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MEXICO

November 2014

ARRANGEMENT UNDER THE FLEXIBLE CREDIT LINE AND CANCELLATION OF THE CURRENT ARRANGEMENT—STAFF REPORT AND PRESS RELEASE

In the context of the arrangement under the Flexible Credit Line and cancellation of the current arrangement, the following documents have been released and are included in this package:

- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 26, 2014, following discussions that ended on September 23, 2014, with the officials of Mexico on economic developments and policies underpinning the IMF arrangement under the Flexible Credit Line. Based on information available at the time of these discussions, the staff report was completed on November 13, 2014
- A **Staff Supplement** of November 13, 2014 on the assessment of the impact of the proposed Flexible Credit Line arrangement on the Fund's finances and liquidity position.
- A **Press Release** including a statement by the Chair of the Executive Board.

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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MEXICO

ARRANGEMENT UNDER THE FLEXIBLE CREDIT LINE AND CANCELLATION OF THE CURRENT ARRANGEMENT

November 13, 2014

EXECUTIVE SUMMARY

Context: Mexico's growth is recovering, supported by strong export demand, while inflation pressures remain contained. The implementation of wide-ranging structural reforms is expected to boost potential growth in the medium term. The current account deficit is projected to remain broadly stable as a share of GDP, and the real exchange rate is judged to be in line with fundamentals. The authorities are committed to maintaining prudent policies. Nevertheless, Mexico's strong trade and financial links to the global economy, while a sign of Mexico's economic strength, make it susceptible to a retrenchment of global risk appetite.

Risks: An abrupt surge in global financial market volatility, caused by uncertainties related to the unwinding of the U.S. monetary policy stimulus or heightened geopolitical tensions, could lead to a reversal of capital flows to emerging markets, including Mexico. A rise in emerging market risk premiums could affect not only portfolio flows, but also FDI flows.

FCL: The authorities are requesting a new two-year precautionary FCL arrangement in the amount of SDR 47.292 billion (1,304 percent of quota, approximately US$72 billion) and the cancellation of the current arrangement, approved on November 30, 2012. They consider that, in an environment where external risks remain elevated, an FCL arrangement in the amount requested will play a critical role in supporting their overall macroeconomic strategy, preserving investors' confidence, and providing insurance against adverse global risks. Staff agreed with the authorities that it would be premature to reduce access under the FCL in the case of Mexico, given the proximity to the takeoff window for the policy interest rate in the U.S. The authorities stated that, conditional on a reduction of global risks, they intend to cut access to Fund resources in any subsequent FCL arrangements, with a view to gradually phasing out Mexico's use of this arrangement. In the staff's assessment, Mexico continues to meet the qualification criteria for access under the FCL arrangement.

Fund liquidity: The proposed commitment would have a manageable impact on the Fund's liquidity position.

Process: An informal meeting to consult with the Executive Board on a possible FCL arrangement for Mexico was held on November 7, 2014.

Approved By
Robert Rennhack and Vivek Arora

This report was prepared by a team comprising Dora Iakova (head), Herman Kamil, Alexander Klemm, Fabian Valencia (all WHD); Jianping Zhou (MCM); Isabel Rial (FAD); and Phil de Imus (SPR).

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CONTEXT

1. **Mexico's macroeconomic policies and policy frameworks remain very strong.** Monetary policy is guided by an inflation targeting framework in the context of a flexible exchange rate regime and fiscal policy is anchored by the fiscal responsibility law. The external current account deficit is low and stable, and the real effective exchange rate is in line with economic fundamentals. The 2011 FSAP found that the financial regulatory and supervisory framework was sound. The authorities remain committed to maintaining an open capital account and further development and deepening of Mexico's financial markets. Over the last two years, the government has made impressive progress in advancing an ambitious agenda of structural reforms in a broad range of areas. At the conclusion of the 2014 Article IV Consultation, Executive Directors expressed confidence in Mexico's very strong policy fundamentals and policies.

2. **Despite Mexico's sound fundamentals, it remains exposed to external risks.** Mexico has close ties with the global economy, and particularly with the U.S., through both trade and financial channels. Foreign-owned banks account for about 70 percent of banking system assets, with a large presence of Spanish banks. There has been a sizeable increase in portfolio inflows into the domestic sovereign bond market since the inclusion of Mexico in the World Global Bond Index (WGBI) in 2010. International investors now hold 52 percent of total public debt, and 37 percent of local currency-denominated sovereign bonds, reflecting the strength of the Mexican economic policy framework and yielding many economic benefits, including a lower cost of finance and a more diversified investor base. At the same time, they can make Mexico more exposed to abrupt shifts in investor sentiment toward emerging markets. Based on BIS data, the Mexican peso is the most actively traded emerging market currency in the world, with a daily global trading volume of US$135 billion.

RECENT DEVELOPMENTS

3. **Mexico has completed the legislative process underpinning its comprehensive structural reforms agenda.** Over the last two years, important reforms have been approved in the areas of energy, telecommunications, anti-trust, labor markets, education, and the financial sector. Secondary laws for the energy and telecommunication reforms were recently approved by Congress, clearing the way for implementation. The energy reform opened the door to private investment in the sector, ending a 75-year state monopoly in oil and gas production and distribution. By enhancing competition, reducing labor market frictions, and encouraging investment, the reforms are expected to boost productivity and output over the medium term.

4. **After a sharp slowdown in 2013, growth is projected to recover to 2.4 percent this year** (Figure 1). Real GDP grew 1.1 percent in 2013, reflecting weak external demand and a decline in construction activity. Economic activity has accelerated in recent months. The strong recovery in the U.S. in the second quarter of 2014 has triggered a rebound in Mexico's manufacturing production and exports (especially in the automotive sector). In addition, construction activity is firming up,

supported by a rebound of residential investment and an increase of government spending on infrastructure. The recovery is increasingly broad-based, with activity in the service sector picking up as well. Inflationary pressures remain contained, and the degree of slack in the labor market suggests that the economy continues to operate below potential.

5. **Bond issuance has been robust, while bank credit growth has moderated** (Figure 2). Over the last year, gross portfolio inflows have rebounded and bond spreads have narrowed. Private corporations and the government have taken advantage of the renewed investors' risk appetite to issue foreign-currency bonds at favorable rates. The nominal exchange rate has remained relatively stable, and the implied exchange rate volatility from option prices has fallen to historical lows. In February, Moody's raised Mexico's foreign currency sovereign rating to A3, citing the expected positive impact of structural reforms on potential growth. At the same time, commercial bank credit growth slowed down to about 8 percent year-on-year in nominal terms in the first half of 2014. The deceleration has been concentrated in construction and consumer credit growth.

6. **Mexico's external sector position remains strong.** The current account deficit widened to 2.1 percent of GDP in 2013, reflecting higher net factor payments, while the trade balance remained stable. In 2014, the current account deficit is projected to remain broadly unchanged. The nominal and real effective exchange rates have depreciated modestly since end-2013. The current account deficit and the real effective exchange rate are broadly in line with fundamentals and desirable policy settings according to staff's assessment. External competitiveness remains strong. Mexico's share in U.S. manufacturing imports has increased from 10 to 13 percent over the last five years, and unit labor costs in manufacturing have declined.

7. **Mexico's net international investment liability position has remained stable at about 40 percent of GDP.** The country has seen a surge in capital inflows since 2010, when Mexico was included in Citigroup's World Government Bond Index. However, these inflows have not translated into external or domestic imbalances as the accumulation of gross external liabilities has been matched by a rise in external asset holdings (residents' foreign assets stood at 45 percent of GDP in June 2014). Steady reserve accumulation has helped Mexico maintain broadly stable measures of reserve adequacy over time (Table 7). Reserves amounted to 116 percent on the ARA metric in 2013.

OUTLOOK AND POLICIES

8. **Real GDP growth is projected to accelerate to 3.5 percent in 2015.** Export demand from the US is expected to remain strong, underpinning the recovery of manufacturing production and related services. Construction activity has also firmed up, supported by the expansion of public investment in infrastructure. Business investment is expected to recover as spare capacity diminishes and business sentiment improves after the recent approval of secondary legislation for the energy and telecommunications reforms. The negative output gap—estimated by staff at around 1 percent as of mid-2014—is expected to close gradually over the next year.

9. The wave of structural reforms should increase potential output over the medium term. Overall, the broad package of reforms is expected to stimulate growth through increased investment, the introduction of new technologies, reduction of business costs, and a rise in productivity. Staff estimates suggest an increase in potential growth to 3½ to 4 percent in the medium term (potential growth is estimated at around 2¾–3 percent in 2014, while actual growth in Mexico has averaged 2½ percent over the last fifteen years).

10. With the economy still operating below potential, monetary policy remains consistent with achieving the inflation target. The authorities stressed that the recent increase in headline inflation has been driven by temporary factors. The annualized quarter-on-quarter growth of core prices has remained stable around 3 percent and long-term inflation expectations are well anchored. Continued weakness in the labor market suggests that demand pressures on prices remain contained. Headline inflation is expected to decline toward the target in 2015 as tax-related base effects dissipate and gasoline price increases moderate. The authorities are monitoring the price and wage developments closely and would adjust policy as needed to keep inflation in line with the target.

11. The 2015 budget proposal implies a mild withdrawal of fiscal stimulus next year with further deficit reductions planned thereafter. In the budget proposal sent to Congress in September, the overall fiscal deficit in 2015 is projected to narrow slightly relative to 2014 (from 4.2 to 4.0 percent of GDP). The budget envisages a reduction in expenditure of about ½ percent of GDP, offset by a decline in oil production and revenues, which is expected to be temporary.[1] The authorities plan to reduce the fiscal deficit further over the next four years, with a goal of stabilizing public debt and setting it on a downward path. The consolidation relies mostly on a gradual increase in tax revenues related to the 2014 tax reform.

12. Amendments to the Fiscal Responsibility Law, approved by Congress in 2014, strengthen the fiscal framework in several ways. First, the public sector borrowing requirement (PSBR), which is a broader measure of the public sector balance than the "traditional balance", was made an official target for fiscal policy. Second, real growth in current structural expenditure will be capped at 2 percent per year in 2015–16, and at the rate of potential output growth thereafter.[2] Finally, a new sovereign Oil Stabilization and Savings Fund has been created to manage oil revenues. Overall, these measures would help maintain fiscal discipline and strengthen Mexico's fiscal buffers over time.

[1] Oil production is projected to increase gradually over the medium term as a result of the energy reform.

[2] Structural current expenditure, comprising about 50 percent of total public expenditure, is defined as indirect capital spending plus current spending minus pensions, electricity subsidies, transfers to states and municipalities from oil revenue-sharing agreements, and interest payments. It also excludes the expenditure of Pemex and the state electricity company.

13. The authorities remain committed to strengthening the regulatory and supervisory framework of the financial sector. A financial sector reform was approved in 2014. It enhanced the collection of credit information for individuals and businesses through extending reporting requirements to the credit bureaus to a wide set of entities. In addition, the legal framework for bank resolution has been strengthened in line with the 2011 FSAP recommendations. Another important aspect of the reform was the easing of legal hurdles for banks to repossess collateral through the creation of specialized federal courts. The supervision framework for large financial groups has also been improved.

THE ROLE OF THE FLEXIBLE CREDIT LINE

14. The FCL has served the Mexican economy well. The previous FCL arrangements provided useful insurance in the immediate aftermath of the 2008–09 global financial crisis and during the euro area crisis (Mexico has strong financial linkages with the euro area as host of subsidiaries of several European banks). Staff's econometric analysis suggests that during the taper talk episode in mid-2013, exchange rate pressures eased more rapidly for emerging markets with an FCL arrangement, after accounting for the role of fundamentals (Box 1). An empirical analysis of sovereign spreads in a recent Fund review of precautionary credit instruments also found that the FCL has been effective in helping bolster confidence; and respondents to a survey agreed that the FCL had been an important addition to the IMF lending tool kit.[3]

[3] Review of the Flexible Credit Line, the Precautionary and Liquidity Line, and the Rapid Financing Instrument, IMF, January, 2014.

Box 1. Currency Movements During the 2013 Taper Talk Episode: The Role of Fundamentals and the FCL

Analysis of daily nominal exchange rate data during the 2013 taper tantrum reveals that after an initial period of indiscriminate sell-off of emerging markets currencies, investors started to differentiate on the basis of fundamentals. In addition, the presence of an FCL arrangement reduced depreciation pressures (controlling for the role of fundamentals).

The Mexican peso was one of the hardest hit emerging market currencies in the immediate aftermath of the May 2013 taper tantrum, despite the country's strong fundamentals (Figure A). Staff analysis suggests that countries with deeper and more liquid financial markets experienced larger depreciations at the beginning of the episode (the foreign exchange turnover is the main variable explaining initial currency movements). The Mexican peso is fully convertible and can be traded 24 hours a day. It is now the emerging market currency with the highest daily turnover, and anecdotal evidence suggests that it is sometimes traded as a proxy for other emerging market currencies at times of financial stress, which could account for its initial sharp depreciation.

After approximately one and a half months, fundamentals became increasingly important in explaining exchange rate movements (Figure B). This is consistent with the fact that in the second month after the taper talk, the Mexican peso showed the largest appreciation among emerging markets—reflecting its robust fundamentals and potential benefits from the recovery in the United States.[1] The econometric analysis confirms that emerging markets with smaller current account deficits and REER misalignments, and lower inflation experienced lower cumulative currency depreciation between May and November.

The presence of an FCL arrangement also reduced foreign exchange pressures, even after accounting for the role of fundamentals. Countries with an FCL experienced, on average, 3 percent lower depreciation between May 21st and July 22nd compared to other countries (Figure B).

Methodology: Successive OLS cross-sectional regressions were run of cumulative depreciation between May 21st 2013 and each following day through November 21st on a set of explanatory variables capturing fundamentals:

$$Cum\Delta NER_{i,t} = \beta_0 + \beta_t' X_i + \rho_t REERmis_i + \gamma_t FCL_i + \epsilon_{i,t}$$

$\mathrm{Cum\Delta NER}$ is the percentage change in the nominal exchange rate between May 21st 2013 and each subsequent date *t* for country *i* (a positive value indicating a depreciation); *X* is a set of fundamentals measured as of end-2012 (and thus pre-determined); REERmis is the real effective exchange rate misalignment (where a positive value indicates an overvalued exchange rate); and FCL is a dummy indicating an FCL arrangement. The explanatory variables are: inflation; current account deficit as a share of GDP, real GDP growth, public sector debt as a share of GDP; reserves to external debt, FX market turnover, and a dummy indicating whether the exchange rate regime is fixed or floating.

For each variable, the econometric results yield a set of time-varying coefficients, which are plotted in the chart. The color of the plot indicates the degree of statistical significance at window *t*, and the dotted vertical lines indicate the day when the effect of the given variable becomes consistently statistically different from zero. In all cases, the coefficients have the expected sign.

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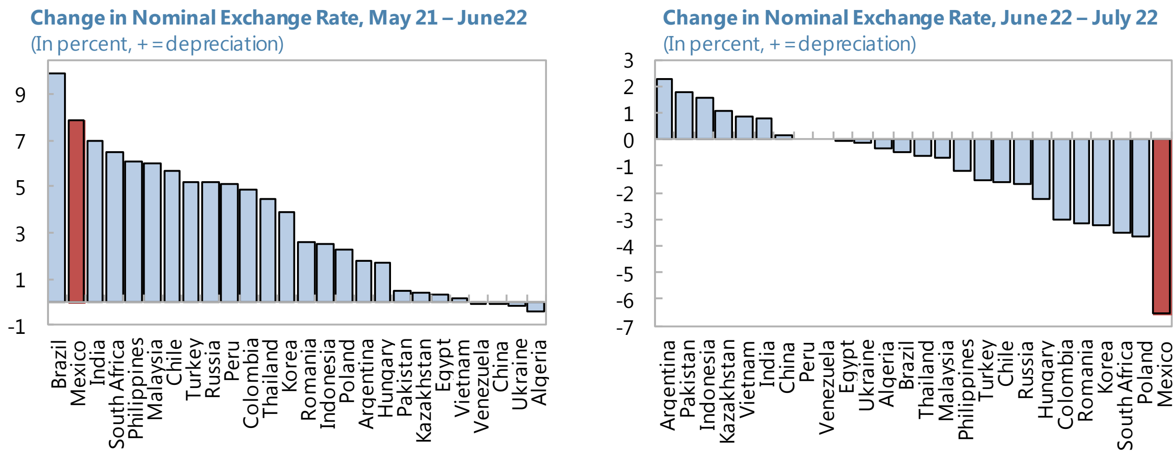
[1] Poland, and Colombia which also have an FCL arrangement, showed the second-largest appreciation across EM countries and Latin-American countries, respectively.

Box 1. Currency Movements During the 2013 Taper Talk Episode: The Role of Fundamentals and the FCL (Continued)

Figure A. Change in Nominal Exchange Rate



Sources: Bloomberg; and IMF staff estimates.

Box 1. Currency Movements During the 2013 Taper Talk Episode: The Role of Fundamentals and the FCL (Concluded)

Figure B. Differentiation on Macro-Fundamentals and FX Market Liquidity Post-Taper Talk in 2013
(Estimated Coefficients from Regressions)

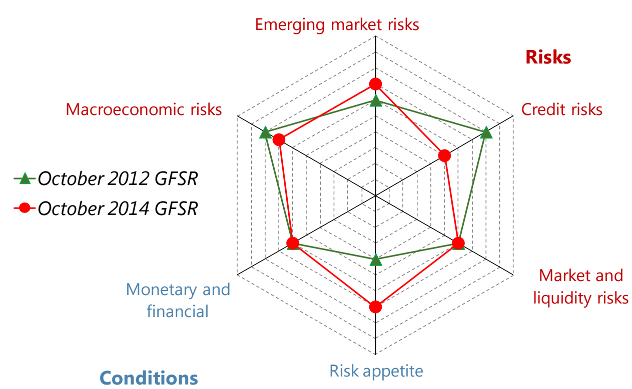
Sources: Authors' calculations.

15. The authorities are requesting a new FCL arrangement for two years at the same level of access. In their view, the risk of a rapid rebalancing of investor portfolios away from emerging markets remains elevated. They are concerned that the process of normalization of U.S. monetary policy carries risks of global financial market volatility that could affect Mexico, given its close trade and financial links to the U.S. The requested 2-year duration would cover much of the transition period of U.S. monetary normalization. Mexico is now in the initial phase of implementation of important structural reforms, which will be financed in part by foreign investments, and financial market disruptions could endanger this process. In their view, a new FCL arrangement for the next two years would help limit the risk that disruptive financial conditions would halt the nascent economic recovery or diminish the effectiveness of the structural reforms.

A. Access Considerations

16. Global risks remain elevated, justifying the need for additional protection against balance of payments shocks. In particular, the risk of a surge in financial markets volatility continues to be high, geopolitical tensions have intensified, and the global growth outlook has deteriorated since the last approval of an FCL in 2012. The recent bout of financial market volatility in October 2014 highlights the risk of sudden shifts in investor risk appetite, which could lead to rapid reassessment of emerging market risk.

Global Financial Stability Map



Source: IMF staff estimates.
Note: Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.

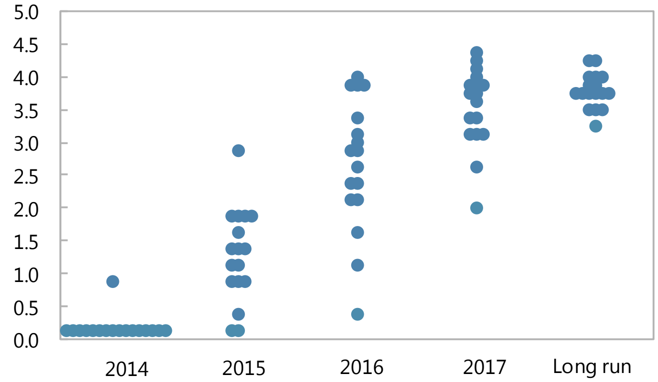
- Analysis in the latest GFSR report indicates that some key risks have increased over the last two years. In particular, risk appetite has gone up significantly. Reflecting the ongoing search for yield, financial markets have rallied in 2014 despite relatively weak global growth, pushing up asset prices and compressing risk spreads. Valuations across asset classes appear to be stretched relative to historical norms, and asset price volatility has declined to 15-year lows.[4] These developments increase the risk that a correction in the underpricing of risk could trigger a sharp volatility in asset prices. Spillovers across asset classes could be exacerbated by the build-up of leverage among some investors and by heightened liquidity risks.

- Potential triggers for financial instability include elevated concerns about global economic stagnation, an earlier or sharper-than-expected rise in U.S. interest rates (for example due to

[4] October 2014 Global Financial Stability Report, Chapter 1.

an unexpected rise in inflation, a rapid decompression of U.S. term premiums, or lack of agreement to raise the debt ceiling), geopolitical events, or investors' reassessment of sovereign risks more generally. Uncertainty about the path of the U.S. interest rates runs high as demonstrated by the dispersion of the forecasts among FOMC participants (see chart), which could cause a sudden shift in market expectations.[5] A materialization of these risks could lead to sudden capital outflows from emerging markets and a sharp increase in the volatility of asset prices. A generalized pullback from emerging markets is likely to affect initially particularly countries with open capital accounts and liquid financial markets such as Mexico, despite the long-term benefits of such policies. A protracted period of financial market instability could also have negative impact on the confidence of long-term investors, leading to lower-than-expected FDI inflows, and slowing the implementation of structural reforms.

FOMC Participants' Forecast of the Target Federal Funds Rate 1/



1/ As of June 2014.

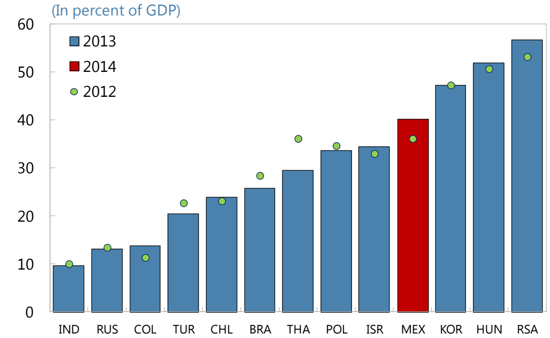
- An external economic stress index for Mexico (Box 2) shows that external conditions are expected to remain broadly unchanged in the baseline scenario, but could deteriorate rapidly if risks materialize. The downside scenario illustrated with the index is based on an abrupt surge in global financial market volatility. Bouts of market volatility and higher-than-expected increases in long-term rates could occur as the U.S. exits from unconventional monetary policy. Market expectations of the speed of interest rate adjustment in the U.S. could be revised upward and trigger a sustained reversal of capital flows, a broad-based correction in valuations, and an intensification of liquidity strains. The scenario is assumed to entail an increase in long-term U.S. interest rates of 100 basis points in the absence of stronger growth, driven by inflation shocks, a decompression of the term premiums, or a shock to confidence.[6] The rise in interest rates is likely to affect negatively U.S. growth (the specific assumption is that growth would decline by ½ percentage point). The increase in interest rates is assumed to be accompanied by stress in financial markets, with the emerging market volatility index increasing by two standard deviations. Under this scenario, the index would fall to post-Lehman lows.

[5] There is substantial uncertainty about the degree of slack in the U.S. labor markets, reflected in significant dispersion of the federal funds rate forecasts among FOMC members.

[6] An increase in interest rates driven by stronger U.S. demand, however, would probably be beneficial for Mexico, as rising exports would compensate for the negative effect of the interest shock.

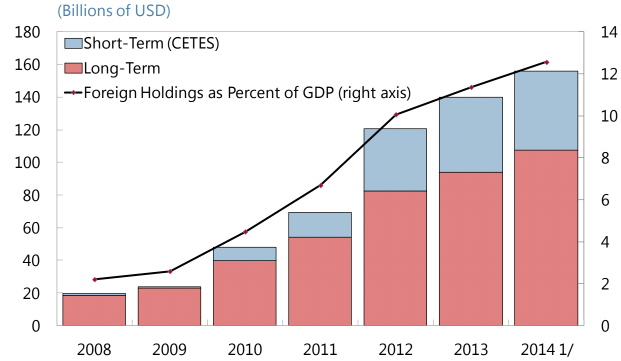
17. Mexico is highly exposed to external financial shocks given its open capital account and sizeable stock of foreign portfolio investment. Foreign portfolio exposures have increased significantly since the global financial crisis, particularly in the sovereign debt markets. There has also been a notable increase since the last FCL request in 2012 (see chart). The strong investor appetite for Mexican assets has been based on Mexico's strong fundamentals, growth prospects, and policy frameworks; the absence of controls on the capital account and a stable regulatory and tax environment; and the depth and liquidity of its financial markets. This is a positive development that has lowered the cost of finance and diversified the investor base not only for sovereign debt, but also for the Mexican private sector. The stock of foreign portfolio investment in Mexico reached US$473 billion (about 38 percent of GDP) in 2013. Foreigners currently hold 37 percent of all local-currency public debt (and about 55 percent of the most liquid segment of local-currency denominated sovereign bonds, Mbonos, and short-term paper, Cetes), and most of Mexico's foreign currency-denominated sovereign and corporate debt.[7] A surge in global risk aversion and a pullback from emerging markets, including from countries with strong economic policies such as Mexico, represent a material risk to the balance of payments.

Stock of Non-Resident Portfolio Investment in Emerging Markets
(In percent of GDP)



Sources: National authorities; and IFS.

Non-Residents' Holdings of Domestic Sovereign Debt
(Billions of USD)



Source: Banxico.
1/ As of Sep. 25, 2014

[7] Total external debt has increased from 19 percent of GDP in 2008 to 35 percent of GDP in 2014.

Box 2. The Calculation of the External Economic Stress Index

Staff calculated an external economic stress index based on the methodology suggested in *The Review of Flexible Credit Line, the Precautionary and Liquidity Line, and the Rapid Financing Instrument*, IMF Policy Paper, May 2014. The calculation of the index requires three main choices: (i) selection of relevant external risks, (ii) selection of proxy variables capturing these risks, and (iii) choice of weights for these variables. For Mexico, these were chosen as follows:

Risks. Mexico's exports, remittances, and inward FDI are closely related to economic developments in the United States. The open capital account and the significant stock of debt and equity portfolio investment increase Mexico's susceptibility to changes in global financial conditions. Finally, the profitability of oil production and fiscal revenues depend on world energy price developments.

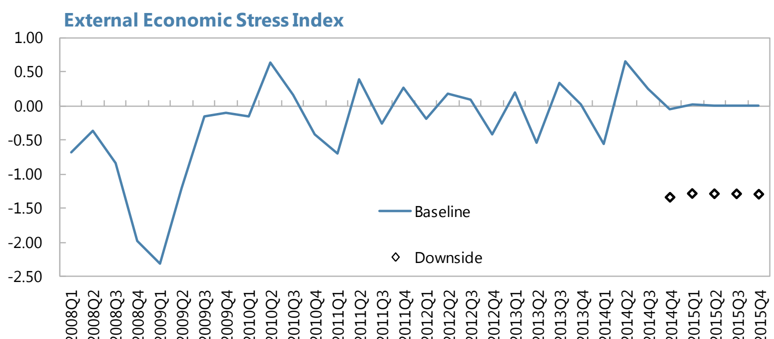
Variables. Risks to exports, remittances and inward FDI are all proxied by U.S. growth. Risks to debt and equity portfolio flows are proxied by the emerging market volatility index (VXEEM) and the change in the U.S. Treasury 10-year yield. Risks to the oil industry are proxied by the change in world oil prices.

Weights. The weights were estimated using balance of payment and international investment position data, all expressed as shares of GDP. The weight on U.S. growth (0.47) corresponds to the sum of exports, FDI, and remittances; the weights on the change in the U.S. long-term yield (0.31) and the VXEEM (0.17) correspond to the stocks of foreign debt and equity; and the weight on the change in the oil price (0.05) corresponds to oil exports.

Baseline scenario. This scenario corresponds to the WEO projections for U.S. growth, oil prices, and the U.S. 10-year bond yield. The VXEEM is assumed to remain unchanged at its level as of October 20, 2014.

Downside scenario. This scenario is in line with the first layer of the downside scenario in the 2014 Spillover report, which is based on a "sooner than expected tightening of financial conditions caused by normalization in major advanced economies."[1] Specifically it assumes that U.S. long-term interest rates rise more than expected, for reasons other than a positive U.S. growth shock (for example, financial stability concerns, an inflationary shock, a decompression of term premiums, or a shock to investor confidence). This shock leads to a reduction in U.S. growth and an abrupt surge in global financial market volatility. The associated volatility surge prompts a general tightening of global financial conditions and an abrupt reversal of capital flows into risk assets, including those in emerging markets. The downside scenario is illustrated in the chart by dots, which represent the points to which the index would fall if the shock materializes in any given quarter. The specific assumptions underlying the scenario are as follows:

- The U.S. long-term interest rate is assumed to increase by 100 basis points above the baseline, as assumed in the 2014 Spillover Report.
- As a result, U.S. growth is assumed to drop by 0.5 percentage points (which is less pessimistic than the October 2014 WEO downside scenario of 1 percentage point decline in growth of the advanced economies and the 2014 spillover report, which allows for a deterioration of almost 0.8 percentage points over the year, without specifying the quarterly pattern).
- These developments are accompanied by stress in financial markets and the VXEEM is assumed to rise by two standard deviations.[2] This is qualitatively line with the 2014 Spillover Report, which mentions intense financial pressures on emerging markets in such a scenario, although without quantifying them.



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[1] The 2014 Spillover Report also considers a second layer, which is "a deeper than expected structural slowdown in emerging markets." For Mexico, this would be an internal rather than external threat, so we have not considered this in the construction of the index.

[2] For comparison, the VXEEM increased by 4 standard deviations in 2008Q4 and 2011Q3.

18. While steady reserve accumulation has increased external buffers, reserve coverage remains relatively low in terms of balance sheet exposures that could unwind in the case of global financial distress. The ratio of reserves to GDP has increased steadily, while international reserves have been broadly stable in terms of months of imports and in percent of broad money (Table 7). However, as foreign holdings of domestic assets increased rapidly, reserves have declined significantly as a share of short-term external debt by residual maturity. In international comparison, Mexico has one of the lowest coverage ratios of reserves to total portfolio investment (Figures 5 and 6). Relative to the ARA metric, reserves have been broadly unchanged since 2009, and amounted to 116 percent at end-2013.

B. Adverse Scenario

19. In an estimate of financing needs in a global adverse scenario, the main drains on reserves would come from a turnaround in portfolio flows and a reduction in FDI inflows. The access case is based on a tail risk scenario of a surge in risk aversion, in which rollover rates for external debt coming due would be reduced, FDI inflows would be lower than projected, and foreign holdings of domestic equity would fall (Box 3). Domestic institutional investors are also assumed to increase the share of foreign assets in their portfolios.[8]

20. The shocks in the risk scenario are the same or less severe than those used in the current FCL arrangement for Mexico, and are in line with historical cross-country experiences. In particular, the scenario no longer includes a shock to the external current account, even though a rise in U.S. interest rates driven by an inflation shock or a decompression of risk premiums could affect U.S. growth and the housing market, with potential negative effects for Mexico's exports and remittances. Debt rollover rates are close to the median observed in a large sample of emerging markets during an external shock, and are the same or more favorable than the rollover rates in the 2012 Mexico FCL arrangement (Box 3: Figure A). Unlike in previous FCL requests, a drawdown of accumulated reserves is built in the risk scenario. The 2012 request had no drawdown, and previous requests envisaged continued accumulation even in the downside scenario. Nonetheless, the increase in foreign liabilities in recent years implies that the potential financing needs remain significant and would justify access at the same level (US$72 billion, Box 3 Table A).

[8] Analysis by Adler, Djigbenou, and Sosa ("Global Financial Shocks and Foreign Asset Repatriation: Do Local Investors Play a Stabilizing Role?" IMF Working Paper No. 14/60, 2014) shows that in periods of global financial stress, with non-residents pulling out of emerging markets, residents tend to play an offsetting role if the shock is a generalized increase in risk aversion (a rise in the VIX), but behave the same way as non-residents in response to a rise in U.S. interest rates. Staff analysis of resident and non-resident mutual fund behavior in Mexico reaches a similar conclusion (2014 Article IV Selected Issues Paper, Chapter 3).

C. Exit Strategy

21. In making their request for a new FCL arrangement, the authorities emphasize that Mexico has no intention of using this facility on a permanent basis. However, they take the view that it would be premature to scale back the use of the FCL in the current global environment. They noted that global risks remain elevated, with ongoing risks of a surge in financial market volatility and continuing geopolitical tensions amid a weaker outlook for global growth. Conditional on a reduction of global risks affecting Mexico, including risks related to the normalization of U.S. monetary policy, they intend to cut access to Fund resources in any subsequent FCL arrangements, with a view to gradually phasing out Mexico's use of the facility.

Box 3. Illustrative Adverse Scenario

An illustrative adverse scenario suggests that the requested access level of SDR 47.292 billion (US$72 billion) remains justified. The proposed access level, combined with a drawdown of reserves of about US$5–7 billion, would help fill the estimated potential financing needs of US$79 billion in 2015 and US$77 billion in 2016.

The main assumptions underlying the scenario are as follows (Table A and Figure A):

Portfolio investment. The assumption is that investors do not fully rollover the debt coming due, though there is no net divestment of government paper in secondary markets.

- For public debt, the assumed rollover rates are 95 percent for medium and long-term (MLT) foreign currency-denominated bonds (higher than in 2012); 85 percent for MLT local-currency bonds (higher than in 2012), and 90 percent for short-term debt (same as in 2012).

- For private debt, foreign investors are assumed to renew 95 percent of MLT debt coming due and 90 percent of short-term debt. Both are the same assumptions as in 2012.

- Foreign investors would sell about 5 percent of the stock of equity they currently hold (equivalent to a 1½ standard deviation shock to equity portfolio inflows, less severe than assumed in 2012).

Other private sector financing flows

- Foreign direct investment inflows are assumed to be lower than in the baseline. In the baseline projection, FDI is projected to rise as a result of structural reforms in the energy and telecommunication sectors. A rise in financing costs or an increase in uncertainty may cause delays or cancelations of investment plans. Net FDI inflows are assumed to fall to 90 percent of the average of the previous 3 years (close to the median of the cross-country distribution of historical outcomes). The assumed fall in FDI is comparable to reductions experienced in 2012 (the year following the euro area crisis), and is milder than the reduction after the global financial crisis.

- The rollover rate of foreign banks' cross-border lending to the private sector is assumed to remain relatively resilient at 95 percent (same as 2012). No rollover shocks are assumed for public bank debt.

- Finally, 1½ standard deviation shock is assumed for resident portfolio outflows (same as in 2012). The magnitude of the shock is similar to the experience in mid-2013, when residents increased their foreign asset holdings by over $20 billion in response to the taper tantrum.

Box 3. Illustrative Adverse Scenario (Continued)

Table A. Mexico: External Financing Requirements and Sources

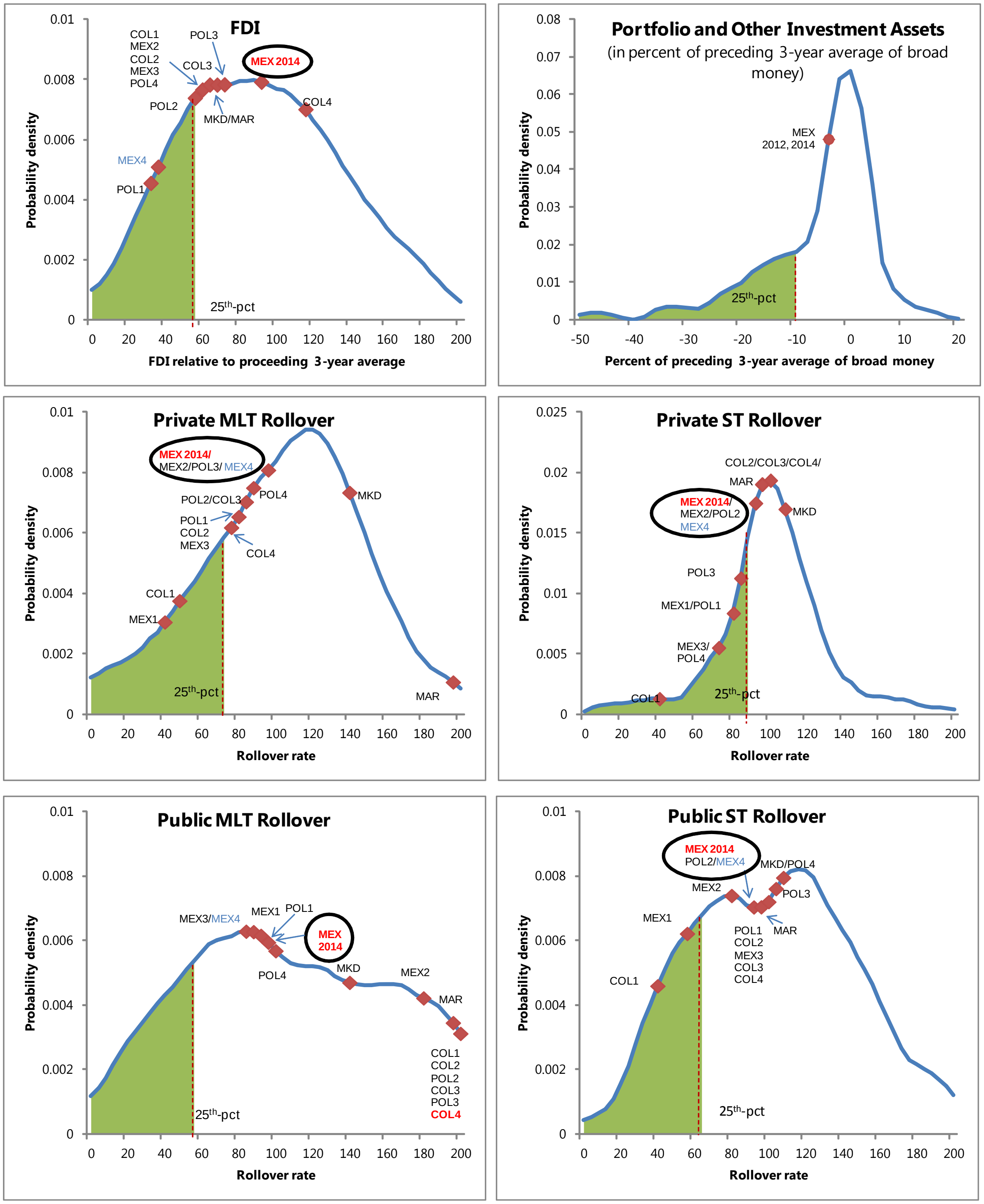
(In billions of U.S. dollars)

	2012	2013	Projection 2014	2015	2016	Adverse 2015	Contribution to Gap	Adverse 2016	Contribution to Gap	2014 Rollover /Shock	2012 Rollover /Shock	2014 vs. 2012 shock
Gross external financing requirements	**109.4**	**136.1**	**170.5**	**161.0**	**176.8**	**140.8**	**-20.3**	**158.2**	**-18.6**			
Current account deficit	15.3	26.3	27.0	27.9	33.9	27.9		33.9		No net shock	$10 bn shock	Lower
Amortization of Bonds and Loans	76.3	96.7	128.8	119.8	129.2	119.8		129.2				
Public sector MLT coming due	10.9	15.9	21.3	19.2	16.0	19.2		16.0				
FX denominated bonds	1.8	3.9	5.2	4.0	2.9	4.0		2.9				
Local currency bonds	3.6	7.1	10.9	10.3	10.2	10.3		10.2				
FX Bank Financing	5.4	4.8	5.2	4.9	2.9	4.9		2.9				
Private sector MLT amortization	11.7	12.3	16.3	14.3	19.2	14.3		19.2				
FX denominated bonds	6.3	8.0	10.7	11.8	13.2	11.8		13.2				
Bank Financing	5.5	4.3	5.6	2.5	6.1	2.5		6.1				
Short term debt coming due	50.5	68.7	90.4	84.6	91.2	84.6		91.2				
Public sector	17.1	36.6	53.8	44.8	44.8	44.8		44.8				
FX denominated	2.1	7.4	9.0	0.0	0.0	0.0		0.0				
Local Currency	15.0	29.2	44.8	44.8	44.8	44.8		44.8				
Private sector	18.7	14.5	18.1	19.6	24.1	19.6		24.1				
Trade credit	14.8	17.6	18.4	20.3	22.3	20.3		22.3				
Change in international reserves	17.8	13.2	14.7	13.3	13.7	-6.9	-20.3	-4.9	-18.6	USD 5-7 bn	No use of reserves	
Available external financing	**109.4**	**136.1**	**170.5**	**161.0**	**176.8**	**68.8**	**92.3**	**86.2**	**90.6**			
Net FDI inflows	-4.7	26.0	14.0	18.5	28.0	10.6	7.9	17.6	10.4	90%	37%	Lower
Gross Equity Portfolio Inflows	9.9	-0.9	0.8	0.8	0.9	-7.8	8.6	-7.8	8.6	1.5 std dev	1.9 std dev	Lower
Financing through Bonds and Loans	135.4	161.5	154.3	159.6	162.6	107.2		114.7				
Public sector MLT financing	48.1	28.5	44.0	43.1	39.2	17.5		14.4				
FX denominated bonds	12.0	15.1	11.2	10.7	10.3	3.8	6.9	2.8	7.9	95%	86%	Lower
Local currency bonds	36.0	13.5	27.6	27.5	26.0	8.8	18.8	8.7	17.3	85%	80%	Lower
FX Bank Financing	0.0	0.0	5.2	4.9	2.9	4.9		2.9				
Private sector MLT financing	18.7	42.5	25.7	25.3	29.3	13.5		18.2				
FX denominated bonds	21.0	26.2	18.1	20.8	21.2	11.2	9.6	12.5	8.8	95%	95%	Same
FX Bank Financing	-2.4	16.3	7.6	4.5	8.1	2.3	2.1	5.7	2.3	95%	95%	Same
Short-term financing	68.7	90.4	84.6	91.2	94.1	76.2		82.1				
Public sector	36.6	53.8	44.8	44.8	44.8	40.3		40.3				
FX denominated	7.4	9.0	0.0	0.0	0.0	0.0		0.0				
Local Currency	29.2	44.8	44.8	44.8	44.8	40.3	4.5	40.3	4.5	90%	90%	Same
Private sector	14.5	18.1	19.6	24.1	24.7	17.6	6.5	21.7	3.0	90%	90%	Same
Trade credit	17.6	18.4	20.3	22.3	24.5	18.2	4.1	20.1	4.5	90%	90%	Same
Other flows	-31.2	-50.3	1.4	-17.9	-14.7	-41.2		-38.0				
Residents' foreign portfolio & other investment	-6.3	-27.3	-8.6	-13.6	-13.6	-36.9	23.3	-36.9	23.3	1.5 std dev	1.5 std dev	Same
Financing Gap (USD billions)							**72.0**		**72.0**			
SDR							47.3		47.3			
Percent of quota							1,304		1,304			

Sources: Mexican authorities and IMF staff estimates.

Box 3. Illustrative Adverse Scenario (Concluded)

Figure A. Comparing Adverse Scenario Assumptions to History, and Current and Previous Arrangements



REVIEW OF QUALIFICATION

22. Mexico continues to meet the qualification criteria for an FCL arrangement according to staff's assessment (Figure 3). The authorities have in place a very strong policy framework. Monetary policy is guided by an inflation-targeting framework in the context of a flexible exchange rate regime, and fiscal policy is anchored by the fiscal responsibility law.

- **Sustainable external position.** The external current account deficit is small (around 2 percent of GDP) and is envisaged to remain moderate over the medium term, while the exchange rate remains broadly in line with fundamentals. The updated external debt sustainability analysis shows that Mexico's external debt is relatively low, and would rise only moderately over the medium term even under negative shocks (Figure 4).

- **Capital account position dominated by private flows.** The bulk of Mexico's external debt is owed to private creditors. Private portfolio flows (debt and non-debt creating) and FDI continue to be large relative to the overall balance of payments flows.

- **Track-record of steady sovereign access to international capital markets at favorable terms.** Mexico is among the highest-rated emerging markets and its 10-year sovereign bond spread remains low at about 173 basis points (as of September 15, 2014). Five-year CDS spreads have come down to around 78 basis points (as of September 15, 2014), close to historic lows. Public debt has average maturity of close to 8 years, and Mexico continues to place successfully sovereign bonds in international capital markets at historically low yields.[9]

- **Relatively comfortable international reserve position.** Gross international reserves reached US$193 billion at end-August 2014, compared to US$168 billion in November 2012, when the previous FCL arrangement was approved. This level is comfortable relative to standard reserve coverage indicators (Figures 5 and 6).

- **Sustainable public debt position and sound public finances.** Fiscal policy remains prudent, and the level of public debt to GDP is moderate. The updated debt sustainability analysis shows that the debt trajectory is overall robust to standard shocks (Figures 7 and 8). The debt projection is sensitive to growth and the evolution of oil prices, but debt would remain moderate even under negative shocks. Overall, the rules embedded in the Fiscal Responsibility Law provide an assurance that the fiscal position would be adjusted as needed to maintain debt sustainability.

[9] In January, Mexico issued US$1 billion bonds due in 2021 at 3.6 percent, and US$3 billion in debt maturing in 2045. In March 2014, Mexico issued a 100-year bond denominated in GBP equivalent to US$1.6 billion with a yield of 5.75 percent—becoming the only country to have issued two century bonds. In April, Mexico raised US$2.8 billion in Euro-denominated bonds, with yields of 2.4 (maturing 2021) and 3.7 percent (maturing 2029).

- **Low and stable inflation**. Inflationary pressures remain contained and inflation expectations are anchored. Core inflation has remained close to target of 3 percent, though headline inflation is temporarily elevated due to one-off effects from the tax reform and high food prices.

- **Sound financial system and the absence of solvency problems that may threaten systemic stability.** As of July 2014, the banking system's capital adequacy ratio stood at 15.9 percent, broadly unchanged from a year ago. All banks meet the Basel III capital requirements, and the new liquidity coverage ratios will be introduced gradually starting in 2015. The broader financial system is also sound. Private pension funds, which held assets of 12.5 percent of GDP at end-2013, have a conservative investment profile. Capital in the insurance sector also exceeds the minimum requirements, and all insurance companies are expected to satisfy the new capital requirements under the Solvency II regime to be adopted in 2015. Real estate investment trusts have grown since 2011, but remain small and are financed mostly by equity, with new statutory limits on their leverage.

- **Effective financial sector supervision.** The 2011 FSAP Update concluded that Mexico's overall financial sector supervision framework remains effective. Since then, Mexico has adopted early the Basel III capital requirements. The regulation of financial groups was enhanced in January 2014 through the implementation of supervision at the group level. The authorities monitor closely the operations of foreign bank subsidiaries—about 70 percent of banking system assets—to ensure compliance with regulatory norms and restrict potential funding drains.

- **Data transparency and integrity.** The overall quality of Mexican data continues to be very good as described in the October 2010 data ROSC update. Mexico remains in observance of the Special Data Dissemination Standards (SDDS). STA recently conducted a ROSC assessment of the national income accounts and concluded that statistics were generally of high quality and adequate for effective surveillance.

23. International indicators of institutional quality show that Mexico has above average government effectiveness. According to the World Bank's Worldwide Governance Indicators, Mexico's government effectiveness ranks at the 63rd percentile among all countries. Mexico is at the 43rd percentile on control of corruption, slightly below the median. However, the recently approved structural reforms, once implemented, are likely to lead to an improvement on both measures. The strengthening of the powers of the anti-trust authorities, for example, would improve governance and competition; while the education reform would help increase government effectiveness. The institutional quality of economic policy is underpinned by the inflation-targeting framework (anchored by a strong, independent central bank), the fiscal responsibility law and the strong prudential and regulatory framework for financial supervision as assessed by the 2012 FSAP update.

IMPACT ON FUND FINANCES, RISKS, AND SAFEGUARDS

24. Access under the proposed FCL arrangement for Mexico of 1,304 percent of quota (SDR 47.292 billion) is substantial, but the impact on Fund liquidity is manageable. As with the current arrangement, if drawn, the proposed FCL arrangement would become the Fund's largest single credit exposure. However, the Fund's liquidity is expected to remain adequate after an approval of the proposed FCL arrangement for Mexico.

25. Notwithstanding the size of the possible commitment, the risks to the Fund are judged to be low. The authorities have stated that they intend to treat the arrangement as precautionary. Even if a full drawing under the arrangement were to be made on approval, Mexico's external debt would remain moderate at about 40.7 percent of GDP in 2016, when debt service peaks (Table 1). Peak debt service ratios would be broadly in line with those in recent years and remain well within the range seen in other emerging market countries. Moreover, Mexico has an excellent track record of meeting its obligations to the Fund.

26. Staff has completed the safeguards procedures for Mexico's 2012 FCL arrangement. The authorities provided the necessary authorization for Fund staff to communicate directly with the Bank of Mexico's external auditor, PricewaterhouseCoopers (PwC) México. PwC issued an unqualified audit opinion on the Bank of Mexico's 2012 financial statements on March 27, 2013. Staff reviewed the 2012 audit results and discussed these with PwC. No significant safeguards issues emerged from the conduct of these procedures. In preparation of the prospective successor arrangement, the Bank of Mexico has agreed to provide the authorizations needed for an update of the safeguards procedures to be conducted connected to the proposed arrangement.

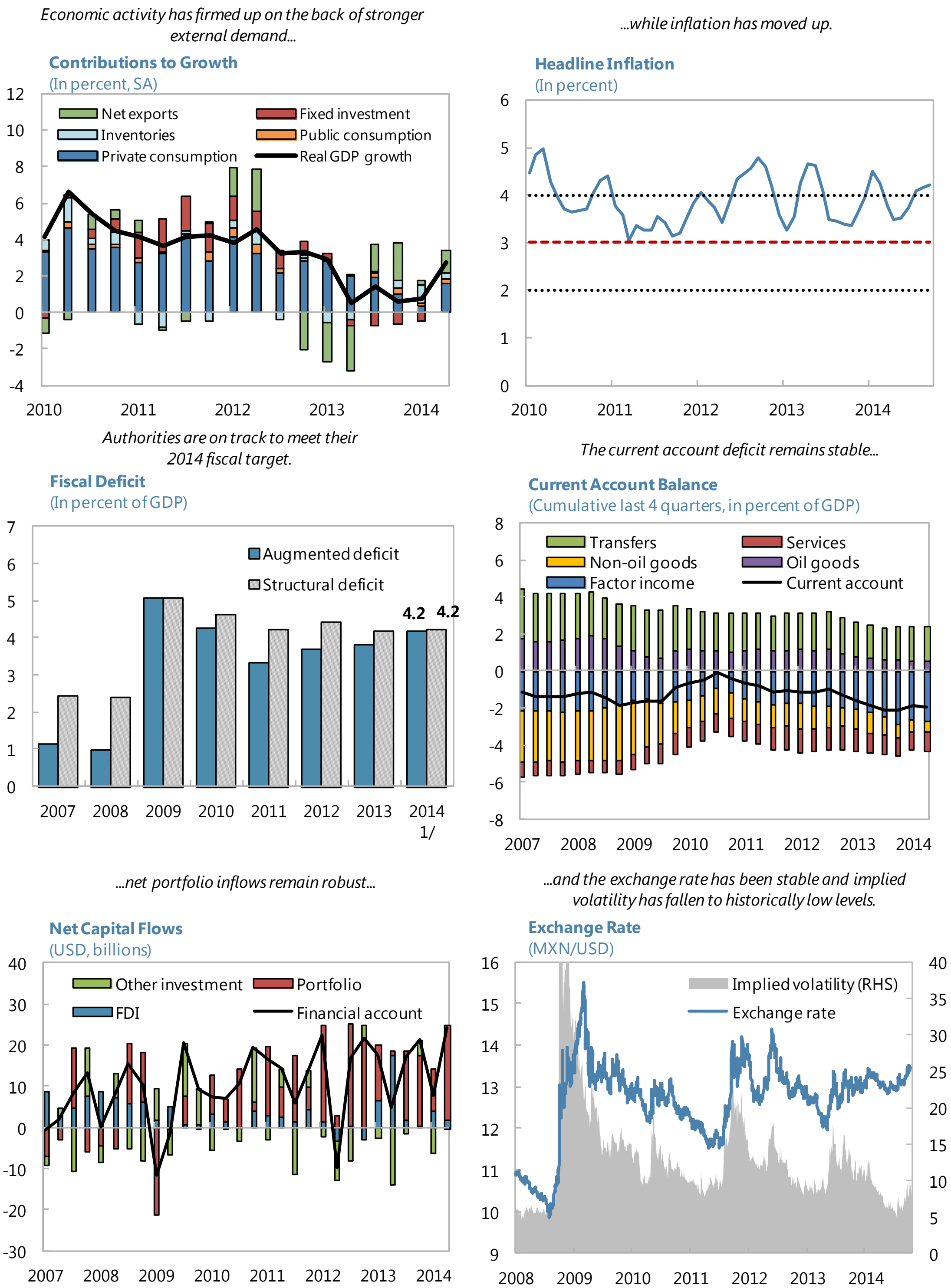
STAFF APPRAISAL

27. The staff's assessment is that Mexico continues to meet the qualification criteria for access to FCL resources. As noted in the staff appraisal for the Article IV, Mexico has a very strong policy framework and economic fundamentals. The authorities have a successful record of sound policy management and are firmly committed to maintaining prudent policies going forward. At the same time authorities are in the process of implementation of an ambitious structural reform package, which is expected to boost medium-term economic prospects.

28. Staff considers the proposed access level of SDR 47.292 billion (1,304 percent of quota) to be appropriate. Uncertainties surrounding the global outlook, including risks related to the tightening of monetary policy in the United States, remain high. Mexico, with its open capital account and significant stocks of foreign portfolio investment is exposed to changes in investors' preferences. The recent bout of financial market volatility in October 2014 highlights the risk of sudden shifts in investor risk appetite, which could lead to rapid reassessment of emerging market risk. The new FCL arrangement would continue to support the authorities' overall economic strategy, and would supplement Mexico's external buffers by providing insurance against tail risks. Staff supports the authorities' view that a reduction in access under the FCL is not advisable in the case of Mexico, given the proximity to the takeoff window for the policy interest rate in the U.S. and the country's close trade and financial ties with the U.S. Staff welcomes the authorities' exit strategy, which foresees a reduction in access in any future arrangements, subject to a reduction in global risks affecting Mexico.

29. Staff judges the risks to the IMF arising from the proposed FCL arrangement to be low. The authorities have an excellent policy implementation track record, and they intend to maintain a very strong policy framework. Risks to the Fund are further contained by the authorities' intent to treat the FCL arrangement as precautionary; Mexico's strong repurchase record with the Fund, and its manageable external debt service profile even if the full amount of the FCL were to be drawn.

Figure 1. Recent Economic Developments

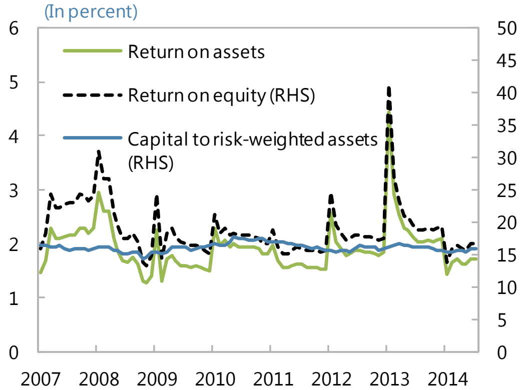


Sources: National authorities; Haver Analytics; Bloomberg; and IMF staff calculations.
1/ IMF staff projections.

Figure 2. Recent Financial Developments

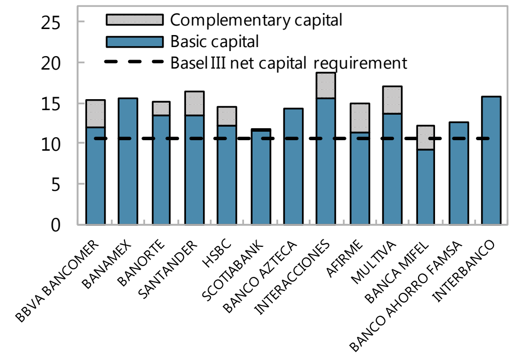
The banking sector remains profitable…

Commercial and Development Banking Sector 1/
(In percent)



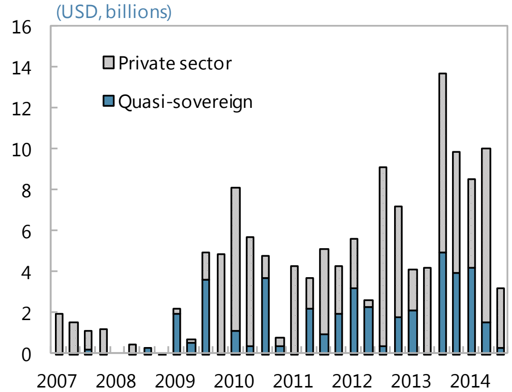
…and well capitalized.

Capital to Risk-Weighted Assets
(In percent)



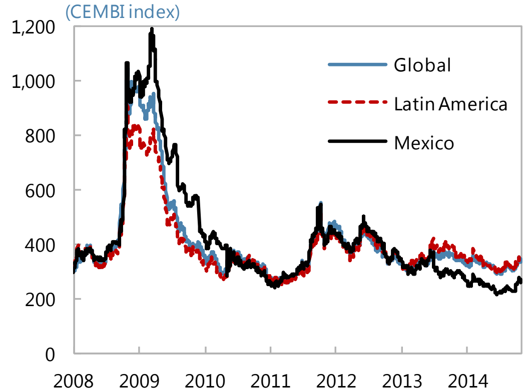
Corporate bond issuance has been strong since mid-2013…

Corporate Bond Issuance: Foreign Placements
(USD, billions)



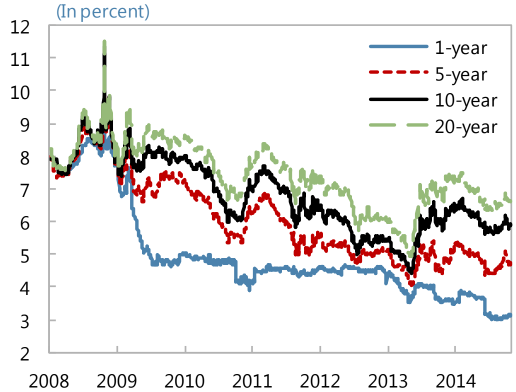
…and corporate bond yields have declined.

Corporate Bond Yields
(CEMBI index)



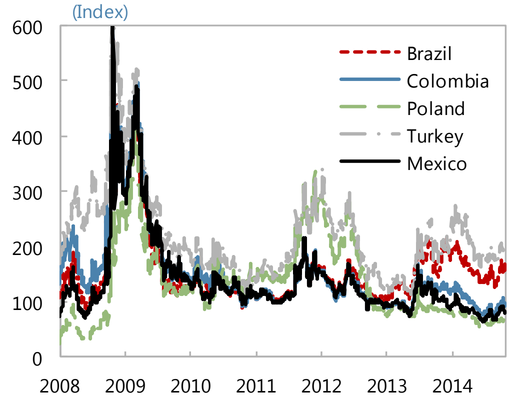
Government bond yields have fallen since the start of 2014…

Government Bond Yields
(In percent)



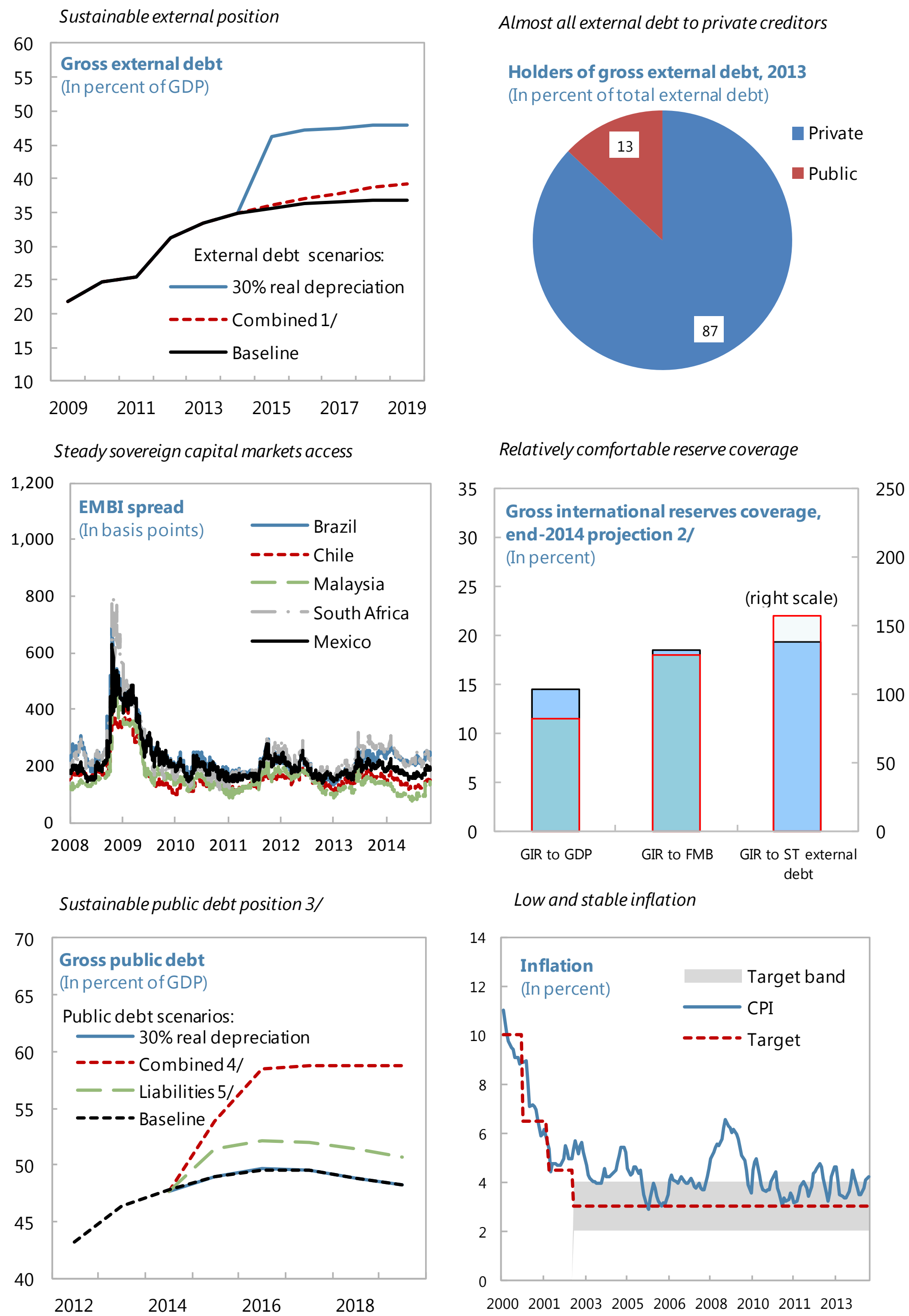
…and sovereign risk premia on external debt have come down.

Risk Premia
(Index)



Sources: National authorities; Haver Analytics; Dealogic; EPFR; Bloomberg; and IMF staff calculations.
1/ As of July 2014.

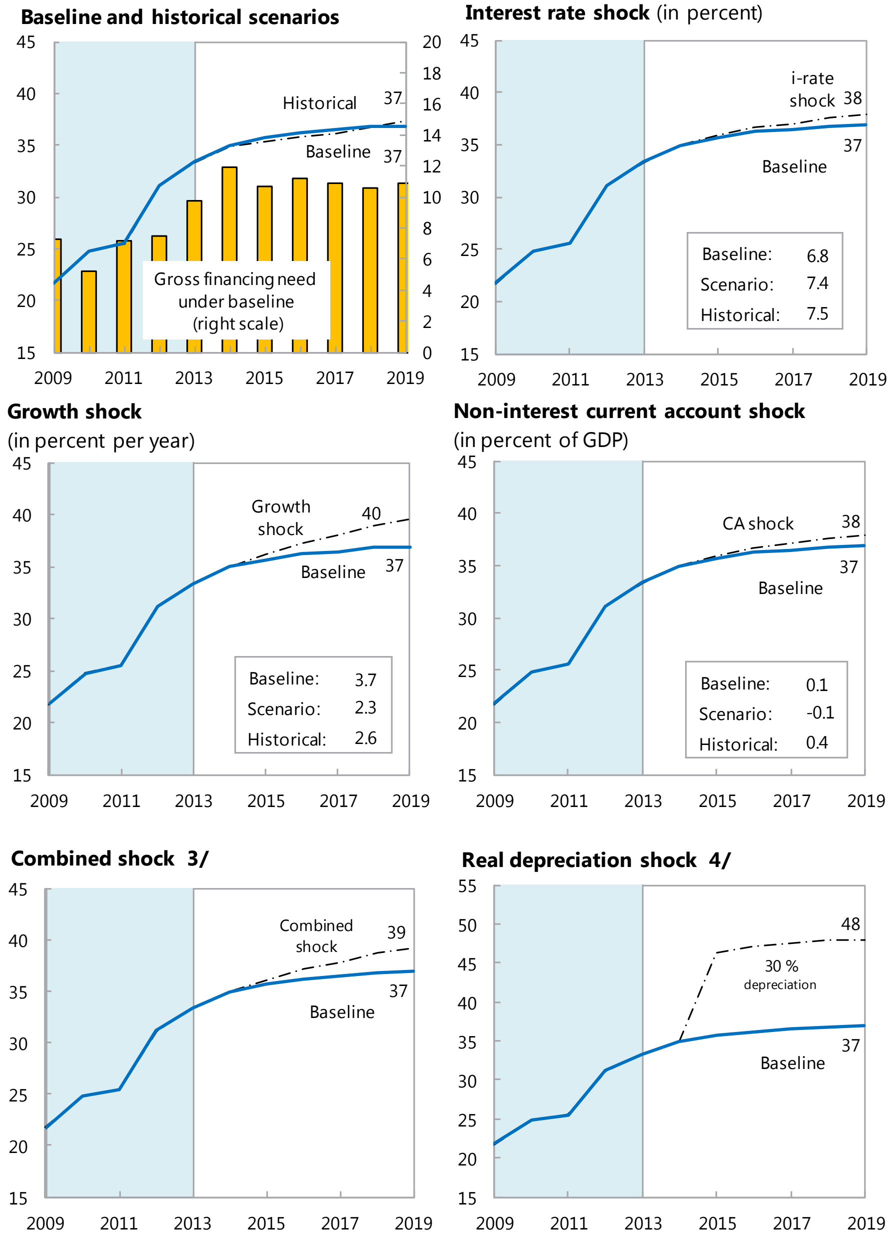
Figure 3. Qualification Criteria



Sources: Bloomberg L.P.; Datastream; EMED; Haver Analytics; and IMF staff calculations.
1/ Combined permanent 1/4 standard deviation shocks applied to interest rate, growth, and primary current account balance.
2/ Red bar shows ratio for end-year 2010, when FCL was approved.
3/ Not taking into account offsetting measures required under the balance budget rule.
4/ Combined permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
5/ One-time 10 percent of GDP increase in debt-creating flows.

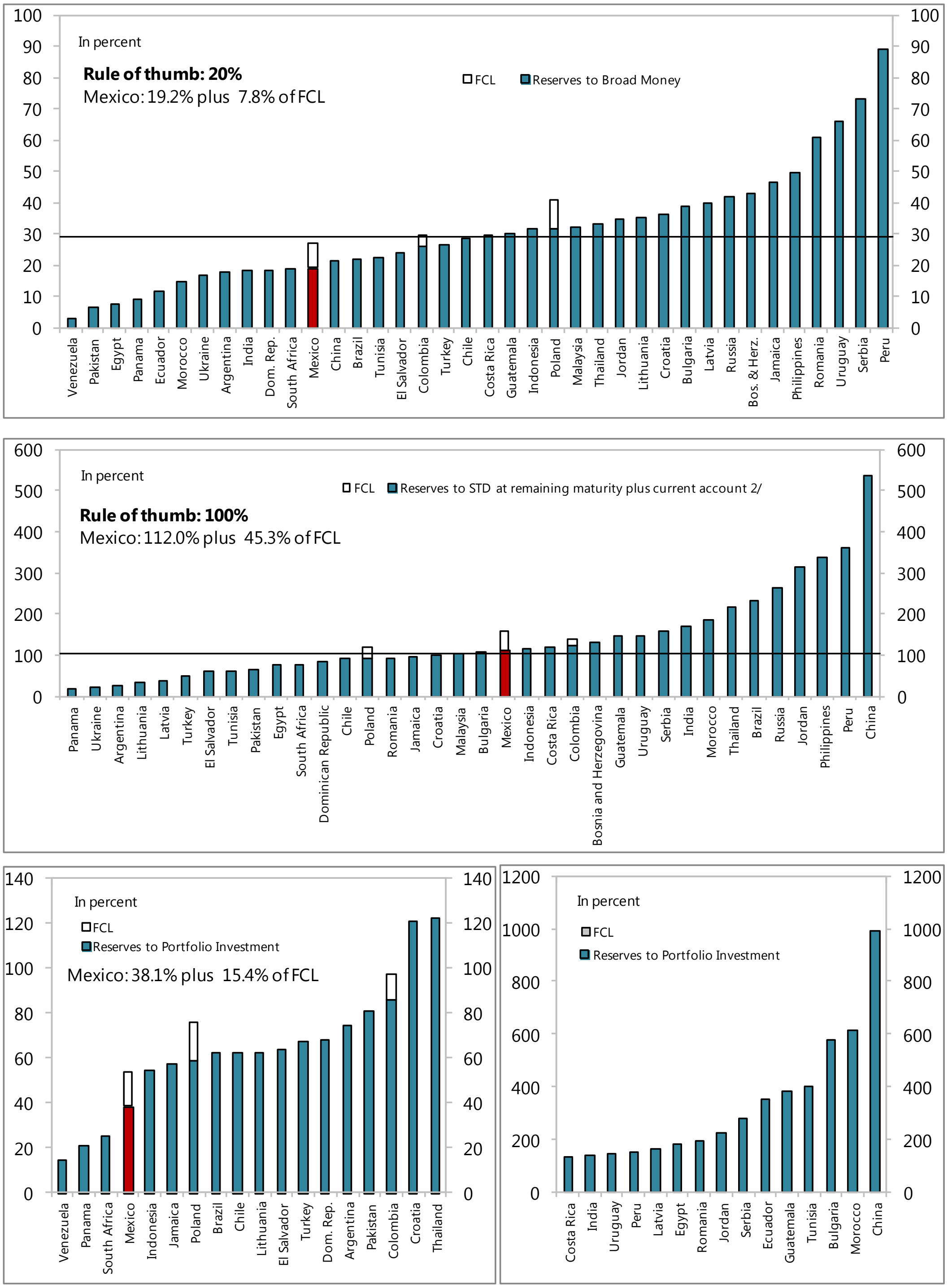
Figure 4. External Debt Sustainability: Bound Tests [1/ 2/]

(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 2014.

Figure 5. Reserve Coverage in an International Perspective 2013 (1) [1/]

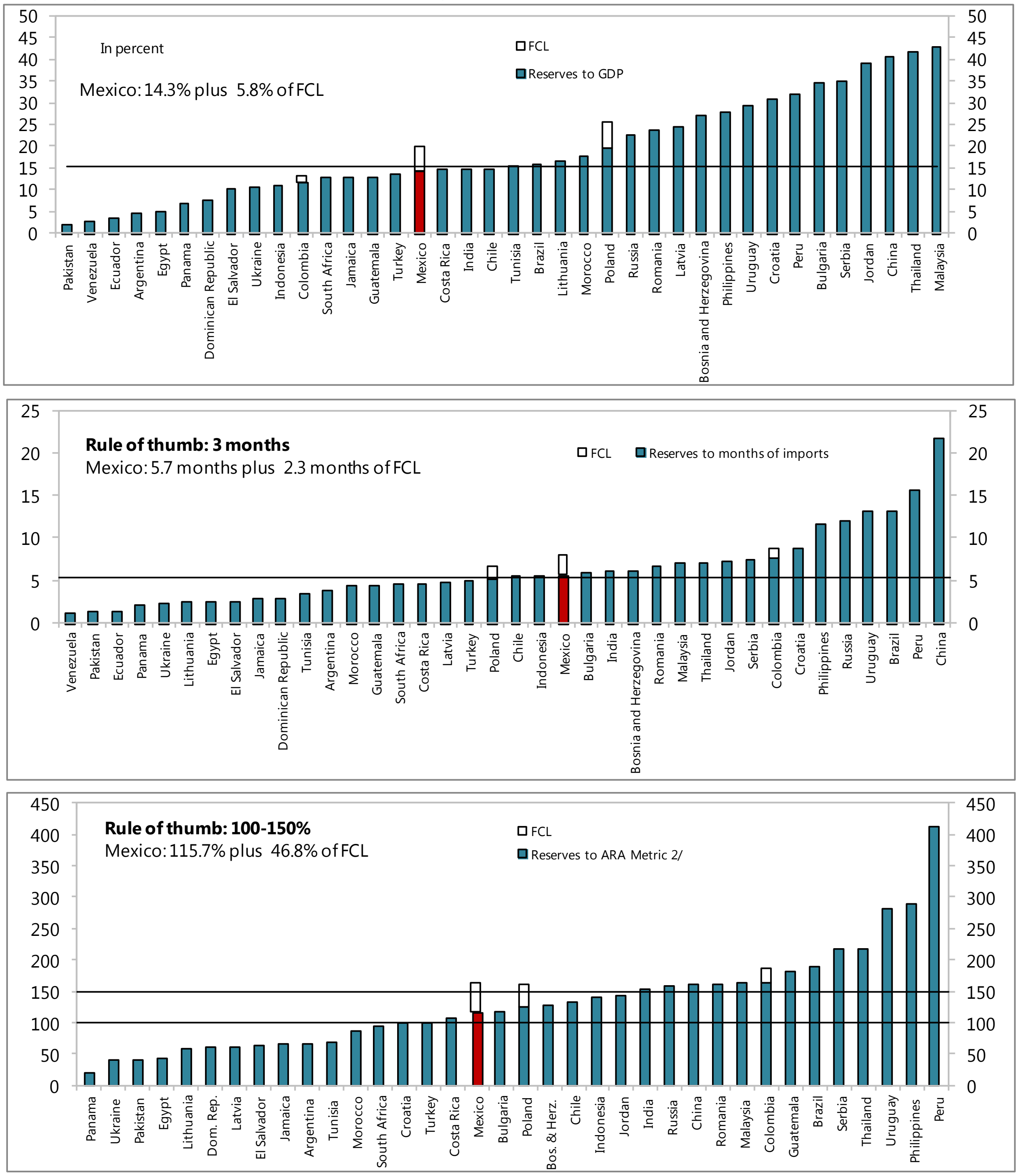


Sources: World Economic Outlook, and IMF staff estimates.

1/ Horizontal lines represent median in all the charts.

2/ Reserves at the end in percent of short-term debt at remaining maturity and estimated current account deficit in 2013. The current account is set to zero if it is in surplus.

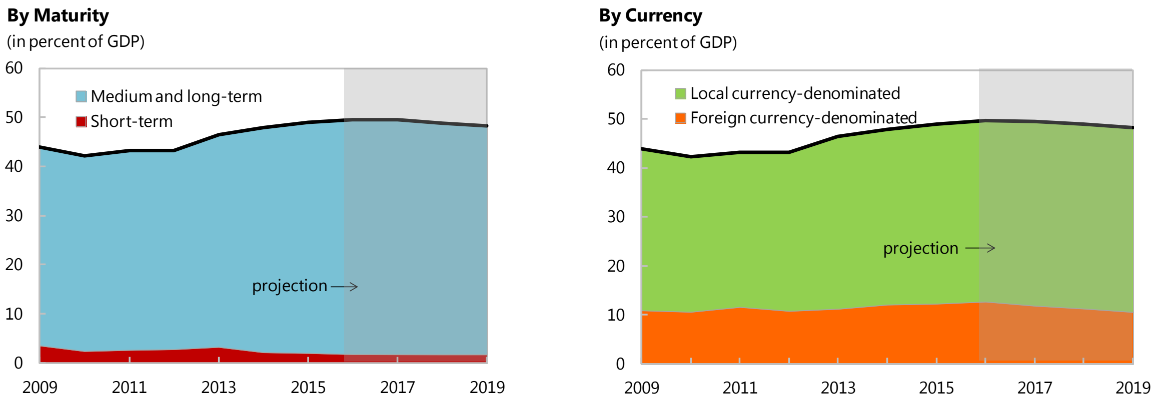
Figure 6. Reserve Coverage in an International Perspective 2013 (2) [1/]



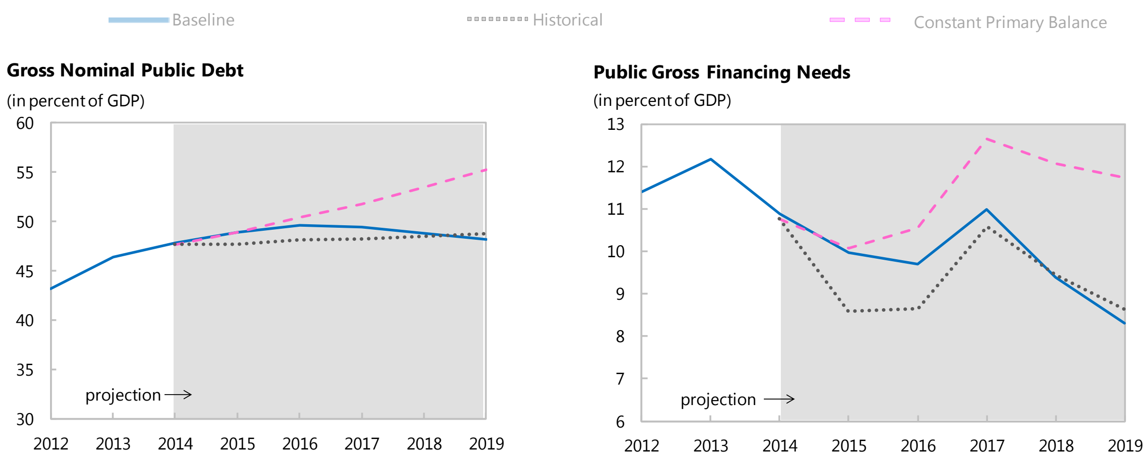
Sources: World Economic Outlook, Balance of Payments Statistics Database, and IMF staff estimates.
1/ Horizontal lines represent median in all the charts.
2/ The ARA metric was developed by SPR to assess reserve adequacy. For the stock of porfolio liabilities, data on 2013, 2012, or 2011 is used depending on data availability.

Figure 7. Public DSA—Composition of Public Debt and Alternative Scenarios

Composition of Public Debt



Alternative Scenarios



Underlying Assumptions
(in percent)

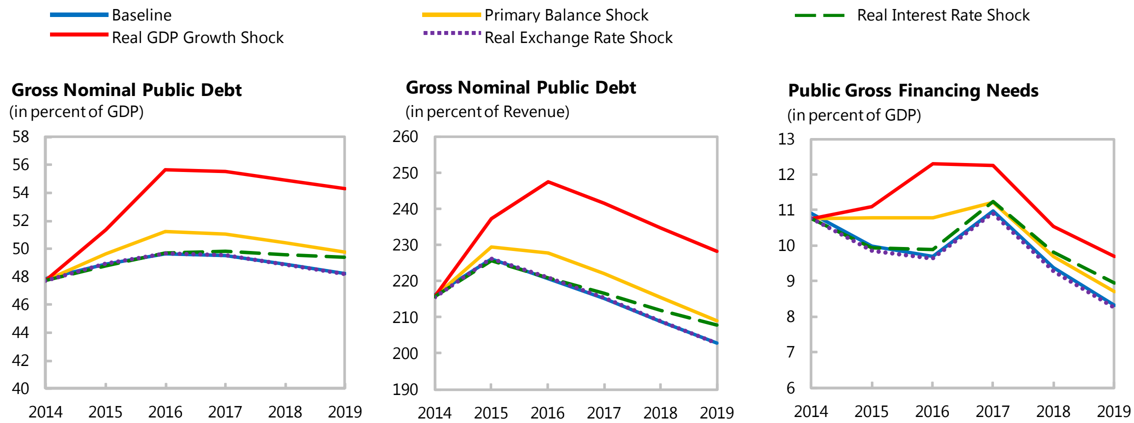
Baseline Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	2.4	3.5	3.8	3.8	3.8	3.8
Inflation	4.0	3.3	2.5	3.1	3.0	3.0
Primary Balance	-1.5	-1.4	-0.7	0.0	0.8	0.9
Effective interest rate	6.1	6.0	6.1	6.5	7.0	7.4
Constant Primary Balance Scenario						
Real GDP growth	2.4	3.5	3.8	3.8	3.8	3.8
Inflation	4.0	3.3	2.5	3.1	3.0	3.0
Primary Balance	-1.5	-1.5	-1.5	-1.5	-1.5	-1.5
Effective interest rate	6.1	6.0	6.1	6.4	6.9	7.3

Historical Scenario	2014	2015	2016	2017	2018	2019
Real GDP growth	2.4	2.6	2.6	2.6	2.6	2.6
Inflation	4.0	3.3	2.5	3.1	3.0	3.0
Primary Balance	-1.5	0.0	0.0	0.0	0.0	0.0
Effective interest rate	6.1	6.0	5.8	5.9	6.2	6.4

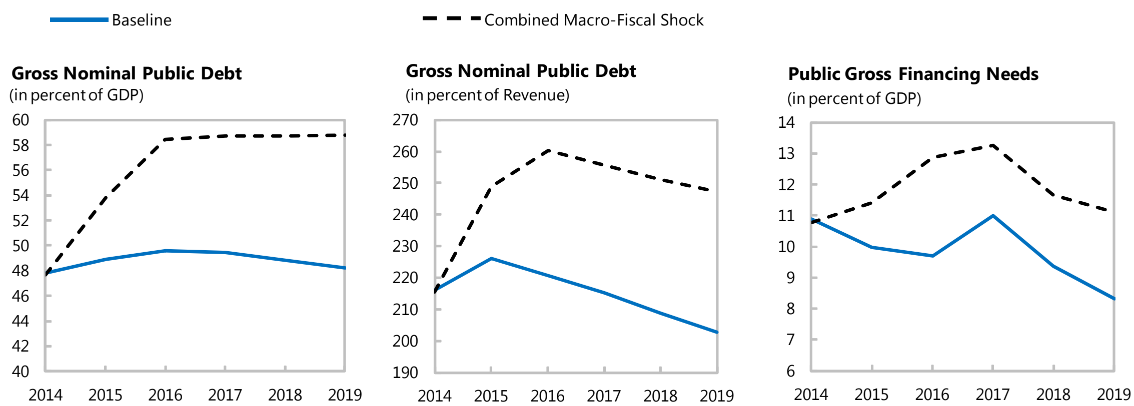
Source: IMF staff.

Figure 8. Public DSA—Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions
(in percent)

	2014	2015	2016	2017	2018	2019
Primary Balance Shock						
Real GDP growth	2.4	3.5	3.8	3.8	3.8	3.8
Inflation	4.0	3.3	2.5	3.1	3.0	3.0
Primary balance	-1.5	-2.2	-1.5	0.0	0.8	0.9
Effective interest rate	6.1	6.0	6.2	6.5	6.9	7.3
Real Interest Rate Shock						
Real GDP growth	2.4	3.5	3.8	3.8	3.8	3.8
Inflation	4.0	3.3	2.5	3.1	3.0	3.0
Primary balance	-1.5	-1.4	-0.7	0.0	0.8	0.9
Effective interest rate	6.1	6.0	6.5	7.1	7.9	8.4
Combined Shock						
Real GDP growth	2.4	0.6	0.9	3.8	3.8	3.8
Inflation	4.0	2.6	1.7	3.1	3.0	3.0
Primary balance	-1.5	-2.2	-2.4	0.0	0.8	0.9
Effective interest rate	6.1	6.2	6.5	7.1	7.9	8.4

	2014	2015	2016	2017	2018	2019
Real GDP Growth Shock						
Real GDP growth	2.4	0.6	0.9	3.8	3.8	3.8
Inflation	4.0	2.6	1.7	3.1	3.0	3.0
Primary balance	-1.5	-2.2	-2.4	0.0	0.8	0.9
Effective interest rate	6.1	6.0	6.2	6.6	7.0	7.3
Real Exchange Rate Shock						
Real GDP growth	2.4	3.5	3.8	3.8	3.8	3.8
Inflation	4.0	8.2	2.5	3.1	3.0	3.0
Primary balance	-1.5	-1.4	-0.7	0.0	0.8	0.9
Effective interest rate	6.1	6.2	6.1	6.3	6.8	7.2

Source: IMF staff.

Table 1. Indicators of Fund Credit

	Projections						
	2014	2015	2016	2017	2018	2019	2020
Stocks from prospective drawings 1/							
Fund credit in millions SDR	47,292	47,292	47,292	47,292	23,646	0	0
In percent of quota	1,304	1,304	1,304	1,304	652	0	0
In percent of GDP	6	5	5	5	2	0	0
In percent of exports of goods and services	17	16	15	14	6	0	0
In percent of gross reserves	37	35	33	31	15	0	0
Flows from prospective drawings 2/							
Charges in millions of SDR	236	1,195	1,216	1,215	1,227	319	1
Debt service due on GRA credit in millions of SDR	236	1,195	1,216	1,215	24,873	23,965	1
In percent of quota	6.5	33.0	33.5	33.5	686.0	661.0	0.0
In percent of GDP	0.0	0.1	0.1	0.1	2.4	2.2	0.0
In percent of exports of goods and services	0.1	0.4	0.4	0.4	6.6	5.8	0.0
In percent of gross reserves	0.2	0.9	0.8	0.8	15.3	13.8	0.0
Memo Item:							
Total external debt (percent of GDP)	40.4	40.7	41.0	41.0	38.8	36.6	36.6

Sources: IMF Finance Department; Mexican authorities, and Fund staff estimates

1/ End of period. Assumes full drawings under the FCL upon approval of the review. The Mexican authorities have expressed their intention to treat the arrangement as precautionary.

2/ Based on the rate of charge as of October 16, 2014. Includes GRA charges, surcharges under the system currently in force and service charges.

Table 2. Proposed Access

	Proposed Arrangement FCL	Proposed Arrangement (Percentile)	High-Access Cases 1/ 20th	65th	80th	Median
			Percentile (Ratio)			
Access						
In millions of SDRs	47,292	99	1,386	10,981	15,418	6,662
Average annual access (percent of quota)	652	83	171	394	647	271
Average annual access (percent of total) 2/	652	82	300	778	1,009	575
Total access in percent of: 3/						
Actual quota	1,304	87	341	800	1,053	600
Gross domestic product	6	44	3.0	7.3	9.6	6.2
Gross international reserves	37	36	26	55	85	48
Exports of goods and nonfactor services 4/	17	38	11.2	27.9	39.0	20
Imports of goods and nonfactor services	17	48	9.7	22.9	32.9	18
Total debt stock 5/						
Of which: Public	12	44	8	16	29	12
External	17	73	7	15	22	12
Short-term 6/	51	64	21	51	112	36
M2	7	23	6	15	24	12

Source: Executive Board documents, MONA database, and Fund staff estimates.

1/ High access cases include available data at approval and on augmentation for all the requests to the Board since 1997 which involved the use of the exceptional circumstances clause or SRF resources. Exceptional access augmentations are counted as separate observations. For the purpose of measuring access as a ratio of different metrics, access includes augmentations and previously approved and drawn amounts.

2/ Correspond to quotas prior to 2008 Reform.

3/ The data used to calculate ratios is the actual value for the year prior to approval for public, external, and short-term debt, and the projection at the time of program approval for the year in which the program was approved for all other variables (projections for 2012 were used).

4/ Includes net private transfers.

5/ Refers to net debt.

6/ Refers to residual maturity.

Table 3. Selected Economic, Financial, and Social Indicators

I. Social and Demographic Indicators

GDP per capita (U.S. dollars, 2013)	10,650	Poverty headcount ratio (% of population, 2012) 1/	45.5
Population (millions, 2013)	118.4	Income share of highest 20 percent / lowest 20 percent (2010)	11.4
Life expectancy at birth (years, 2012)	74.5	Adult illiteracy rate (2012)	5.8
Infant mortality rate (per thousand, 2013)	12.8	Gross primary education enrollment rate (2012) 2/	105.0

II. Economic Indicators

	2011	2012	2013	Proj. 2014	Proj. 2015
(Annual percentage change, unless otherwise indicated)					
National accounts (in real terms)					
GDP	4.0	4.0	1.1	2.4	3.5
Consumption	4.5	4.6	2.3	1.5	3.3
Private	4.8	4.9	2.5	1.6	2.8
Public	2.4	3.4	1.2	0.7	2.0
Investment	5.4	5.5	-2.4	1.8	5.0
Fixed	7.8	4.5	-1.8	0.4	5.2
Private	12.1	8.8	-1.3	3.4	5.4
Public	-4.1	-9.5	-3.6	-2.6	4.2
Inventories 3/	-0.5	0.2	-0.2	0.3	0.0
Exports of goods and services	8.2	5.9	1.2	6.8	4.4
Imports of goods and services	8.0	5.5	1.5	5.6	5.1
Exchange rates					
Nominal exchange rate (US$/Mex$)					
(average, appreciation +) 4/	1.7	-5.7	3.1	1.4	…
Employment and inflation					
Consumer prices (average)	3.4	4.1	3.8	3.9	3.5
Formal sector employment, IMSS-insured workers (average) 5/	4.3	4.6	3.5	2.7	…
National unemployment rate (annual average)	5.2	5.0	4.9	4.8	4.5
Unit labor costs: manufacturing (real terms, average) 6/	-1.8	-2.8	0.8	-0.2	…
Money and credit					
Nominal bank credit to non-financial private sector 7/	17.1	11.0	12.0	10.7	11.7
Broad money (M4a) 8/	15.7	14.5	8.8	9.5	9.9
Public sector finances (in percent of GDP)					
General government revenue	22.9	23.4	23.3	21.9	21.3
General government expenditure	26.2	27.1	27.1	26.1	25.3
Overall fiscal balance (public sector borrowing requirements) 9/	-3.3	-3.7	-3.8	-4.2	-4.0
Gross public sector debt	43.2	43.2	46.4	47.8	48.9
External sector					
External current account balance (in percent of GDP)	-1.1	-1.3	-2.1	-2.1	-2.0
Exports of goods, f.o.b.	17.1	6.1	2.5	3.9	6.9
Export volume	2.2	9.0	2.8	6.5	4.0
Imports of goods, f.o.b.	16.4	5.7	2.8	3.6	6.8
Import volume	8.5	4.6	3.0	5.9	5.3
Net capital inflows (in percent of GDP)	4.3	4.3	4.8	3.2	3.0
Real effective exchange rate (CPI based)					
(average, appreciation +)	0.4	-2.9	6.1	-0.7	…
Terms of trade (improvement +)	6.8	-3.6	-0.1	-0.3	1.3
Memorandum items					
Output gap	-0.6	0.8	-0.7	-1.1	-0.4

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/ CONEVAL uses a multi-dimensional approach to measuring poverty based on a "social deprivation index," which goes beyond the level of income and also factors in the level of education, access to health services, access to social security, quality and the size of one's home, access to basic services in the dwelling, and access to food.

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

3/ Contribution to growth. Excludes statistical discrepancy.

4/ 2014 based on data available until September 2014.

5/ 2014 based on data available until June 2014.

6/ 2014 based on data available until July 2014.

7/ Includes commercial banks and direct credit by development banks.

8/ Includes money held by the public sector.

9/ Federal Government plus Social Security and State-owned Companies, excl. nonrecurring revenue and transfers to stabilization funds.

Table 4. Financial Operations of the Public Sector, Authorities' Presentation

(In percent of GDP)

	2010	2011	2012	Prel. 2013	Staff Projections 2014	2015	2016	2017	2018	2019
Budgetary revenue, by type	**22.3**	**22.5**	**22.5**	**23.6**	**22.4**	**22.0**	**23.0**	**23.6**	**24.0**	**24.2**
Oil revenue	7.3	7.6	7.6	7.8	7.2	6.7	7.2	7.3	7.3	7.5
Non-oil tax revenue 1/	9.9	9.9	9.7	10.2	10.3	10.8	11.3	11.8	12.2	12.2
Non-oil non-tax revenue	5.1	5.0	5.2	5.6	5.0	4.6	4.5	4.5	4.5	4.5
Budgetary expenditure	**25.1**	**25.0**	**25.1**	**25.9**	**25.9**	**25.5**	**26.0**	**26.1**	**26.0**	**26.2**
Primary	23.2	23.1	23.2	24.0	23.8	23.3	23.6	23.6	23.4	23.5
Programmable	19.7	19.7	19.9	20.6	20.5	20.0	20.1	20.0	19.8	19.9
Current	14.7	14.8	15.1	15.2	15.6	15.4	15.6	15.4	15.1	14.9
Wages	6.0	5.9	5.9	6.0	6.0	5.9	5.9	5.8	5.8	5.7
Pensions	2.6	2.7	2.8	2.9	3.1	3.2	3.3	3.4	3.5	3.6
Subsidies and transfers	2.8	3.0	3.1	3.3	3.5	3.5	3.5	3.5	3.2	3.0
Other	3.3	3.2	3.3	3.0	3.0	2.9	2.9	2.7	2.5	2.5
Capital	5.0	4.8	4.7	5.4	4.9	4.6	4.5	4.6	4.7	5.0
Physical capital	4.7	4.5	4.4	4.6	4.7	4.4	4.3	4.4	4.5	4.8
Of which: Pemex	*2.0*	*1.8*	*2.0*	*2.0*	*2.0*	*2.0*	*2.0*	*2.0*	*2.0*	*2.0*
Financial capital 2/	0.3	0.4	0.4	0.9	0.2	0.2	0.2	0.2	0.2	0.2
Nonprogrammable	3.5	3.4	3.3	3.4	3.3	3.3	3.4	3.6	3.6	3.7
Of which: revenue sharing	3.3	3.3	3.2	3.3	3.2	3.2	3.4	3.5	3.5	3.6
Interest payments 3/	1.9	1.9	2.0	2.0	2.1	2.2	2.4	2.5	2.6	2.6
Traditional balance	**-2.8**	**-2.5**	**-2.6**	**-2.3**	**-3.5**	**-3.5**	**-3.0**	**-2.5**	**-2.0**	**-2.0**
Adjustments to the traditional balance	**1.5**	**0.9**	**1.1**	**1.5**	**0.7**	**0.5**	**0.5**	**0.5**	**0.5**	**0.5**
Public sector borrowing requirements 4/	**-4.3**	**-3.3**	**-3.7**	**-3.8**	**-4.2**	**-4.0**	**-3.5**	**-3.0**	**-2.5**	**-2.5**
Augmented interest expenditure 5/	2.5	2.4	2.5	2.5	2.7	2.7	2.8	3.0	3.3	3.4
Augmented primary balance	-1.7	-1.0	-1.1	-1.3	-1.5	-1.4	-0.7	0.0	0.8	0.9
Memorandum items										
Total revenue 6/	22.4	22.9	23.4	23.3	22.1	21.4	22.6	23.2	23.6	23.8
Total expenditure 7/	26.7	26.2	27.1	27.1	26.3	25.5	26.1	26.2	26.1	26.3
Total primary expenditure 8/	24.2	23.9	24.6	24.6	23.7	22.8	23.3	23.2	22.8	22.9
Structural current spending 9/	12.9	12.9	13.0	13.1	13.0	12.7	12.6	12.5	12.4	12.4
Structural current spending real growth (y/y, in percent) 10/	-0.3	5.7	4.6	-0.1	1.7	1.0	2.1	3.2	3.7	3.7
Crude oil export price, Mexican mix (US$/bbl)	72	101	102	98	97	94	92	90	89	88
Non-oil augmented balance 11/	-8.4	-8.0	-8.2	-8.7	-8.3	-7.7	-7.6	-7.2	-6.7	-6.9
Structural Primary Fiscal Balance	-2.1	-1.8	-1.9	-1.6	-1.5	-1.4	-0.7	0.1	0.9	1.0
Fiscal Impulse 12/	-0.2	-0.3	0.0	-0.2	-0.1	-0.2	-0.7	-0.8	-0.8	-0.1
Gross public sector debt	42.2	43.2	43.2	46.4	47.8	48.9	49.5	49.4	48.8	48.2
Net public sector debt	36.2	37.5	37.7	40.4	42.0	43.1	43.7	43.6	43.0	42.4
Nominal GDP (billions of Mexican pesos)	13,282	14,550	15,615	16,104	17,156	18,345	19,506	20,867	22,318	23,879

Sources: Mexican authorities and IMF staff estimates. Data refer to non-financial public sector, including PEMEX and other public entities but excluding state and local governments.

1/ From 2015 onwards, in line with the 2015 Income Law, excise on gasoline is classified as non-oil tax revenue.

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

3/ Includes transfers to IPAB and debtor support programs.

4/ Public Sector Borrowing Requirements excl. adjustments for net inflows to stabilization funds.

5/ Treats transfers to IPAB as interest payments.

6/ Budgetary revenue, excluding nonrecurrent revenue and gasoline subsidy.

7/ Budgetary expenditure, including adjustments to the traditional balance with the exception of adj. for nonrecurrent revenue and gasoline subsidy.

8/ Total expenditure minus augmented interest payments.

9/ The 2014 amendment to the FRL introduced a cap on structural current spending real growth. The latter is defined as total budgeary expenditure, excluding: (i) interest payments; (ii) non-programable spending; (iii) fuel costs of CFE; and (iv) direct physical and financial investment of the federal government.

10/ The cap on structural current spending real growth was set at 2.0 percent for 2015 and 2016, and equal to potential GDP real growht from 2017 onwards.

11/ Excludes oil revenue (oil extraction rights, PEMEX net income, oil excess return levies, excise tax on gasoline) and PEMEX operational and physical capital expenditure.

12/ 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 5. Summary Balance of Payments

	2010	2011	2012	2013	Projections 2014	2015	2016	2017	2018	2019
	(In billions of U.S. dollars)									
Current account	-4.1	-12.8	-15.3	-26.3	-27.0	-27.9	-33.9	-34.3	-35.4	-36.1
Merchandise trade balance	-3.0	-1.4	0.0	-1.2	0.5	1.1	-2.1	0.7	-0.2	3.2
Exports	298.5	349.4	370.8	380.0	395.7	423.1	463.0	510.9	558.2	613.0
o/w Manufactures 1/	246.1	279.2	302.7	315.3	330.6	354.9	381.4	411.2	441.5	470.0
Imports	-301.5	-350.8	-370.8	-381.2	-395.2	-422.1	-465.1	-510.2	-558.4	-609.7
o/w Petroleum and derivatives	30.2	42.7	41.1	40.9	38.8	38.9	39.3	39.5	38.9	39.8
Net other goods 2/	0.1	0.2	0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Net services	-10.6	-14.8	-14.6	-12.0	-11.9	-12.3	-12.7	-13.2	-13.6	-14.1
Net factor income	-12.1	-19.7	-23.6	-35.5	-38.4	-40.7	-44.0	-47.9	-48.5	-53.1
o/w Gross Repatriation of Profits and Interest Payments Abroad	-22.9	-30.3	-36.7	-45.1	-48.4	-52.6	-58.3	-65.0	-68.8	-75.8
Net transfers (Remittances)	21.5	23.0	22.6	22.1	22.9	24.1	25.0	26.0	27.0	27.9
Financial Account	44.5	50.9	51.4	61.0	41.7	41.3	47.6	48.9	51.6	56.4
Foreign direct investment, net	8.4	11.1	-4.7	26.0	14.0	18.5	28.0	29.3	30.6	37.9
Direct investment into Mexico	23.5	23.7	17.8	39.2	22.8	27.5	37.3	38.9	40.6	48.1
Direct investment abroad	-15.0	-12.6	-22.5	-13.2	-8.7	-9.0	-9.3	-9.6	-9.9	-10.3
Portfolio investment, net	31.4	45.9	72.7	49.0	30.9	33.8	32.2	29.2	30.1	29.1
Liabilities	37.3	40.6	81.2	51.1	30.9	33.8	32.2	29.2	30.1	29.1
Public Sector	28.1	37.0	56.9	33.2	22.7	23.9	23.2	24.5	25.9	25.3
o/w Local currency domestic-issued bonds	23.1	31.6	46.6	22.0	16.7	17.2	15.8	16.4	17.1	15.8
Private sector	9.2	3.6	24.3	17.9	8.2	9.9	9.0	4.7	4.2	3.8
Assets	-5.9	5.3	-8.5	-2.1	0.0	0.0	0.0	0.0	0.0	0.0
Other investments, net	4.6	-6.1	-16.6	-14.0	-3.2	-11.1	-12.6	-9.6	-9.1	-10.6
Liabilites	31.6	-2.5	-10.3	13.3	5.4	2.5	1.0	5.0	7.5	6.0
Assets	-27.0	-3.7	-6.3	-27.3	-8.6	-13.6	-13.6	-14.6	-16.6	-16.6
Errors and Omissions	-19.8	-10.0	-18.7	-16.9	0.0	0.0	0.0	0.0	0.0	0.0
Change in net international reserves	20.7	28.6	17.8	13.2	14.7	13.3	13.7	14.6	16.2	17.3
Valuation adjustments	-0.1	-0.4	-0.3	4.6	0.0	0.0	0.0	0.0	0.0	0.0
	(In percent of GDP)									
Current account balance	-0.4	-1.1	-1.3	-2.1	-2.1	-2.0	-2.3	-2.2	-2.2	-2.1
o/w Hydrocarbons trade balance	1.1	1.2	1.0	0.7	0.1	0.0	0.1	0.2	0.6	0.7
o/w Non-hydrocarbons trade balance 3/	-1.4	-1.3	-1.0	-0.8	-0.1	0.0	-0.2	-0.2	-0.6	-0.5
Net capital inflows	4.2	4.3	4.3	4.8	3.2	3.0	3.3	3.2	3.1	3.2
Net FDI inflows	0.8	0.9	-0.4	2.1	1.1	1.3	1.9	1.9	1.9	2.2
Net portfolio inflows	3.0	3.9	6.1	3.9	2.4	2.4	2.2	1.9	1.8	1.7
Net other investment inflows	0.4	-0.5	-1.4	-1.1	-0.2	-0.8	-0.9	-0.6	-0.6	-0.6
Memorandum items										
Hydrocarbons exports volume growth (in percent)	11.2	-1.7	-6.1	-2.8	0.0	-4.8	0.0	0.0	0.0	0.0
Non-hydrocarbons exports volume growth (in percent)	17.3	3.3	8.4	5.5	7.3	5.0	5.4	7.5	7.5	6.9
Hydrocarbons imports volume growth (in percent)	15.4	7.4	-4.6	-8.1	5.0	3.6	3.1	2.6	-0.2	3.4
Non-hydrocarbons imports volume growth (in percent)	24.1	8.6	6.5	4.4	5.9	5.3	10.2	8.7	7.6	7.6
Crude oil export volume (millions of bbl/day)	1.4	1.3	1.3	1.2	1.2	1.2	1.2	1.2	1.2	1.2
Gross domestic product (in billions of U.S. dollars)	1,052	1,172	1,186	1,261	1,310	1,388	1,461	1,548	1,640	1,737

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

1/ Total exports are defined net of imports by the maquila sector. Correspondingly, total imports do not include maquila sector imports.
2/ Goods procured in ports by carriers.
3/ Excluding oil exports, petroleum products and natural gas imports.

Table 6. Financial Soundness Indicators

(In percent)

	2009	2010	2011	2012	2013	2014 1/
Capital Adequacy						
Regulatory capital to risk-weighted assets	16.2	17.6	16.5	16.0	16.2	15.9
Regulatory Tier 1 capital to risk-weighted assets	14.0	15.1	14.3	13.8	14.5	14.0
Capital to assets	9.8	10.8	10.0	10.5	10.8	10.4
Gross asset position in financial derivatives to capital	82.3	65.1	72.8	78.4	72.7	82.8
Gross liability position in financial derivatives to capital	85.5	65.8	72.6	78.1	72.2	83.3
Asset Quality						
Nonperforming loans to total gross loans	3.1	2.3	2.4	2.5	3.3	3.2
Provisions to Nonperforming loans	173.3	200.0	191.0	185.4	147.6	142.3
Earnings and Profitability						
Return on assets	1.6	2.0	1.6	1.9	2.4	1.7
Return on equity	17.2	18.1	15.9	18.3	22.1	16.6
Liquidity						
Liquid assets to short-term liabilities	56.7	56.8	56.9	50.9	47.0	47.7
Liquid assets to total assets	41.5	41.8	42.5	37.7	35.2	35.7
Customer deposits to total (noninterbank) loans	88.8	85.9	82.8	88.6	86.9	90.0

Sources: Financial Soundness Indicators

1/ As of June 2014.

Table 7. Financial Indicators and Measures of External Vulnerabilities [1/]

	2008	2009	2010	2011	2012	2013	Proj. 2014
Financial market indicators 2/							
Exchange rate (per U.S. dollar, average)	11.1	13.5	12.6	12.4	13.2	12.8	13.2
(year-to-date percent change, + depreciation)	1.8	21.4	-6.5	-1.7	6.0	-3.0	2.6
28-day treasury auction rate (percent; period average)	7.7	5.4	4.4	4.2	4.2	3.8	2.8
EMBIG Mexico (basis points; period average)	254	302	187	186	188	189	180
Sovereign 10-year local currency bond yield (period average)	8.3	8.0	7.0	6.8	5.7	5.6	6.0
Stock exchange index (period average, year on year percent change)	-9.6	-5.8	31.5	9.2	10.2	5.1	11.9
Financial system							
Bank of Mexico net international reserves (US$ billion)	85.4	90.8	113.6	142.5	163.5	176.5	191.2
Nominal bank credit to the non-financial private sector (year on year percent change) 3/ 4/	5.5	-0.2	10.3	17.1	11.0	12.0	10.7
Nonperforming loans to total gross loans 3/	2.7	3.1	2.3	2.4	2.5	3.3	3.2
External vulnerability indicators							
Gross financing needs (billions of US$)	86.8	70.8	77.4	113.0	109.4	136.1	170.5
Gross international reserves (end-year, billions of US$) 5/	95.3	99.9	120.6	149.2	167.1	180.2	194.9
Change (billions of US$)	8.1	4.6	20.7	28.6	17.8	13.2	14.7
Months of imports of goods and services	3.7	5.1	4.8	5.1	5.4	5.7	5.9
Months of imports plus interest payments	3.9	5.4	5.0	5.4	5.7	6.0	6.3
Percent of broad money	18.4	17.2	17.5	21.2	19.3	19.2	19.1
Percent of foreign portfolio liabilities	34.9	41.6	39.6	48.2	39.0	38.0	38.6
Percent of short-term debt (by residual maturity)	181.5	207.8	222.1	156.7	174.0	145.8	133.7
Percent of ARA Metric 6/	105.4	117.1	109.4	129.0	118.1	115.9	117.2
Percent of GDP	8.7	11.2	11.5	12.7	14.1	14.3	14.9
Gross total external debt (in percent of GDP)	18.6	21.7	24.7	25.5	31.1	33.3	34.9
Of which: In local currency	1.8	2.7	5.8	7.3	12.0	12.9	13.7
Gross total external debt (billions of US$)	205.0	194.5	260.1	298.9	369.2	420.5	457.5
Of which: In local currency	19.6	24.0	60.5	85.7	142.1	162.9	179.6
External debt service (in percent of exports and net transfers)	19.4	22.1	17.6	24.4	25.9	32.6	36.8

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/ All data for 2014 are projections, unless otherwise specified.

2/ As of September 2014.

3/ As of June 2014.

4/ Includes commercial banks and direct credit from development banks.

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/ The ARA metric was developed by the Strategy and Policy Review Department at the IMF to assess reserve adequacy.

Table 8. Baseline Medium-Term Projections

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
					Staff projections					
					(Annual percentage change, unless otherwise indicated)					
National accounts (in real terms)										
GDP	5.1	4.0	4.0	1.1	2.4	3.5	3.8	3.8	3.8	3.8
Consumption	5.1	4.5	4.6	2.3	1.5	3.3	4.1	3.6	3.4	3.2
Private	5.7	4.8	4.9	2.5	1.6	2.8	4.4	3.8	3.4	3.1
Public	1.7	2.4	3.4	1.2	0.7	2.0	2.4	2.7	3.5	4.4
Investment	4.5	5.4	5.5	-2.4	1.8	5.0	9.3	5.8	5.0	6.8
Fixed	1.3	7.8	4.5	-1.8	0.4	5.2	9.6	6.0	5.1	7.0
Private	1.9	12.1	8.8	-1.3	3.4	5.4	10.5	6.1	5.2	7.5
Public	-0.5	-4.1	-9.5	-3.6	-2.6	4.2	6.3	4.8	4.9	4.6
Inventories 2/	0.7	-0.5	0.2	-0.2	0.3	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	20.5	8.2	5.9	1.2	6.8	4.4	5.4	7.6	7.6	6.9
Imports of goods and services	20.5	8.0	5.5	1.5	5.6	5.1	10.1	8.5	7.5	7.5
Consumer prices										
End of period	4.4	3.8	3.6	4.0	4.0	3.2	3.0	3.0	3.0	3.0
Average	4.2	3.4	4.1	3.8	3.9	3.5	3.1	3.0	3.0	3.0
External sector										
Current account balance (in percent of GDP)	-0.4	-1.1	-1.3	-2.1	-2.1	-2.0	-2.3	-2.2	-2.2	-2.1
Non-hydrocarbon current account balance (in percent of GDP) 1/	-1.5	-2.3	-2.3	-2.8	-2.3	-2.1	-2.5	-2.5	-2.8	-2.8
Exports	29.9	17.1	6.1	2.5	3.9	6.9	9.4	10.4	9.3	9.8
Imports	28.6	16.4	5.7	2.8	3.6	6.8	10.2	9.7	9.4	9.2
Terms of trade (improvement +)	7.6	6.8	-3.6	-0.1	-0.3	1.3	4.1	2.2	0.4	1.7
Crude oil export price, Mexican mix (US$/bbl)	72.5	101.1	101.8	98.5	97.2	94.0	92.1	90.3	89.1	88.2
					(In percent of GDP)					
Non-financial public sector										
Overall balance	-4.3	-3.3	-3.7	-3.8	-4.2	-4.0	-3.5	-3.0	-2.5	-2.5
Primary balance	-1.7	-1.0	-1.1	-1.3	-1.5	-1.4	-0.7	0.0	0.8	0.9
Saving and investment 3/										
Gross domestic investment	22.1	22.3	23.1	21.5	21.6	22.0	23.3	23.7	23.9	24.6
Fixed investment	21.1	21.7	22.4	21.0	20.9	21.3	22.6	23.1	23.4	24.1
Public	5.6	5.2	4.6	4.3	4.0	4.0	4.1	4.2	4.2	4.3
Private	15.5	16.5	17.8	16.7	16.9	17.3	18.5	18.9	19.2	19.8
Gross domestic saving	21.7	21.2	21.8	19.5	19.5	19.9	20.9	21.4	21.7	22.4
Public	0.9	1.4	0.4	0.2	0.0	0.4	0.6	0.8	0.7	0.5
Private	20.7	19.8	21.4	19.3	19.6	19.6	20.3	20.6	21.0	21.9
Memorandum items										
Output gap	-2.1	-0.6	0.8	-0.7	-1.1	-0.4	0.0	0.0	0.0	0.0

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.

2/ Contribution to growth. Excludes statistical discrepancy.

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

Table 9. External Debt Sustainability Framework

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2009	2010	2011	2012	2013			2014	2015	2016	2017	2018	2019	**Debt-stabilizing non-interest current account 6/**
1 **Baseline: External debt**	21.7	24.7	25.5	31.1	33.3			**34.9**	**35.6**	**36.2**	**36.4**	**36.8**	**36.9**	**-2.0**
2 Change in external debt	3.1	3.0	0.8	5.6	2.2			1.6	0.7	0.6	0.2	0.3	0.1	
3 Identified external debt-creating flows (4+8+9)	3.6	-3.5	-1.7	0.1	-1.4			0.2	-0.5	-0.9	-0.9	-1.0	-1.4	
4 Current account deficit, excluding interest payments	-0.5	-1.0	-0.4	-0.4	0.2			0.1	-0.1	0.1	0.0	-0.2	-0.2	
5 Deficit in balance of goods and services	1.7	1.3	1.4	1.2	1.0			0.9	0.9	1.1	0.9	0.9	0.7	
6 Exports	27.4	29.9	31.2	32.7	31.8			31.8	32.0	33.3	34.6	35.6	36.8	
7 Imports	29.0	31.2	32.6	33.9	32.8			32.7	32.9	34.3	35.4	36.5	37.5	
8 Net non-debt creating capital inflows (negative)	-1.3	-0.8	-0.4	-0.4	-2.0			-1.1	-1.4	-2.0	-2.0	-1.9	-2.2	
9 Automatic debt dynamics 1/	5.5	-1.7	-0.9	1.0	0.4			1.3	1.0	1.0	1.0	1.1	1.1	
10 Contribution from nominal interest rate	1.4	1.3	1.5	1.7	1.8			2.0	2.1	2.3	2.3	2.4	2.4	
11 Contribution from real GDP growth	1.1	-0.9	-0.9	-1.0	-0.3			-0.8	-1.2	-1.3	-1.3	-1.3	-1.3	
12 Contribution from price and exchange rate changes 2/	3.0	-2.1	-1.5	0.3	-1.2			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	-0.5	6.5	2.5	5.5	3.6			1.4	1.2	1.4	1.2	1.3	1.5	
External debt-to-exports ratio (in percent)	79.5	82.8	81.8	95.2	104.9			109.9	111.2	108.9	105.5	103.4	100.1	
Gross external financing needs (in billions of US dollars) 4/	65.4	54.7	84.1	88.4	123.1			155.8	147.7	163.1	167.7	173.5	188.9	
in percent of GDP	7.3	5.2	7.2	7.5	9.8	10-Year	10-Year	11.9	10.6	11.2	10.8	10.6	10.9	
Scenario with key variables at their historical averages 5/								**34.9**	**35.4**	**35.8**	**36.1**	**36.6**	**37.3**	**-1.3**
						Historical	Standard							
Key Macroeconomic Assumptions Underlying Baseline						Average	Deviation							
Real GDP growth (in percent)	-4.7	5.1	4.0	4.0	1.1	2.6	2.9	2.4	3.5	3.8	3.8	3.8	3.8	
GDP deflator in US dollars (change in percent)	-15.3	11.6	7.1	-2.7	5.2	3.4	7.4	1.4	2.4	1.4	2.1	2.0	2.0	
Nominal external interest rate (in percent)	6.3	7.3	6.8	6.8	6.3	7.5	1.2	6.4	6.5	6.8	6.8	7.0	6.9	
Growth of exports (US dollar terms, in percent)	-20.9	28.3	16.4	6.0	3.4	9.2	12.7	4.0	6.9	9.2	10.2	9.1	9.6	
Growth of imports (US dollar terms, in percent)	-22.5	26.0	16.5	5.4	3.0	8.9	12.8	3.5	6.7	9.8	9.4	9.1	8.9	
Current account balance, excluding interest payments	0.5	1.0	0.4	0.4	-0.2	0.4	0.4	-0.1	0.1	-0.1	0.0	0.2	0.2	
Net non-debt creating capital inflows	1.3	0.8	0.4	0.4	2.0	1.6	0.8	1.1	1.4	2.0	2.0	1.9	2.2	

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

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

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

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

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

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

Appendix. Letter from the Authorities Requesting FCL

Mexico City, November 7, 2014

Ms. Christine Lagarde
Managing Director
International Monetary Fund 700 19th Street NW
Washington, DC 20431

Dear Ms. Lagarde,

For many years, the United Mexican States (Mexico) has been implementing very strong economic policies that have promoted macroeconomic stability and anchored confidence in the country's economic outlook. As a signal of that confidence, Moody's upgraded Mexico's foreign currency sovereign debt to A3 earlier this year, the government placed a 100-year bond in the United Kingdom in mid-2014 and spreads on government securities and the volatility of the Mexican peso remain relatively low. As highlighted in the 2014 Article IV Consultation, the adoption of transformative structural reforms in many areas is expected to boost potential output growth.

At the same time, Mexico remains prone to tail risks arising from global economic developments given its open capital account and active participation of non-resident investors in its financial markets. These tail risks could come from several sources-the possibility of a disorderly process of normalization of monetary policy in the United States, heightened regional geopolitical tensions, or spillovers from slower growth in other developed and emerging market economies. If they materialize, they could lead to surges in global risk aversion and possibly lead to potentially destabilizing financial conditions that could adversely affect Mexico. These risks are highlighted in the International Monetary Fund (IMF) latest World Economic Outlook and Global Financial Stability Report. Moreover, these risks could surge precisely at a moment when the process of implementation of the critical, growth-enhancing structural reforms is still at an early stage.

For this reason, we hereby request a successor 24-month Flexible Credit Line (FCL) arrangement for Mexico at the same level of access of 1,304 percent of quota (SDR 47,292 million) as in the current arrangement. We believe that the renewal of the FCL arrangement, which we again intend to treat as precautionary, will continue to play a strong role in insuring against tail risk events and supporting confidence. We would like to emphasize that we do not intend to make permanent use of the FCL. Conditional on a reduction of global risks, including those related to the normalization of U.S. monetary policy, we intend to request reduced access in any subsequent FCL arrangements.

Our economic policies will continue to preserve economic and financial stability, while strengthening policy buffers. Most importantly, we are laying the foundations for strong and sustainable medium-term growth through the structural reforms. We are one of the few countries in the world that have been able to achieve such breadth and depth of reform in a non-crisis period. Among these reforms, the energy reform should be highlighted, which ends the 75-year old monopoly of the state in the hydrocarbons sector and opens the door for active private sector participation in all phases of this sector. Our country also made fundamental changes to create more competition in all of its markets through the reforms to the telecommunications sector, financial sector and antitrust framework.

Macroeconomic policies will continue to be anchored by a strong medium term fiscal framework. The Fiscal Responsibility Law was amended to strengthen the commitment to keep public debt on a sustainable path and control the procyclicality of spending through the introduction of a cap on the real growth in structural current spending. We also created a new sovereign Oil Stabilization and Savings Fund to provide greater stability in oil revenues for budget purposes, and to ensure that a large share of any future oil income windfall would be saved. We are committed to reducing the overall fiscal deficit gradually over the next four years, so as to place public debt on a downward path in relation to GDP over the medium term.

Our monetary policy remains underpinned by the inflation-targeting regime, which has effectively anchored medium-term inflation expectations. Despite a temporary rise due to one-off effects from tax changes in early 2014, inflationary pressures have remained contained, and we expect headline inflation to converge to the target of 3 percent during 2015. The central bank remains fully committed to adjusting the policy interest rate as necessary to keep inflation in line with the target over the medium term.

Another critical component of our policy framework is the flexible exchange rate regime, which proved to be a key shock absorber during periods of global financial turmoil. We have continued to build our international reserves by accumulating net foreign exchange receipts from oil production and the Federal Government. This policy would allow the central bank to maintain reserve coverage ratios at adequate levels for normal precautionary purposes.

The financial sector remains sound, underpinned by a strong regulatory framework. Banks are profitable, well capitalized, liquid and resilient to credit and market risks, as proven by the stress tests presented in the latest report of Mexico's Financial System Stability Council. Insurance companies are well capitalized, while pension funds maintain conservative investment profiles. We have continued to take steps to improve our financial regulation and supervision, which would allow for the adoption of the Basel Ill framework. In fact Mexico adopted the Basel Ill capital requirements in early 2013 and the liquidity coverage ratio will be mandatory starting in early 2015. Insurance companies are immersing in a transitory regime to gradually adopt the Solvency II, and fully comply during 2016. The National Banking and Securities Commission (CNBV) has put in place stronger provisioning rules on bank loans and has strengthened the framework for bank resolution and consolidated supervision. Furthermore, in light of the presence of foreign banks in our financial system, we continue to monitor developments closely, including through home-host supervisory colleges, and active involvement in international regulatory forums for banks and derivatives.

In sum, as Executive Directors acknowledged in the latest Article IV consultation discussion, Mexico's policy framework remains very strong, and economic policies have responded in a timely and appropriate fashion in managing the impact of the global crisis and subsequently to support economic activity and rebuilding buffers. As external risks remain elevated, we are maintaining the same basic strategy as the one we have adopted under the current FCL arrangement. We will continue to react as needed within this framework to any future shocks that may arise. We would like to add that we regard the IMF's support through the Flexible Credit Line as an integral part of our strategy and we greatly appreciate this support.

Sincerely yours,

/s/	/s/
Luis Videgaray Caso	Agustín Guillermo Carstens Carstens
Secretary of Finance and Public Credit	Governor of Banco de México

INTERNATIONAL MONETARY FUND

MEXICO

November 13, 2014

ASSESSMENT OF THE IMPACT OF THE PROPOSED FLEXIBLE CREDIT LINE ARRANGEMENT ON THE FUND'S FINANCES AND LIQUIDITY POSITION

Approved By
Andrew Tweedie and Vivek Arora

Prepared by the Finance and Strategy, Policy, and Review Departments

CONTENTS

INTRODUCTION

1. This note assesses the impact of the proposed Flexible Credit Line (FCL) arrangement for Mexico on the Fund's finances and liquidity position, in accordance with the policy on FCL arrangements.[1] The proposed arrangement would cover a 24-month period and access would be in an amount of SDR 47.292 billion (1,304 percent of quota). It would succeed the existing FCL arrangement of the same amount, which would be cancelled upon approval of the proposed arrangement. The full amount of access proposed would be available throughout the arrangement period, in one or multiple purchases.[2] The authorities intend to treat the arrangement as precautionary.

BACKGROUND

2. Since the onset of the global economic and financial crisis, Mexico has entered into successive FCL arrangements with the Fund under which no drawings have been made. A one-year FCL arrangement equivalent to SDR 31.5 billion (1000 percent of quota) was approved on April 17, 2009. This arrangement was succeeded by another FCL arrangement on identical terms approved on March 25, 2010. Subsequently, a two-year FCL arrangement in the amount of SDR 47.292 billion (1304 percent of quota) was approved on January 10, 2011 and cancelled before its expiration upon approval of a successor two-year FCL arrangement in the amount on November 30, 2012. Mexico's very strong policy framework and fundamentals helped it weather the sluggish global economic recovery and bouts of stress in global financial markets. More recently, it benefitted from the recovery in US manufacturing to which Mexico's economy is closely connected. Against this backdrop, no drawings have been made under all FCL arrangements. As discussed in Annex I, Mexico has a history of strong performance under earlier Fund arrangements and an exemplary record of meeting its obligations to the Fund.

3. Total external and public debt levels are moderate and are expected to remain stable over the medium run under the baseline. External debt has increased in recent years, but is projected at a moderate level of almost 35 percent of GDP at end-2014, of which 24½ percent of GDP is accounted for by public external debt. Gross public debt is estimated at

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[1] See *GRA Lending Toolkit and Conditionality—Reform Proposals* (3/13/09) and *Flexible Credit Line (FCL) Arrangements,* Decision No.14283-(09/29), adopted March 24, 2009 as amended by Decision No. 14714-(10/83), adopted August 30, 2010; the *Fund's Mandate—The Future Financing Role: Reform Proposals* (http://www.imf.org/external/np/pp/eng/2010/062910.pdf, 6/29/2010) and *the IMF's Mandate—The Future Financing Role: Revised Reform Proposals and Revised Proposed Decisions* (http://www.imf.org/external/np/pp/eng/2010/082510.pdf, 8/25/2010); *Review of the Flexible Credit Line, the Precautionary and Liquidity Line, and the Rapid Financing Instrument—Specific Proposals* (http://www.imf.org/external/np/pp/eng/2014/043014.pdf, 5/1/2014 and Decision No. 15593-(14/46)).

[2] If the full amount is not drawn in the first year of the arrangement, subsequent purchases can only be made following completion of a review of Mexico's continued qualification for the FCL arrangement.

just over 47¾ percent of GDP at end-2014 and is projected to be contained within 50 percent of GDP over the medium-term. Debt sustainability analyses suggest that both external and public debt would remain manageable under a range of scenarios.

Table 1. Mexico: External Debt and Debt Service, 2010–14 1/

	2010	2011	2012	2013	2014 2/
			In billions of US dollars)		
Total external Debt	260.1	298.9	369.2	420.5	457.5
Public	170.9	202.1	267.8	297.4	320.0
Private	89.2	96.7	101.3	123.1	137.5
Total external debt service	59.1	94.7	106.0	137.9	161.6
Public	25.1	23.3	23.8	32.5	37.7
Private	34.0	71.4	82.2	105.3	123.8
			(In percent of GDP)		
Total external Debt	24.7	25.5	31.1	33.3	34.9
Public	16.3	17.3	22.6	23.6	24.4
Private	8.5	8.3	8.5	9.8	10.5
Total external debt service	5.6	8.1	8.9	10.9	12.3
Public	2.4	2.0	2.0	2.6	2.9
Private	3.2	6.1	6.9	8.3	9.5
Memorandum item					
Public external debt service in percent of exports	8.0	6.4	6.2	8.1	9.1

Source: Mexican authorities and IMF staff estimates.
1/ End of period, unless otherwise indicated.
2/ Assumed potential disbursement under the proposed FCL arrangement and related interest are not included.

THE NEW FLEXIBLE CREDIT LINE ARRANGEMENT—FUND RISK EXPOSURE AND THE IMPACT ON THE FUND'S LIQUIDITY POSITION

A. Risk to the Fund

4. The proposed FCL arrangement—with proposed access unchanged from the existing FCL—would continue to be the largest Fund commitment to date. If the full amount available under the FCL arrangement were drawn, Mexico's outstanding use of GRA resources would reach SDR 47.3 billion. This would be more than twice the Fund's largest credit exposure to date.

5. Mexico's debt and debt service ratios are generally in the low to moderate range relative to recent exceptional access precautionary arrangement cases.

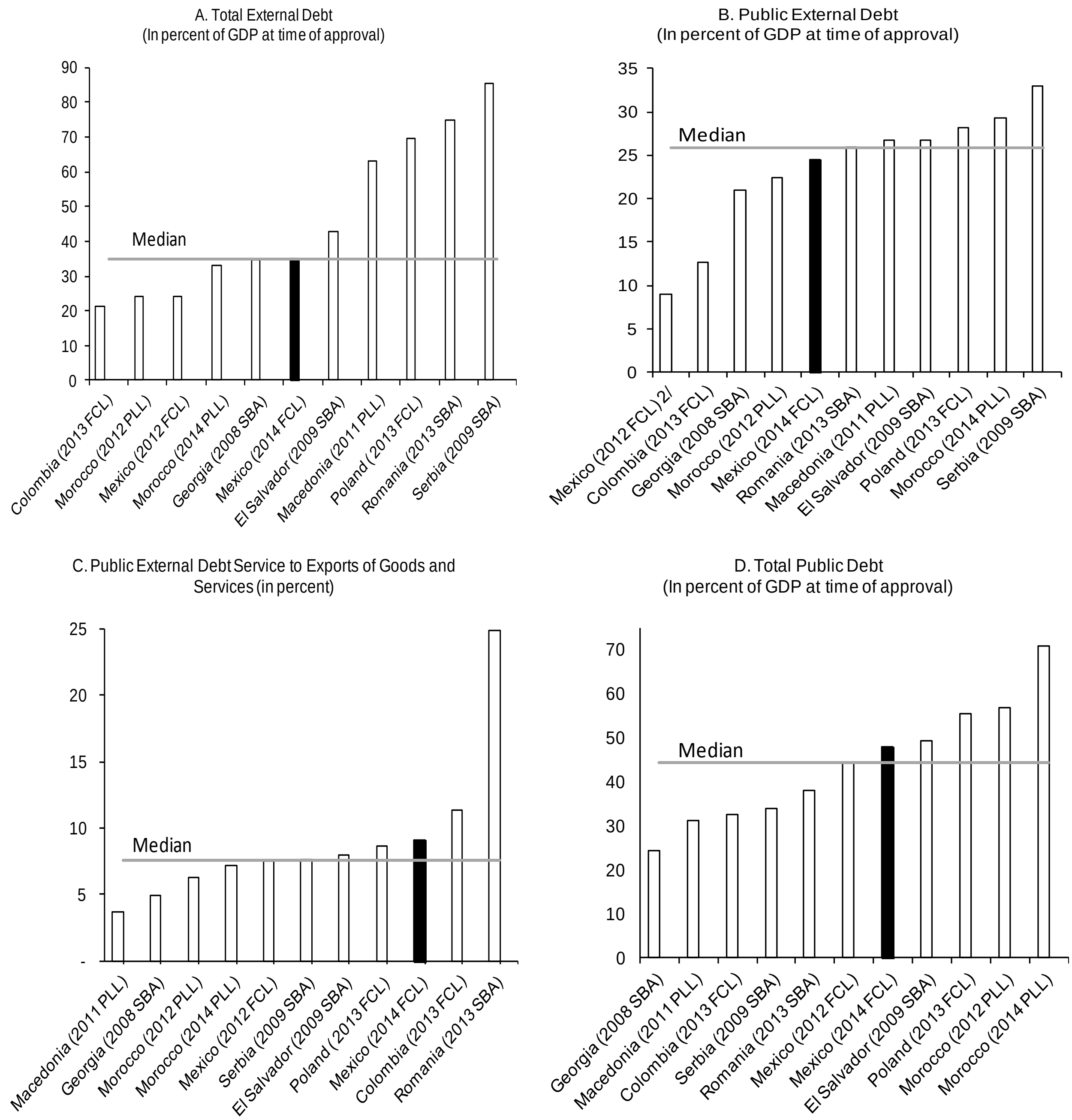
- At almost 35 percent of GDP, total external debt is at the median of recent exceptional access precautionary arrangement cases (Table 1 and panel A of Figure 1).

- Total public debt is sustainable though it is slightly above the median of recent precautionary access cases (Figure 1, panel D). The authorities' envisaged fiscal consolidation over the medium term is expected to help stabilize total public debt at just under 50 percent of GDP and put it on a downward path thereafter (see Staff Report).

- Public external debt is below the median of recent exceptional access precautionary arrangement cases (Figure 1, panel B). While it does not stand out as a particular risk factor, it is associated with relatively large debt service obligations. Public external debt service represents almost 3 percent of GDP and 9 percent of exports of goods and services. In terms of exports of goods and services, it is slightly above the median of recent exceptional access precautionary arrangement cases (Figure 1, panel C).

6. The FCL arrangement complements Mexico's very strong fundamentals by providing insurance against tail risks stemming from heightened stress in global financial markets. Mexico's experience with capital flows points to higher vulnerability to capital account shocks relative to other recent exceptional access precautionary arrangement cases. Over the past five years, Mexico has, on average, attracted larger capital flows than other recent exceptional access precautionary arrangement cases in the corresponding years preceding the approval of the arrangements. For Mexico, steady reserve accumulation has helped reduce the ratio of short-term debt-to-reserves compared to its level at the time of the Fund's approval of the 2012 FCL arrangement and Mexico is at a more comfortable position compared to recent exceptional access precautionary arrangement cases (Figure 2, panel A). However, the ratio of portfolio and other flows to reserves is at the high end of the distribution, signaling greater vulnerability to flow reversals (Figure 2, panel B). Large FDI flows mitigate external vulnerabilities as they cover a higher percentage of the current account deficit relative to recent exceptional access precautionary arrangement cases. On balance, as discussed in the 2014 Article IV consultation report, Mexico's overall external position is consistent with medium-term fundamentals and desirable policies.

Figure 1. Debt Ratios for Recent Exceptional Access Precautionary Arrangements 1/

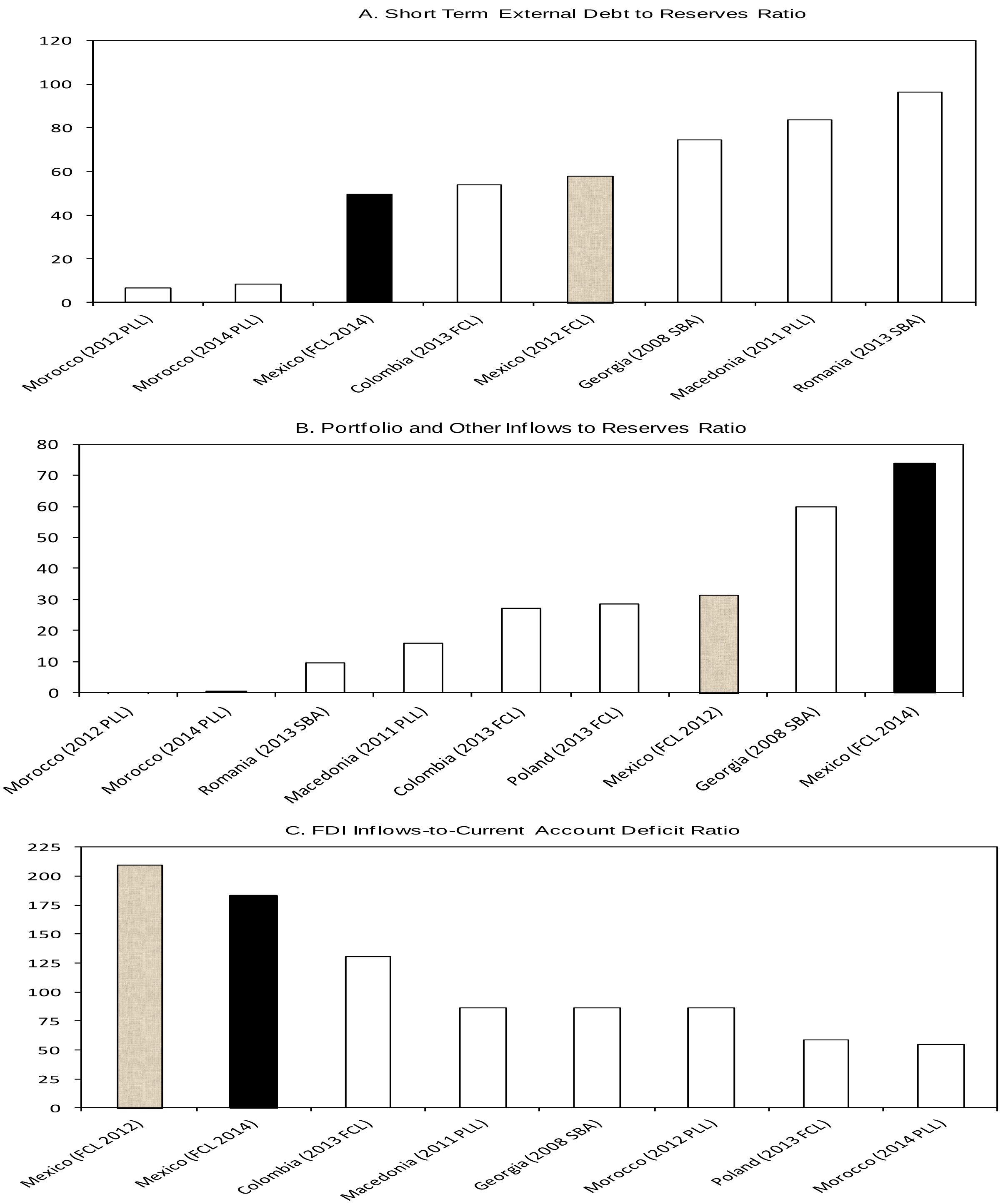


Source: IMF staff calculations.

1/ Estimates as reported in each staff report on the request of the arrangement.

2/ Public external debt for Mexico (2012 FCL) includes only foreign currency debt while Mexico (2014 FCL) includes also domestic currency debt held by foreigners. Using the broader concept, the number for Mexico (2012 FCL) would have been about 22 percent of GDP.

Figure 2. Selected Balance of Payment Ratios 1/
(In percent)



Source: Staff calculations, IFS, WEO, and the Joint External Data Hub (JEDH).

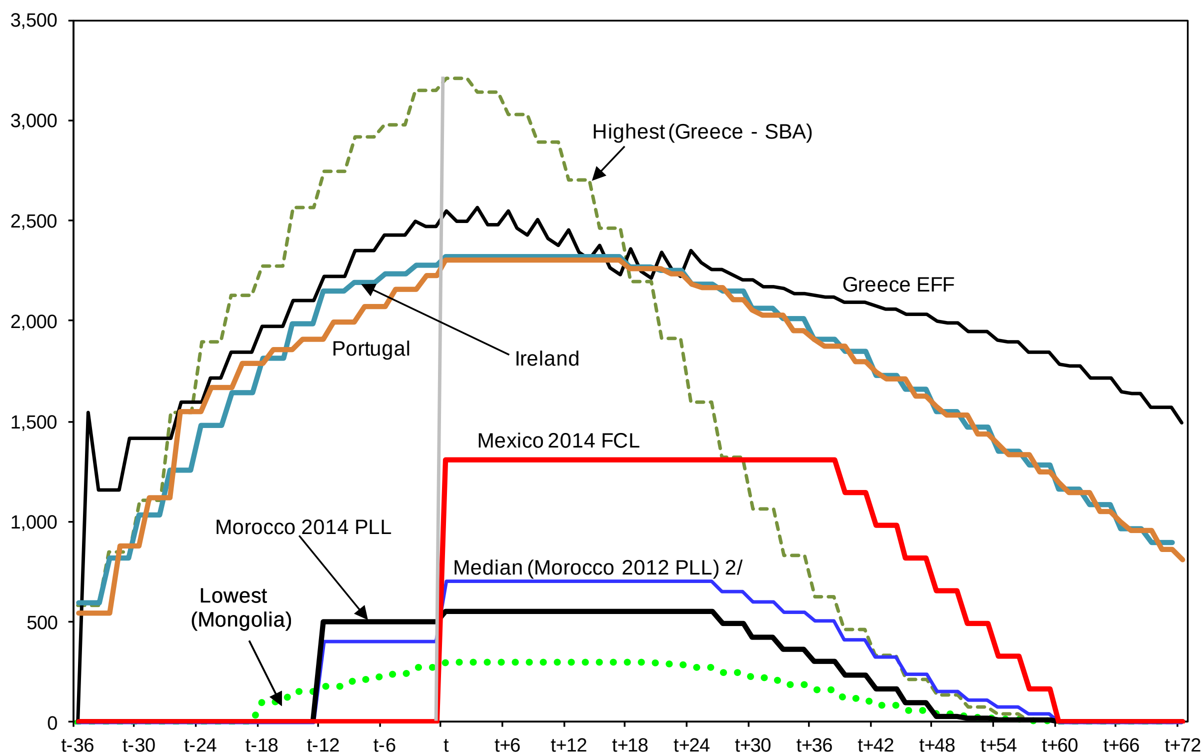
1/ Five year averages ending the first full year immediately preceding the year of the relevant program approval.

7. If the full amount available under the proposed FCL arrangement were disbursed, Fund exposure to Mexico would be large.

- The level of access relative to quota would be considerable. It would significantly exceed the median of the peak levels of exceptional access cases while remaining below the levels of several recent exceptional access cases such as Greece, Ireland, and Portugal (Figure 3).

- Mexico's external debt would remain moderate, with Fund credit representing a non-trivial share of this debt. Total external debt would rise to 40½ percent of GDP initially, and public external debt would rise to 30 percent of GDP, with Fund credit representing 5½ percent of GDP (Table 2). Mexico's outstanding use of GRA resources would account for almost 13¾ percent of total external debt, 18½ percent of public external debt, and just over 27 percent of gross international reserves.

Figure 3. Projected Fund Credit Outstanding in the GRA around Peak Borrowing 1/
(In percent of quota)



Source: IFS, Finance Department, and IMF staff estimates.

1/ Peak borrowing 't' is defined as the highest level of credit outstanding for a member. Repurchases are assumed to be on an obligations basis. For illustrative purposes, assumes Mexico makes full purchases of available commitment as was assumed for Morocco under the 2012 and 2014 PLL arrangements.
2/ Median credit outstanding at peak is 751 percent of quota; average is 1,036 percent of quota.

- External debt service would increase over the medium-term, but remain manageable under staff's medium-term macroeconomic projections (Table 2). Mexico's projected debt service to the Fund would peak in 2018 at about SDR 24.9 billion, or nearly 2¼ percent of GDP.[3] In terms of exports of goods and services, external debt service to the Fund would peak at about 6½ percent, accounting for almost 57 percent of total projected public external debt service while public external debt service would peak at just over 11½ percent of exports of goods and services.

Table 2. Mexico—Capacity to Repay Indicators, 2013–19 1/

	2013	2014	2015	2016	2017	2018	2019
Exposure and Repayments (In SDR millions)							
GRA credit to Mexico	--	47,292.0	47,292.0	47,292.0	47,292.0	23,646.0	--
(In percent of quota)	--	(1,304.4)	(1,304.4)	(1,304.4)	(1,304.4)	(652.2)	--
Charges due on GRA credit 2/	--	236.5	1,130.0	1,220.8	1,219.7	1,251.2	367.0
Debt service due on GRA credit 2/	--	236.5	1,130.0	1,220.8	1,219.7	24,897.2	24,013.0
Debt and Debt Service Ratios 3/							
In percent of GDP							
Total external debt	33.3	40.5	40.9	41.2	41.2	39.0	36.9
Public external debt	23.6	30.0	30.0	30.1	30.0	27.7	25.3
GRA credit to Mexico	--	5.5	5.2	5.0	4.7	2.2	--
Total external debt service	10.9	12.4	12.7	12.7	12.3	14.3	14.4
Public external debt service	2.6	2.9	2.2	2.0	2.1	4.1	4.2
Debt service due on GRA credit	--	0.0	0.1	0.1	0.1	2.4	2.2
In percent of Gross International Reserves							
Total external debt	233.3	198.3	202.0	204.1	205.8	221.1	237.1
Public external debt	165.0	146.8	148.3	149.2	150.1	156.9	162.9
GRA credit to Mexico	--	27.1	25.9	24.7	23.6	12.7	--
In percent of Exports of Goods and Services							
Total external debt service	34.5	38.9	39.5	38.2	35.6	40.3	39.1
Public external debt service	8.1	9.1	6.8	5.9	6.0	11.6	11.4
Debt service due on GRA credit	--	0.1	0.4	0.4	0.4	6.6	5.8
In percent of Total External Debt							
GRA credit to Mexico	--	13.7	12.8	12.1	11.5	5.7	--
In percent of Public External Debt							
GRA credit to Mexico	--	18.4	17.4	16.6	15.8	8.1	--

Sources: Mexican authorities, Finance Department, World Economic Outlook, and IMF staff estimates.
1/ Assumes full drawings under the FCL arrangement upon approval. The Mexican authorities have expressed their intention to treat the arrangement as precautionary.
2/ Based on the rate of charge as of November 3, 2014. Includes surcharges under the system currently in force and service charges.
3/ Staff projections for external debt ratios (to GDP, gross international reserves, and exports of goods and services) adjusted for the impact of the assumed drawing under the FCL arrangement.

[3] The figures on debt service used in this report are calculated assuming that the full amount available under the arrangement is purchased upon approval of the arrangement, and that all repurchases are made as scheduled.

B. Impact on Fund Finances

8. The immediate net liquidity impact of the proposed arrangement would be to lower the Fund's current forward commitment capacity (FCC) by SDR 35.47 billion (13 percent). As the existing FCL arrangement was approved after the 2011 first activation of the expanded and amended New Arrangements to Borrow (NAB), the ratio of 3:1 of NAB-to-quota resources would apply for financing of purchases under the arrangement based on prevailing guidelines. The cancellation of the arrangement would free up the quota resources and raise the FCC by SDR 11.8 billion whereas approval of the successor arrangement would reduce the Fund's FCC by the proposed access (SDR 47.29 billion).[4] Overall, the net reduction in the FCC would amount to SDR 35.47 billion, equivalent to 13 percent of the current FCC (Table 3).[5]

9. If the resources available under the FCL arrangement were fully drawn, credit concentration would increase and potential GRA credit exposure to Mexico would be large.

- Fund credit to Mexico would represent about 37 percent of total GRA credit, the single largest Fund exposure, and the concentration of Fund credit among the top five users of GRA resources would increase to about 91½ percent, from 89 percent as of end-October 2014.
- Relative to the Fund's current level of precautionary balances, potential GRA exposure to Mexico would be very large. Fund credit to Mexico would be nearly 3¾ times the Fund's current precautionary balances.
- Were Mexico to accrue arrears on charges after drawing under the proposed arrangement, the Fund's burden sharing mechanism would be insufficient. In a low interest rate environment, such as the current one, potential charges for Mexico would significantly exceed the Fund's limited capacity to absorb charges in arrears through the burden sharing mechanism.

[4] The freed up bilateral resources cannot be used to finance new commitments unless NAB participants and the Executive Board were to approve an increase in the maximum resources available during the current activation period. Such an increase is not being proposed at this time.

[5] If Mexico were to draw upon the proposed arrangement, there would be an additional impact on the FCC as Mexico would no longer participate in the Financial Transactions Plan and the NAB Resource Mobilization Plan.

Table 3. Mexico—Impact on GRA Finances
(millions of SDR unless otherwise noted)

	as of 10/31/2014
Liquidity measures	
Forward Commitment Capacity (FCC) before approval 1/	273,659
FCC on approval 2/	238,190
Change in percent	-13.0
Prudential measures	
Fund GRA commitment to Mexico including credit outstanding	
in percent of current precautionary balances	369.5
in percent of total GRA credit outstanding 3/	60.0
Fund GRA credit outstanding to top five borrowers	
in percent of total GRA credit outstanding 3/	88.8
in percent of total GRA credit outstanding including Mexico's assumed full drawing	91.4
Mexico's projected annual GRA charges for 2015 in percent of the Fund's residual burden sharing capacity	41,403
Memorandum items	
Fund's precautionary balances (FY14)	12,800
Fund's Residual Burden Sharing Capacity 4/	2.7

Sources: Finance Department and IMF staff estimates.

1/ The FCC is defined as the Fund's stock of usable resources less undrawn balances under existing arrangements, plus projected repurchases during the coming 12 months, less repayments of borrowing due one year forward, less a prudential balance. The FCC does not include about SDR 287 billion (equivalent to US$422.7 billion at November 3, 2014 exchange rates) in bilateral pledges from members to boost IMF resources. These resources will only be counted towards the FCC once: (i) individual bilateral agreements are effective and (ii) the associated resources are available for use by the IMF, in accordance with the borrowing guidelines and the terms of these agreements.
2/ Current FCC minus new access plus access under the expiring program adjusted for the NAB financed portion of the expiring commitment (about SDR 35.47 billion), which was considered as already committed at the time of the most recent NAB activation and is therefore not available to finance new commitments under the current activation period.
3/ As of October 31, 2014.
4/ Burden-sharing capacity is calculated based on the floor for remuneration at 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges and takes into account the loss in capacity due to nonpayment of burden sharing adjustments by members in arrears.

ASSESSMENT

10. The proposed FCL arrangement would have a significant but manageable impact on the Fund's liquidity position. The current liquidity position appears sufficiently strong to accommodate the proposed arrangement, especially since the cancellation of Mexico's existing FCL arrangement would partially offset the liquidity effect from the proposed new FCL arrangement. However, the persistent uncertainty in the global economy that could result in an increased demand for Fund resources calls for continued close monitoring of the Fund's liquidity.

11. If drawn, Mexico's FCL would become the Fund's largest credit exposure, but risks to the Fund are mitigated by several factors. As before, Mexico intends to treat the FCL arrangement as precautionary. The risks to the Fund from a potential credit exposure to Mexico would be mitigated by, among other factors, Mexico's adequate buffers and the credibility of its policy framework. Mexico has a sustained track record of implementing very strong policies, including during the global financial crisis, and the authorities are committed to maintaining implementation of such policies in the future. Also, Mexico's overall external debt and debt service ratios are expected to remain moderate even assuming full drawing under the proposed arrangement. Against this backdrop, Mexico's capacity to repay is projected to remain strong.

Annex I. Mexico: History of IMF Arrangements

This annex provides a brief overview of Mexico's Fund arrangements from 1983 to present.

Prior to the FCL arrangements approved in April 2009, March 2010, January 2011, and in November 2012, Mexico had several Fund arrangements in the 1980s and 1990s. It fully repaid its remaining outstanding credit in 2000 (Table I.1). Mexico has an exemplary track record of meeting its obligations to the Fund.

From 1983 to 2000, Mexico had two arrangements under the Extended Fund Facility (EFF) and three Stand-By Arrangements (SBAs). Below is a brief description of the two most recent SBAs:

- In February 1995, the Fund approved an SBA equivalent to SDR 12.1 billion (688 percent of quota) to support Mexico's adjustment program to deal with a major financial and economic crisis. Under that arrangement, Mexico made purchases totaling SDR 8.8 billion, and its outstanding credit peaked at SDR 10.6 billion (607 percent of quota) at end-1995 (Figure I.1). After regaining access to international capital markets in the second half of 1996, Mexico made sizable advance repurchases.

- In July 1999, an SBA equivalent to SDR 3.1 billion (120 percent of quota) was approved as the recovery in economic performance was disrupted by unsettled conditions in international capital markets. Solid performance under the program supported by this SBA allowed Mexico to fully repay all its outstanding obligations to the Fund through a series of advance repurchases before the SBA expired in November 2000.

Since the global financial crisis, Mexico has had several FCL arrangements under which no drawings have been made. A one-year FCL arrangement equivalent to SDR 31.5 billion (1000 percent of quota) was approved on April 17, 2009 to support Mexico's economic policies and bolster confidence during the crisis. A successor FCL arrangement on identical terms was approved on March 25, 2010. This arrangement was cancelled and a new two-year FCL was approved in January 2011 increasing access to SDR 47.3 billion (1304 percent of quota). On November 30, 2012, a two-year successor FCL arrangement was approved for the same access as the January 2011 FCL arrangement.

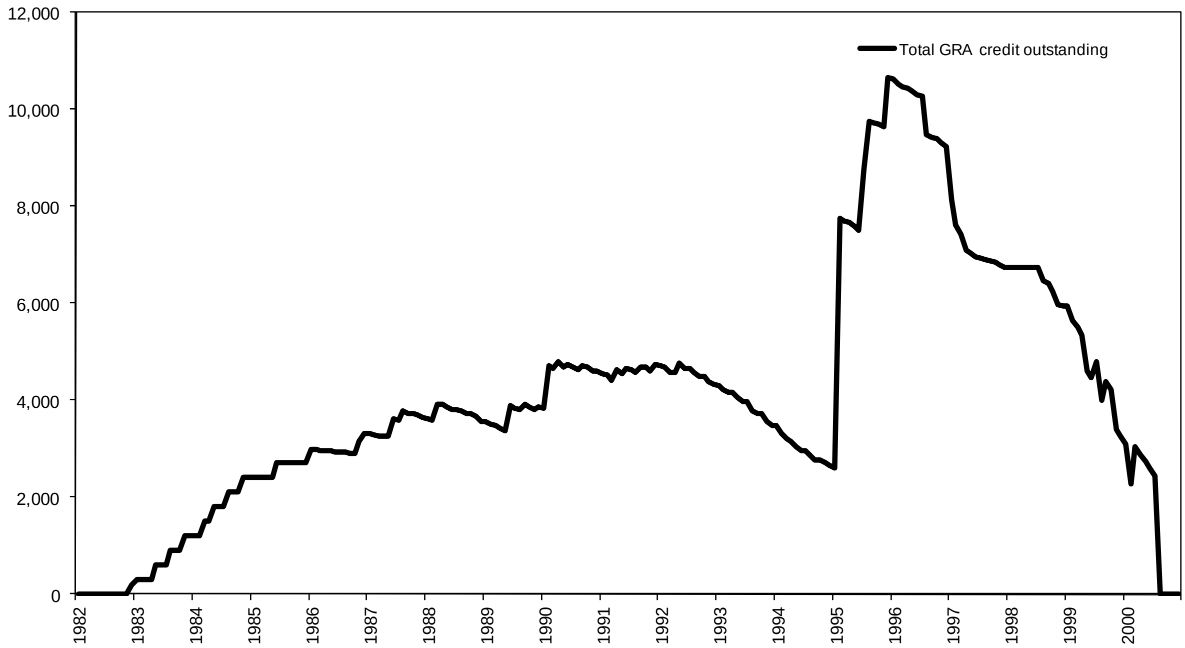
Annex Table I.1. Mexico: IMF Financial Arrangements, 1983-2014
(In millions of SDRs)

Year	Type of Arrangement	Date of Arrangement	Date of Expiration or Canellation	Amount of New Arrangement	Amount Drawn	Purchases	Repurchases	Fund Exposure 1/
1983	EFF	1-Jan-83	31-Dec-85	3,410.6	2,502.7	1,003.1	0.0	1,203.8
1984						1,203.8	0.0	2,407.5
1985						295.8	0.0	2,703.3
1986	SBA	19-Nov-86	1-Apr-88	1,400.0	1,400.0	741.4 2/	125.4	3,319.3
1987						600.0	280.0	3,639.3
1988						350.0	419.0	3,570.3
1989	EFF	26-May-89	25-May-93	3,729.6	3,263.4	943.0 3/	639.6	3,873.6
1990						1,608.4	877.1	4,604.9
1991						932.4	807.4	4,729.9
1992						233.1	636.1	4,327.0
1993						0.0	841.7	3,485.2
1994						0.0	841.0	2,644.2
1995	SBA	1-Feb-95	15-Feb-97	12,070.2	8,758.0	8,758.0	754.1	10,648.1
1996						0.0	1,413.6	9,234.5
1997						0.0	2,499.2	6,735.2
1998						0.0	783.7	5,951.5
1999	SBA	07-Jul-1999	30-Nov-2000	3,103.0	1,939.5	1,034.4	3,726.7	3,259.2
2000						905.1	4,164.3	0.0
…								
2009	FCL	17-Apr-2009	16-Apr-2010	31,528.0	0.0	0.0	0.0	0.0
2010	FCL	25-Mar-2010	09-Jan-2011	31,528.0	0.0	0.0	0.0	0.0
2011	FCL	10-Jan-2011	09-Jan-2013	47,292.0	0.0	0.0	0.0	0.0
2012	FCL	30-Nov-2012	29-Nov-2014	47,292.0	0.0	0.0	0.0	0.0

Source: Finance Department.

1/ As of end-December.
2/ Includes a first credit tranche purchase of SDR 291.4 million.
3/ Includes a purchase of SDR 453.5 million under the Compensatory Financing Facility.

Annex Figure I.1. Mexico: IMF Credit Outstanding, 1982-2000
(In millions of SDRs)



Source: Finance Department.

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International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves New Two-Year US$70 Billion Flexible Credit Line Arrangement with Mexico

The Executive Board of the International Monetary Fund (IMF) today approved a successor two-year arrangement for Mexico under the Flexible Credit Line (FCL) in an amount equivalent to SDR 47.292 billion (about US$70 billion). The Mexican authorities stated their intention to treat the arrangement as precautionary.

The FCL is particularly useful for crisis prevention purposes as it provides the flexibility to draw on the credit line at any time. Disbursements are not phased nor conditioned on compliance with policy targets as in traditional IMF-supported programs. This flexible access is justified by the very strong track records of countries that qualify for the FCL, which gives confidence that their economic policies will remain strong.

Mexico's first FCL arrangement was approved on April 17, 2009 (see Press Release No. 09/130), and was renewed on March 25, 2010 (see Press Release No. 10/114), January 10, 2011 (see Press Release No. 11/4), and November 30, 2012 (see Press Release No. 12/465).

Following the Executive Board's discussion on Mexico, Mr. David Lipton, First Deputy Managing Director and Acting Chair, issued the following statement:

"Mexico has in place very strong policy frameworks aimed at maintaining prudent macroeconomic policies. Monetary policy is guided by an inflation targeting regime in the context of a flexible exchange rate; fiscal policy is governed by a fiscal responsibility law; and financial oversight is based on a sound regulatory and supervisory framework. These frameworks and strong public and private sector balance sheets have underpinned Mexico's resilience to the global crisis.

"The authorities have made impressive strides in advancing structural reforms over the past year and a half, including in the energy, telecommunications, and financial sectors, as well as anti-trust regulation, labor markets, and the education sector. These reforms will boost productivity and output over the medium term.

"Mexico's economic growth is recovering, supported by a strengthening U.S. economy. Macroeconomic policies have aimed to support the recovery and gradually build policy buffers. Mexico's open and liquid financial markets have bolstered foreign portfolio and direct investments in recent years and can facilitate adjustment to external shocks.

"The country's close ties with the global economy are a testament to the economy's strength but heighten the economy's exposure to external risks. An abrupt surge in global financial market volatility could lead to a reversal of capital flows to emerging markets, including to Mexico. The authorities are committed to adopting appropriate measures to deal with any shock. The successor arrangement under the Flexible Credit Line (FCL), which the authorities intend to treat as precautionary, will continue to play an important role in supporting the authorities' macroeconomic strategy by providing insurance against global downside risks and bolstering market confidence.

"The authorities do not intend to make permanent use of the FCL. They will continue to assess global conditions and intend to reduce access in any subsequent FCL arrangement, conditional on a reduction of global risks affecting Mexico."