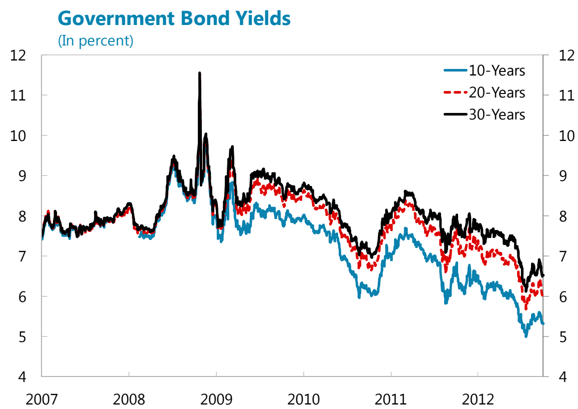
Exchange rate volatility has been associated with global uncertainty and hedging of peso positions…



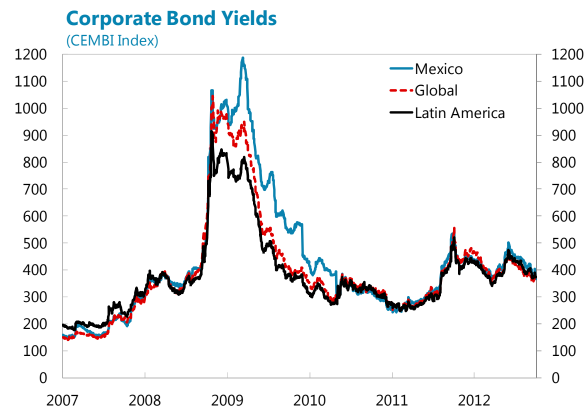
… while sovereign debt markets remained resilient.



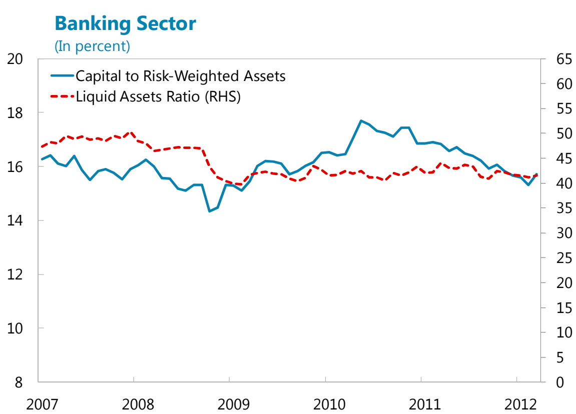
Sovereign bonds have recorded historically low yields…



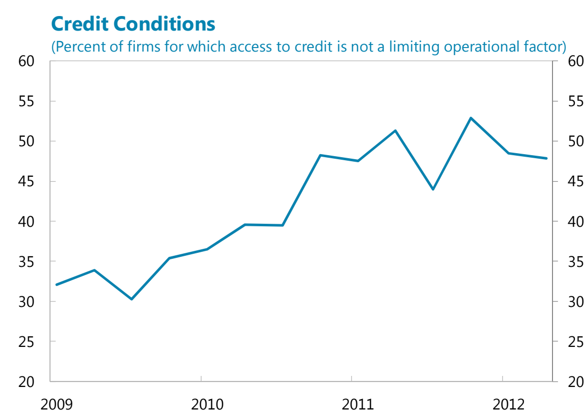
…while corporate yields are also subdued.



The banking sector remains liquid and well capitalized…



…while credit conditions have improved.



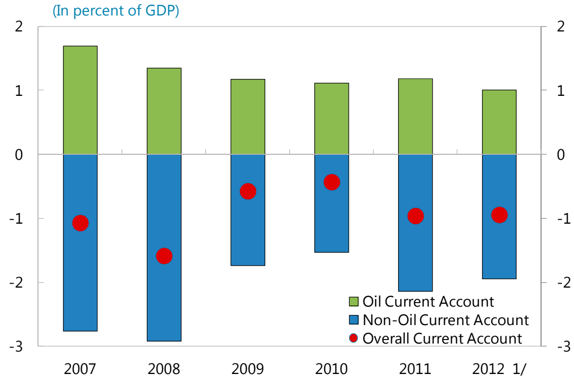
Sources: INEGI, Banxico, and Bloomberg.

1/ Non-commercial positions are those taken by traders that are not involved in the physical receipt/delivery of a commodity or asset.

Figure 4. Mexico: External Sector, 2007–2012

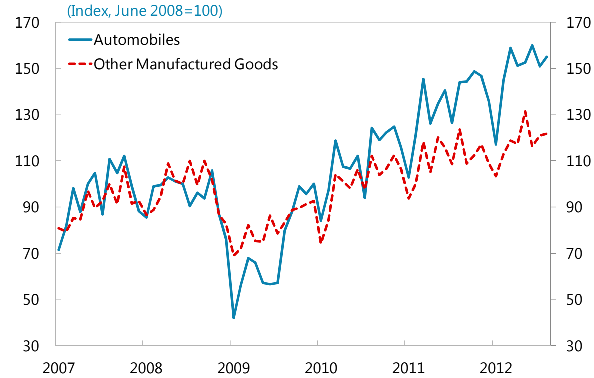
The current account has remained in moderate deficit…

Current Account Balance
(In percent of GDP)



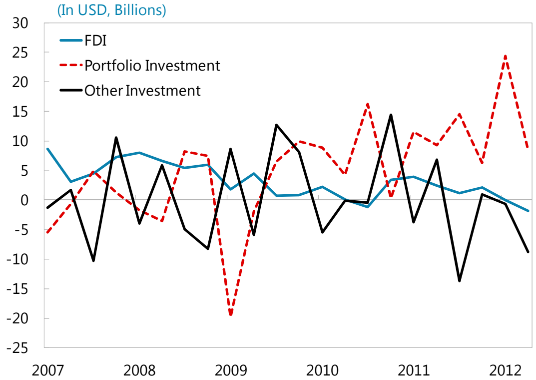
…with strong performance of manufacturing exports.

Manufactured Goods Exports
(Index, June 2008=100)



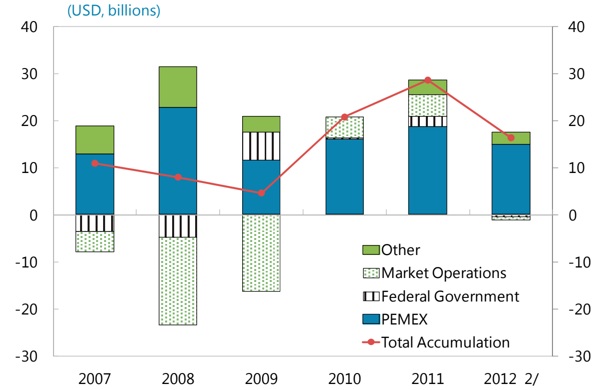
Foreign portfolio investment has remained strong…

Net Capital Inflows
(In USD, Billions)



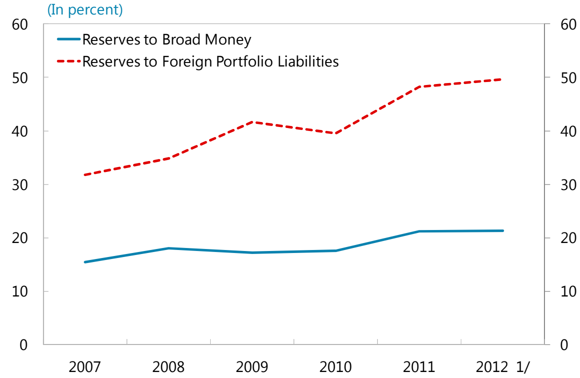
…and reserve accumulation has maintained a steady pace due to robust oil revenue…

Sources of Reserve Accumulation
(USD, billions)

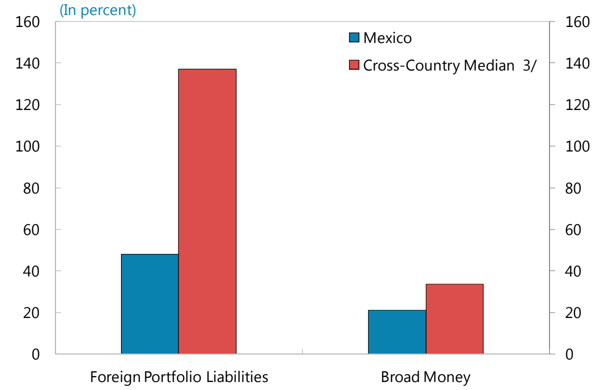


With an open capital account, Mexico has relatively low reserve coverage of balance sheet exposures.

Reserve Coverage
(In percent)



Reserve Coverage: Cross Country Comparison (2011)
(In percent)



Sources: INEGI, Haver Analytics, Banxico, and IMF Staff Calculations

1/ Data based on IMF staff estimates.
2/ 2012 data based on data available through September 2012.
3/ Group of countries listed in Annex 1, "Metrics of Reserve Coverage" charts.

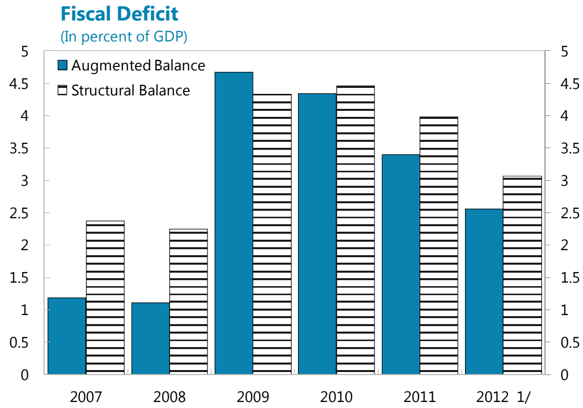
7. The policy stance has judiciously balanced the need to support the recovery while gradually rebuilding policy buffers in the context of heightened global risks. Mexico has continued to implement sound economic policies. Together with the flexible exchange rate regime, the policy mix—combining a gradual fiscal consolidation with stimulative monetary policy—has helped Mexico cope with capital inflows:

- **Monetary policy**. The policy rate has been maintained at 4½ percent since 2009, equivalent to an (ex-ante) real interest rate of about ½ percent, with medium-term inflation expectations remaining firmly anchored (Figure 2).
- **Fiscal policy**. Continuing the fiscal consolidation that began after the fiscal stimulus during the crisis, the structural primary deficit is expected to fall by about 1 percent in 2012—and thus return to balance. The consolidation efforts have helped stabilize public debt at around 43 percent of GDP (Figure 5).
- **Exchange rate**. Mexico's exchange rate flexibility has continued to play a key buffering role during the repeated bouts of global risk aversion. The central bank's rule-based intervention policy has sought to limit excess currency volatility. The peso has depreciated nearly 10 percent with respect to the U.S. dollar over the last year.

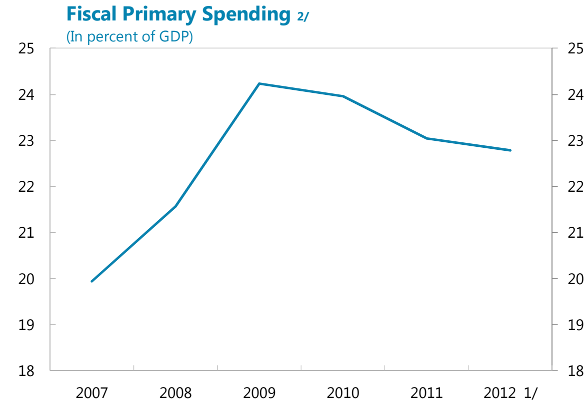
8. A new administration will take office in December. Mr. Enrique Peña Nieto (PRI) was elected president last July with nearly 40 percent of the vote and will take office on December 1. Since no party has a majority in congress, the new administration will need to marshal support to pursue its reform agenda. Among his closing acts in office, President Calderon (PAN) introduced two reform projects to congress in September—a labor reform to flexibilize labor markets and a public transparency initiative to improve information and monitoring of subnational governments—that were approved with PRI support (see Box 2). Mr. Peña Nieto's reform priorities, expressed during the campaign, also include: (i) opening up the energy sector to private investment; (ii) a tax reform to increase public revenues; and (iii) reforms to foster competition.

Figure 5. Mexico: Fiscal Sector, 2007–2012

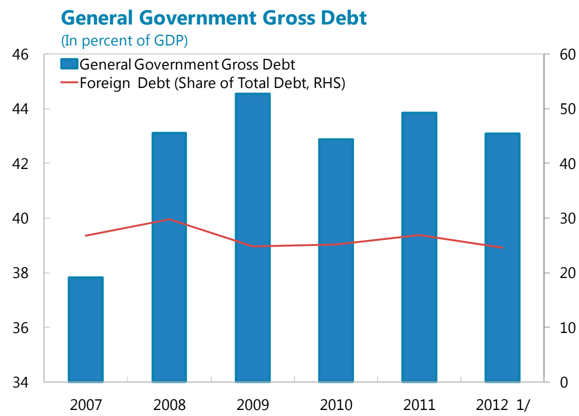
Past fiscal stimulus is being gradually withdrawn…



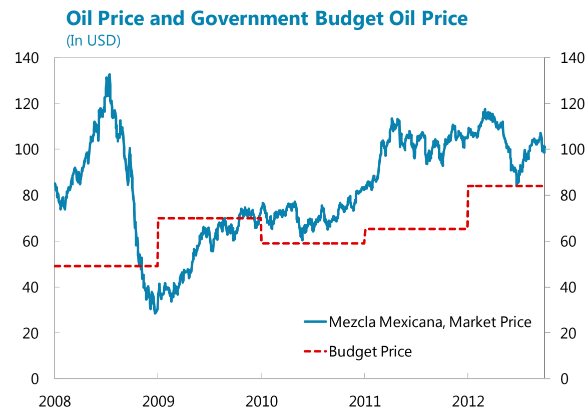
…and primary spending is moderating…



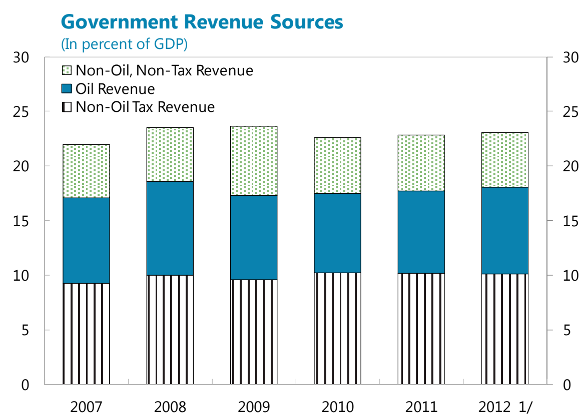
…while public debt has stabilized with a low share of foreign currency denominated debt.



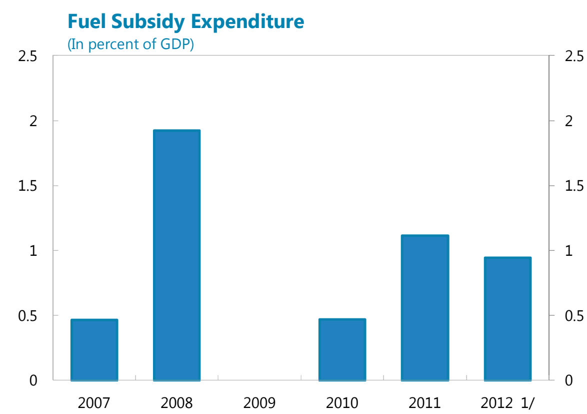
Oil windfalls will be less likely in the future.



Fiscal revenues depend importantly on oil revenues.



Fuel subsidies remain high.



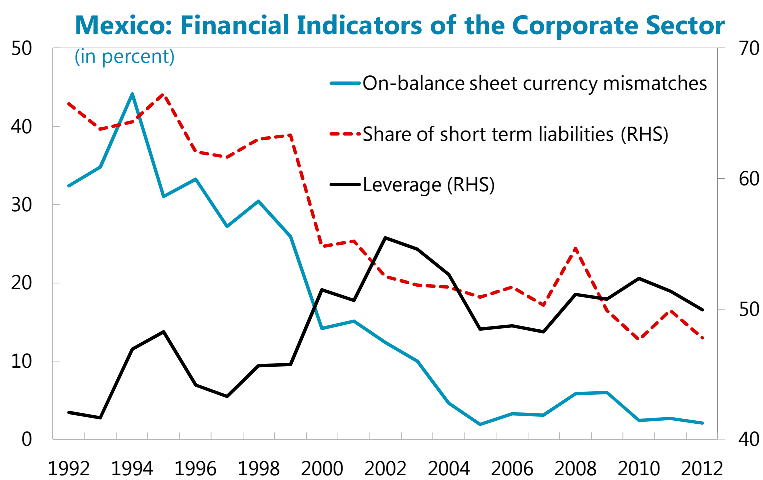
Sources: INEGI, Banxico, Bloomberg, SHCP, and IMF Staff Calculations

1/ 2012 data based on IMF staff calculations.
2/ Fiscal primary spending includes budgetary adjustments.

Box 1. Mexico: Corporate Sector Financial Position

Mexico's corporate sector appears resilient to potential adverse shocks, including a sudden depreciation of the exchange rate or a spike in interest rates.[1] Median leverage ratios, while increasing slightly from their pre-crisis levels, are contained at 49 percent, below those of comparator countries. Short-term maturity exposures have continued to decline and are below the levels observed before the Lehman crisis. On-balance sheet currency mismatches, as measured by the difference between foreign currency debt and natural hedges (export revenues) as a percent of total liabilities, have fallen steadily and by the first quarter of 2012 reached the lowest point in the last 20 years (see Figure). Average interest coverage ratios, defined as operating profits to gross interest expenses, have also improved and remain at comfortable levels.[2]

There is no evidence of a build-up of systemic risk from foreign exchange derivative positions in the corporate sector, based on first quarter information reported by the firms. Following the large losses at the end of 2008 by a number of large corporations from speculative derivative positions, supervisory agencies introduced stricter reporting and disclosure requirements on financial derivative instruments and their associated exposures. All publicly listed firms and those issuing bonds are now required to provide in their quarterly financial statements detailed information about financial derivative operations and potential losses under adverse scenarios. Authorities are closely monitoring compliance with disclosure requirements by market participants.[3] At present, there are 60 firms reporting derivative positions, including several that suffered losses in the past. Since 2008, firms have become more conservative in their use of derivatives and there appears to be no concentration of risk exposures associated with derivative instruments. Nevertheless, vigilance is important, particularly in a low-volatility and high global liquidity environment where are increased incentives for search for yield and risk taking.



Source: IMF staff estimates based on data from Economatica.

Box 1. Mexico: Corporate Sector Financial Position (concluded)

Comparison of Financial Ratios Pre-Lehman and 2012
(in percent, averages except where noted)

	Pre-Lehman 1/	2012Q1
Leverage and Maturity Structure		
Total liabilities over total assets 2/	48.5	49.9
Short term liabilities over total liabilities	51.0	47.8
Short term over total financial debt	35.5	30.5
Currency Composition		
FX liabilities over total liabilities	27.3	27.4
On-balance sheet currency mismatch 3/	3.2	2.0
Liquidity and Profitability Indicators		
Current ratio 4/	1.9	2.0
Interest coverage ratio 5/	1.5	2.9
Operating margin 6/	13.9	14.4

Source: IMF staff estimates based on data from Economatica.

Notes:
1/Average of the indicators for 2006 and 2007.
2/ Median values for each year.
3/ Difference between foreign currency liabilities minus exports, in percent of total liabilities; median values calculated over firms with foreign currency debt.
4/ Current (liquid) assets to current liabilities.
5/ Operating profits to gross interest expenses.
6/ Net profits (EBITDA) in percent of sales.

1/ This box takes stock of the financial structure and performance of the corporate sector in Mexico through the first quarter of 2012, using a panel of 186 publicly listed firms.

2/ Recent studies confirm Mexico's corporate sector resilience to external financing shocks (Gonzalez-Miranda, 2012, "Vulnerabilities in the Non-Financial Corporate Sector in Latin America: Should we Worry?," IMF Working Paper forthcoming).

3/ These include: (i) the type of derivatives being used and the underlying asset; (ii) whether they are used for hedging or speculative purposes, clearly identifying whether the position is short or long; (iii) the kind of derivative strategies being implemented and valuation techniques used by the firm; (iv) the markets where they are contracted, counterparties and the kind of collateral being posted for margin calls, if any; (v) method used by the firm to determine expected losses or the sensitivity of the price of the derivative, including volatility; (vi) estimates of potential losses under three adverse scenarios (referred as "likely", "possible" and "remote"), describing the parameters and assumptions being used. In particular, the "remote" or stress scenario should consider an adverse variation of 50 percent in the underlying asset.

Box 2. Mexico: Recent Reforms of Labor Market Regulations and Reporting of Subnational Government Finances

In the final days of his administration, President Calderon (PAN) introduced two reform initiatives: a labor reform to flexibilize labor markets (which is in the final stage of approval by Congress) and the modification of the General law of Government Accounting that improves reporting of data at the subnational level.

The labor reform bill would overhaul labor laws dating back to 1970. The new legislation introduces flexible modalities for hiring and dismissal, streamlines dispute resolution, promotes incentives for productivity, regulates outsourcing practices and improves labor conditions. Specifically, the law introduces:

- **New types of temporary employment contracts**, which can be defined per project, for a specific period of time, per season, on a trial basis and/or for training purposes. All these categories will accrue wages, social security and other benefits;
- **Hourly pay contracts**, provided that the pay is not below the equivalent of the minimum wage;
- **Provisions to streamline the settlement of labor lawsuits and to limit compensation for unjustified dismissals to one year of salary.** These provisions would simplify the current lengthy dispute resolution process (which can hold up severance pay for several years) and provide more legal certainty;
- **More flexible seniority rules, including productivity and labor skills as criteria for promotion**. The law recognizes training as the most important factor for increasing productivity and establishes a National Committee for Productivity;
- **New social protection guarantees** that formally ban child labor under 14 years of age and promote gender equality at work. The reform also improves labor conditions for mining, rural, and domestic workers, and provides for five days of paid paternity leave;
- **A new regulatory framework for outsourcing**, banning the transfer of the majority of workers in a firm to an outsourcing company in order to reduce labor benefits.

The Law on Government Accounting harmonizes the reporting, and enhances the transparency, of subnational finances. The transparency law introduces a common template for reporting financial and budgetary information at the state and municipal levels, which will have to be published on a quarterly basis. The main provisions of the law include:

- **Subnational governments will be required to publish all financial information (revenues, expenditures, debt and financing sources) in a detailed and homogenous format**. Budget expenditures, in particular, should include expenditure priorities and a detailed breakdown of current and investment outlays (including wages and pensions). The reporting of public debt should contain all obligations, including short-term supplier credit. Local governments will also need to make public the norms that govern the process of preparing and approving the revenue and expenditure laws.
- **Financial information is to be published quarterly** and posted on the internet for at least six years.
- **Local governments will also need to enhance the accountability of their public programs**. They are required to provide specific information on beneficiaries of public programs, and the indicators used to evaluate their performance. Beneficiary payments will need to be done electronically through bank accounts.
- **Stiffer penalties for government officials**. Public servants who fail to fulfill the law will incur severe penalties, including prison.

OUTLOOK AND RISKS

9. **Growth is expected to moderate towards Mexico's potential rate next year**. Growth in 2013 is envisaged to converge to 3½ percent, close to Mexico's long-term potential growth rate. Despite a subdued U.S. recovery, external demand is still expected to contribute moderately next year, while domestic demand is envisaged to maintain its momentum underpinned by sustained business and consumer confidence. High capacity utilization rates suggest that the recovery in fixed investment will continue, while favorable credit conditions and sustained employment growth should help underpin consumption. As food price shocks dissipate, headline inflation is expected to revert towards the middle of the inflation target range.

10. **Short-term risks are associated mainly with unsettled external conditions, while longer-term risks are linked to Mexico's structural challenges**. The short-term balance of risks is tilted to the downside, linked to the global environment:

- **Slowdown in the U.S**. Despite Mexico's strong economic performance since the global crisis, a significant U.S. slowdown would be a major drag on growth due to its close integration with the U.S. economy, particularly the manufacturing sector.

- **Heightened global risk aversion**. Given high integration with international capital markets, a surge in global risk aversion from an intensification of the crisis in Europe could affect even strong sovereigns like Mexico. A generalized pullback from the emerging market asset class would be a material risk, due to the substantial equity and debt portfolio holdings of foreign investors (30 percent of GDP), including short-term government paper. The large presence of Spanish banks in Mexico also represents a risk. However, the subsidiary model (with high levels of required capital, exposure limits, and reliance on a broad and stable domestic deposit base in local currency) as well as effective supervisory oversight (as noted in the December 2011 FSAP Update) would help contain spillovers from potential shocks to the parent banks. Moreover, any deleveraging or divestment is considered likely to be offset in part by other financial institutions taking the opportunity to expand in the profitable Mexican market.

- **Structural reforms**. Longer-term challenges for Mexico arise from the need of reforms to address pressures from a decline in oil revenues and increasing health and pension spending. In turn, a decisive implementation of productivity-enhancing structural reforms could provide considerable upside to Mexico's growth outlook.

KEY POLICY ISSUES

11. With Mexico operating close to potential but external risks looming large, policy discussions focused on: (i) the appropriate policy stance (from a cyclical perspective) and policy mix (to restore Mexico's fiscal buffers); and (ii) contingent policy responses if global downside risks materialize. The policy stance and mix have been broadly appropriate and, combined with the flexible exchange rate, have helped cope with capital inflows amid lax monetary conditions in advanced economies. Discussions on policies going forward centered on:

- **Under the baseline scenario:** the need to continue with consolidation efforts to restore Mexico's fiscal buffers to pre-crisis levels (given that the potential for global shocks remains high); the challenges for monetary policy to assess and steer the right policy course, taking into account domestic conditions and headwinds from the global environment.

- **If downside risks materialize:** the policy response and room to contain the fallout, including the key role of exchange rate flexibility. In particular, discussions focused on the response to a significant U.S. slowdown and to a potential intensification of the global financial crisis.

A. Near-Term Macroeconomic Policies

12. Overall, the authorities stressed that policy continuity is underpinned by a strong consensus in Mexico about macroeconomic stability. Mexico has continued to implement sound policies supported by its strong policy frameworks, and the incoming administration (through the representative of President-elect Peña Nieto) stressed that it remains strongly committed to maintaining prudent policies within the current frameworks. Monetary policy will continue to be guided by the inflation targeting framework, in the context of the floating exchange regime, while fiscal policy will be anchored by the balanced budget rule.[8]

Fiscal policy

13. Under the baseline scenario, further fiscal consolidation efforts next year would help continue rebuilding policy buffers. As discussed with the authorities, continued fiscal consolidation in 2013 would help turn the primary balance into a slight surplus and return to a balanced budget under the fiscal rule.[9] This consolidation, underpinned by sustained oil revenues and containment of investment expenditure, would help to stabilize public debt at about 43 percent of GDP (Table 2). Staff supports the continuing efforts, while emphasizing that stepping up fiscal consolidation to return to the primary surplus prevailing before the global crisis would help put the debt ratio on a more sustained downward path towards pre-crisis levels, which is particularly important in the present juncture where the potential for external shocks remains high. In this

[8] Mexico's Fiscal Responsibility Law establishes that the overall position of the public sector, excluding PEMEX's investment, should be balanced.

[9] Given the presidential transition, the 2013 budget will be discussed and approved during December 2012.

context, staff noted that it would be useful for revenue-enhancing reforms to include some frontloaded elements—like the re-establishment of a positive excise tax on gasoline prices—to help avoid over-reliance on restraining public investment to achieve fiscal consolidation. The authorities concurred with the need to mobilize non-oil revenues, and took note of staff's proposals to re-establish a positive excise tax on gasoline prices as in the past, to broaden the tax base for the VAT, and to reform the income tax, including the elimination of loopholes and special regimes.

14. The authorities concurred that the fiscal policy environment will probably be more challenging from now on, given the likely end of large oil windfalls.[10] The significant increase in oil prices during past years—which increased the budget price, albeit less than market prices—together with limitations in the design of the stabilization funds that effectively capped the saving of oil windfalls, allowed primary spending to rise by 3 percent of GDP in the last four years.[11] Going forward, the likely convergence of the budget and actual oil prices makes windfalls less likely, meaning that expenditures will need to be more strictly prioritized in the budget process. It will probably also make Mexico's oil price hedge significantly more costly.

15. The recent modification of the General Law of Government Accounting will enhance the reporting and monitoring of subnational government finances (see Box 2). On average, over 90 percent of states' revenues come from central government transfers with limited restrictions on spending, thereby reducing incentives for prudent fiscal management at the subnational level. Subnational governments' (SNG) debt has doubled since 2008, while SNG also face future pension liabilities. However, SNG debt remains moderate at about 3 percent of GDP, posing little risk to macroeconomic stability. The authorities recognize that SNGs are vulnerable to shocks (notably a reduction in oil prices), particularly in light of limitations in their capacity for fiscal management and lack of own-revenues. They are also concerned with the rapid build-up of subnational debt and noted that addressing the issue will require tackling entrenched incentive problems among SNGs and lenders. They see the new reporting requirements for SNGs as a vital prerequisite and an important advancement toward strengthening subnational finances. The staff concurred that the debt build-up and pension commitments warrant close monitoring and supported the authorities' resolve to improve fiscal discipline at the subnational level.

Monetary and financial policies

16. The Central Bank remains vigilant to risks from the possible persistence of recent supply shocks, as well as to cyclical conditions. Banxico has judiciously maintained a stimulative monetary policy, with the policy rate at 4½ percent since 2009, supporting the recovery in the context of continued fiscal consolidation. The authorities noted that the breach of the inflation target range has primarily been due to temporary supply shocks and that medium-term inflation

[10] Oil windfalls refer to revenues from oil prices above the budget price (see Figure 5).

[11] Since 2008, the increase in the budget price of oil reached 70 percent, with actual market prices above the budget price by about 30 percent on average each year (see Figure 5). The rules for transfers to stabilization funds allow offsets when revenues are below budget; moreover, funds are subject to accumulation ceilings.

expectations remain firmly anchored. Nonetheless, they are committed to closely monitor the determinants of inflation (including cyclical conditions, the persistence of supply shocks and global headwinds) in order to adjust monetary policy as necessary to keep inflation in line with the target. Staff concurred that vigilance is warranted (taking also into account fiscal consolidation plans which can provide further margin to take stock of evolving conditions), and that an important challenge ahead will be to communicate effectively the stance of monetary policy vis-à-vis temporary supply shocks, emphasizing that its primary role lies with preventing second-round effects and maintaining inflation expectations well-anchored.

17. The floating exchange rate has continued to play a key role amid persistent global uncertainty. The authorities noted that currency volatility has been associated with the recurrent bouts of global risk aversion and the hedging of local currency positions by portfolio investors. Exchange rate flexibility has continued to play a central part in the policy response to external shocks due to the absence of significant balance-sheet or pass-through effects. The authorities underscored that the exchange rate will continue to play a key buffering role against potential shocks, with rules-based FX intervention limited to smoothing disorderly market conditions. In this context, the authorities, including the incoming administration, concurred that Mexico's level of international reserves appears adequate for normal times (based on staff assessment of reserve adequacy against a broad range of metrics; see Annex 1) but that, amid heightened external uncertainty and Mexico's high integration with international capital markets, the FCL remains a key insurance complement against global tail risks.[12] The build-up of reserves will continue primarily through the acquisition of PEMEX's net FX balance. In the staff's baseline scenario, the projected rule based accumulation of international reserves would be consistent with the increase in foreign portfolio liabilities and monetary aggregates. This would allow the authorities to broadly maintain current reserve coverage ratios, which continue to appear relatively low in terms of balance sheet exposures that are particularly relevant for global tail risks.

18. The financial sector has proved resilient to the recurrent bouts of global risk aversion, but further efforts are needed to enhance the regulatory and supervisory framework. The banking system remains sound, with good levels of liquidity, capital and profitability.[13] The recent FSAP Update highlighted several issues that require attention, stemming mainly from limitations to the consolidated supervision of financial conglomerates and from portfolio concentration. The concentration of the system in a few large conglomerates creates also potential conflicts of interest and may hinder competition. The authorities are closely monitoring external risks and the operations of local subsidiaries of foreign banks to ensure compliance with regulatory norms, which have been tightened recently in the area of asset sales from parents to subsidiaries. Moreover, while the fast

[12] Mexico's FCL has played an important role by supporting the authorities' macroeconomic strategy and bolstering market confidence on the country's ability to withstand external tail shocks. Recent studies on the effectiveness of the FCL (IMF, 2011) support this view, showing a significant reduction in Mexico's EMBI spreads around the time of the FCL announcement.

[13] Mexico's high capitalization levels will allow for an early adoption of most elements of the Basel III capital requirements.

growth in lending to subnational governments and in consumer credit (particularly payroll lending) is not a systemic threat, the authorities' initiatives to monitor this closely and devise measures to contain risks are well warranted.[14] These could be enhanced by adopting FSAP recommendations to tighten concentration limits and implement Pillar 2 of Basel II.[15] Although implementation of FSAP recommendations has been limited so far, given that most require legal changes, progress is being made particularly on the groundwork for the legal reforms, promoting contestability and access, and refining pension fund investment guidelines to ensure a greater focus on long term returns (Box 3). The FSAP noted that enhancing supervisory independence remains a priority, including to ensure budgetary autonomy. Moreover, the authorities agreed that CNBV's powers to mitigate concentration and conglomeration risks should be strengthened.

19. The authorities reiterated that the international financial regulatory reforms could have unintended consequences for Mexico's banking system. The authorities expressed concerns that new capital surcharges for systemic and trading risks could negatively impact Mexican financial markets, as could the introduction of the Volcker rule which would prohibit banks with presence in the U.S. to engage in proprietary trading. These concerns arise from the effects that these regulations may have on the cost of capital and liquidity of domestic sovereign debt markets, in which domestic affiliates of global banks are active participants, as it is difficult to distinguish between market making and proprietary trading. The authorities have asked the FSB to study the unintended consequences of the agreed regulatory reforms on emerging and developing economies. They have also sent formal comments on the Volcker rule to U.S. agencies, requesting an exemption for Mexican government securities (similar to that granted to U.S. government securities).

[14] Banks total exposures to subnational borrowers are less than 10 percent of total loans and related NPLs (plus write-offs) are less than 1 percent of exposure. The Financial System Stability Council has been monitoring these risks, as highlighted in its recent financial stability report, and the Bank and Securities Commission (CNBV) tightened provisioning requirements in 2011.

[15] Currently, lending to sub nationals that is guaranteed by federal transfers are not subject to limits or capital requirements.

Box 3. Status of Key FSAP Update Recommendations

Mexico undertook an FSAP Update last year, which was discussed by the Board in December 2011. Overall the assessment found that Mexico's banking system was profitable, liquid and well capitalized, and able to withstand severe shocks. The FSAP advised Mexico to continue monitoring emerging risks and address developmental challenges, with the main recommendations focused on:

- **Increasing the budget autonomy, independence and accountability of financial sector supervision to consolidate recent gains.** Financial sector supervisory agencies (CNBV and CNSF) should have the authority to amend their organizational structures, make key staffing decisions, or modify their budgets (as the regulatory perimeter for CNBV is expanding and below-market salaries have led to high staff turnover). In addition, the FSAP recommended increased independence (in particular, a fixed-term appointment for the President of the Banking and Securities Commission, defined appointment periods for—and clear grounds for dismissal of—senior officers, and adequate legal protection for staff) and accountability. Over the medium term, it proposed reviewing Mexico's supervisory architecture to reduce overlap of responsibilities for the effective supervision of a more integrated financial sector.
- **Mitigating the risks and potential conflict of interest from the high level of portfolio concentration and conglomeration in Mexico's financial system.** To provide additional supervisory tools, the FSAP Update recommended implementing Pillar 2 of Basel II (including introducing a capital charge for concentration risk and requiring buffers above regulatory minima), as well as tightening concentration limits. To strengthen consolidated supervision, and to mitigate risks and conflicts of interest from financial conglomeration, it would be important to amend the law to transfer group regulatory powers from the SHCP to CNBV and extend prudential requirements and governance and risk management standards to the holding company level.
- **Improving some areas of the financial sector safety net.** Key FSAP recommendations were to strengthen the deposit guarantee fund by a gradual transfer of IPAB's legacy debt to the government, and set up an emergency contingency funding mechanism with a government guarantee, as well as to establish a program to address weak and not yet regulated cooperatives. The FSAP also recommended disclosing the broad features of emergency liquidity assistance, consulting the Financial Stability Committee on the systemic importance of institutions requesting ELA access, adding liquidity triggers in the prompt corrective action regime, shortening delays in revoking a bank license and channeling bank liquidation through an administrative process. Furthermore, increased market discipline-supporting measures for deposit insurance, such as a reduction in coverage and the charging of risk-based premiums, would also be useful.
- **Enhancing competition in financial services and the development of capital markets.** Key recommended measures were to review the structure of retail banking fees to ensure that they promote contestability and access, strengthen consumer financial protection, encourage pension funds to focus more on long-term returns, increase pension replacement rates, improve the legal framework for derivatives, strengthen competition in the mutual fund sector, and promote integration with the larger capital markets in the region.

The authorities have made important progress on some of the main recommendations or aspects that do not require legal reforms. CONSAR, the pension regulator, has revised guidelines and is proposing further changes to increase pension funds' focus on asset allocation and long-term strategies, and cut down on excessive switching of contributors across funds. The CNBV has established working groups to assess the changes needed to fully implement Pillar 2 and a pilot program using pillar 2-type requirements to address concentration risks at some banks. It has also proposed concentration limits on bank loans to subnational governments that are guaranteed by federal transfers, while Banxico tightened the rule on relevant related-party transactions. Furthermore, the authorities continue to monitor closely risks associated with consumer lending and corporates' use of derivatives, as well as effective home-host cooperation through supervisory colleges.

However, most of the recommendations require legal reforms. The authorities are working on a number of legal reforms needed to address FSAP Update recommendations, which would help the incoming administration to advance the reform agenda and legislative process.

B. Global Spillovers

20. The authorities concurred that Mexico's policy response to the materialization of global risks would depend on the nature of the external shock. (See Chapter 1 of the Selected Issues paper).

- **A slowdown in the U.S**. would be a material drag on growth in Mexico. The flexible exchange rate would be expected to continue playing a key role, while there remains room to reduce the policy rate (currently at 4½ percent) to help contain the fallout provided that global financial conditions remain benign. In that case, on the fiscal side, automatic stabilizers could be allowed to operate. However, the authorities and the staff concurred that the room for effective discretionary fiscal stimulus would be limited, given that Mexico is still rebuilding its policy buffers.[16]

- **A surge in global risk aversion** from unsettled conditions in Europe and a generalized pullback from the emerging market asset class could have a significant impact on Mexico, given the large stock of foreign portfolio investment. Exchange rate flexibility would be expected to remain the first line of defense, but tight financing conditions and acute currency pressures would constrain the room for monetary and fiscal policy to limit the fallout. However, Mexico has significant foreign exchange buffers to deploy if necessary to limit overshooting and dysfunctional market conditions, including the FCL in case tail risks materialize.

[16] If the shock in the U.S. also affects global risk aversion and financial conditions, the policy room will be more limited.

Mexico: Risk Assessment Matrix

Source of Risk	Up/Downside	Risk	Impact	Policy Response
		Low, Medium, High	Low, Medium, High	
Significant deceleration in the United States	↓	M	H	Exchange rate flexibility as a first line of defense, coupled with monetary easing and automatic stabilizers.
Intensification of the euro area crisis and surge in global risk aversion	↓	M	H	Exchange rate flexibility, together with provision of FX liquidity.
Surge in portfolio inflows as investors differentiate across EMs	↑	L	L	Exchange rate flexibility
Oil price supply shock (with negative effect on U.S. and global growth)	↓	L	M	Exchange rate flexibility as a first line of defense, coupled with monetary easing and automatic stabilizers.
U.S. fiscal cliff (fiscal withdrawal of over 4% of GDP in 2013)	↓	L	H	Exchange rate flexibility as a first line of defense, coupled with monetary easing and automatic stabilizers.

C. Longer-Term Challenges

21. Unleashing Mexico's growth potential remains a key challenge. Global conditions are not likely to be supportive in the near future, given the prospects for subdued growth in advanced economies and protracted global financial uncertainty. Mexico, however, should benefit from a broadening recognition of its sound fundamentals, the high integration within NAFTA and commitment to free trade, favorable demographics, and the recent improvement in relative labor costs compared to key competitors. Nevertheless, boosting potential growth will require a comprehensive approach to structural reforms to ensure that productivity gains accrue to all sectors and thus entrench the recent remarkable gains of Mexico's manufacturing sector. A comprehensive approach would involve:

- *Energy reform*. Overall, reforms should address impediments to private investment and to efficiency in the public sector (including cost over-runs, subsidies, the deficit in refining operations, and pension liabilities). The new administration is considering opening the hydrocarbon sector to private investment, by providing the legal basis for private sector participation in these sectors.

- *Boosting competition*. Recent anti-trust reforms have strengthened the powers of regulatory bodies to curb anti-competitive practices, including in consumer markets, but concentration remains high in key sectors (e.g., telecommunications, transportation, energy).[17] The incoming administration has indicated that boosting competition will be crucial to bolster Mexico's growth. Recent initiatives to reduce the lengthy resolution of disputes of the rulings by the Federal Competition Commission and to improve consumer protection and price setting are welcome.

- *Broadening access to credit, especially for SMEs*. While Mexico's financial sector is sophisticated, bank intermediation remains relatively low compared with other emerging economies, with limited access to credit for small and medium enterprises (SMEs) (see Chapter 4 of the Selected Issues paper). Improving information about borrowers and strengthening the legal framework for the use of collateral would support the expansion of bank credit to SMEs, thereby supporting their growth, increasing productivity and bolstering employment creation.

- *Improving education*. The quality of education in Mexico remains below that of peers according to standardized assessments.[18] Enhancing the quality would reduce the skills gap and help integrate more of the labor force into the formal sector.

- *Reinforcing domestic security*. Ongoing efforts to fight organized crime, including through strengthening the AML framework, are important to foster investment and growth.

22. Mexico will face fiscal challenges over the longer term from diminishing oil revenues and increasing age-related spending:

- **Oil revenues**. While risks to the level of oil production seem to have declined, reliance on oil revenues will represent a drag on public finances over the longer term. Oil revenues currently account for a third of government revenues, and, in the absence of a significant increase in production volume, are projected to fall by 2–3 percent of GDP through 2030.

- **Population aging** and the transition costs associated with the reform of the old pension system are projected to put pressure on health and pension spending, which is expected to increase by about 2 percent of GDP through 2030.

[17] The competition law was amended in 2011 giving greater powers to the Federal Competition Commission (Cofeco) to investigate and impose sanctions for monopolistic practices. Proposals to further strengthen Cofeco and the Federal Communications Commission (Cofetel), including granting autonomy, show the resolve to improve competition.

[18] The OECD's Program for International Student Assessment ranked Mexico 47th out of 65 countries assessed, and the lowest among OECD countries. The gap compared to the highest-ranked OECD country was estimated to be equivalent to more than two years of schooling.

23. The authorities agreed that coping with these pressures will require a combination of non-oil revenue mobilization, including at the subnational level, and expenditure rationalization. On the revenue side, staff argued that mobilization efforts should focus on re-establishing a positive excise tax on gasoline prices, broadening the base of the VAT, overhauling the property tax, and eliminating preferential treatments in the income tax, such as the special regime for maquiladoras (see Chapter 3 of the Selected Issues paper). On the expenditure side, staff suggested that significant savings could be achieved by consolidating pension eligibility requirements, revisiting the retirement age in the unreformed system, and reforming special regimes. In addition, a rationalization of fuel and electricity subsidies would provide significant fiscal savings.

24. Over the medium term, Mexico would benefit from enhancing its fiscal framework to reduce procyclicality. The strong fiscal framework has been instrumental in ensuring public debt sustainability, but spending has been procyclical, particularly over the prolonged period of high oil prices. This underscores the need to revisit the design of the stabilization funds, given their limited effectiveness in saving oil windfalls and, more generally, to reduce procyclicality.

STAFF APPRAISAL

25. Mexico's resilient economic performance attests to its strong fundamentals and sound policy management. The strength of the recovery after the global crisis has been underpinned by Mexico's sound balance sheets, strong policy frameworks, and skillful macroeconomic management. The recognition of Mexico as a predictable and prudently managed economy, as well as its open capital account, market-friendly and transparent regulations for foreign investment, and deep and liquid financial markets, have bolstered large foreign investment in recent years. Amid persistent global financial uncertainty, the successive FCL arrangements have supported Mexico's economic policies by providing a significant buffer against tail risks.

26. The strong consensus in Mexico about macroeconomic stability remains a key pillar of policy continuity. The crises of past decades have deeply ingrained in Mexico the value of preserving macroeconomic stability to avoid large output losses and their burden on vulnerable segments of the population. The authorities' continued implementation of sound policies and the incoming administration's firmly-expressed commitment to maintaining Mexico's strong policy frameworks (monetary policy under the inflation-targeting framework, a floating exchange regime, and fiscal policy anchored by the balanced budget rule) are commendable and attest to the importance assigned to stable macroeconomic conditions as a prerequisite for sustained growth.

27. With the economy close to potential but external risks looming large, the policy challenges ahead involve maintaining an appropriate policy stance and mix, and weighing contingent policy responses to global downside scenarios. The policy stance and mix have been broadly appropriate and, combined with the flexible exchange rate, have enabled Mexico to cope with capital inflows amid lax monetary conditions in advanced economies. Going forward:

- The heightened potential for global shocks suggests that stepping up fiscal consolidation efforts would be important to restore pre-crisis fiscal buffers. These efforts would support monetary policy by providing further margin to take stock of evolving conditions.

- If downside risks materialize, the policy response and room to contain the fallout will greatly depend on the extent to which global financial stress and risk aversion spillover to Mexico. In any event, exchange rate flexibility will continue to play a vital buffering role, inter alia to increase the cost of capital outflows.

- Addressing Mexico's longer-term challenges will require decisive action on structural reforms. Revenue mobilization and subsidy rationalization (specifically fuels and electricity) will be essential to compensate for future pressures from population aging and declining oil revenues, while structural reforms to unleash Mexico's growth potential would benefit from a broad approach, including energy, competition, and education reforms to ensure that productivity gains accrue to all sectors.

28. The ongoing fiscal consolidation remains judicious, and stepping up these efforts would help restore Mexico's fiscal buffers. Under the baseline scenario, returning in 2013 to the balanced budget rule—which has proven critical to stabilize public debt—would provide a strong signal of commitment to the fiscal framework and to maintaining prudent macroeconomic policies. Moreover, in the face of persistent heightened global risks, stepping up fiscal consolidation efforts further would help put the debt ratio on a more sustained downward path towards pre-crisis levels and restore the policy buffers that Mexico had before the global crisis. In this context, revenue-enhancing reforms to address longer-term fiscal challenges could usefully include some frontloaded elements to make fiscal consolidation feasible without excessive compression of public investment.

29. The end of the oil windfalls that Mexico enjoyed in recent years would pose new challenges for fiscal policy, underscoring the need for further enhancing the fiscal framework. The persistent rise in oil prices of recent years allowed the expenditure envelope to expand significantly, given the shortcomings in the design of stabilization funds (which meant that effectively little of the oil windfalls were saved). The convergence of the budgeted and actual oil prices will make windfalls less likely going forward (requiring greater prioritization of expenditures in the budget process); increase the cost of the oil price hedge (constraining Mexico's ability to insure against lower oil prices); and reduce the scope for spending growth.

30. Enhancing the reporting and monitoring of subnational government finances is a priority. Although subnational government debt remains moderate, its steep increase in recent years justifies close monitoring. The recent modification of the General Law of Government Accounting should help improve the reporting and coverage of subnational government accounts, which will be a key prerequisite for assessing their fiscal position and reinforcing fiscal discipline.

31. The monetary authorities remain appropriately vigilant, with the task ahead being to assess the right policy course taking into account domestic conditions and global headwinds. Banxico's strong policy track record gives it credibility and margin of action to assess conditions in the current uncertain juncture. Going forward, while underlying inflationary pressures have been contained so far, recent supply shocks and cyclical conditions warrant Banxico's heightened vigilance. The challenge ahead will be to communicate effectively the appropriate stance of monetary policy vis-à-vis temporary supply shocks, emphasizing the role of preventing second-round effects and maintaining inflation expectations well anchored.

32. Mexico's floating exchange rate should continue to play a key role in buffering external shocks. The flexibility of the exchange rate has been particularly beneficial in light of the persistent global financial uncertainty. The absence of significant balance-sheet and pass-through effects implies that the exchange rate can continue to be a key pillar of the policy response to external shocks. The real exchange rate is consistent with underlying fundamentals and desirable policy settings. The level of reserves appears adequate for normal times but, in the context of heightened global uncertainty and Mexico's high integration into international capital markets, the FCL remains a key insurance complement against potential global tail risks.

33. The financial sector remains sound, showing resilience to the recurrent bouts of global risk aversion, but further efforts are needed to enhance the regulatory and supervisory framework. The recent FSAP Update highlighted the need to enhance supervisory independence, including to ensure budgetary autonomy of the CNBV. It also noted potential issues stemming mainly from limitations to the consolidated supervision of financial conglomerates and from portfolio concentration. The concentration of the system in a few large financial conglomerates also creates potential conflicts of interest and may hinder competition. Implementation of FSAP recommendations has been limited so far, as many of them require legislative changes, but progress is being made on the groundwork for the legal reforms, which should be taken up by the incoming administration. The authorities' close monitoring of the operations of local subsidiaries of foreign banks, lending to subnational governments, and consumer credit (particularly payroll loans), is welcomed.

34. Potential global spillovers warrant close monitoring. The authorities' careful assessment of external conditions and potential implications for Mexico, including in the Financial System Stability Council report and Central Bank publications, is to be commended. The policy response to the materialization of global risks would depend on the nature of the external shock, but the flexible exchange rate would be expected to continue playing a key role in all circumstances. Although Mexico cannot be expected to decouple from a significant U.S. slowdown, monetary policy and automatic stabilizers could help contain the impact, provided that global financial conditions remain benign, but the room for discretionary fiscal stimulus would remain limited given that Mexico is still rebuilding its policy buffers. A surge in global risk aversion and a generalized pullback from emerging markets remains a material risk for Mexico given the large stock of foreign portfolio investment. In this case, tight financing conditions and acute currency pressures would tend to constrain the policy room to contain the fallout. However, Mexico has significant foreign exchange buffers to deploy if necessary to limit overshooting and dysfunctional market conditions, including access to the FCL in case tail risks materialize.

35. A broad structural reform agenda is needed to unleash Mexico's growth potential. The agenda would involve inter alia reforming the energy sector; enhancing competition; improving the quality of education; facilitating access to credit for SMEs; and strengthening the rule of law. Structural reforms would benefit from a broad-spectrum approach to ensure that productivity gains accrue to all sectors.

36. Mexico's longer-term fiscal challenges from population aging and declining oil revenues will require additional revenue mobilization and expenditure rationalization. On the revenue side, mobilization efforts should focus on re-establishing a positive excise tax on gasoline, broadening the base of the VAT, eliminating preferential treatments in the income tax, and increasing subnational property taxes. On the expenditure side, savings could be achieved by consolidating pension eligibility requirements, revisiting the retirement age in the unreformed system, and reforming special regimes (notably PEMEX's). Moreover, over the medium term, Mexico's fiscal framework could be enhanced by adding mechanisms to help save oil windfalls and reduce fiscal procyclicality, while maintaining its key role of ensuring debt sustainability.

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

Table 1. Mexico: Selected Economic, Financial, and Social Indicators, 2008–2013

I. Social and Demographic Indicators

GDP per capita (U.S. dollars, 2011)	10,161.1	Poverty headcount ratio (% of population, 2010) 1/	51.3
Population (millions, 2011)	113.7	Income share of highest 20 percent / lowest 20 percent	11.3
Life expectancy at birth (years, 2012)	75.6	Adult illiteracy rate (2011-2012)	6.4
Infant mortality rate (per thousand, 2012)	13.2	Gross primary education enrollment rate (2010)	114.1

II. Economic Indicators

	2008	2009	2010	2011	Proj. 2012	Proj. 2013
(Annual percentage change, unless otherwise indicated)						
National accounts in constant prices						
Real GDP	1.2	-6.0	5.6	3.9	3.8	3.5
Net exports (contribution)	-0.7	2.1	0.0	-0.1	0.1	0.2
Total domestic demand	1.8	-7.8	5.4	3.9	3.6	3.4
o/w Consumption	1.6	-5.8	4.6	3.9	3.5	3.7
Gross fixed investment	5.5	-11.8	6.2	8.9	5.0	5.0
External sector						
Exports of goods, f.o.b.	7.2	-21.2	29.9	17.1	7.4	5.8
Export volume	-2.4	-7.7	15.8	2.2	7.4	6.2
Imports of goods, f.o.b.	9.5	-24.0	28.6	16.4	7.0	6.4
Import volume	1.0	-21.0	23.3	8.5	7.2	7.1
Petroleum exports (percent of total exports of goods)	17.4	13.4	14.0	16.1	15.2	14.2
Terms of trade (deterioration -)	1.3	-11.2	7.6	6.8	0.1	0.2
Exchange rates						
Nominal exchange rate (US$/Mex$)						
(average, depreciation -)	-1.8	-17.6	6.9	1.7	-7.9	...
Real effective exchange rate (CPI based)						
(average, depreciation -)	-1.6	-12.4	8.6	0.4	-5.1	-0.7
Employment and inflation						
Consumer prices (annual average)	5.1	5.3	4.2	3.4	4.1	3.5
Formal sector employment, IMSS-insured workers (annual average) 2/	2.1	-3.1	3.8	4.3	3.3	...
National unemployment rate (annual average)	4.0	5.5	5.4	5.2	4.8	...
Unit labor costs: manufacturing (real terms, annual average) 2/	2.5	1.1	-7.3	-1.4	-3.3	...
Money and credit						
Bank credit to non-financial private sector (percent growth)	13.5	-1.0	10.0	17.2	15.9	14.5
Broad money (M4a)	16.8	6.1	12.0	15.7	15.3	10.7
Treasury bill rate (28-day cetes, in percent, annual average)	7.7	5.4	4.4	4.2	4.4	...
(In percent of GDP)						
Nonfinancial public sector						
Government revenue	23.5	23.6	22.6	22.8	23.1	23.2
Government expenditure	23.6	25.9	25.5	25.3	25.4	25.1
Traditional balance 3/	-0.1	-2.3	-2.8	-2.5	-2.4	-1.9
Augmented balance 4/	-1.1	-4.7	-4.3	-3.4	-2.6	-2.1
Gross public sector debt	43.1	44.5	42.9	43.8	43.1	43.2
Net public sector debt	33.4	36.7	36.8	38.0	37.8	37.7
Savings and investment						
Gross domestic investment	26.9	23.7	24.0	25.1	24.9	25.3
Public	5.6	6.1	6.1	5.9	5.5	5.2
Private	16.5	15.2	14.5	15.2	16.3	16.9
Gross domestic saving	25.3	23.2	23.6	24.1	24.0	24.2
Public 5/	4.1	0.9	1.3	2.0	2.5	2.6
Private	21.3	22.3	22.3	22.1	21.5	21.7
External current account balance	-1.6	-0.6	-0.4	-1.0	-1.0	-1.1
Non-oil external current account balance	-2.9	-1.7	-1.5	-2.1	-1.9	-1.9
Net foreign direct investment	2.4	0.9	0.4	0.8	1.1	1.1
Net portfolio investment	0.4	1.7	3.6	3.5	3.6	2.3
Memorandum items						
Gross external debt (in percent of GDP, end of period)	18.6	22.0	23.9	24.3	27.4	28.1
Total external debt service (in percent of exports and other FX income)	6.8	6.7	4.8	6.5	5.9	5.5
Crude oil export price, Mexican mix (US$/bbl)	84.4	57.4	72.3	101.0	103.1	102.1

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 IMF staff estimates.

1/ Broadest national definition (CONEVAL).
2/ 2012 based on data available until June 2012.
3/ Authorities' definition. The break in the series in 2009 is due to definitional and accounting changes of PIDIREGAS.
4/ Federal Government plus Social Security and State-owned Companies, excl. nonrecurring revenue and transfers to stabilization funds.
5/ Estimated as the difference between the augmented fiscal balance, as reported by SHCP, and public investment, as reported in the national accounts.

Table 2. Mexico: Financial Operations of the Public Sector, 2008–2017

(In percent of GDP)

	2008	2009	2010	2011	2012 Proj.	2013 Proj.	2014 Proj.	2015 Proj.	2016 Proj.	2017 Proj.
Budgetary revenue, by type	**23.5**	**23.6**	**22.6**	**22.8**	**23.1**	**23.2**	**23.2**	**23.5**	**23.0**	**22.6**
Oil revenue	8.6	7.7	7.3	7.5	7.9	8.2	8.4	8.7	8.3	7.9
Non-oil tax revenue 1/	10.0	9.6	10.2	10.2	10.1	10.0	9.8	9.8	9.7	9.7
Non-oil non-tax revenue	4.9	6.3	5.1	5.1	5.0	5.0	5.0	5.0	5.0	5.0
Budgetary revenue, by entity	23.5	23.6	22.6	22.8	23.1	23.2	23.2	23.5	23.0	22.6
Federal government revenue	16.8	16.8	15.9	16.2	16.7	17.2	17.8	18.6	18.3	18.1
Tax revenue, *of which:*	8.2	9.5	9.6	9.0	9.1	9.4	9.8	10.4	10.4	10.5
excises (including fuel)	-1.4	0.4	0.0	-0.5	-0.4	-0.1	0.5	1.2	1.2	1.3
Nontax revenue	8.7	7.3	6.3	7.2	7.6	7.8	8.0	8.2	7.9	7.6
Public enterprises	6.7	6.8	6.7	6.6	6.3	6.0	5.4	4.9	4.7	4.5
PEMEX	3.0	3.2	2.9	2.8	2.7	2.4	1.8	1.2	1.0	0.9
Other	3.7	3.6	3.8	3.9	3.6	3.6	3.6	3.6	3.6	3.6
Budgetary expenditure	**23.6**	**25.9**	**25.5**	**25.3**	**25.4**	**25.1**	**25.0**	**25.2**	**24.7**	**24.3**
Primary	21.7	23.7	23.5	23.4	23.4	23.0	22.8	22.8	22.3	21.9
Programmable	18.2	20.4	20.0	20.0	19.8	19.3	19.0	18.9	18.4	18.0
Current	13.8	15.3	15.0	15.0	15.1	15.0	14.9	14.8	14.7	14.6
Wages	5.8	6.4	6.1	6.0	6.0	5.9	5.8	5.7	5.6	5.5
Pensions	2.1	2.4	2.6	2.7	2.8	2.9	3.0	3.1	3.2	3.3
Subsidies and transfers	2.6	2.9	2.9	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Other	3.3	3.6	3.4	3.3	3.3	3.1	3.0	2.9	2.8	2.7
Capital	4.4	5.1	5.0	4.9	4.7	4.3	4.1	4.1	3.7	3.4
Physical capital	3.1	4.6	4.8	4.5	4.3	3.9	3.7	3.8	3.5	3.2
Of which: non Pemex	*2.5*	*2.5*	*2.7*	*2.6*	*2.4*	*2.0*	*1.9*	*2.1*	*1.8*	*1.5*
Financial capital 2/	1.3	0.5	0.3	0.4	0.4	0.4	0.3	0.3	0.2	0.2
Nonprogrammable	3.6	3.3	3.5	3.5	3.6	3.7	3.8	4.0	3.9	3.9
Of which: revenue sharing	3.5	3.1	3.3	3.3	3.4	3.5	3.6	3.8	3.8	3.7
Interest payments 3/	1.9	2.2	2.0	1.9	2.1	2.1	2.2	2.3	2.4	2.4
Traditional balance 4/	**-0.1**	**-2.3**	**-2.8**	**-2.5**	**-2.4**	**-1.9**	**-1.8**	**-1.7**	**-1.7**	**-1.7**
Traditional balance for balanced budget rule	0.5	-0.2	-0.8	-0.5	-0.4	0.0	0.0	0.0	0.0	0.0
Adjustments to the traditional balance	**1.0**	**2.4**	**1.5**	**0.9**	**0.2**	**0.2**	**0.2**	**0.3**	**0.3**	**0.3**
PIDIREGAS	1.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
IPAB	0.2	0.1	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Budgetary adjustments	0.3	0.3	0.5	0.2	0.2	0.2	0.2	0.2	0.2	0.2
PEMEX, oil stabilization fund, FARP (-: net inflows)	-1.0	0.7	0.4	0.0	-0.4	-0.4	-0.3	-0.3	-0.2	-0.2
FARAC/FONADIN	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debtor support	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development banks (changes in capital)	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Nonrecurring revenue	0.5	1.3	0.4	0.7	0.3	0.3	0.3	0.3	0.3	0.3
Augmented balance 5/	**-1.1**	**-4.7**	**-4.3**	**-3.4**	**-2.6**	**-2.1**	**-2.0**	**-2.0**	**-2.0**	**-2.0**
Augmented interest expenditure 6/	2.5	2.7	2.6	2.4	2.6	2.6	2.7	2.8	2.9	2.9
Augmented primary balance	1.4	-1.9	-1.8	-1.0	0.0	0.5	0.7	0.8	0.9	0.9
Memorandum items										
Crude oil export price, Mexican mix (US$/bbl)	84	57	72	101	103	102	98	94	90	86
Development banks (net lending)	0.4	0.5	0.3	0.4	0.4	0.4	0.4	0.4	0.4	0.4
Non-oil augmented balance 7/	-9.0	-9.5	-9.1	-9.2	-8.7	-8.1	-7.7	-7.4	-7.0	-6.5
Non-oil augmented balance excluding development banks	-8.6	-9.0	-8.8	-8.8	-8.3	-7.7	-7.3	-7.0	-6.6	-6.1
Oil augmented balance	7.4	4.3	4.3	5.3	5.6	5.5	5.2	4.9	4.4	4.0
Structural Primary Fiscal Balance	0.3	-1.6	-1.9	-1.5	-0.5	0.2	0.5	0.8	0.9	1.0
Fiscal Impulse 8/	0.0	1.9	0.3	-0.4	-1.0	-0.7	-0.4	-0.2	-0.1	-0.1
Gross public sector debt	43.1	44.5	42.9	43.8	43.1	43.2	43.2	43.1	43.0	42.9
o/w Domestic (percentage of total debt)	70.3	73.0	76.7	75.5	75.4	76.8	77.9	79.0	80.0	81.1
Net public sector debt	33.4	36.7	36.8	38.0	37.8	37.7	37.7	37.6	37.5	37.5
Nominal GDP (billions of Mexican pesos)	12,176	11,930	13,084	14,336	15,667	16,713	17,819	18,968	20,204	21,503

Sources: Mexican authorities; and IMF staff estimates. Data refer to non-financial public sector, including PEMEX and other public enterprises but excluding state and local governments (except as noted).

1/ Total tax revenue excluding excise tax on gasoline.
2/ Includes transactions in financial assets and capital transfers.
3/ Includes transfers to IPAB and the debtor support programs.
4/ The break in the series in 2009 is due to definitional and accounting changes.
5/ Public Sector Borrowing Requirements excl. nonrecurrent revenue.
6/ Treats transfers to IPAB as interest payments.
7/ Excludes oil revenue (oil extraction rights, PEMEX net income, oil excess return levies, excise tax on gasoline) and PEMEX operational expenditure, interest payments, and capital expenditure.
8/ Negative of the change in the structural primary fiscal balance, measured adjusting tax revenue for the cycle and oil net exports using a long-term moving average of oil prices.

Table 3. Mexico: Summary Balance of Payments, 2008–2017

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
					Projections					
					(In billions of U.S. dollars)					
Current account	-17.9	-5.3	-4.8	-11.6	-11.1	-13.5	-14.7	-16.0	-15.8	-16.6
Merchandise trade balance, f.o.b.	-18.2	-5.2	-3.3	-1.7	-0.7	-3.2	-5.2	-7.1	-6.6	-5.3
Exports	291.3	229.7	298.5	349.4	375.1	396.8	419.2	446.5	477.1	514.8
Imports	-309.5	-234.9	-301.7	-351.1	-375.8	-400.0	-424.4	-453.6	-483.7	-520.1
Factor income	-18.1	-13.3	-13.0	-18.7	-19.4	-19.683	-19.4	-19.3	-19.6	-21.9
Net services	-7.1	-8.5	-10.1	-14.2	-14.4	-14.583	-15.0	-15.3	-15.6	-16.0
Net transfers	25.5	21.6	21.5	23.0	23.4	23.990	24.8	25.7	26.0	26.5
of which Remittances	25.1	21.3	21.3	22.8	23.2	23.791	24.6	25.5	25.8	26.3
Financial account	24.5	26.9	44.9	42.0	47.1	29.5	26.7	26.0	23.8	23.6
Public sector 1/	14.9	11.9	33.3	37.0	39.0	24.3	16.4	11.6	3.8	4.1
Medium- and long-term borrowing	-2.4	8.0	10.2	5.3	-1.9	-1.0	-1.0	-1.0	-1.0	-1.0
Disbursements	8.8	19.1	18.8	21.1	12.4	13.1	13.8	13.8	10.8	14.5
Amortization 2/	11.1	11.1	8.7	15.8	14.3	14.1	14.8	14.8	11.8	15.5
Pidiregas, net 3/	12.9	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other, including non-resident purchases of domestic bonds	4.4	4.0	23.1	31.6	40.9	25.3	17.4	12.6	4.8	5.1
Of which: oil hedging capital income	...	5.1	...	...	...	...	...	...	...	...
Private sector	9.6	15.0	11.6	5.0	8.1	5.2	10.3	14.4	20.0	19.5
Direct investment, net	26.1	7.9	4.7	9.7	13.2	12.9	14.2	14.7	15.3	15.9
Bonds and loans	-2.5	-1.5	40.2	5.4	-1.3	-3.0	0.6	2.8	7.6	6.3
Equity investments and change in assets abroad	-14.0	8.6	-33.2	-10.1	-3.8	-4.7	-4.6	-3.1	-2.9	-2.7
Errors and omissions and valuation adjustments	0.3	-16.5	-17.7	-2.5	-15.0	0.0	0.0	0.0	0.0	0.0
Net international reserves (increase -)	-7.4	-5.4	-22.8	-28.9	-21.0	-16.0	-12.0	-10.0	-8.0	-7.0
					(In percent of GDP, unless otherwise indicated)					
Memorandum items:										
Current account balance	-1.6	-0.6	-0.4	-1.0	-1.0	-1.1	-1.2	-1.2	-1.1	-1.1
Nonoil current account balance 4/	-2.9	-1.7	-1.5	-2.1	-2.0	-2.0	-1.8	-1.7	-1.4	-1.3
Nonoil trade balance 4/	-3.0	-1.8	-1.4	-1.3	-1.1	-1.1	-1.0	-1.0	-0.8	-0.5
Merchandise exports	26.4	26.0	28.8	30.2	32.3	32.8	32.9	33.4	33.8	34.6
Petroleum and derivatives exports	4.6	3.5	4.0	4.9	4.9	4.7	4.2	3.9	3.5	3.2
Merchandise imports	-28.0	-26.6	-29.1	-30.4	-32.3	-33.1	-33.4	-33.9	-34.3	-35.0
Petroleum and derivatives imports	3.2	2.3	2.9	3.7	3.9	3.8	3.6	3.4	3.2	3.0
Oil trade balance	1.4	1.2	1.1	1.2	1.0	0.8	0.6	0.5	0.3	0.2
Nonoil Exports volume growth (in percent)	0.4	-7.3	17.3	3.3	9.1	7.3	7.7	7.9	7.8	8.4
Nonoil Imports volume growth (in percent)	0.8	-22.0	24.1	8.6	7.3	7.2	7.2	7.6	7.0	7.5
Gross financing needs (billions of US$)	90.0	70.6	77.9	117.3	114.5	112.3	109.9	112.7	109.0	125.9
Gross international reserves (change, billions of US$) 5/	8.1	4.6	20.7	28.6	21.0	16.0	12.0	10.0	8.0	7.0
End-year (billions of US$)	95.3	99.9	120.6	149.2	170.2	186.2	198.2	208.2	216.2	223.2
Months of imports of goods and services	3.1	4.4	3.7	3.8	4.4	4.7	4.9	4.9	4.8	4.7
Percent of broad money	18.0	17.2	17.5	21.2	20.7	20.6	20.3	19.7	18.9	17.9
Percent of foreign portfolio liabilities	34.9	41.6	39.6	48.2	48.4	49.1	49.5	49.6	50.1	50.2
Percent of short-term debt (by residual maturity) 6/	147.0	154.9	174.0	179.7	190.9	206.5	221.8	236.5	245.5	242.4
Gross total external debt	18.6	22.0	23.9	24.3	27.4	28.1	28.1	27.8	27.1	25.7
Of which: Public external debt	11.9	13.6	15.3	16.1	19.4	20.7	20.9	20.7	19.9	18.5
Gross total external debt (billions of US$)	205.3	195.0	247.6	281.0	318.7	340.0	357.1	371.4	382.9	382.9
Of which: Public external debt 7/	131.8	120.4	158.9	186.2	225.2	249.6	266.0	277.6	281.4	274.8
External debt service (in percent of exports and other FX income) 8/	6.8	6.7	4.8	6.5	5.9	5.5	5.4	5.2	4.4	5.0

Sources: Bank of Mexico; Secretariat of Finance and Public Credit; and Fund staff projections.

1/ Including the financing of PIDIREGAS.

2/ Includes pre-payment of external debt.

3/ Break in the series in 2009 due to accounting changes.

4/ Excluding oil exports and petroleum products imports.

5/ 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.

6/ In percent of short-term debt by residual maturity. Historical data include all prepayments.

7/ Includes gross external debt issued by the federal government, development banks and nonfinancial public enterprises. Adjusted for PIDIREGAS, and includes non-residents' holdings of domestic-currency debt.

8/ Includes amortization on medium and long-term bonds and debt, and interest payments.

Table 4. Mexico: Financial Soundness Indicators, 2008–2012

(in percent)

	2008	2009	2010	2011	2012 1/
Capital Adequacy					
Regulatory capital to risk-weighted assets	15.3	16.5	16.9	15.7	15.7
Regulatory Tier 1 capital to risk-weighted assets	13.3	14.6	14.9	13.6	13.8
Capital to assets	9.2	10.7	10.4	9.9	10.1
Gross asset position in financial derivatives to capital	92.7	57.6	56.5	77.5	73.2
Gross liability position in financial derivatives to capital	100.4	59.5	55.6	79.6	71.9
Asset Quality					
Nonperforming loans to total gross loans	3.0	2.8	2.0	2.1	2.2
Provisions to Nonperforming loans	161.2	173.8	200.6	189.6	190.5
Earnings and Profitability					
Return on assets	1.4	1.5	1.8	1.5	1.8
Return on equity	14.8	15.2	16.8	15.5	18.2
Liquidity					
Liquid assets to short-term liabilities	56.1	57.7	58.2	55.3	55.7
Liquid assets to total assets	40.4	42.7	43.3	41.7	41.6
Customer deposits to total (noninterbank) loans	89.6	90.4	87.9	83.1	82.8

Sources: FSI & CNBV.

1/ As of March 2012

Table 5. Mexico: Indicators of External Vulnerability, 2008–2012

	2008	2009	2010	2011	2012 Latest 1/
Financial market indicators					
Exchange rate (per U.S. dollar, end-period)	13.5	13.1	12.4	14.0	12.9
(year-to-date percent change, + depreciation)	24.6	-3.5	-5.4	13.2	-3.8
28-day treasury auction rate (percent; period average)	7.7	5.4	4.4	4.2	4.2
EMBIG Mexico (basis points; period average)	254	301	186	186	166
Stock exchange index in U.S. dollar terms (year on year percent change)	-39.2	48.8	26.8	-15.0	26.7
Financial system					
Bank of Mexico net international reserves (US$ billion)	85.4	90.8	113.6	142.5	161.3
Real credit to the non-financial private sector (12-month percent change)	8.0	-6.0	5.6	13.3	11.4
Commercial banks' nonperforming loans (percent of loans granted to non-financial private sector)	3.0	2.8	2.0	2.1	2.2
Exports and imports					
Trade balance (US$ billion; year-to-date)	-17.3	-4.7	-3.0	-1.5	3.3
Exports (year to date, annual percentage change) 2/	7.2	-21.2	29.9	17.1	19.5
Of which					
Non-oil	5.2	-17.4	29.1	14.1	21.6
Imports (year to date, annual percentage change) 2/	9.5	-24.0	28.6	16.4	19.2
Of which					
Consumer goods	11.3	-31.5	26.2	25.0	18.7
Capital goods	16.4	-21.6	-1.3	15.8	25.1
Terms of trade (12-month percent change)	1.3	-11.2	7.6	6.8	-4.5
Real effective exchange rate (CPI based; 12 month percent change) 3/	-12.1	2.6	6.7	-9.4	-7.9
External Debt					
Non-financial public sector external debt (percent of GDP) 4/	11.9	13.6	15.3	16.1	19.4
Non-financial public sector short-term external debt (percent of GDP) 4/ 5/	1.9	1.5	2.7	2.7	4.5
Private sector external debt (percent of GDP) 4/	6.7	8.5	8.6	8.2	8.0
Private sector short-term external debt (percent of GDP) 4/ 5/	3.7	5.0	3.7	4.0	2.6
Memorandum items:					
Gross international reserves to short-term debt (by residual maturity, percent) 5/	147.0	154.9	174.0	179.7	190.9
Monetary base to gross international reserves (percent)	44.8	48.5	46.5	36.6	33.6
Gross international reserves to M2	19.1	18.3	19.4	24.4	24.0

Sources: Bank of Mexico; National Banking and Securities Commission; National Institute of Statistics and Geography; Secretary of Finance and Public Credit; and IMF staff estimates

1/ Financial market indicators data as of September, all other data as of August, except NPL ratio which is as of March.

2/ In U.S. dollar terms.

3/ Increase represents appreciation.

4/ Projections for end-year 2012.

5/ Short-term debt by residual maturity includes pre-payment of debt.

Table 6. Mexico: Baseline Medium-Term Projections, 2008–2017

					Staff projections					
	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
	(Annual percentage change, unless otherwise indicated)									
National income and prices										
Real GDP	1.2	-6.0	5.6	3.9	3.8	3.5	3.5	3.3	3.3	3.3
Consumer prices (end of year)	6.5	3.6	4.4	3.8	4.2	3.2	3.0	3.0	3.0	3.0
Consumer prices (average)	5.1	5.3	4.2	3.4	4.1	3.5	3.0	3.0	3.0	3.0
External sector										
Non-oil current account balance (as a share of GDP) 1/	-2.9	-1.7	-1.5	-2.1	-2.0	-2.0	-1.8	-1.7	-1.4	-1.3
Exports, f.o.b.	7.2	-21.2	29.9	17.1	7.4	5.8	5.7	6.5	6.9	7.9
Imports, f.o.b.	9.5	-24.0	28.6	16.4	7.0	6.4	6.1	6.9	6.7	7.5
Terms of trade (deterioration -)	1.3	-11.2	7.6	6.8	0.1	0.2	0.0	0.1	0.1	0.2
Oil export price (US$ / bbl)	84.4	57.4	72.3	101.0	103.1	102.1	97.7	93.6	90.1	86.4
	(In percent of GDP)									
Non-financial public sector										
Augmented fiscal balance	-1.1	-6.0	-4.8	-3.4	-2.6	-2.1	-2.0	-2.0	-2.0	-2.0
Augmented primary balance	1.4	-3.3	-2.2	-1.0	0.0	0.5	0.7	0.8	0.9	0.9
Saving and investment										
Gross domestic investment	26.9	23.7	24.0	25.1	24.9	25.3	25.6	25.5	25.5	25.4
Fixed investment	22.1	21.3	20.6	21.1	21.8	22.0	22.2	22.0	22.0	21.8
Public	5.6	6.1	6.1	5.9	5.5	5.2	5.0	5.1	4.9	4.6
Private	16.5	15.2	14.5	15.2	16.3	16.9	17.2	16.9	17.1	17.2
Gross domestic saving	25.3	23.2	23.6	24.1	24.0	24.2	24.5	24.4	24.4	24.3
Public	4.1	0.9	1.3	2.0	2.5	2.6	2.5	2.6	2.4	2.1
Private	21.3	22.3	22.3	22.1	21.5	21.7	22.0	21.7	22.1	22.2
Current account balance	-1.6	-0.6	-0.4	-1.0	-1.0	-1.1	-1.2	-1.2	-1.1	-1.1

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

1/ Excluding oil exports and petroleum products imports.

Table 7. Mexico: Statement of Operations of Central Government Non-financial Public Sector, 2005–2011 1/

	2005	2006	2007	2008	2009	2010	2011
			(In percent of GDP)				
Revenue 2/	**21.1**	**22.2**	**22.4**	**25.3**	**23.7**	**23.2**	**24.0**
Taxes	8.8	9.0	9.3	10.0	9.6	10.2	10.2
Income taxes	4.2	4.3	4.7	5.2	5.0	5.2	5.3
Value added tax	3.4	3.7	3.6	3.8	3.4	3.9	3.7
Excises	0.5	0.4	0.4	0.5	0.6	0.6	0.6
Import duties	0.3	0.3	0.3	0.3	0.3	0.2	0.2
Other	0.3	0.3	0.3	0.3	0.4	0.3	0.3
Other revenue	12.3	13.2	13.1	15.3	14.1	13.0	13.8
Property income	5.7	5.6	4.9	7.4	4.1	4.9	5.9
Oil fees	5.7	5.6	4.9	7.4	4.1	4.9	5.9
Other revenue	6.6	7.6	8.2	7.9	10.1	8.1	7.9
Public enterprises	5.8	6.8	6.8	6.7	6.8	6.7	6.6
Other nontax	0.8	0.8	1.4	1.2	3.2	1.4	1.2
Expenditure 2/	**21.2**	**22.1**	**22.4**	**25.4**	**26.0**	**26.0**	**26.4**
Expense	18.8	19.7	19.6	22.3	21.4	21.3	21.9
Compensation of employees	6.0	5.9	5.8	5.8	6.4	6.1	6.0
Purchases of goods and services	2.7	2.9	3.2	3.3	3.6	3.4	3.3
Interest	2.0	2.0	1.9	1.6	1.9	1.8	1.8
Domestic	1.2	1.3	1.2	1.1	1.4	1.4	1.4
Foreign	0.8	0.8	0.6	0.6	0.6	0.5	0.4
Subsidies and transfers 2/	2.2	2.6	2.6	4.4	3.1	3.5	4.2
Grants	3.0	3.2	2.9	3.5	3.1	3.3	3.3
Social benefits	1.9	1.9	2.1	2.1	2.4	2.6	2.7
Other expense	1.0	1.1	1.2	1.6	0.9	0.5	0.6
IPAB and debtor support programs	0.3	0.4	0.2	0.2	0.3	0.1	0.1
Adefas and others	0.1	0.2	0.1	0.1	0.1	0.2	0.1
Financial assets and others 3/	0.6	0.6	0.8	1.3	0.5	0.3	0.4
NLB of public entities (indirect control)	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net acquisition of nonfinancial assets	2.4	2.5	2.8	3.1	4.6	4.8	4.5
Fixed capital assets	2.4	2.5	2.8	3.1	4.6	4.8	4.5
Net lending/borrowing (overall balance) 4/ 5/	**-0.1**	**0.1**	**0.0**	**-0.1**	**-2.3**	**-2.8**	**-2.5**
Augmented balance (excl. net lending of dev. banks) 6/	**-1.4**	**-1.0**	**-1.2**	**-1.1**	**-4.7**	**-4.3**	**-3.4**
Augmented traditional balance (excl. adj. of stabilization funds and nonrecurring revenue) 7/	**-1.3**	**-1.2**	**-1.0**	**-1.6**	**-2.6**	**-3.5**	**-2.7**
Net financial transactions	**-1.3**	**-1.2**	**-1.0**	**-1.6**	**-2.6**	**-3.5**	**-2.7**
Net acquisition of financial assets ("+": increase in assets) 8/	0.4	1.6	1.2	1.0	-1.8	-0.4	0.7
Net incurrence of liabilities ("+": increase in liabilities)	1.7	2.8	2.2	2.6	0.9	3.1	3.4
Memorandum items:							
NLB of CG's public sector (excl. fin. cap. assets)	0.5	0.7	0.8	1.3	-1.8	-2.5	-2.0
Primary balance	1.9	2.1	1.9	1.6	-0.4	-1.0	-0.6
Oil revenue	8.4	8.4	7.8	8.6	7.7	7.3	7.5
Non-oil revenue	12.6	13.9	14.6	16.7	16.0	15.9	16.4
Augmented balance (excl. net lending of dev. Banks) 6/	-1.4	-1.0	-1.2	-1.1	-4.7	-4.3	-3.4
Augmented interest expenditure	2.9	2.8	2.6	2.5	2.7	2.6	2.4
Augmented primary balance (excl. Dev. Banks) 9/	1.5	1.8	1.5	1.4	-1.9	-1.8	-1.0
Adjustment to net lending/borrowing balance	1.3	1.1	1.2	1.0	2.4	1.5	0.9
PIDIREGAS	0.9	1.1	0.9	1.1	0.0	0.1	0.1
IPAB	0.2	0.1	0.1	0.2	0.1	0.1	0.1
Budgetary adjustments	0.1	0.2	0.4	0.3	0.3	0.5	0.2
PEMEX, oil stabilization fund, FARP (net inflows)	-0.1	-0.5	-0.4	-1.0	0.7	0.4	0.0
FARAC/FONADIN	0.0	0.0	-0.2	0.0	0.0	0.0	0.0
Debtor support	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development banks (changes in capital)	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Nonrecurring revenue	0.2	0.3	0.6	0.5	1.3	0.4	0.7
Crude oil export price, Mexican mix (US$/bbl)	0.5	0.5	0.5	0.7	0.5	0.6	0.7
Development banks	-0.1	-0.5	0.0	0.4	0.5	0.3	0.4
Gross public sector debt	39.8	38.4	37.8	43.1	44.5	42.9	43.8
Domestic (percentage of total debt)	67.9	73.5	73.0	70.3	73.0	76.7	75.5
Foreign currency-denominated (percentage of total debt)	32.1	26.5	27.0	29.7	27.0	23.3	24.5
Net public sector debt	32.2	30.2	29.3	33.4	36.7	36.8	38.0
Nominal GDP in market prices	9,247	10,374	11,314	12,176	11,930	13,084	14,336

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

1/ Data exclude state and local governments.

2/ Revenue and expenditure figures may differ from official data due to differences in the treatment of the negative excise on gasoline, which is included here under subsidies and transfers.

3/ In GFSM 2001, all financial asset flows should be recorded in financial accounts. Due to lack of disaggregated date this item includes both financing and capital transfers.

4/ Includes transactions in financial capital assets.

5/ The break in the series in 2009 is due to definitional and accounting changes. This balancing item is equivalent to the public sector balance as defined by Mexican authorities.

6/ Public Sector Borrowing Requirements, which may differ from official figures due to differences in the treatment of nonrecurring revenue and transfers to stabilization funds.

7/ Public Sector Borrowing Requirements excl. nonrecurring revenues, as defined by Mexican authorities.

8/ Transactions on liquid financial assets excluding those classified as financial assets with policy purposes by Mexican authorities.

9/ Treats transfers to IPAB as interest payments.

Table 8. Mexico: Central Government's Public Sector Financial Balance Sheet 1/

(In billions of Pesos)

	2007			2008			2009			2010			2011			2012
	Opening balance	Transactions	Other flows 2/	Opening balance	Transactions	Other flows 2/ 3/	Opening balance	Transactions	Other flows 2/	Opening balance	Transactions	Other flows 2/	Opening balance	Transactions	Other flows 2/	Opening balance
Net worth	**....**			**....**			**....**			**....**			**....**			**....**
Nonfinancial assets	**....**			**....**			**....**			**....**			**....**			**....**
Net financial assets	**-3,135.4**			**-3,314.5**			**-4,063.4**			**-4,382.3**			**-4,813.2**			**-5,450.5**
Financial Assets 4/	**843.0**	130.4	-7.7	**965.6**	125.5	94.8	**1,185.9**	-209.9	-46.1	**929.9**	-47.7	-86.5	**795.7**	98.7	-59.5	**834.9**
Liabilities	**3,978.4**	246.1	55.6	**4,280.1**	322.5	646.7	**5,249.3**	103.5	-40.7	**5,312.1**	404.0	-107.2	**5,608.9**	487.7	188.8	**6,285.5**
Memorandum items:																
Net financial worth (in % of GDP)	-30.2			-29.3			-33.4			-36.7			-36.8			-38.0
Financial assets (in % of GDP)	8.1			8.5			9.7			7.8			6.1			5.8
Liabilities (in % of GDP)	38.4			37.8			43.1			44.5			42.9			43.8
GDP nominal prices	10,374			11,314			12,176			11,930			13,084			14,336

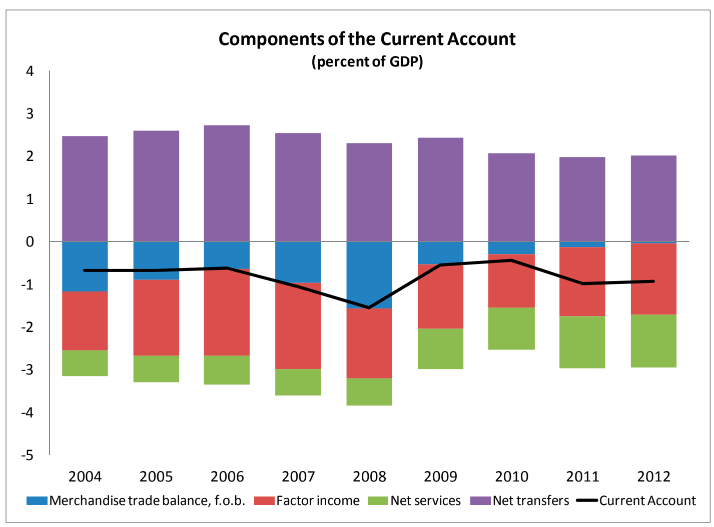
Sources: Mexico authorities; and Fund staff estimates and projections.
1/ Excludes state and local governments.
2/ Includes exchange rate and various accounting adjustments.
3/ Includes Mex$ 291.9 billion in new liabilities due to ISSSTE Law Reform.
4/ Liquid financial assets excluding those classified as financial assets with policy purposes by official authorities.

ANNEX I. MEXICO: EXTERNAL SECTOR ASSESSMENT

Mexico's current account deficit and exchange rate level appear broadly in line with fundamentals and desirable policy settings. The country's floating exchange rate has been a key shock absorber in the context of a volatile external environment, with large and symmetric fluctuations since the global crisis. Rule-based intervention in the foreign exchange market, which has been minimal, has sought to limit excess volatility and disorderly market conditions. Foreign investment in peso-denominated government debt has increased significantly since 2010 amidst broadening recognition of Mexico's strong fundamentals and lax global monetary conditions. Reserve accumulation (mainly from PEMEX's foreign exchange balance) has allowed Mexico to maintain adequate reserve buffers for normal times, given the substantial increase in portfolio inflows. However, the large stock of foreign portfolio investment, including in government paper, can pose risk in an unsettled external environment. In this context, Mexico's FCL arrangement is an important complement to reserve buffers against global tail risks.

Current Account

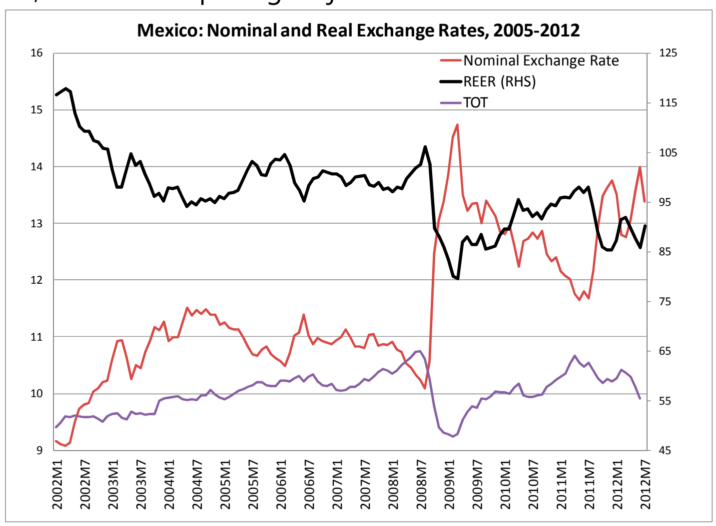
1. **Mexico's current account deficit has remained relatively stable at about 1 percent of GDP over the past few years**. This has reflected balanced and resilient growth (supported by both domestic and external demand), as well as a market-determined exchange rate in line with fundamentals. The v-shaped recovery in exports after the global crisis (particularly in manufacturing, which constitutes about 80 percent of total exports) was accompanied by a strong recovery of imports, linked to Mexico's high integration into the U.S. manufacturing supply chain and exports' heavy reliance on imported inputs. The robust performance of Mexico's manufacturing sector was supported by continued strong demand from the U.S. (Mexico's major trading partner and the destination of about 80 percent of its exports) and an increase in market share. The latter was due to significant FDI inflows in the past (particularly into the automobile industry) and improved relative ULCs (from increased productivity, contained wage growth from lower migration and increased labor market participation, and the depreciation of the exchange rate). The recovery of Mexico's terms of trade to pre-crisis levels also helped underpin export values. The large and steady flow of remittances, particularly from the U.S., was partly offset by the net factor income balance (driven primarily by interest payments to foreign holders of Mexican debt) and the non-factor services balance (closely linked to trade-related freight and insurance services).



2. Over the medium term, the current account deficit is expected to remain stable at about 1 percent of GDP (at constant real exchange rate and given current medium-term assumptions in the World Economic Outlook). The projected deterioration in the oil trade balance (in line with the constant volume of production and projected decline in oil prices) is envisaged to be offset by an improvement in the non-oil trade balance (led by continued strong growth in manufactured exports). Mexico is expected to continue to attract FDI into the manufacturing sector. Macro policy continuity and growth-promoting structural reforms introduce upside potential for exports, both in manufacturing and energy.[19]

Exchange Rate

3. Mexico's flexible exchange rate has served as an important buffer against heightened external risks and uncertainties. The nominal exchange rate has shown significant volatility during the recurrent periods of global risk aversion, but without posing major difficulties for the balance sheets of households, corporates and financial institutions. The volatility of the exchange rate during periods of global financial turmoil is in part due to the fact that the peso market is highly liquid, open around-the-clock, and therefore used by market participants across the globe to take positions in reaction to external developments.[20] As such, part of Mexico's currency volatility in recent years has reflected global sentiments rather than country-specific factors.[21] This has been shown by the contrasting behavior of the exchange rate and sovereign interest rates, whereby upsurges in global risk aversion have not led to foreign divestment from government debt with interest rates remaining remarkably stable.



[19] According to the U.S. Energy Information Administration, Mexico has the fourth largest reserves of shale gas in the world.

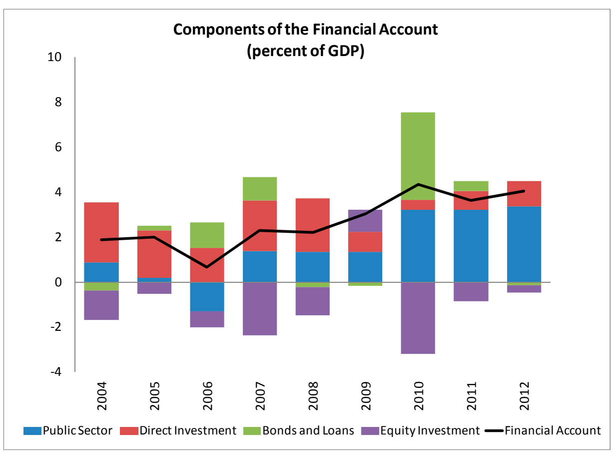
[20] According to a 2010 BIS survey, the Mexican peso is the third most traded emerging market currency, next to South Korea's won and the Singapore dollar. The bulk of currency trading is conducted outside Mexico by foreign market participants.

[21] The real effective exchange rate depreciated by about 25 percent from peak to trough during the 2008–09 global crisis. Since the crisis, the real effective exchange rate has strengthened and weakened, including in the second half of 2011, mainly reflecting nominal exchange rate movements driven by the recurrent bouts of global risk aversion. The nominal exchange rate depreciated by about 50 percent against the U.S. dollar during the 2008–09 crisis in a period of seven months.

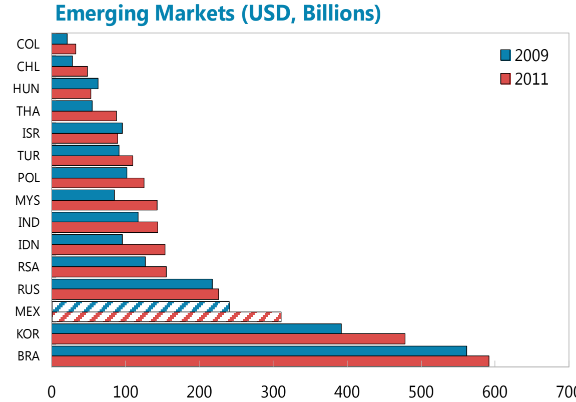
4. A range of metrics and methodologies indicate that Mexico's external position is broadly in line with fundamentals. The analyses in the 2012 Pilot External Sector Report and the recently-released External Balances Assessment (EBA) indicate that Mexico's cyclically-adjusted current account and real effective exchange rate are broadly consistent with fundamentals and desirable policies. The overall assessment of the most recent CGER results also indicates that Mexico's real effective exchange rate is in line with fundamentals.

Capital account, international reserves and international investment position

5. Mexico has experienced large capital inflows during the last years, which have been driven by both external and domestic factors. The former have been associated with lax global monetary conditions and, as a recurring offset, with the repeated bouts of global risk aversion. Domestic factors have been related to Mexico's strong macroeconomic fundamentals, which led to its inclusion in the World Global Bond Index (WGBI) in 2010 and the opening of Mexico's assets to a new class of institutional investors. Although the bulk of foreign investors are from the U.S., the investor base has increasingly diversified across a broader range of countries, including from the Asia-Pacific region seeking exposures in emerging markets.



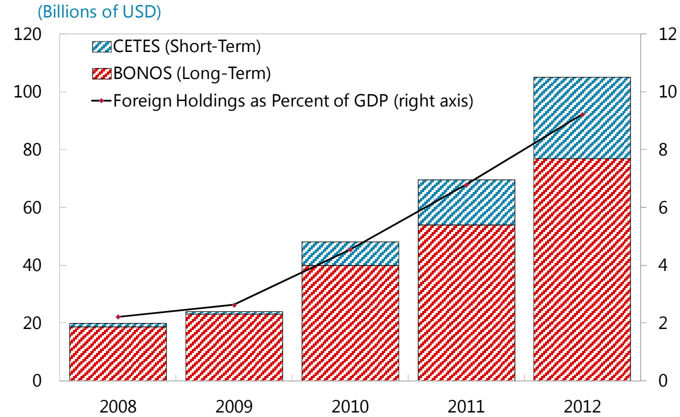
Stock of Non-resident portfolio Investment in Emerging Markets (USD, Billions)



Sources: IFS

6. Foreign portfolio exposures have increased significantly since the global crisis, particularly in sovereign debt markets. Increased investor appetite for Mexican assets has been associated with: (i) the broadening recognition of Mexico's sound macro policies; (ii) the absence of controls on the capital account and stability of taxes and regulations for foreign investment; and (iii) the liquidity of its sovereign and FX markets. The stock of foreign portfolio investment in Mexico has increased by almost

Mexico: Foreign Holdings of Domestic Government Debt
(Billions of USD)

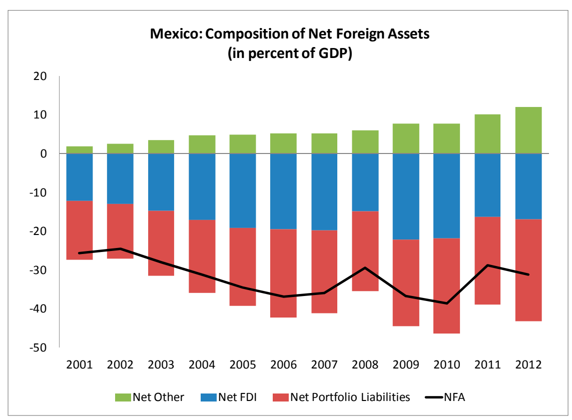


Sources: Banxico

80 percent during the last three years, from about US$200 billion at end-2009 to US$355 billion in mid 2012. Capital inflows have been particularly large, channeled to domestic sovereign debt markets where the stock of foreign portfolio holdings increased from about US$30 billion in 2009 to US$100 billion in mid-2012. A significant part of portfolio inflows has been from institutional investors into the long-end of the yield curve, driven largely by Mexico's strong fundamentals and its inclusion in the WGBI. More recently, flows to short-term government paper (CETES) have increased considerably, driven in part by carry trade operations. Given the impact that a surge in global risk aversion could have on emerging markets as an asset class, including sound countries like Mexico, the large portfolio exposure of foreign market participants represents significant risks.

7. **While reserve coverage has increased moderately since the global crisis, it remains low in terms of balance sheet exposures against comparator emerging markets**. The increased investor appetite for Mexican assets has meant that despite efforts to rebuild reserve buffers, the coverage ratio vis-à-vis foreign portfolio liabilities has increased only modestly and still appears low (48 percent) compared with the median for a group of emerging markets (147 percent). The coverage of monetary aggregates shows a similar picture, with the increase in coverage from 16 percent to 21 percent of broad money still low compared to the median for emerging markets of 33 percent.[22] Other metrics show that Mexico is below the median for emerging markets in the case of reserves to GDP, and above the median for the coverage of short-term debt at residual maturity plus the current account deficit. The ARA metric and reserves as months of imports show that Mexico is in line with the median for emerging markets. However, Mexico has low short-term debt and current account deficits, and high correlation between exports and imports, which suggests that less weight can be given to these metrics as indicators of potential external drains.

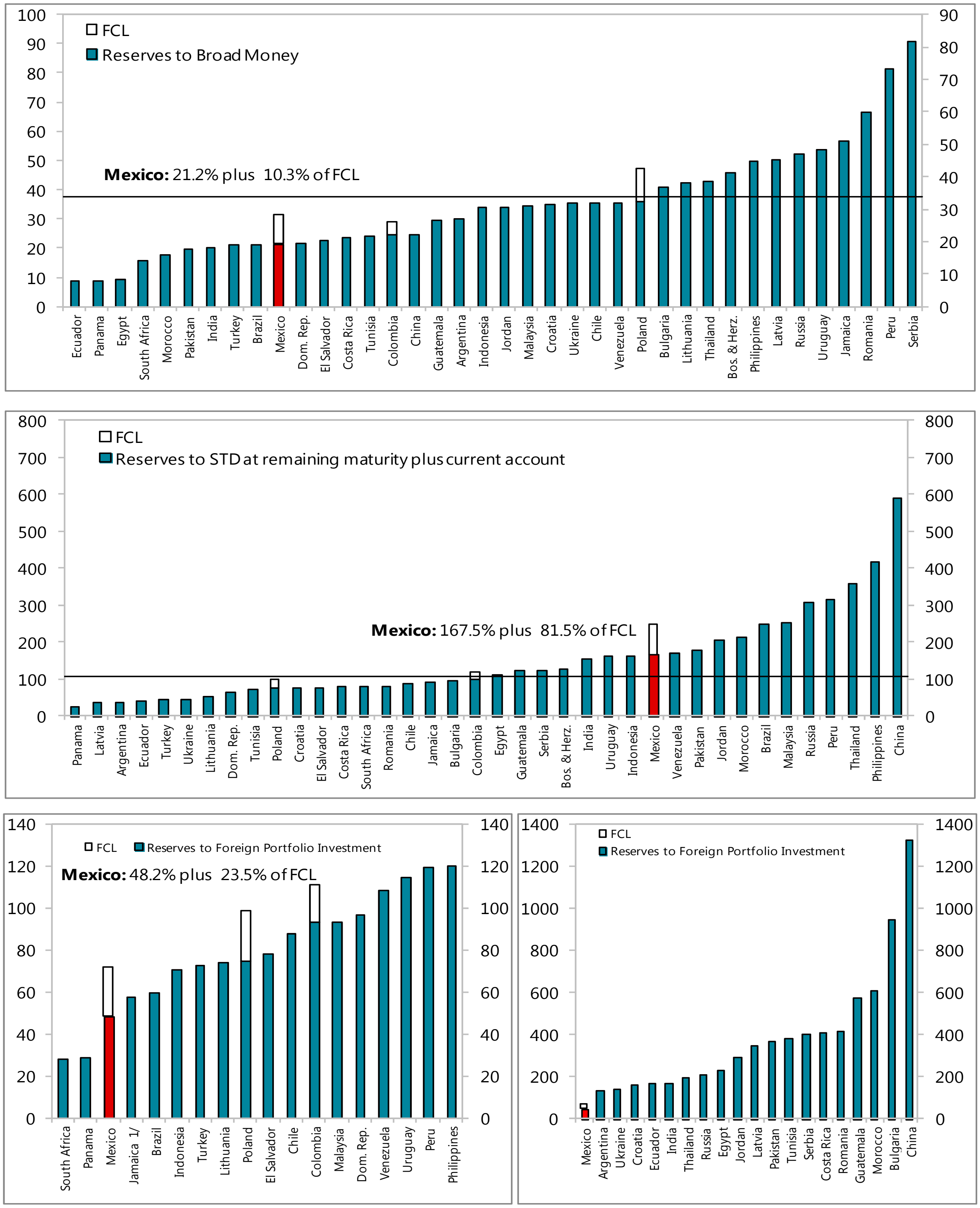
8. **Mexico's net foreign asset position remains moderate, narrowing slightly below pre-crisis levels**. As of the end of the second quarter of 2012, Mexico's net foreign assets position stood at about negative 31 percent of GDP (from negative 36 percent at the end of 2007). Over the medium term, the NFA is expected to remain broadly stable as the current account is projected to be in line with the NFA-stabilizing level of 1.1 percent.[23]



[22] This is an indicator of coverage against the risk of capital flight that has been shown to be of particular importance for emerging markets (Maurice Obstfeld, Jay C. Shambaugh, and Alan M. Taylor, 2010. "Financial Stability, the Trilemma, and International Reserves," *American Economic Journal: Macroeconomics*, American Economic Association, vol. 2(2), pages 57–94, April.)

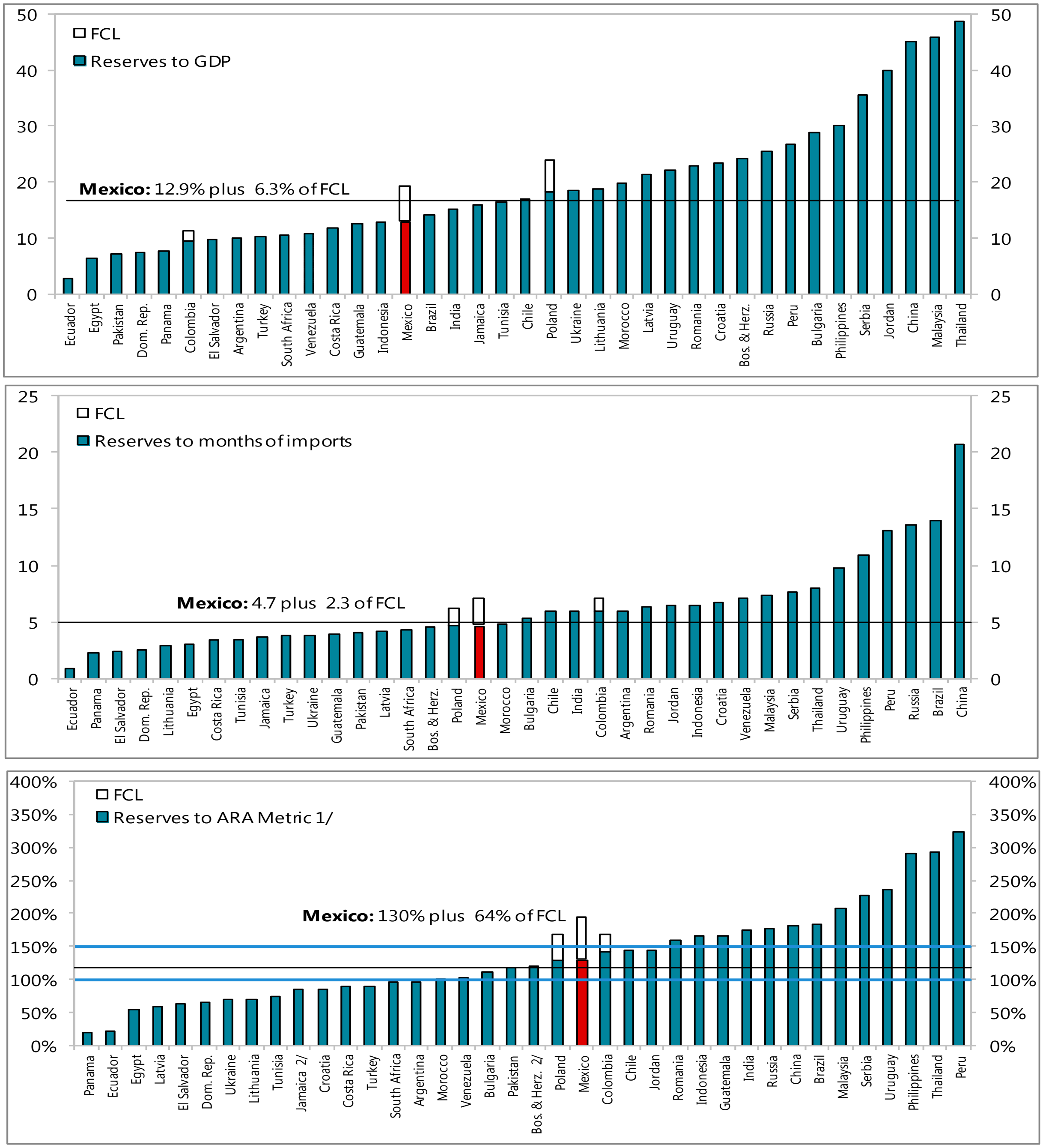
[23] Based on results of the External Balances Assessment.

Mexico: Metrics of Reserve Coverage in a Cross-Country Perspective, 2011



Sources: World Economic Outlook, and IMF staff estimates.
1/ Portfolio liabilities only available until 2010.
Note: Black line represents the cross-country median.

Mexico: Metrics of Reserve Coverage in a Cross-Country Perspective, 2011 (Cont.)



Sources: World Economic Outlook, Balance of Payments Statistics Database, and IMF staff estimates.
1/ The ARA metric was developed by SPR to assess reserve adequacy. For the stock of porfolio liabilities, data on 2010 or 2011 is used depending on data availability.
2/ Portfolio liabilities only available until 2010.
Note: Black line represents the cross-country median.

INTERNATIONAL MONETARY FUND

MEXICO

November 1, 2012

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

Approved By
Adrienne Cheasty and Lorenzo Giorgianni

Prepared by the Staff of the International Monetary Fund

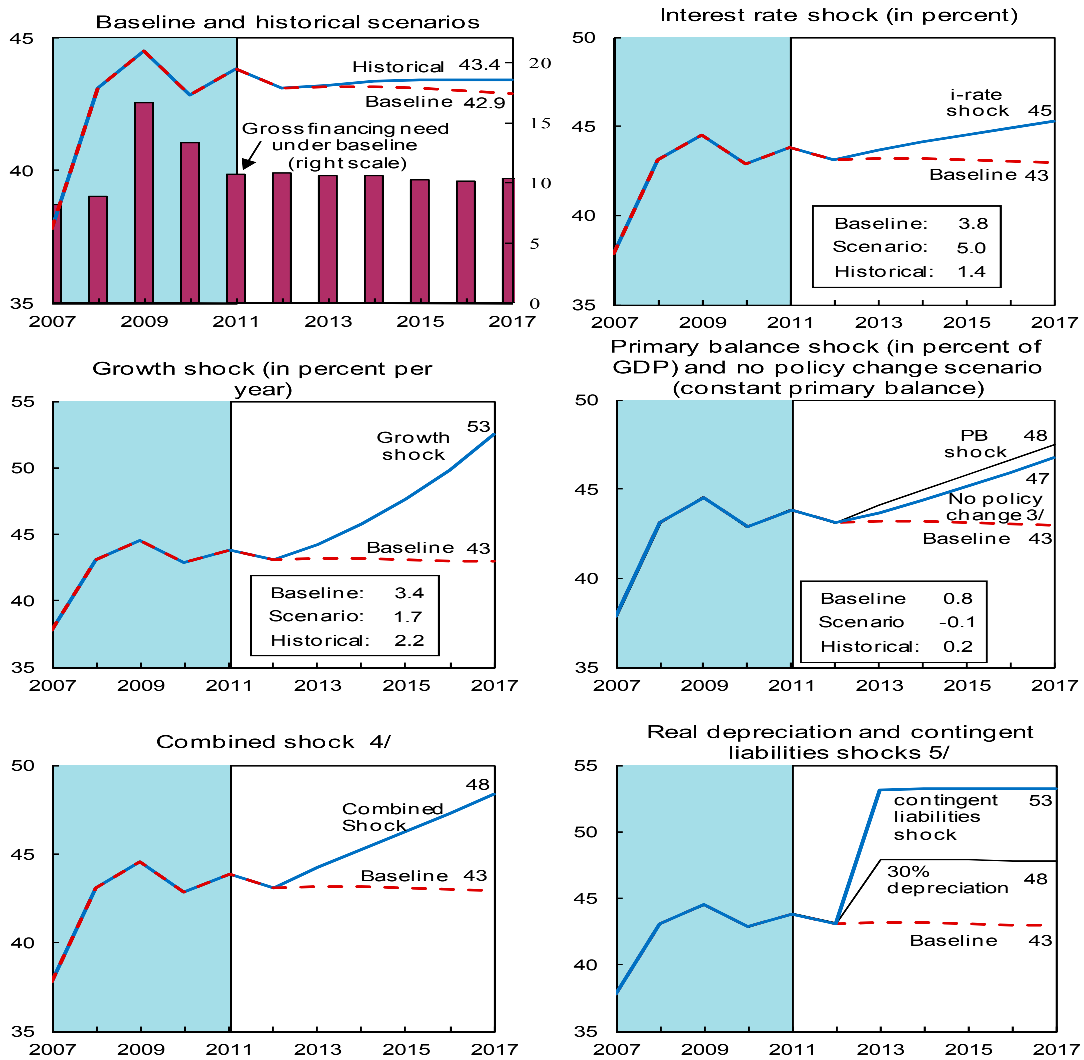
FIGURES

TABLES

FISCAL DEBT SUSTAINABILITY ANALYSIS

Mexico's public debt is moderate and is projected to remain stable over the medium term under the baseline scenario, at around 43 percent of GDP. Standard DSA bound tests suggest that public debt would remain at moderate levels under standard shocks. Moreover, Mexico's balanced-budget framework is a strong fiscal anchor against the materialization of such scenarios.

Figure 1. Public Debt Sustainability: Bound Tests 1/ 2/
(Public debt in percent of GDP)



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/ This mechanical exercises assumes that the budget rule does not hold.
4/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
5/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 1. Public Sector Debt Sustainability Framework, 2007–2017
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Debt-stabilizing primary balance 9/
Baseline: Public sector debt 1/	37.8	43.1	44.5	42.9	43.8	**43.1**	**43.2**	**43.2**	**43.1**	**43.0**	**42.9**	**0.2**
o/w foreign-currency denominated	10.2	12.8	12.0	10.0	10.8	9.9	9.4	8.8	8.3	7.8	7.0	
Change in public sector debt	-0.5	5.3	1.4	-1.7	1.0	-0.7	0.1	0.0	-0.1	-0.1	-0.1	
Identified debt-creating flows (4+7+12)	-2.4	-0.1	7.1	0.7	0.9	-1.6	-1.0	-1.0	-0.9	-0.9	-0.8	
Primary deficit	-1.5	-1.4	3.3	2.2	1.0	0.0	-0.5	-0.7	-0.8	-0.9	-0.9	
Revenue and grants	21.4	23.0	22.3	22.2	22.1	22.8	22.9	22.9	23.2	22.7	22.3	
Primary (noninterest) expenditure	19.9	21.6	25.5	24.4	23.0	22.8	22.4	22.2	22.3	21.9	21.4	
Automatic debt dynamics 2/	-0.6	2.4	3.1	-2.0	0.0	-1.2	-0.1	0.1	0.2	0.2	0.3	
Contribution from interest rate/growth differential 3/	-0.5	-0.2	3.6	-1.4	-1.3	-1.2	-0.1	0.1	0.2	0.2	0.3	
Of which contribution from real interest rate	0.6	0.3	1.0	0.9	0.2	0.4	1.4	1.5	1.5	1.6	1.7	
Of which contribution from real GDP growth	-1.1	-0.4	2.6	-2.3	-1.5	-1.5	-1.4	-1.4	-1.3	-1.3	-1.3	
Contribution from exchange rate depreciation 4/	0.0	2.5	-0.5	-0.6	1.3	...	...	...	...	...	...	
Other identified debt-creating flows	-0.4	-1.0	0.7	0.4	0.0	-0.4	-0.4	-0.3	-0.3	-0.2	-0.2	
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (transfers to stabilization funds: '-' indicates net inflows)	-0.4	-1.0	0.7	0.4	0.0	-0.4	-0.4	-0.3	-0.3	-0.2	-0.2	
Residual, including asset changes (2-3) 5/	1.9	5.4	-5.7	-2.3	0.1	0.8	1.0	1.0	0.9	0.8	0.7	
Public sector debt-to-revenue ratio 1/	176.8	187.6	199.7	193.2	198.5	189.2	188.6	188.7	186.2	189.4	192.3	
Gross financing need 6/	8.2	8.8	16.6	13.3	10.7	10.8	10.6	10.6	10.2	10.2	10.4	
in billions of U.S. dollars	84.8	96.7	147.0	138.0	123.7	125.4	128.3	135.3	137.0	143.7	154.0	
Scenario with key variables at their historical averages 7/						**43.1**	**43.3**	**43.4**	**43.4**	**43.4**	**43.4**	**-0.5**
Scenario with no policy change (constant primary balance) in 2012-2017						**43.1**	**43.7**	**44.4**	**45.1**	**45.9**	**46.7**	**0.2**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	3.2	1.2	-6.0	5.6	3.9	3.8	3.5	3.5	3.3	3.3	3.3	
Average nominal interest rate on public debt (in percent) 8/	7.5	7.2	6.2	6.3	6.2	6.4	6.5	6.7	6.9	7.1	7.2	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	1.9	0.8	2.0	2.4	0.8	1.1	3.5	3.7	3.9	4.0	4.2	
Nominal appreciation (increase in US dollar value of local currency, in percent)	0.1	-19.7	3.7	5.7	-11.7	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	5.6	6.4	4.2	3.9	5.4	5.3	3.0	3.0	3.1	3.1	3.0	
Growth of real primary spending (deflated by GDP deflator, in percent)	4.3	9.4	11.4	0.8	-1.8	2.6	1.8	2.6	3.9	1.1	1.2	
Primary deficit	-1.5	-1.4	3.3	2.2	1.0	0.0	-0.5	-0.7	-0.8	-0.9	-0.9	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.

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

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi\ (1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

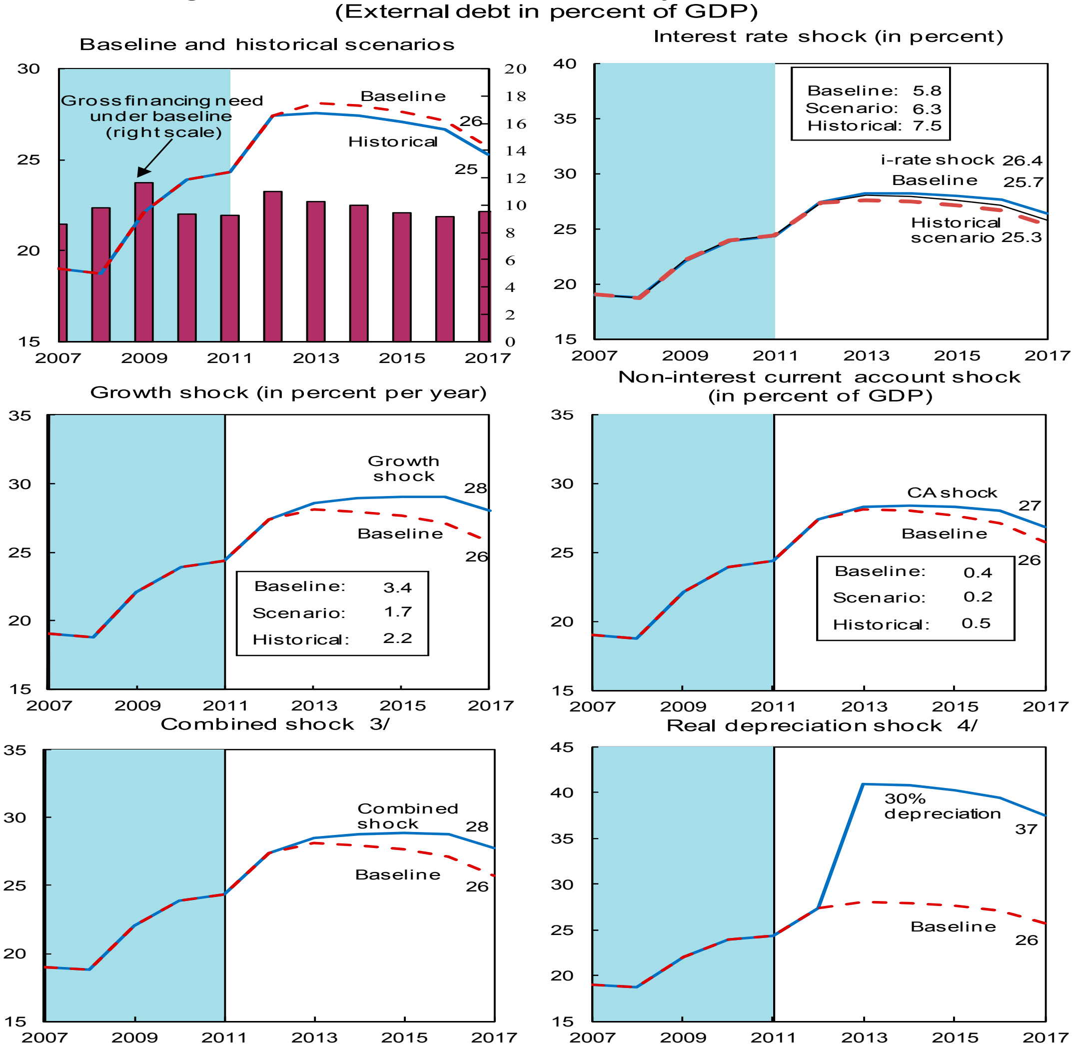
8/ Derived as nominal interest expenditure divided by previous period debt stock.

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.

EXTERNAL DEBT SUSTAINABILITY ANALYSIS

Mexico's external-debt-to GDP ratio continues to be low and sustainable, and is expected to remain stable over the medium-term. In the most extreme shock—a 30 percent real exchange rate depreciation—the debt-to-GDP ratio would increase to 37 percent, which is still a moderate level. Mitigating factors include the fact that a larger share of Mexico's (public) debt is now denominated in pesos, and Mexico has taken advantage of low interest rates and the recognition of its strong macroeconomic fundamentals to lengthen the maturity structure of its external debt. Other shocks, including to interest rates, current account and growth have only a marginal impact on Mexico's debt-to-GDP ratio.

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



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 2012.

Table 2. External Debt Sustainability Framework, 2007–2017
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	**Debt-stabilizing non-interest current account 7/**
Baseline: External debt	19.0	18.8	22.1	23.9	24.3	**27.4**	**28.1**	**28.0**	**27.6**	**27.1**	**25.7**	**-1.3**
Change in external debt	1.0	-0.2	3.3	1.8	0.4	3.1	0.7	-0.1	-0.3	-0.5	-1.4	
Identified external debt-creating flows (4+8+9)	-2.8	-0.9	3.2	-4.5	-2.5	-1.4	-1.2	-1.3	-1.3	-1.4	-1.3	
Current account deficit, excluding interest payments	-0.5	0.1	-0.8	-0.9	-0.6	-0.7	-0.5	-0.3	-0.3	-0.4	-0.6	
Deficit in balance of goods and services	1.6	2.2	1.5	1.3	1.4	1.3	1.4	1.6	1.6	1.5	1.4	
Exports	27.9	28.2	27.7	30.3	31.6	33.7	34.2	34.3	34.8	35.2	36.0	
Imports	29.5	30.5	29.2	31.6	33.0	34.9	35.7	35.9	36.4	36.8	37.4	
Net non-debt creating capital inflows (negative)	-2.4	-1.5	-1.8	-1.7	-1.0	-1.4	-1.4	-1.5	-1.6	-1.6	-1.6	
Automatic debt dynamics 1/	0.1	0.5	5.9	-1.9	-0.9	0.7	0.6	0.5	0.6	0.7	0.8	
Denominator: 1+g+r+gr	1.1	1.1	0.8	1.2	1.1	1.0	1.0	1.1	1.1	1.1	1.1	
Contribution from nominal interest rate	1.6	1.5	1.4	1.3	1.5	1.6	1.5	1.4	1.5	1.5	1.7	
Contribution from real GDP growth	-0.5	-0.2	1.4	-1.0	-0.8	-0.9	-0.9	-0.9	-0.9	-0.9	-0.8	
Contribution from price and exchange rate changes 2/	-0.9	-0.8	3.1	-2.2	-1.6	…	…	…	…	…	…	
Residual, incl. change in gross foreign assets (2-3) 3/	3.8	0.7	0.1	6.4	3.0	4.5	1.9	1.2	1.0	0.9	-0.1	
External debt-to-exports ratio (in percent)	68.1	66.5	79.8	78.9	77.0	81.4	82.1	81.5	79.5	77.0	71.4	
Gross external financing need (in billions of US dollars) 4/	89.2	107.2	103.0	97.0	106.5	127.6	123.9	127.1	126.6	129.5	142.1	
in percent of GDP	8.6	9.8	11.7	9.4	9.2	11.0	10.3	10.0	9.5	9.2	9.5	
Scenario with key variables at their historical averages 5/						**27.4**	**27.6**	**27.4**	**27.1**	**26.7**	**25.3**	**-1.3**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	3.2	1.2	-6.0	5.6	3.9	3.8	3.5	3.5	3.3	3.3	3.3	
GDP deflator in US dollars (change in percent)	5.4	4.5	-14.2	11.1	7.2	-3.0	0.5	1.8	1.8	2.1	2.1	
Nominal external interest rate (in percent)	9.5	8.2	6.0	7.2	7.1	6.7	5.9	5.4	5.5	5.8	6.5	
Growth of exports (US dollar terms, in percent) 6/	8.8	6.9	-20.9	28.3	16.3	7.2	5.7	5.6	6.5	6.8	7.8	
Growth of imports (US dollar terms, in percent) 6/	9.7	9.1	-22.7	26.9	16.4	6.7	6.2	6.0	6.7	6.5	7.3	
Current account balance, excluding interest payments	0.5	-0.1	0.8	0.9	0.6	0.7	0.5	0.3	0.3	0.4	0.6	
Net non-debt creating capital inflows	2.4	1.5	1.8	1.7	1.0	1.4	1.4	1.5	1.6	1.6	1.6	

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

2/ The contribution from price and exchange rate changes is defined as $[-\rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt stock. ρ increases with an appreciating domestic currency ($\varepsilon > 0$) 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.

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/ Goods and non-factor services.

7/ 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.

INTERNATIONAL MONETARY FUND

MEXICO

November 1, 2012

STAFF REPORT FOR THE 2012 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By | Western Hemisphere Department

CONTENTS

ANNEX 1. FUND RELATIONS

(As of September 30th, 2012)

The 2012 Article IV discussions were held in Mexico City during September 18–27, 2012. The staff team comprised Martin Kaufman (head), Herman Kamil, Esteban Vesperoni (all WHD); Pamela Madrid Angers (MCM); Santiago Acosta Ormaechea (FAD); and Gilda Fernandez (SPR). Ms. Adrienne Cheasty (WHD) participated in the concluding meetings. The mission met with the Minister of Finance, the Governor of the Bank of Mexico, senior staff of several government ministries and agencies, representatives of regulatory agencies, and private sector representatives. Mesrrs. Carlos Perez-Verdia and Erick Ramos-Murillo (OED) attended most meetings.

Mexico has accepted the obligations of Article VIII, sections 2, 3, and 4, and does not have restrictions on payments for current international transactions.

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	3,625.70	100.00
Fund holdings of currency	2,389.09	65.89
Reserve position in Fund	1,236.65	34.11
New Arrangement to Borrow	540.70	

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	2,851.20	100.00
Holdings	2,774.11	97.30

Outstanding Purchases and Loans: None

Latest Financial Arrangements

Type	**Arrangement Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
FCLC	Jan 10, 2011	Jan 09, 2013	47,292.00	0.00
FCLC	Mar 25,2010	Jan 09, 2011	31,528.00	0.00
FCLC	Apr 17, 2009	Apr 16, 2010	31,528.00	0.00

Projected Payments to the Fund (SDR million):

	Forthcoming				
	2011	2012	2013	2014	2015
Principal					
Charges / Interest	0.54	1.10	1.10	1.10	1.10
Total	0.54	1.10	1.10	1.10	1.10

Exchange Rate Arrangement: Mexico has a free floating exchange rate regime since November 2011. Mexico maintains an exchange system that is free of 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 July 27, 2011. The relevant staff report was IMF Country Report No. 11/250.

Technical Assistance

Year	Dept.	Purpose
2012	FAD	Pension and Health Systems
2012	FAD	Treasury
2012	FAD	Tax Regimes for PEMEX
2011	FAD	Custom Administration
2011	FAD	Tax policy
2010	FAD	Fiscal Risks Management
2010	FAD	Treasury
2009	STA	National Accounts
2009	FAD	Fiscal Framework
2008	FAD	Customs Administration
2007	FAD	Intergovernmental Fiscal Relations
2007	FAD	Customs Administration
2007	FAD	Treasury
2007	MCM	Accounting and Budgeting Functions, BoM
2005	STA	National Accounts

Resident Representative: None

ANNEX 2. RELATIONS WITH THE WORLD BANK AND BANK-FUND COLLABORATION UNDER THE JMAP

A. Relations with the World Bank

Mexico has had a longstanding partnership with the World Bank Group encompassing the delivery of the full menu of financial, knowledge, and coordination and convening services. The flexibility of the FY08–13 Country Partnership Strategy (CPS) was instrumental in helping Mexico adjusting to the large adverse shocks experienced during 2008–2009. The global economic downturn and tightening in financial conditions combined with the outbreak of the A (H1N1) influenza in April 2009 led much of the World Bank's assistance to Mexico to focus on financial services while continue working on a broad knowledge agenda.

Since then, Mexico's growth has held up reasonably well despite turbulence in Europe, in part as a result of the slow but steady recovery in the United States. As expected, Mexico has lowered IBRD lending to protect exposure from US$6.4 billion in FY10 to US$1.46 billion in FY12, The WBG engagement with Mexico is structured around an innovative and thematic approach with an engagement model that fully provides customized development solutions utilizing packages of financial, knowledge and convening services. A new CPS will be prepared during the second half of FY13 to be implemented during the next six-year period.

As of September 30, 2012, Mexico had 17 projects under supervision for a total net commitment amount of US$7,153 million, placing Mexico in the fourth position amongst the top 5 countries with the largest portfolio under supervision in the World Bank. In terms of Borrower's obligation, Mexico has the largest debt outstanding at US$13,801 million.

B. Bank-Fund Collaboration under the JMAP

The Bank and Fund teams have discussed the following priorities:

- The need for non-oil revenue mobilization. These efforts would be important to address Mexico longer-term fiscal challenges from gradually diminishing oil revenues and increasing age-related spending.
- Structural reforms. Boosting potential growth will require a comprehensive approach to structural reforms to ensure that productivity gains accrue to all sectors and thus entrench the recent remarkable gains of Mexico's manufacturing sector.
- Addressing climate change. Support the authorities' efforts to reduce Mexico's carbon footprint, including increasing sources of renewable energy, and improving efficiency of lighting and appliances.
- Financial sector surveillance. The Fund will continue with the surveillance of the financial sector. The FSAP update took place in the second half of 2011, a joint Bank-Fund effort.

ANNEX 3. STATISTICAL ISSUES

Data provision is adequate for surveillance. 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 October 8, 2010 and was published as IMF Country Report No. 10/330. There are various areas where improvements could be made. The authorities are aware of this situation and are continuing work in this regard.

Although some items of the balance of payments statistics conform to the *Fifth edition of the Balance of Payments Manual*, a full transition has not yet been completed.[1] 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).

The national accounts statistics generally follow the recommendations of the *System of National Accounts, 1993 (1993 SNA).* 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. Changes in inventories are obtained as residuals, so there is no independent verification between the production and expenditure measures of GDP. 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.

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 will be conducted in November 2012.

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 international organizations and national accounts.
The authorities are committed to reporting government financial statistics in GFSM 2001 format, as well as data for the GFS Yearbook.

[1] Since the release of the balance of payments figures for the second quarter of 2010 (August, 25th, 2010), Banco de Mexico has been publishing a new format that follows the guidelines of the Fifth edition of the Balance of Payments Manual.

The methodological foundations of monetary statistics are generally sound. However, the recording of financial derivative and, to a lesser extent, repurchase agreements transactions are overstating the aggregated other depository corporations (ODC) balance sheet and survey. Availability of data on other financial intermediaries such as insurance companies and pension funds allow for the construction of a financial corporations survey with full coverage of the Mexican financial system, which is published on a monthly basis in International Financial Statistics.

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

Mexico: Table of Common Indicators Required for Surveillance

As of October 10, 2012

	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Memo Items: Data Quality-Methodological Soundness[8]	Memo Items: Data Quality Accuracy and Reliability[9]
Exchange Rates	September 2012	September 2012	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	August 2012	August 2012	M	M	M		
Reserve/Base Money	August 2012	August 2012	M	D, M	W	LO, O, O, LO	LO, O, O, O, O
Broad Money	August 2012	August 2012	M		W		
Central Bank Balance Sheet	September 2012	September 2012	W	W	W		
Consolidated Balance Sheet of the Banking System	August 2012	August 2012	M	M	M		
Interest Rates[2]	September 2012	September 2012	D	D	D		
Consumer Price Index	September 2012	September 2012	Bi-W	Bi-W	Bi-W	O, O, LNO, O	LO, LNO, O, O, LNO
Revenue, Expenditure, Balance and Composition of Financing[3] – General Government[4]	August 2012	August 2012				LO, LNO, LNO, O	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3] – Central Government	August 2012	August 2012	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	August 2012	August 2012	M	NA	M		
External Current Account Balance	Q2 2012	June 2012	Q	Q	Q	LO, LO, LNO, LO	LO, O, O, O, LO
Exports and Imports of Goods and Services	August 2012	August 2012	M	M	Bi-W		
GDP/GNP	Q1 2012	June 2012	Q	Q	Q	O, O, O, LO	LO, O, LO, LO, O
Gross External Debt	August 2012	August 2012	M	M	M		
International Investment Position[6]	Q2 2012	October 2012	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 October 8, 2010, except consumer prices which is based on the ROSC completed on May 23, 2003. 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.

INTERNATIONAL MONETARY FUND
Public Information Notice
EXTERNAL RELATIONS DEPARTMENT

Public Information Notice (PIN) No. 12/xx
FOR IMMEDIATE RELEASE
November XX, 2012

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

IMF Executive Board Concludes 2012 Article IV Consultation with Mexico

On November 19, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Mexico.[1]

Background

Mexico's growth has remained resilient, supported by both external and domestic demand. Since the crisis, Mexico has benefited from the relatively good performance of the U.S. manufacturing sector and achieved a strong recovery of its market share in that market. The gain in market share in the U.S. has come in part from improved relative unit labor costs (ULCs) and a continued flow of foreign direct investment into manufacturing, especially in the automotive sector. In turn, domestic demand has been supported by sustained growth in employment and credit. Inflationary pressures have remained contained thus far, despite the recent uptick in headline inflation associated with food prices. Amid persistent global financial uncertainty, the successive FCL arrangements have supported Mexico's economic policies by providing a significant buffer against tail risks.

Growth in 2013 is envisaged to converge to 3½ percent, close to Mexico's long-term potential growth rate. Despite a subdued U.S. recovery, domestic demand is envisaged to maintain its

[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. 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.

momentum, underpinned by sustained business and consumer confidence. High capacity utilization rates suggest that the recovery in fixed investment will continue, while favorable credit conditions and sustained employment growth should help underpin consumption. As food price shocks dissipate, headline inflation is expected to revert towards the inflation target.

Exchange rate flexibility has played a key shock-absorbing role, amid recurrent bouts of global risk aversion, but without major balance sheet or pass-through effects. In turn, sovereign and financial markets have remained stable, with interest rates near historical lows. Mexico's recognition as a predictable and prudently managed economy, as well as its open capital and current accounts, market-friendly and transparent regulations for foreign investment, and deep and liquid financial markets, have bolstered large foreign investment in recent years.

Executive Board Assessment

Executive Directors commended the authorities' sound rules based policy framework and skillful macroeconomic management, which have underpinned the strong recovery after the global crisis, improved the economy's competitiveness and resilience to shocks, and bolstered foreign investment and growth. At the same time, Directors noted that downside risks prevail in the current uncertain external environment. They therefore welcomed the incoming administration's commitment to maintaining prudent macroeconomic policies within the existing policy framework.

Directors supported the ongoing fiscal consolidation. They encouraged the return to a balanced budget under Mexico's fiscal rule in 2013, which will help put the debt ratio on a downward path and restore fiscal buffers. To this end, revenue mobilization efforts are needed to raise the revenue to GDP ratio from its relatively low level, reduce the dependence on oil revenue, and avoid excessive compression of public investment. Fiscal reforms will also be needed to address pressures on the budget from population aging and declining oil revenues as a percent of GDP. Directors welcomed recent legislation to improve the reporting of sub national government accounts, which will be key to reinforcing fiscal discipline.

Directors agreed that the current accommodative stance of monetary policy has helped sustain the ongoing recovery in the face of fiscal consolidation. The task ahead is to determine the right monetary policy course given cyclical conditions and global headwinds. Recent supply shocks, which caused inflation to rise above the target range, further warrant central bank vigilance. Directors stressed that communicating the appropriate stance of monetary policy in the presence of such shocks is essential to maintain central bank credibility and keep inflation expectations anchored.

Directors agreed that the flexible exchange rate will continue to play a key role in buffering external shocks. They supported limited foreign exchange market intervention through a transparent and rules based mechanism. They took note of staff's conclusion that the real effective exchange rate is consistent with fundamentals and desirable policies. Directors also welcomed the authorities' monitoring of potential cross border spillovers, noting that a surge in global risk aversion could affect Mexico. They agreed that the Flexible Credit Line arrangement with the Fund has provided significant insurance against global downside risks.

Directors noted that Mexico's financial sector remains sound and resilient. Nevertheless, they encouraged further effort to strengthen the regulatory and supervisory framework and reduce concentration in banks' loan portfolios. They also urged stepped up efforts to implement the recommendations under the Financial Sector Assessment Program, and welcomed the close monitoring of lending to sub national governments.

Directors emphasized that boosting Mexico's growth potential will require structural reforms to increase productivity and investment. They welcomed the recently approved labor reform, and underscored the importance of reforms to improve the quality of education, enhance competition, facilitate access to credit by small and medium sized enterprises, and strengthen domestic security.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise

Mexico: Selected Economic and Financial Indicators 1/

	2008	2009	2010	2011	2012 2/
(Annual percentage changes, unless otherwise indicated)					
National accounts and prices					
Real GDP	1.2	-6.0	5.6	3.9	3.8
Real GDP per capita 3/	-0.4	-7.5	4.0	2.5	2.9
Gross domestic investment (in percent of GDP)	26.8	23.8	24.0	25.0	24.9
Gross domestic savings (in percent of GDP)	25.3	23.2	23.6	24.2	24.0
Consumer price index (period average)	5.1	5.3	4.2	3.4	4.1
External sector					
Exports, f.o.b.	7.2	-21.2	29.9	17.1	7.4
Imports, f.o.b.	9.5	-24.0	28.6	16.4	7.0
External current account balance (in percent of GDP)	-1.6	-0.6	-0.4	-1.0	-1.0
Change in net international reserves (end of period, billions of U.S. dollars)	-7.5	-5.4	-22.8	-28.9	-21.0
Outstanding external debt (in percent of GDP)	18.6	22.0	23.9	24.3	27.4
Nonfinancial public sector (in percent of GDP)					
Government Revenue	23.5	23.6	22.6	22.8	23.1
Government Expenditure	23.6	25.9	25.5	25.3	25.4
Augmented overall balance	-1.1	-4.7	-4.3	-3.4	-2.6
Money and credit					
Bank credit to the non-financial private sector (percent growth)	13.5	-1.0	10.0	17.2	15.9
Broad money (M4a)	16.8	6.1	12.0	15.7	15.3

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

2/ Staff projections.

3/ Fund staff estimates.