INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/129

MEXICO

May 2017

REVIEW UNDER THE FLEXIBLE CREDIT LINE—PRESS RELEASE; STAFF REPORT

In the context of the Review Under the Flexible Credit Line, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 22, 2017, following discussions that ended on April 7, 2017, 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 May 4, 2017.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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May 23, 2017

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IMF Executive Board Completes Review of Mexico's Performance under the Flexible Credit Line Arrangement

On May 22, 2017, the Executive Board of the International Monetary Fund (IMF) completed its review of Mexico's qualification for the arrangement under the Flexible Credit Line (FCL) and reaffirmed Mexico's continued qualification to access FCL resources. The Mexican authorities stated their intention to continue treating the arrangement as precautionary.

The two-year FCL arrangement for Mexico in an amount equivalent to SDR 62.389 billion (about US$86 billion[1]) was approved by the IMF's Executive Board on May 27, 2016 (see Press Release No. 16/250). 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), November 30, 2012 (see Press Release No. 12/465), and November 26, 2014 (see Press Release No. 14/543).

Following the Executive Board discussion on Mexico, Mr. David Lipton, First Deputy Managing Director and Acting Chairman of the Board, made the following statement:

"Mexico's economy has shown resilience to bouts of financial market volatility since the approval of the Flexible Credit Line arrangement. The country continues to face elevated external risks related to uncertainty about the future of bilateral relations with the United States, particularly on trade. Despite this uncertainty, moderate growth continues and foreign exchange and sovereign debt markets have continued to function well. While temporary factors have pushed inflation above target, medium-term inflation expectations remain well anchored.

This resilience reflects the country's very strong policies and policy frameworks, with the exchange rate playing a key role as a shock absorber. Looking ahead, the authorities have reaffirmed their commitment to implement their fiscal consolidation plan, which should put the public debt-to-GDP ratio on a downward trajectory; anchor inflation expectations; gradually rebuild foreign exchange reserves; and maintain strong oversight of the financial system. In addition, the implementation of a broad range of structural reforms is expected to raise medium-term growth.

[1] Amount based on the Special Drawing Right (SDR) quote of May 22, 2017 of I USD= SDR 0.722952

The Flexible Credit Line arrangement, for which Mexico continues to meet the qualification criteria, will play an important role in supporting the authorities' macroeconomic strategy by providing additional insurance against tail risks and bolstering market confidence. The authorities continue to treat the arrangement as precautionary, and have stated their intention to reduce access in any possible request of subsequent FCL arrangements, conditional on a reduction of the external risks affecting Mexico."

INTERNATIONAL MONETARY FUND

MEXICO

REVIEW UNDER THE FLEXIBLE CREDIT LINE ARRANGEMENT

May 4, 2017

EXECUTIVE SUMMARY

Context: Mexico's very strong policies and policy frameworks have helped it navigate successfully a complex external environment characterized by the heightened risk of protectionism and financial market volatility. The increased uncertainty is likely to weigh on investment and growth. Inflation is above the central bank's target, reflecting mainly the transitory effects of the liberalization of domestic fuel prices and the pass-through from the currency depreciation. Although the global environment and financial stability have improved somewhat recently, downside risks affecting Mexico remain elevated amid continued uncertainty about the outcome of the discussions with the United States on trade, as well as a possible renewed surge in capital flow volatility.

Policies: In recent years, macroeconomic policies have focused on strengthening fundamentals and safeguarding financial stability. The authorities have adhered to their fiscal consolidation plan designed to gradually reduce public debt in relation to GDP. The monetary tightening over the past year helped keep medium- and long-term inflation expectations well anchored. Continued steady implementation of the structural reform agenda, including further progress in strengthening the rule of law, and anti-corruption measures, would boost the economy's growth potential.

Flexible Credit Line (FCL): On May 27, 2016, the Executive Board approved a 24-month arrangement with Mexico under the FCL in the amount of SDR 62.3889 billion (700 percent of quota, about US$85 billion). The authorities intend to continue treating the arrangement as precautionary.

Qualification: Mexico continues to meet the qualification criteria for access to FCL resources specified under the Executive Board decision on FCL arrangements (Decision No. 14283-(09/29), adopted on March 24, 2009, as amended). Therefore, staff recommends that the Board completes the review under the FCL arrangement which would allow Mexico to make purchases until the expiration of the arrangement on May 26, 2018.

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

This report was prepared by a team comprising Costas Christou, Frederic Lambert, Damien Puy, Fabian Valencia (all WHD), Julian Chow (MCM), Charlotte Lundgren (SPR), and Florian Misch (FAD). Daniela Muhaj and Misael Galdamez provided excellent assistance.

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APPENDICES

CONTEXT

1. **Mexico's economy has shown resilience as a key risk envisaged in the current FCL arrangement appears to be materializing.** Since January 2017, the United States has indicated that it would like to renegotiate the North American Free Trade Agreement (NAFTA), which could lead to a fundamental change in Mexico's trade regime with its most important trading partner. There are other U.S. policy issues affecting Mexico, including immigration reform and a border wall. This policy uncertainty led to a sharp depreciation of the peso vis-à-vis the U.S. dollar, rising yields on Mexican government securities, and falling domestic equity prices through January 2017. Since then, asset prices have recovered, partly because the tone of the discussions on NAFTA has moderated. However, the uncertainty remains. Formal discussions on a possible renegotiation of NAFTA are likely to begin later this year, and at this stage it is unclear whether these discussions will be straightforward or protracted and complex.

2. **This resilience stems in large part from the fact that Mexico's policies and policy frameworks remain very strong.** The flexible exchange rate has continued to play a key role in helping the economy adjust to external shocks, as shown during the recent episode of volatility. Monetary policy is anchored on a credible inflation-targeting framework, with medium-term inflation expectations remaining close to the target. Fiscal policy is guided by the Fiscal Responsibility Law, and the authorities have reiterated their commitment to gradually reduce public debt in relation to GDP over the medium term. The 2016 FSAP concluded that the financial regulatory and supervisory framework was strong. Medium-term growth should benefit from a range of structural reforms, while the anti-corruption reform has the potential to strengthen governance further. Mexico's external position is broadly in line with fundamentals and desirable policies. In concluding the 2016 Article IV consultation, Executive Directors expressed confidence that the country's strong fundamentals and policy frameworks will continue to underpin the economy's resilience. They welcomed Mexico's commitment to fiscal consolidation, but encouraged the authorities to strengthen the fiscal framework further.

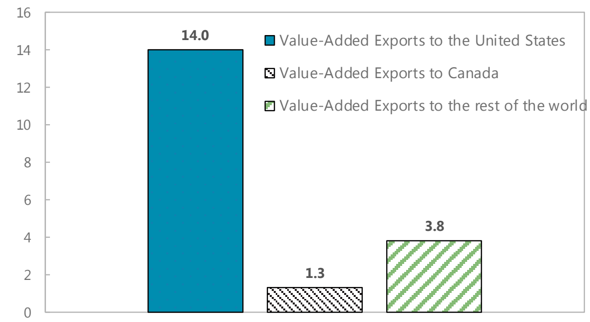
3. **Mexico's FCL has provided a reassuring signal on the strength of Mexico's policies and a valuable insurance against tail risks**. Mexico's deep integration into the global economy, with particularly strong links to the United States, through both trade and financial channels, has helped boost productivity and improve competitiveness, lower financing costs and diversify the investor base (Box 1). At the same time, it has exposed Mexico to abrupt shifts in investor sentiment, especially in the face of uncertainty about Mexico's trade regime with its key trading partner. In 2016, non-residents held 35 percent of local-currency-denominated sovereign bonds and total foreign portfolio investment in Mexico reached US$28.6 billion (2.7 percent of GDP). Finally, as during past episodes of increased volatility, market participants highlighted Mexico's access under the FCL during the recent episode, which sends a clear signal of the strength of Mexico's policy framework and provides a complement to Mexico's net international reserves.

Box 1. Trade and Financial Linkages Between Mexico and the United States

Mexico is particularly exposed to the United States, through both trade and financial channels.

- The United States is Mexico's top export market, representing 71 percent of Mexico's exports. The United States is also Mexico's top supplier, representing 51 percent of Mexico's imports. In value-added terms, 14 percent of Mexico's GDP ends up being consumed by its northern neighbor.

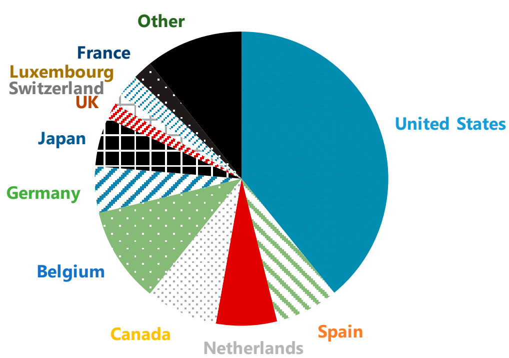
Value Added Exported by Mexico in 2011
(In percent of GDP)



Source: OECD; IMF Staff calculations.

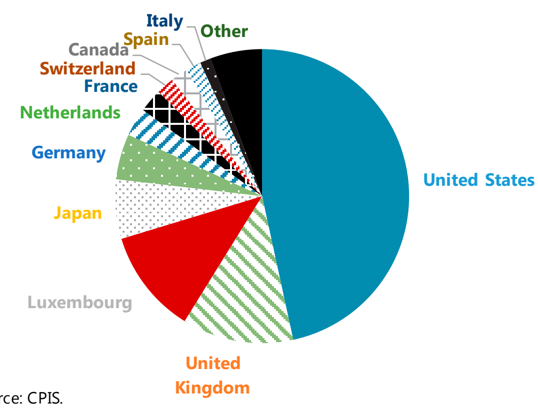
- The United States is also Mexico's biggest foreign investor accounting for 40 percent of Mexico's FDI inflows. Just over half of U.S. FDI goes into manufacturing and a large share into border states. According to the IMF's Coordinated Portfolio Investment Survey (CPIS), the United States is the source of nearly 46 percent of total reported portfolio investment in Mexico, 66 percent of portfolio equity investment, and 38 percent of portfolio investment in debt securities.

FDI Inflows by Origin, 2012-2016*



*2016Q3
Source: National authorities.

Portfolio Investments by Origin, June 2016



Source: CPIS.

RECENT ECONOMIC DEVELOPMENTS AND POLICIES

4. **In the first three quarters of 2016, real GDP expanded by 2¼ percent (y/y), while inflation rose to the target of 3 percent.** Economic activity was supported by a strong performance in the services sector, which more than offset subdued manufacturing activity and falling oil production (Figure 2). Improved labor market conditions (Figure 3) and strong remittances supported real private consumption growth, while the growth in real private investment slowed to just 2.1 percent over the same period, down from 8 percent in 2015. Inflation rose to 3 percent (y/y) in September 2016, reflecting the unwinding of several one-off factors that had pushed inflation well below target in 2015 as well as the pass-through effects

of the depreciation of the peso vis-à-vis the U.S. dollar, which picked up starting in early 2016.[1] In late 2015 the Bank of Mexico began to raise the policy interest rate, which reached 4.75 percent in September 2016, compared with 3.00 percent in November 2015 (Figure 4).

5. Mexico's asset prices weakened in the period November 2016-January 2017. The peso depreciated 18 percent between November 8 and January 22 (Figure 1). On November 8, exchange rate bid-ask spreads exceeded levels seen during the global financial crisis. Yields on the 10-year local-currency government bond increased 145 basis points over the same period, reflecting a shift in long-term U.S. interest rates but also higher sovereign spreads.

6. In response, on November 9, the authorities reaffirmed their commitment to maintaining the policy framework. The government indicated that it would stick with its announced path for fiscal consolidation, which envisages a reduction of the public sector borrowing requirement (PSBR) from 4.6 percent of GDP in 2014 to 2.5 percent of GDP by 2018 to bring the primary surplus above the debt-stabilizing level. Banxico would continue to direct monetary policy at keeping medium-term inflation expectations anchored, while relying on exchange rate flexibility as a shock absorber. They emphasized the credibility of the policy framework, the resilience of the financial system, and the strength of the international reserve buffer, complemented with the resources available under the current FCL.

7. This response helped preserve macroeconomic stability. Growth in the fourth quarter of 2016 turned out somewhat stronger than expected, keeping growth for the year at 2.3 percent. The labor market continued to strengthen with the unemployment rate falling to 3.7 percent in December 2016. By end-2016, headline and core inflation reached 3.4 percent (y/y). The Bank of Mexico raised the policy rate to 5.75 percent by December 2016, with no foreign exchange intervention.[2]

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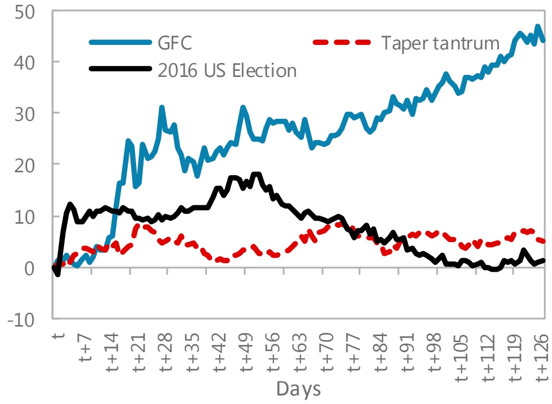
[1] Declining food prices, dissipation of base effects of tax hikes in 2014, lower telecom services prices derived from the telecom reform, and smaller increases in regulated energy prices more than offset the pass-through from the currency depreciation in 2015, causing headline inflation to drop to historical lows by end-2015. As some of these factors faded, the pass-through of the depreciation started to become more visible in 2016.

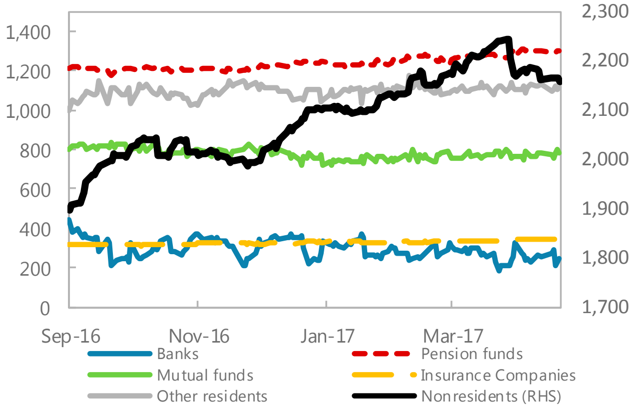
[2] Discretionary intervention was used only once, on January 5, when Banxico sold US$2 billion through direct sales.

Figure 1. Mexico: Evolution of Selected Financial Market Indicators 1/

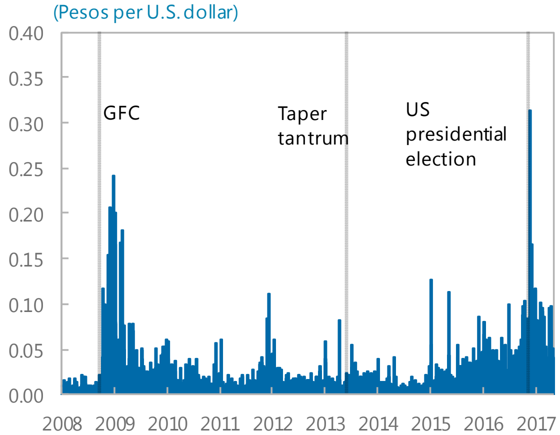
MXN/USD Exchange Rate Depreciation 2/
(In percent)



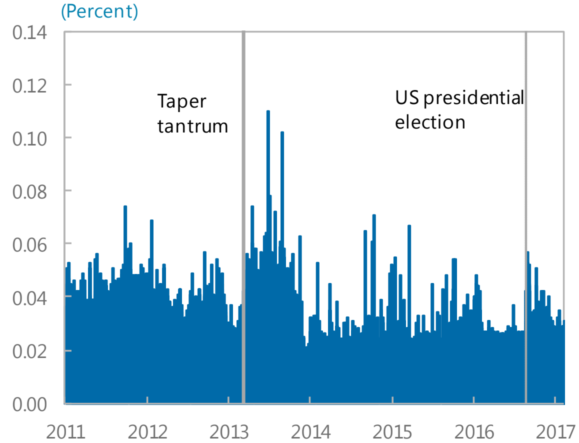
Local-currency Government Securities by Holder
(Billion of pesos; as of April 21, 2017)



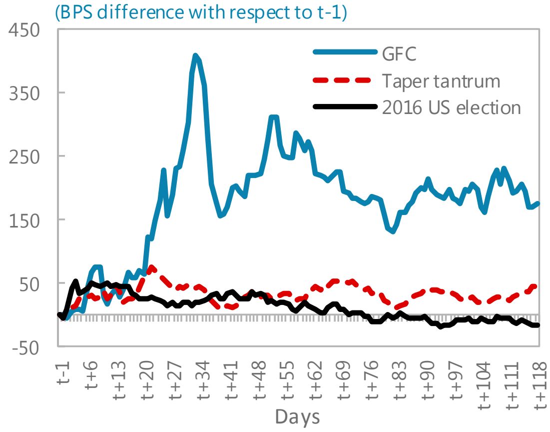
Exchange Rate bid-Ask Spread
(Pesos per U.S. dollar)



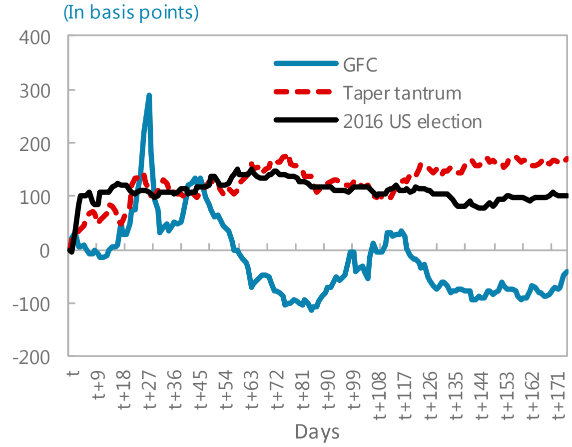
10 YR Local Currency Government Bond Bid-Ask Spread
(Percent)



Mexico: Change in the EMBI+ Index
(BPS difference with respect to t-1)



10 YR Local Currency Government Bond Yield
(In basis points)



Sources: Bloomberg, National authorities, and Fund staff estimates.

1/ Data through May 3, 2017 unless otherwise indicated.

2/ GFC : Global Financial Crisis. Time t denotes September 15, 2008 for GFC; May 21, 2013 for Taper tantrum; and November 8, 2016 for the US Presidential election.

8. So far in 2017, Mexico has benefitted from improved market sentiment and confidence in the country's macroeconomic fundamentals. Since late January, the exchange rate and credit spreads have returned to close to pre-U.S. election levels and net capital inflows have picked up (Figure 5). Notably, non-resident holdings of local-currency long-term government securities have increased since last November. It is, however, too early to determine whether this improved sentiment translated into a recovery in FDI which remained flat for the last three quarters of 2016. Inflation continued to increase in recent months to 5.35 percent y/y in March, following an up-to-20-percent m/m increase in domestic fuel prices in January, as part of the liberalization of these prices. As of March 2017, headline and core inflation expectations over the next twelve months were at 4 percent, while longer term expectations (at a horizon between 5 and 8 years) inched up slightly to return to the historical average of around 3½ percent.[3] The Bank of Mexico raised the policy rate further to 6.5 percent. On February 21, the Foreign Exchange Commission (FEC) announced the introduction of a framework for auctions of up to US$20 billion of non-deliverable forwards (NDF), with US$1 billion auctioned so far.[4]

9. The authorities remain committed to their fiscal consolidation plans. For 2017, the PSBR was targeted at 2.9 percent of GDP (the outturn for 2016), but the government will now cut it to 1.4 percent of GDP, as it channels all the 2016 surplus of Banxico to reduce the deficit (in line with the staff advice during the 2016 Article IV consultation).[5] The authorities are also committed to a PSBR of 2½ percent of GDP in 2018 and beyond. Public debt increased to 58.5 percent of GDP in 2016 in large part due to valuation effects, but is projected to decline to 54.8 percent of GDP in 2017 and stabilize at slightly below that level over the medium term (Figure 6).[6] Staff has taken the view that, while the fiscal target for 2018 is manageable and appropriate, aiming at a lower PSBR for 2019 and beyond would lead to a faster decline in the

[3] The liberalization of fuel prices included sharp increases in gasoline, diesel, and liquefied petroleum gas. The direct effects of these increases explain 1.3 ppts of the 2 ppts change in y/y headline inflation between December 2016 and March 2017. Further increases in prices of non-food merchandise, reflecting the pass-through from the depreciation, explain a further 0.3 ppt. Base effects derived from the stabilization of telecommunications services prices and adjustments in administered prices, particularly urban transportation, explain another 0.2 ppt of the increase in inflation over the same period.

[4] The NDFs will be settled net, in pesos, at the prevailing exchange rate at maturity. They have maturities of up to twelve months, and the central bank will continue to roll over maturing instruments as decided by the FEC with domestic financial institutions acting as intermediaries. The first (and only so far) auction of US$1 billion on March 6, 2017 received favorable demand with total bid-to-cover of 2.1 times.

[5] The central bank law requires the Bank of Mexico to transfer to the federal government the remaining profits (including from exchange rate valuation gains) after increasing its capital sufficiently to ensure that it grows at least at the projected growth rate of nominal GDP and after constituting valuation reserves if the Board decides so. The Bank of Mexico is not consolidated in the public sector fiscal accounts, so these one-off transfers affect the headline fiscal deficit. In compliance with the Fiscal Responsibility Law, at least 70 percent of the transfer will go toward repaying outstanding debt or reducing new issuances, while the remainder will be used to strengthen the Revenue Stabilization Fund (FEIP) or to increase assets that strengthen the financial position of the federal government.

[6] The public debt-to-GDP ratio increased by 12.1 ppts during 2014-16 to 58.5 percent of GDP. This increase is to a large extent due to the real peso depreciation (6.7 ppts contribution) and the pension reform of PEMEX and CFE, which securitized implicit pension liabilities (0.7 ppts and 0.9 ppts contribution, respectively). Cumulative primary deficits over the same period account for 2.1 ppts, that is around 18 percent of the observed increase in debt.

public debt-to-GDP ratio, thus helping strengthen fiscal buffers. Moreover, staff continues to believe there are benefits to strengthening the fiscal framework as highlighted during the 2016 Article IV consultation. Possible steps include tightening the link between the desired level of public debt and PSBR targets, limiting the use of exceptional circumstances clauses, and introducing a non-partisan fiscal council.

10. The implementation of PEMEX's business plan is on track. The ongoing restructuring of PEMEX, which involves sharp expenditure cuts, increased use of joint ventures, and disposal of non-core assets is proceeding as expected and has helped the company stabilize its financial position. Turning PEMEX into an efficient and profitable company in the medium term remains a critical priority of the authorities' fiscal consolidation plan and would require perseverance.

11. The financial and non-financial corporate sectors showed resilience to heightened volatility. The non-financial corporate sector has weathered the currency depreciation well as large corporations have adequate foreign currency earnings to hedge foreign currency liabilities. Some corporations have also reduced their FX exposure by refinancing foreign currency debts with domestic bank loans and bonds and the sector remains liquid (Figure 9). Banks have shown resilience as well. Asset quality remains high and the system is well capitalized and liquid (Figure 10). The latest CNBV bank stress tests, using December 2016 balance sheet information, show that the banking sector would remain resilient even in a severe (albeit short-lived) adverse scenario including a decline in real GDP of 6.7 percent, and a 40-percent currency depreciation. Bank capital needs under this scenario would be small, at 1.1 percent of total banking assets, and systemic banks would not face difficulties.

12. Implementation of a broad structural reform agenda remains on track. Mexico is implementing a broad range of structural reforms in several areas including energy, telecommunications, financial, competition, and education. Most notably, the telecommunications reform has already attracted FDI into the sector and has led to a sizable reduction in the prices of telecommunication services. Under the energy reform, 39 contracts have already been awarded with expected investment flows of US$50 billion. The financial reform is increasing competition, particularly in the mortgage segment, by reducing the costs of refinancing and facilitating portability of loans. A recent anticorruption reform—with secondary legislation promulgated last year—is moving to the implementation phase and has the potential to improve governance.

OUTLOOK AND RISKS

13. The heightened uncertainty would slow real GDP growth, while inflation returns to target. Increased uncertainty and tighter financial conditions are expected to weigh on consumption and investment, particularly in the export-oriented manufacturing sector. These factors are likely to more than offset a positive stimulus derived from the currency depreciation and stronger external demand as U.S. growth picks up, thus slowing real GDP growth to 1.7 percent in 2017. With prolonged uncertainty about the NAFTA negotiations also being compounded by political uncertainty related to the 2018 elections in Mexico, output growth would recover only slightly to 2 percent in 2018.[7] Inflation would remain high at 5.1 percent at end-2017, and converge to the target by early 2019 as the effects of the depreciation and domestic fuel price increases dissipate and the monetary tightening takes effect. The current account deficit is projected to improve slightly from 2.7 percent of GDP in 2016 to 2.3 percent by 2022 (Figure 7). The NIIP is projected to improve to minus 45.4 percent of GDP in 2017 and then continue to strengthen to around minus 40 percent of GDP by 2022.

14. Mexico's external position remains broadly consistent with medium-term fundamentals and desirable policy settings. The current account deficit is broadly in line with medium-term fundamentals and desirable policy settings. The sharp depreciation of the peso vis-à-vis the U.S. dollar in late 2016 and early 2017 largely reflected risks of rising protectionism. With the recent appreciation, as of March 2017, the peso was about 1 percent weaker in real effective terms relative to its 2016 average. In staff's assessment, the peso is currently moderately weaker than the level suggested by fundamentals, under a baseline in which protectionism risks do not materialize. Foreign exchange reserves are adequate according to a range of indicators (Figure 8).

15. Although one year into the FCL arrangement the global environment has improved, external risks for Mexico remain high. External demand has been strengthening and financial market volatility has moderated considerably. Nevertheless, some of the risks identified at the time of the approval of the FCL arrangement have increased as the U.S. has indicated that it would like to renegotiate NAFTA, which could lead to a fundamental change in Mexico's trade regime with its most important trading partner. Protracted negotiations would prolong the current uncertainty and increase financial market volatility. Moreover, and as noted in the April 2017 World Economic Outlook and the Global Financial Stability Report, global risks remain slanted to the downside with policy uncertainty being a key component. Particularly relevant for Mexico are the risks of increased protectionism and a faster-than-expected pace of interest rate hikes in the United States. The former could lead to lower global growth due to reduced trade and cross-border investment flows, while both risks could lead to a resurgence in

[7] The political landscape remains uncertain as official candidates have yet to be announced. An important political development will be the election of governor for the state of Mexico, the largest state in terms of population, in June 2017, which is considered a strong predictor for the July 2018 presidential elections.

volatility in Mexican asset prices. While the discussions surrounding NAFTA have calmed in recent weeks, the issues to be discussed with the U.S. are complex and mean that the uncertainty will remain high and that the risk of further rounds of sharp volatility are elevated. Finally, although the updated external stress index (Box 2) has improved somewhat since the FCL request reflecting some improvements in the global environment and financial stability, factors not captured by the index are critical to risks affecting Mexico at the current juncture and could lead a sharp deterioration in external conditions in a downside scenario.

THE FLEXIBLE CREDIT LINE AND REVIEW OF QUALIFICATION

16. The authorities highlighted that the FCL arrangement continues to support their macroeconomic strategy, providing an insurance against tail risks. The FCL has complemented Mexico's very strong policies and policy frameworks, and international reserves. Over the past several years, Mexico has successfully weathered several bouts of volatility, including the most recent episode during end-2016/early-2017, and the authorities believe that the arrangement will continue to protect Mexico against the external risks highlighted above. Moreover, they are committed to continue enhancing Mexico's resilience to external shocks through steadfast implementation of the ongoing fiscal consolidation plans, continued anchoring of inflation expectations, gradual rebuilding of reserve buffers, and strong oversight of the domestic financial system.

17. The authorities have retained the exit strategy they presented at the time of the FCL renewal in May 2016. The authorities re-affirmed their commitment (expressed in the FCL request) that Mexico does not intend to make permanent use of the FCL. They emphasized though that, although some global risks highlighted at the time of the request have receded somewhat, external risks for Mexico associated with uncertainty about the outcome of the discussions on the bilateral relationship with the U.S., as well as the possibility of sudden surges in capital flow volatility, remain elevated. Nevertheless, conditional on a reduction of these risks, they intend to seek possible subsequent FCL arrangements with lower access, with a view to eventually exit the facility.

18. Staff assesses that Mexico continues to meet the qualification criteria for an arrangement under the FCL. The authorities have continued to implement very strong policies in line with their frameworks. Monetary policy has continued to be guided by a credible inflation-targeting framework in the context of a flexible exchange rate regime, while fiscal policy has been guided by the Fiscal Responsibility Law (Figure 11). Underpinned by these policy frameworks and very strong policy track record**,** Mexico retains policy space to contain the fallout from the materialization of downside risks and the authorities remain committed to take appropriate actions if such risks materialize.

- **Sustainable external position**. The external current account deficit is broadly in line with medium-term fundamentals and desirable policies. The updated external debt sustainability analysis (Annex I) continues to show that Mexico's external debt is relatively low (about

39 percent of GDP) reflecting the low current account deficits and a manageable net foreign asset position, projected to decline to below minus 40 percent of GDP by 2022.

- **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 overall balance of payments flows.

- **Track record of steady sovereign access to international capital markets at favorable terms**. Mexico remains among the highest-rated emerging markets. Mexico’s sovereign bond (EMBI+) spread and five-year CDS spreads increased sharply toward the end of 2016 and in early 2017, but they have partially reversed thereafter, standing at 202 and 126 basis points, respectively (as of April 24, 2017). Mexico continues to place successfully sovereign bonds in international capital markets, recently placing a 30-year, fixed-rate domestic currency bond with a yield of 7.85 percent that attracted 43 percent of foreign participation. Moreover, government’s external financing needs for 2017 are fully covered, and only US$ 1.1 billion, most of which is due to international financial institutions, remains to be financed in 2018. The authorities have also pre-financed 30 percent of redemptions for 2019 through several placements in March 2017.

- **Relatively comfortable international reserve position**. Gross international reserves stood at US$179 billion at end-March 2017, very marginally below the US$182 billion at the time of the approval of the current FCL arrangement. This level is adequate relative to the standard reserve coverage indicators.

- **Sound public finances, including a sustainable public debt position, and a commitment to fiscal consolidation**. Fiscal policy remains prudent and is underpinned by the rules in the Fiscal Responsibility Law. The authorities are undertaking a fiscal consolidation plan—announced in 2014—that envisages reducing the PSBR from 4.6 percent of GDP in 2014 to 2.5 percent of GDP in 2018. The target for 2015 was met, and the authorities went slightly beyond the 2016 target. Moreover, they have committed to save the entirety of a large transfer from the central bank, which is expected to lead to an over performance in the PSBR target this year by the full amount of the transfer. As a result, the public debt-to-GDP ratio would decline to 54.8 percent in 2017 and stabilize at slightly below that level over the medium term. An updated debt sustainability analysis shows that the debt trajectory is overall robust to standard shocks (Annex II). The debt projection is sensitive to growth, exchange rate fluctuations, and the evolution of oil prices, but debt would remain contained even under severe negative shocks.

- **Low and stable inflation**. Headline inflation has recently exceeded the 3 percent target owing mainly to a sharp increase in the prices of domestic fuel, as part of the process of liberalization of these prices, and the pass-through from the currency depreciation, but is expected to converge to the target by early-2019. While near-term inflation expectations are relatively high, medium-term inflation expectations remain close to the target, pointing to the transitory nature of much of the current inflation pressure as well as the credibility of monetary policy. To achieve this, Banxico has tightened monetary policy considerably since December 2015, and stands ready to adjust monetary policy as needed to bring inflation in line with the target.

- **Sound financial system and the absence of solvency problems that may threaten systemic stability**. The capital adequacy ratio for the banking system stood at 14.9 percent in December 2016 and provisioning, at 157 percent of nonperforming loans, is high. Corporate balance sheets remain resilient to exchange rate shocks as large corporations are naturally-hedged, while some corporations have recently reduced exchange rate risk as they switched financing to peso loans and bonds. The broader financial system is also sound. Private pension funds, which hold assets of about 16 percent of GDP, have a conservative investment profile. All insurance companies comfortably satisfy the capital requirements under a Solvency II-type regime adopted in April 2015.

- **Effective financial sector supervision**. The 2012 FSAP concluded that banking supervision in Mexico was effective. Mexico adopted the Basel III capital rules in 2013, and the Basel Committee assessed it as compliant in 2015. Liquidity coverage ratio (LCR) minimum requirements have been in place since January 2015. 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. The 2016 FSAP found that significant progress has been achieved in strengthening financial sector prudential oversight since 2012. The FSAP recommended several areas for further progress, especially to strengthen the governance of the supervisory agencies and IPAB.

- **Data transparency and integrity**. The overall quality of Mexican data continues to be high and adequate to conduct effective surveillance as described in the June 2015 data ROSC update. Mexico remains in observance of the Special Data Dissemination Standards (SDDS).

19. International indicators of institutional quality show that Mexico has above average 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 effective prudential and regulatory framework for financial supervision. According to the 2016 World Bank Governance Indicators, Mexico's government effectiveness ranks at the 62nd percentile among all countries. A weaker area is control of corruption, where Mexico stands at the 25th percentile. However, a constitutional reform (adopted in May 2015) and secondary legislation (promulgated in July 2016) further empowers the federal government to investigate, prosecute, and sanction corrupt activity in Mexico. The reform creates a National Anticorruption System, increases transparency requirements in the use of public funds, and lengthens the statute of limitations. Implementation has begun with the institutional setting at the federal level nearing completion. Finally, Mexico is currently undergoing a full assessment of its anti-money laundering framework, and the report (expected in late 2017) will provide further recommendations to the authorities for strengthening the effectiveness of anti-money laundering measures.

SAFEGUARDS ASSESSMENT

20. Staff has completed the safeguards procedures for Mexico's 2016 FCL arrangement. The authorities provided the necessary authorization for Fund staff to communicate directly with Banco de Mexico's external auditor, Mancera, S.C. (EY México). EY México issued an unqualified audit opinion on the Bank de Mexico's 2015 financial statements. Staff reviewed the 2015 audit results and discussed these with EY México. Staff noted improvements in the quality and transparency of the annual financial statements, including commencement of their publication on the bank's website. While no significant issues emerged from the conduct of the safeguards procedures, the authorities have already taken steps to enhance the independence of the Bank's Audit Committee.

STAFF APPRAISAL

21. Mexico continues to benefit from the FCL arrangement. The country has weathered well bouts of market volatility since the approval of the FCL. The FCL arrangement has supported market confidence by providing a reassuring signal on the strength of Mexico's institutions and policies, and has served as an additional insurance against tail risks. Although the global environment has improved somewhat since the approval of the current FCL, Mexico continues to face elevated external risks associated with uncertainty about the outcome of the discussions on the bilateral relationship with the U.S. and with possible surges in capital flow volatility. The authorities believe that the arrangement will continue to protect Mexico against these risks. They intend to continue treating the FCL as precautionary and consider it a temporary supplement to international reserves. Staff welcomes the authorities' exit strategy, which foresees a reduction in access in possible requests for subsequent FCL arrangements, conditional on a reduction of the external risks affecting Mexico.

22. The government's commitment to fiscal discipline is welcome. It is important that the authorities continue to build on the fiscal consolidation efforts of recent years and put the public debt-to-GDP ratio on a downward trajectory. To this end, the recent decision to use the full profit transfer from the central bank for a net reduction in the PSBR for 2017 is welcome, although this is a one-off measure, and should help enhance the credibility of fiscal policy in a period of heightened uncertainty. It would also be important to strengthen the fiscal framework by tightening the link between the desired level of public debt and PSBR targets, limiting the use of exceptional circumstances clauses, and introducing a non-partisan fiscal council. Beyond 2018, aiming at a more ambitious PSBR target would allow rebuilding fiscal buffers more quickly and strengthen Mexico's resilience to confront downside risks.

23. Mexico continues to meet the qualification criteria for access to the FCL resources. The IMF Board assessment of the 2016 Article IV consultation completed in November 2016 noted Mexico's strong policies and policy framework. The authorities have a successful record of sound policy management and are firmly committed to maintaining prudent policies going forward. Staff therefore recommends completion of the review under the FCL arrangement for Mexico.

Box 2. The Updated External Economic Stress Index

The external economic stress index for Mexico was initially presented in Mexico's staff report on the previous arrangement under the Flexible Credit Line, November 2014. Its methodology is explained in Flexible Credit Line—Operational Guidance Note, IMF Policy Paper, June 2015. The calculation of the index required 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. The updated index is presented below using the same model, proxy variables, and weights.

Risks. Mexico's exports, remittances, and inward FDI are closely related to U.S. economic developments. The open capital account and the significant stock of debt and equity portfolio investment expose Mexico to changes in global financial conditions. Finally, 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 change in the U.S. Treasury 10-year yield and the emerging market volatility index (VXEEM), respectively. 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 (0.33) and the VXEEM (0.16) correspond to the stocks of foreign debt and equity; and the weight on the change in the oil price (0.4) 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 projections are in line with the VIX futures as of March 30, 2017.

Downside scenario. The scenario is based on staff estimates of the global macroeconomic effects from a sharp rise in global protectionism (global increase in trade barriers with a temporary rise in risk premia), which is broadly consistent with the tail risks presented in this paper. Specifically, it is assumed that U.S. growth would be 1.5 percentage points lower than projected in 2017. As a result of weaker global growth, oil prices would be about 25 percent lower and 10-year interest rates 0.3 percentage points lower than in the baseline. In addition, the downside scenario assumes an increase in global financial market volatility, with the VXEEM rising by 3 standard deviations. The downside scenario is illustrated in the chart by dots, which represent the level to which the index would fall if the described risks would materialize.

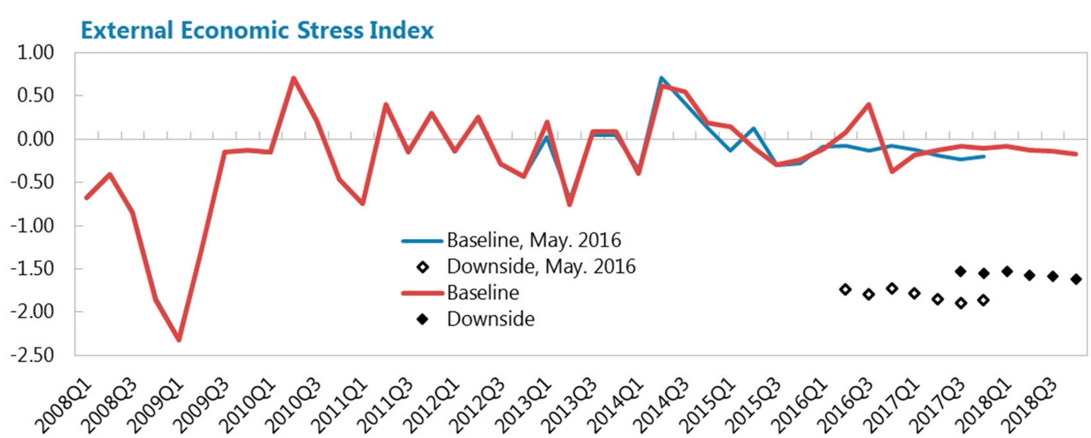
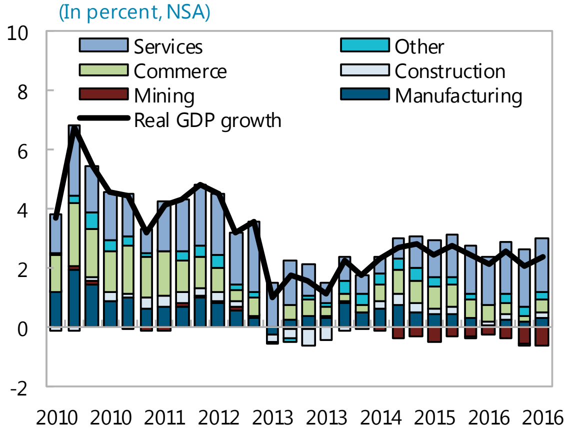


Figure 2. Mexico: Real Sector

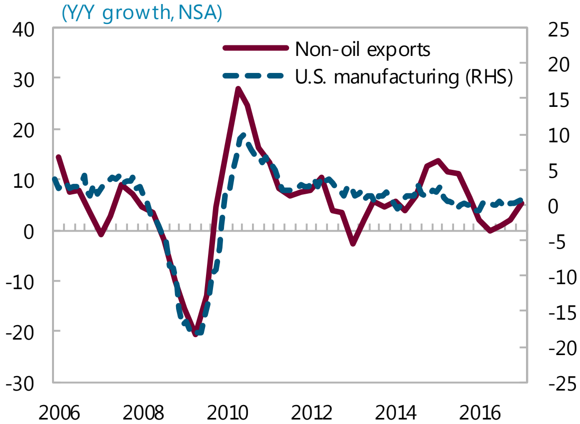
Growth has been sustained by strong services despite falling oil production and weak manufacturing activity.

Supply Contributions to Growth
(In percent, NSA)



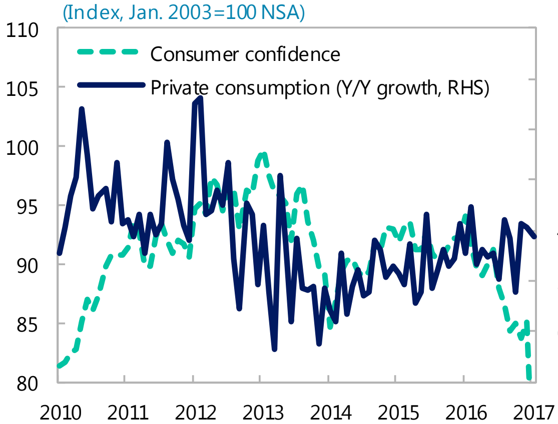
Weak non-oil exports have reflected in part slow U.S. external demand.

Real Export Growth
(Y/Y growth, NSA)



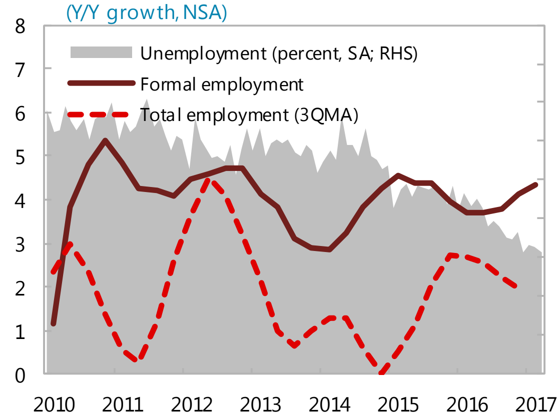
Private consumption has held up despite a sharp decrease in sentiment..

Consumption
(Index, Jan. 2003=100 NSA)



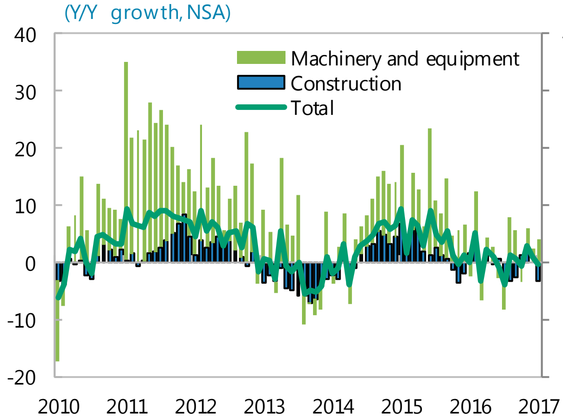
...supported by strong job creation, particularly in the formal sector.

Employment
(Y/Y growth, NSA)



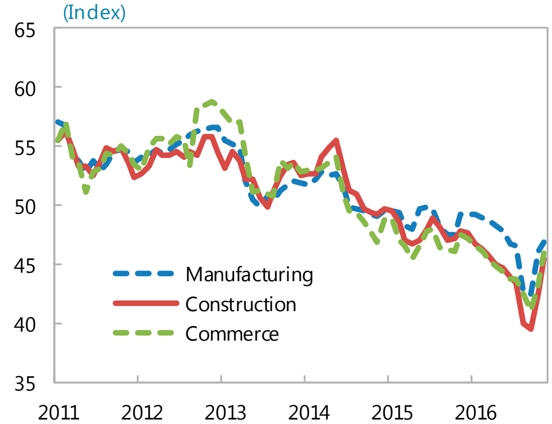
Gross fixed capital formation, however, has weakened since late 2015...

Gross Fixed Capital Formation
(Y/Y growth, NSA)



...reflecting in part deteriorating business confidence.

Business Confidence by Sector
(Index)

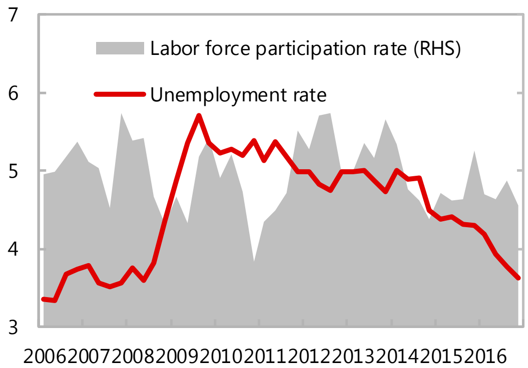


Sources: National authorities, Haver Analytics, and Fund staff estimates.

Figure 3. Mexico: Labor Market Indicators

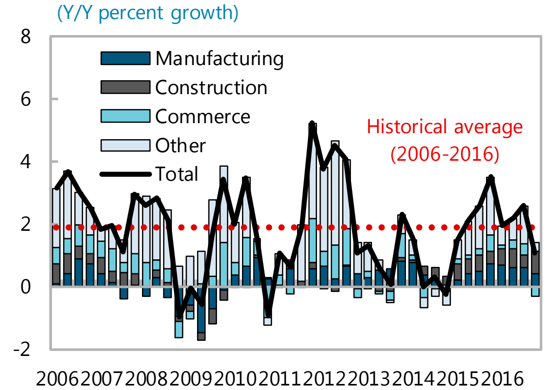
The unemployment rate has continued to decline, falling to the lowest level in a decade.

Unemployment Rate
(In percent, SA)



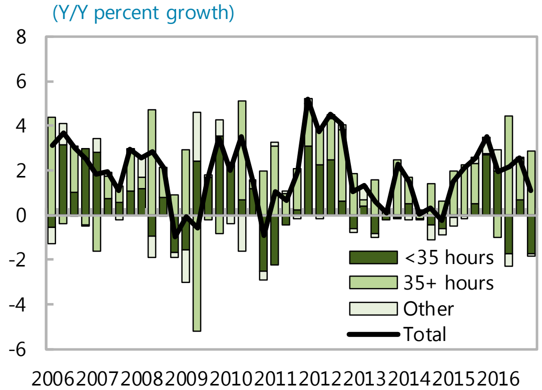
Job creation has slowed but remains close to the historical average.

Contributions to Employment Growth
(Y/Y percent growth)



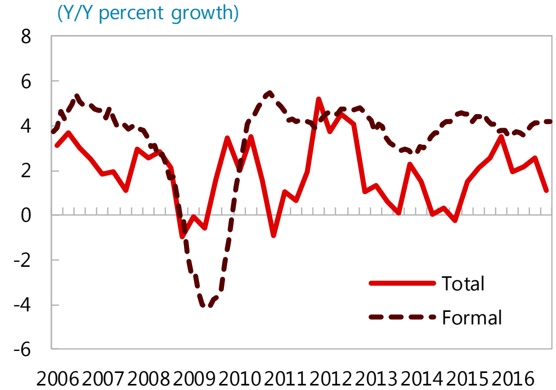
...with robust creation of full-time jobs...

Contributions to Employment Growth
(Y/Y percent growth)



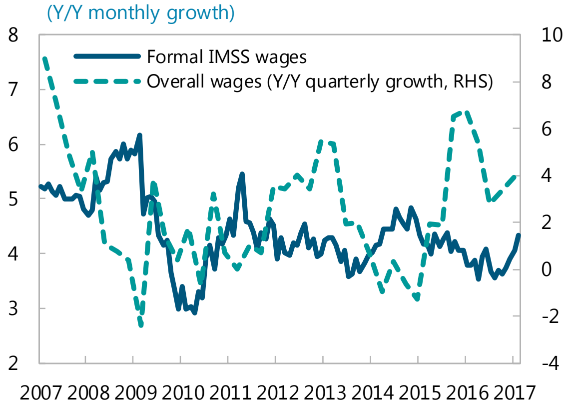
...and of formal employment.

Total and Formal Employment
(Y/Y percent growth)



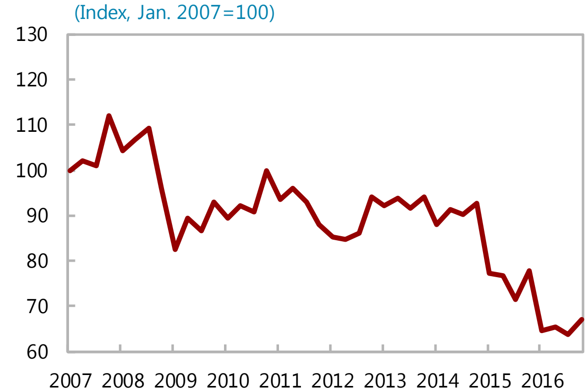
Nominal wage growth is picking up...

Average Nominal Wages
(Y/Y monthly growth)



...but manufacturing unit labor costs remain low relative to main trading partners.

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

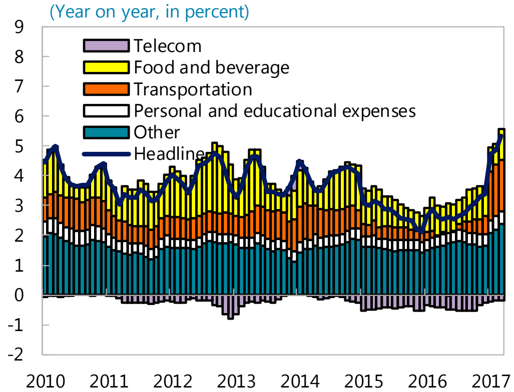


Sources: National authorities, Haver Analytics, and Fund staff estimates.

Figure 4. Mexico: Prices and Inflation

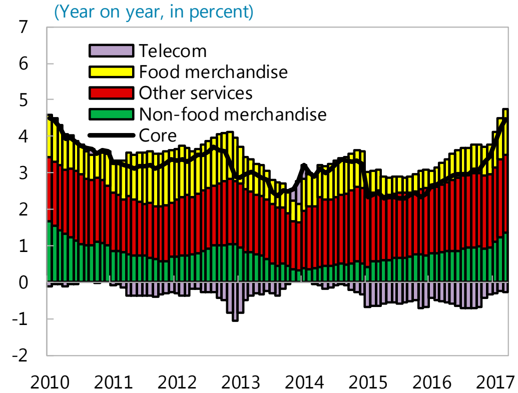
Headline inflation is above the 3-percent target reflecting sharp increases in domestic fuel prices....

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



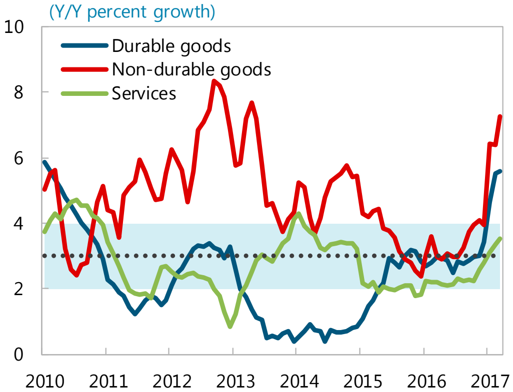
..and increases in core inflation due mainly to base effects from a stabilization of telecom prices and the pass-through from the currency depreciation...

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



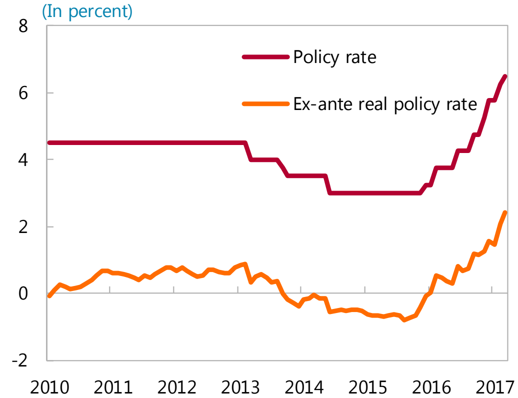
...which is affecting mostly goods, while services inflation is still close to the target.

Inflation
(Y/Y percent growth)



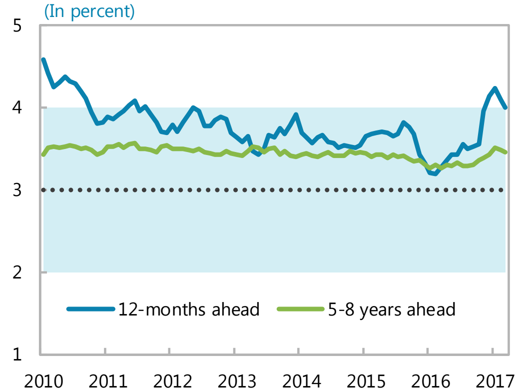
Policy rate hikes over the past year have helped contain second-round effects from the depreciation...

Policy Rates
(In percent)



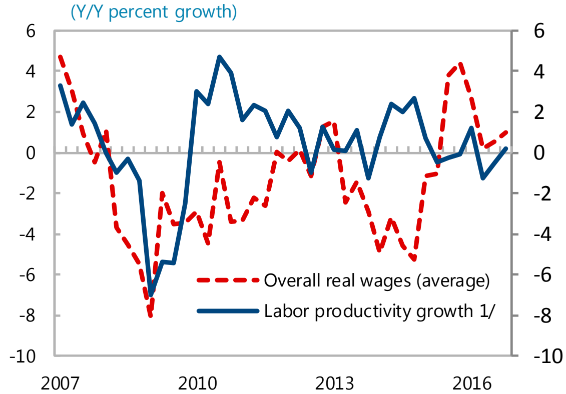
...keeping medium-term inflation expectations anchored close to the target.

Survey-based Inflation Expectations
(In percent)



Real wages are rising but are still catching up with productivity.

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



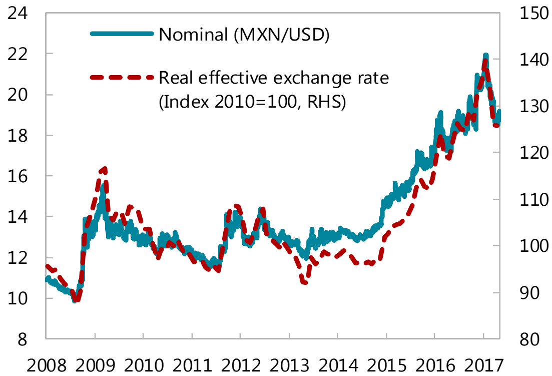
Sources: National authorities, and Haver Analytics.

1/ Based on hours worked.

Figure 5. Mexico: Financial Sector
(As of May 2017)

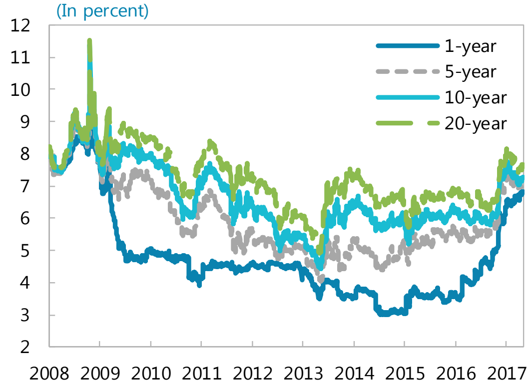
After falling sharply in late 2016 and early 2017, the peso has strengthened reflecting improved sentiment about the NAFTA re-negotiations.

Exchange Rate



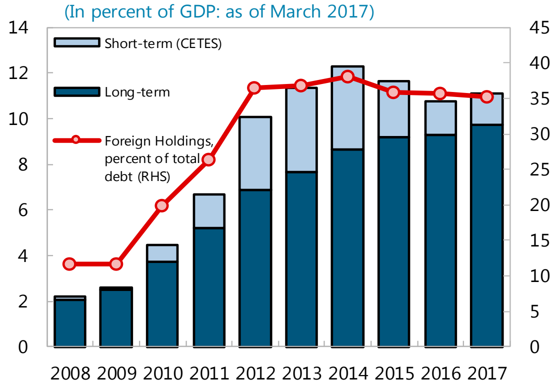
Long-term and government bond yields in local currency have also decreased recently...

Local Government Bond Yields
(In percent)



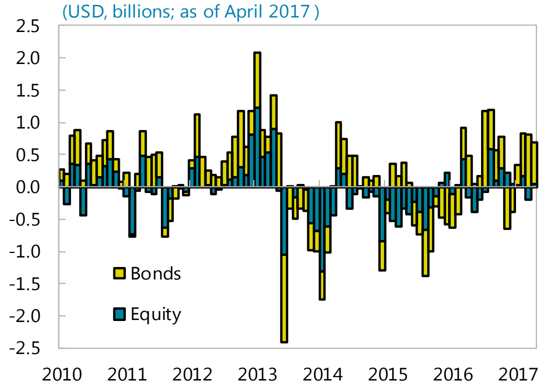
...with foreign holdings of local-currency sovereign debt remaining stable despite the recent financial market volatility.

Non-Residents' Holdings of Local Sovereign Debt
(In percent of GDP: as of March 2017)



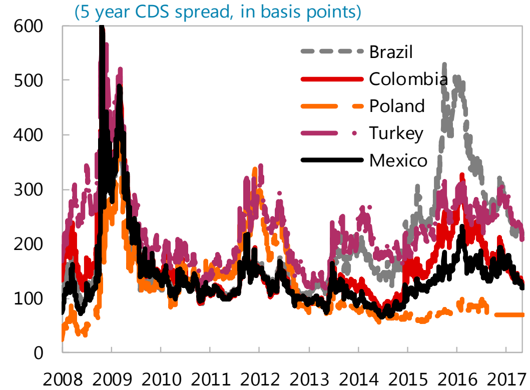
ETF and mutual funds' inflows have recovered since the decline in late 2016.

ETFs and Mutual Fund Flows
(USD, billions; as of April 2017)



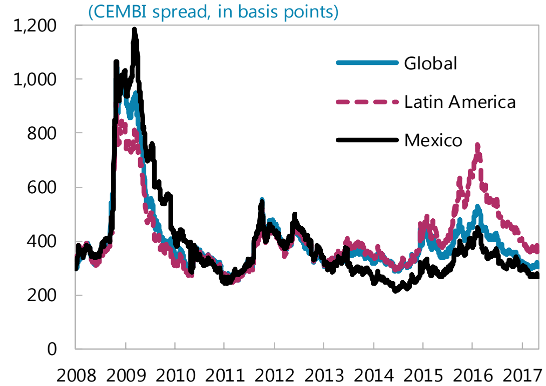
Risk credit spreads on sovereign dollar-denominated debt...

Sovereign Risk Spreads
(5 year CDS spread, in basis points)



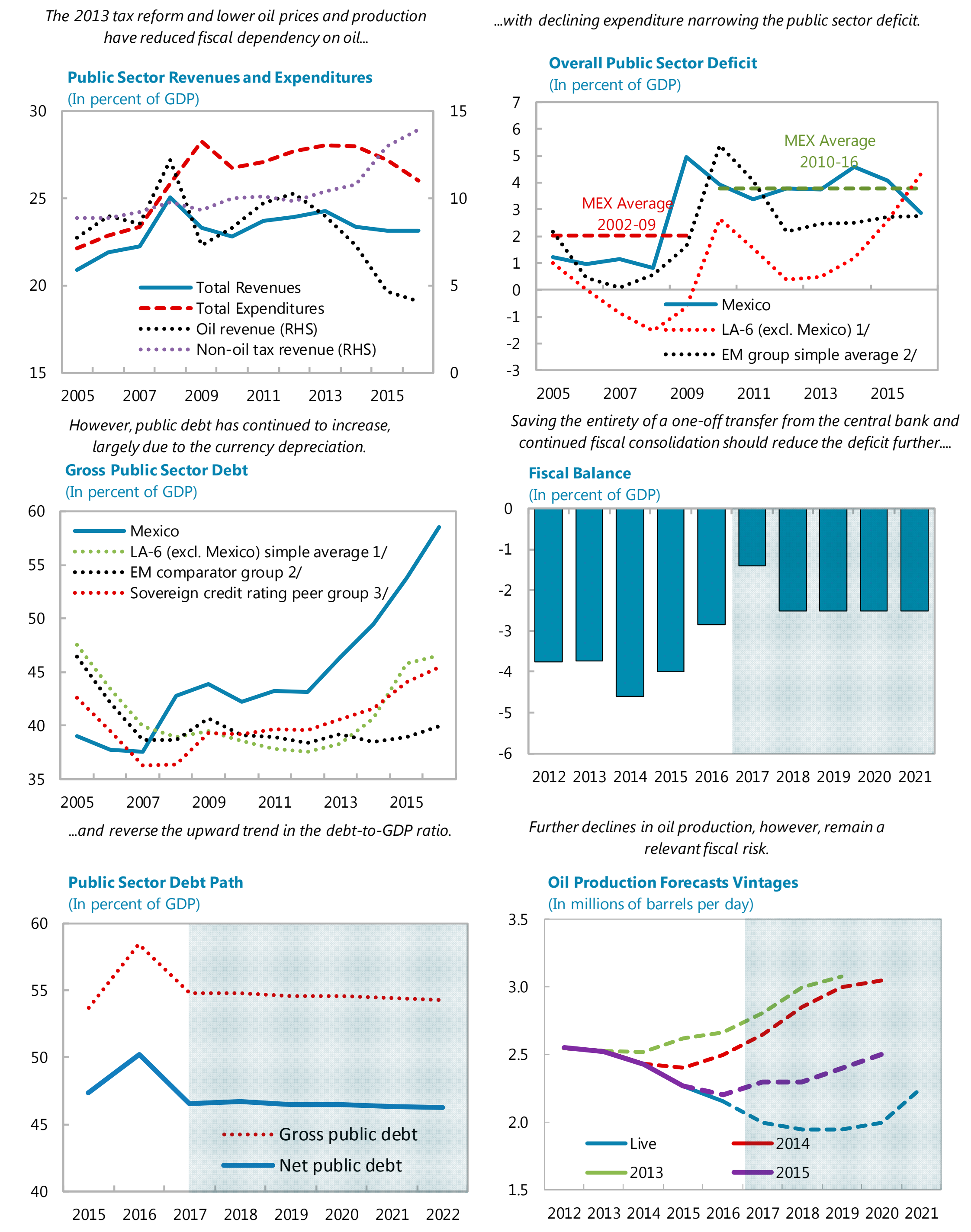
...and on corporate debt have also declined in recent months.

Corporate Risk Spread
(CEMBI spread, in basis points)



Sources: Bloomberg, National authorities, and Haver Analytics.

Figure 6. Mexico: Fiscal Sector



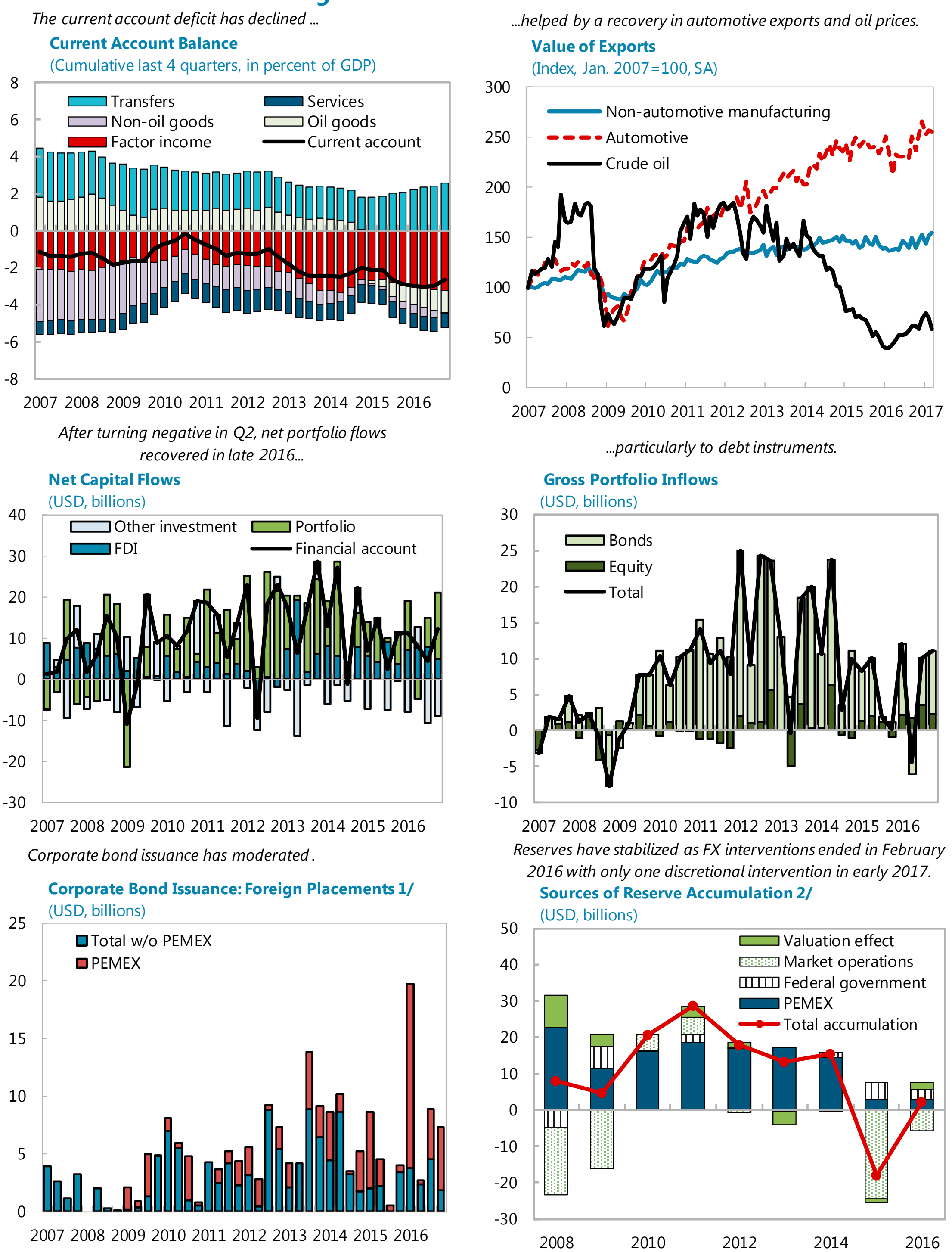
Source: National authorities, World Economic Outlook. Fitch Ratings, and Fund staff estimates.

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

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

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

Figure 7. Mexico: External Sector



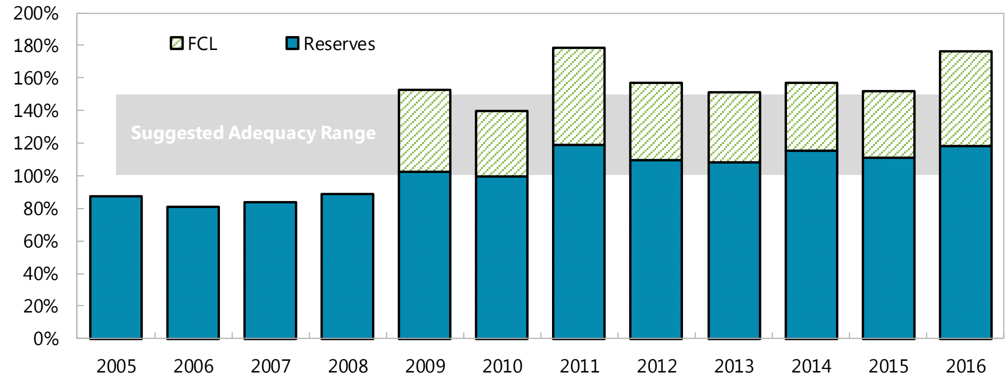
Sources: National authorities, Haver Analytics, Dealogic, and Fund staff estimates.

1/ Data through December 2016.

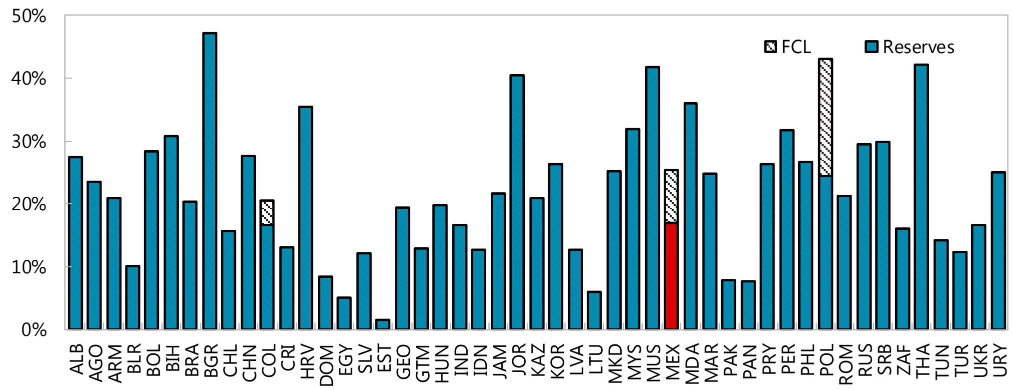
2/ Data through December 2016.

Figure 8. Mexico: Reserve Coverage in an International Perspective, 2016 1/

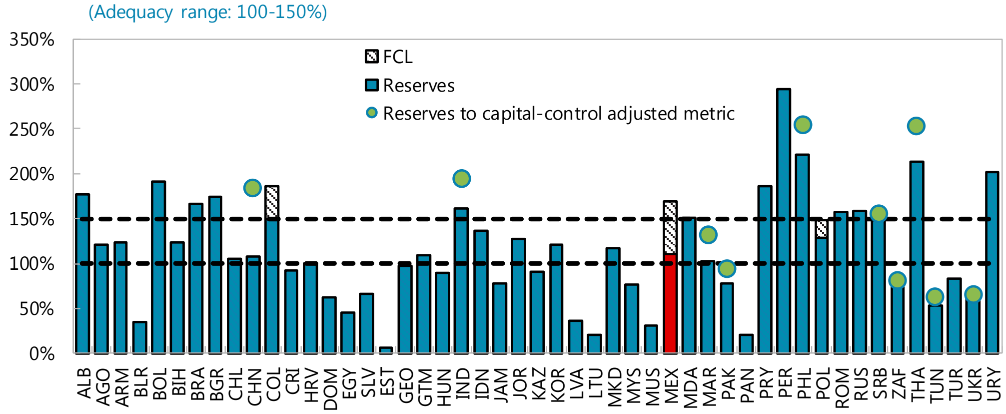
Reserves
(In percent of ARA Metric)



Reserves
(In percent of GDP)

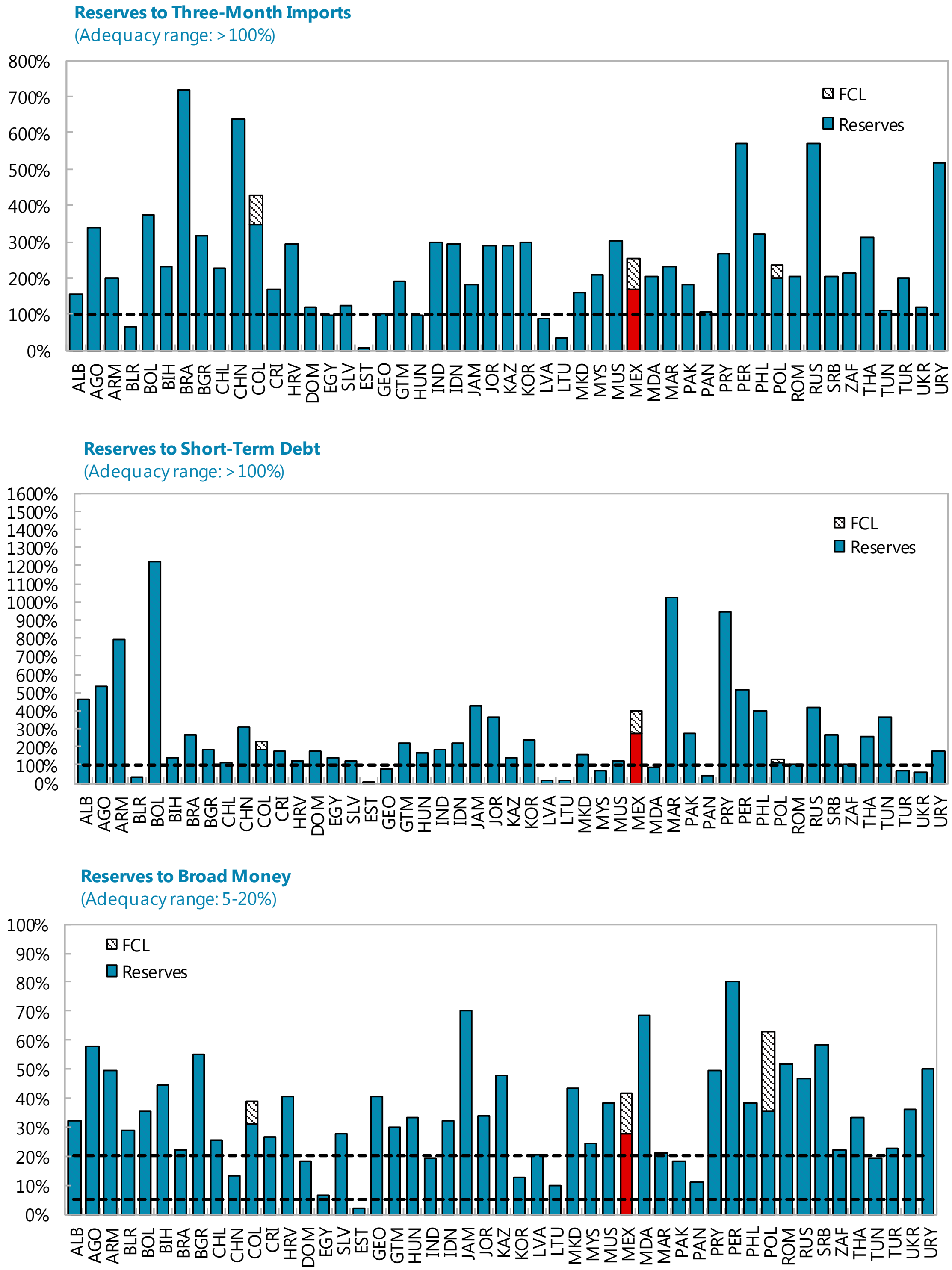


Reserves to ARA Metric
(Adequacy range: 100-150%)



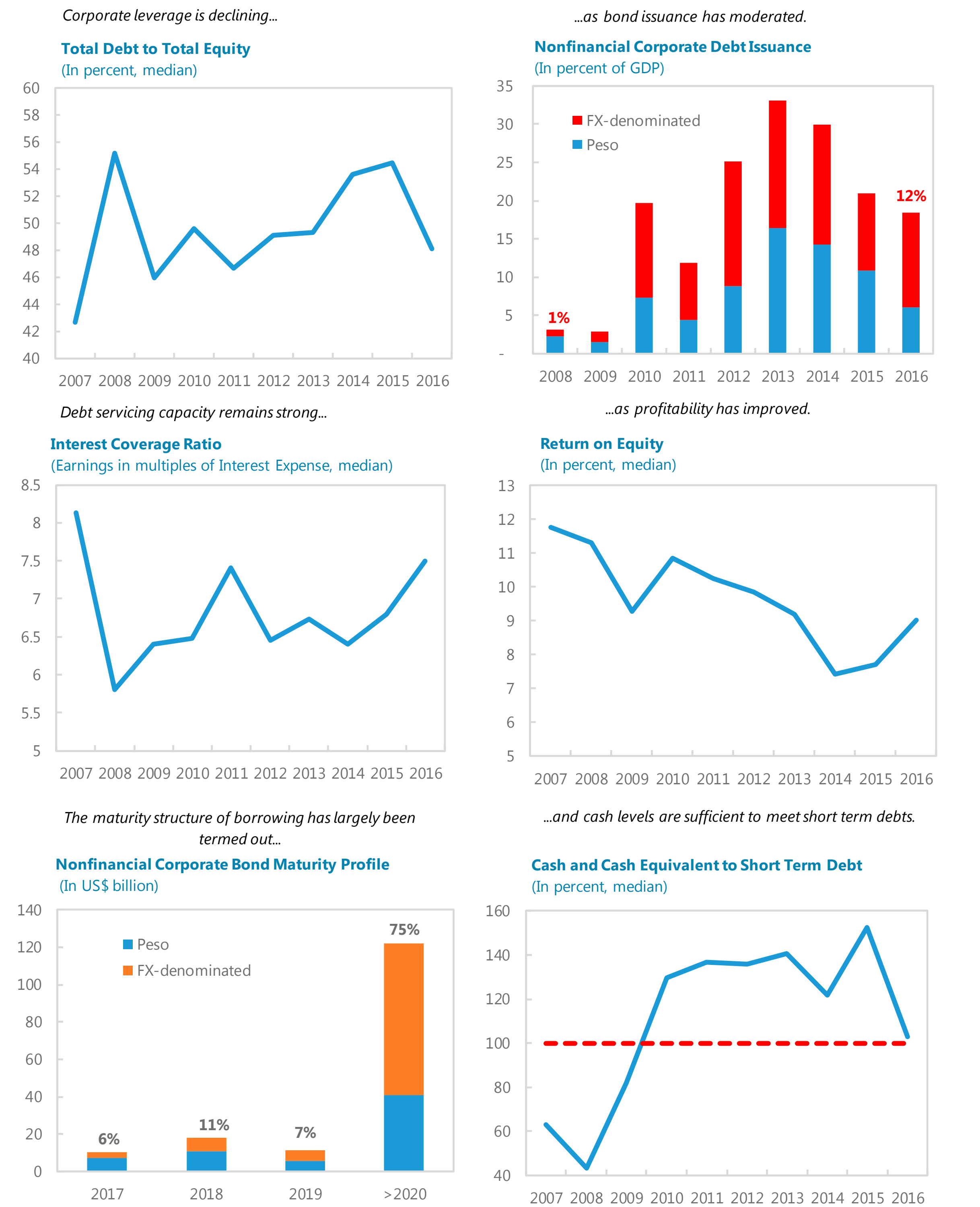
Sources: World Economic Outlook, Balance of Payments Statistics Database, and Fund staff estimates.
1/ The assessing reserve adequacy (ARA) metric for emerging markets comprises four components reflecting potential balance of payment drains: (i) export income, (ii) broad money, (iii) short-term debt,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

Figure 8. Mexico: Reserve Coverage in an International Perspective, 2016 1/ (concluded)



Sources: World Economic Outlook, and Fund staff estimates.

Figure 9. Mexico: Nonfinancial Corporate Sector

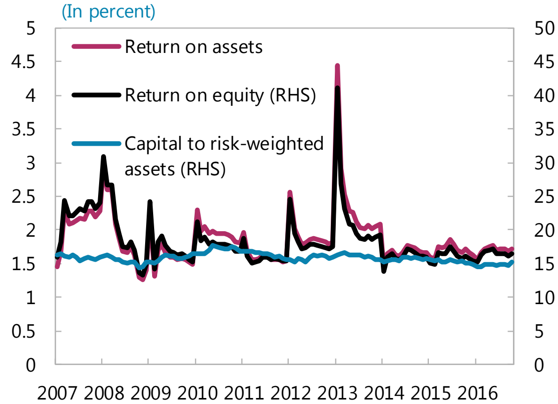


Sources: Bloomberg, External Debt Statistics, Financial Soundness Indicators, and Fund staff estimates.

Figure 10. Mexico: Banking System

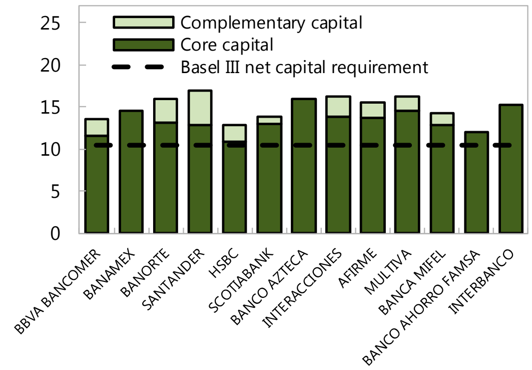
The banking sector remains profitable...

Commercial and Development Banking Sector
(In percent)



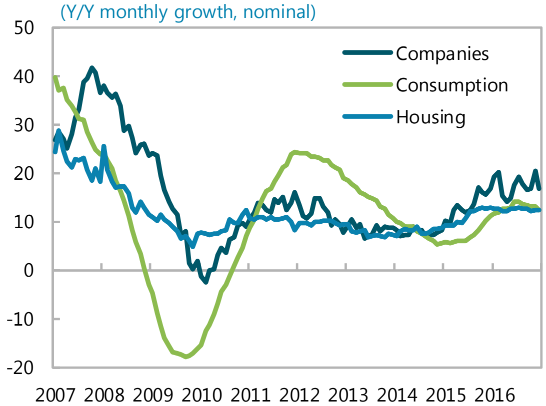
...and well capitalized.

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



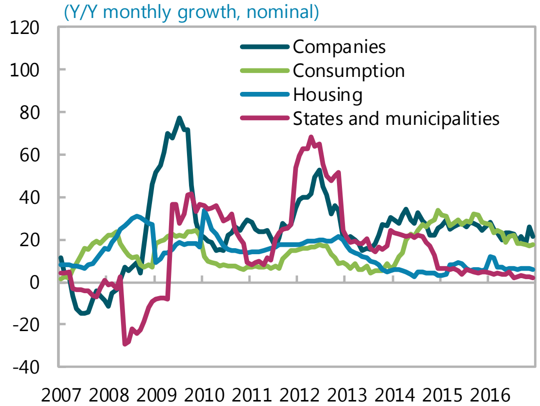
After picking up in late 2015--reflecting in part valuation effects--commercial bank credit growth has stabilized...

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



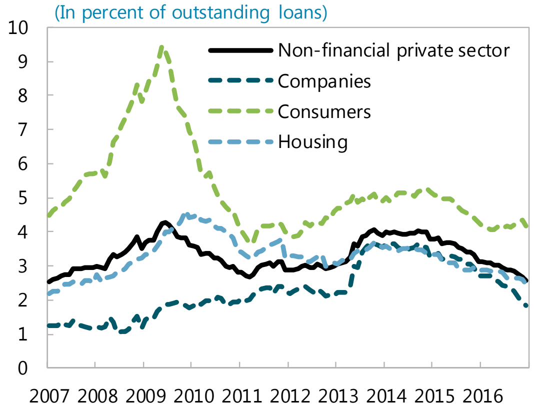
...while development bank credit growth to the private sector remains strong.

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



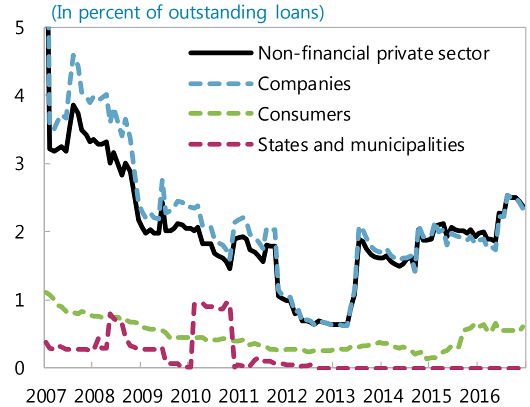
Non-performing loans at commercial banks ...

Total Commercial Bank NPLs
(In percent of outstanding loans)



...and development banks are low.

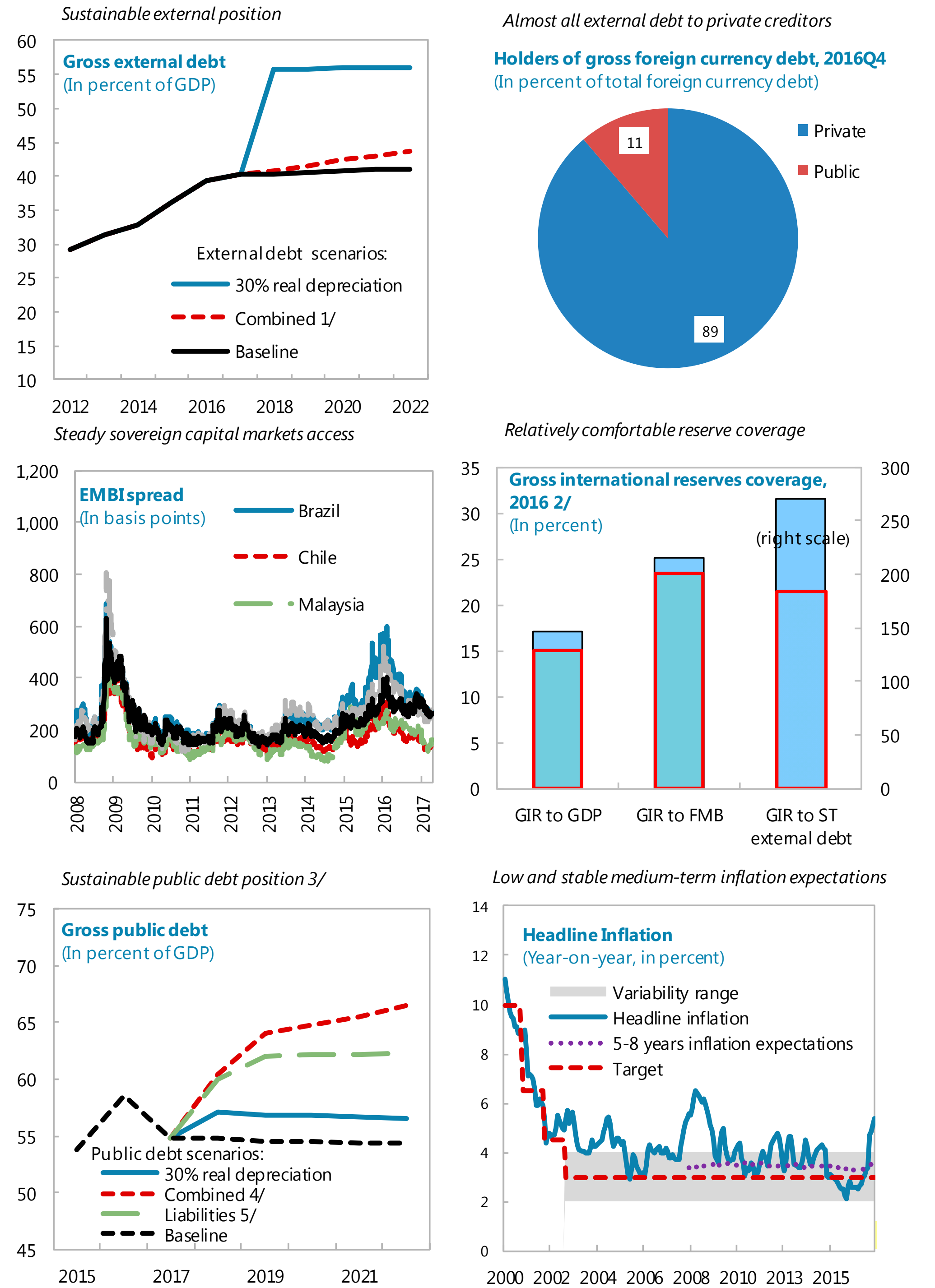
Total Development Bank NPLs
(In percent of outstanding loans)



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

1/ As of January 2017.

Figure 11. Mexico: Qualification Criteria



Sources: Bloomberg L.P., Datastream, EMED, Haver Analytics, and Fund staff estimates.
1/ Combined permanent 1/4 standard deviation shocks applied to interest rate, growth, and current account balance.
2/ Red bar shows ratio for end-year 2015.
3/ Not taking into account offsetting measures required under the balanced 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.

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

I. Social and Demographic Indicators

GDP per capita (U.S. dollars, 2016)	8,415	Poverty headcount ratio (% of population, 2014) 1/	46.2
Population (millions, 2016)	122.3	Income share of highest 20 percent / lowest 20 percent (2014)	10.7
Life expectancy at birth (years, 2015)	74.9	Adult illiteracy rate (2015)	5.5
Infant mortality rate (per thousand, 2015)	11.3	Gross primary education enrollment rate (2014) 2/	103.4

II. Economic Indicators

					Proj.	
	2013	2014	2015	2016	2017	2018
	(Annual percentage change, unless otherwise indicated)					
National accounts (in real terms)						
GDP	1.4	2.3	2.6	2.3	1.7	2.0
Consumption	2.0	1.8	2.3	2.6	1.4	0.9
Private	2.1	1.8	2.3	2.8	1.6	1.4
Public	1.0	2.1	2.3	1.1	0.3	-2.2
Investment	-2.0	3.3	3.1	0.1	-1.7	0.5
Fixed	-1.6	3.0	4.2	0.4	-1.7	0.5
Private	-1.6	5.0	8.0	2.2	1.6	1.4
Public	-1.3	-5.0	-12.0	-9.2	-21.3	-5.7
Inventories 3/	-0.1	0.1	-0.2	-0.1	0.0	0.0
Exports of goods and services	2.4	7.0	10.3	1.2	7.0	8.0
Imports of goods and services	2.6	6.0	8.6	1.1	3.0	5.2
GDP per capita	0.2	1.1	1.5	1.2	0.7	1.0
External sector						
External current account balance (in percent of GDP)	-2.5	-2.0	-2.9	-2.7	-2.4	-2.6
Exports of goods, f.o.b.	2.5	4.4	-4.2	-1.8	7.9	7.5
Export volume	1.7	7.1	9.6	0.1	7.0	8.0
Imports of goods, f.o.b.	2.8	4.9	-1.2	-2.1	7.1	8.2
Import volume	2.5	6.2	9.1	1.3	3.0	5.2
Net capital inflows (in percent of GDP)	5.5	4.7	3.1	3.4	2.6	3.0
Terms of trade (improvement +)	0.4	-1.3	-3.4	1.4	-3.1	-3.2
Exchange rates						
Real effective exchange rate (CPI based, IFS)						
(average, appreciation +)	6.1	-1.0	-10.1	-13.9	...	...
Nominal exchange rate (MXN/USD)						
(average, appreciation +)	-0.5	-12.6	-16.9	-17.7	...	...
Employment and inflation						
Consumer prices (end-of-period)	4.0	4.1	2.1	3.4	5.1	3.3
Core consumer prices (end-of-period)	2.8	3.2	2.4	3.4	4.5	3.1
Formal sector employment, IMSS-insured workers (average)	3.5	3.5	4.3	3.8	...	...
National unemployment rate (annual average)	4.9	4.8	4.3	3.9	3.7	3.7
Unit labor costs: manufacturing (real terms, average)	1.0	-1.2	1.5	6.5	...	...
Money and credit						
Financial system credit to non-financial private sector 4/	9.2	8.7	14.6	16.7	14.1	11.7
Broad money (M2a) 5/	8.3	10.2	7.9	10.0	11.1	8.5
Public sector finances (in percent of GDP) 6/						
General government revenue	24.2	23.3	23.1	23.2	22.6	21.0
General government expenditure	28.0	27.9	27.2	26.0	24.0	23.5
Overall fiscal balance	-3.7	-4.6	-4.1	-2.9	-1.4	-2.5
Gross public sector debt	46.4	49.5	53.7	58.5	54.8	54.8
Memorandum items						
Nominal GDP (billions of pesos)	16,118	17,259	18,242	19,523	21,109	22,270
Output gap	-0.3	-0.4	-0.2	-0.3	-0.8	-0.8

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

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

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

3/ Contribution to growth. Excludes statistical discrepancy.

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

5/ Includes public sector deposits.

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

Table 2. Mexico: Statement of Operations of the Public Sector, Authorities' Presentation 1/

(In percent of GDP)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Projections					
Budgetary revenue, by type	23.6	23.1	23.4	24.8	22.6	21.0	20.8	20.8	20.8	20.8
Oil revenue	8.3	7.1	4.6	4.1	3.7	3.6	3.5	3.5	3.5	3.6
Non-oil tax revenue	9.7	10.5	12.9	13.9	13.2	13.2	13.1	13.1	13.1	13.1
Non-oil non-tax revenue 2/	5.5	5.5	5.8	6.8	5.7	4.2	4.2	4.2	4.2	4.2
Budgetary revenue, by entity	23.6	23.1	23.4	24.8	22.6	21.0	20.8	20.8	20.8	20.8
Federal government revenue	16.8	16.7	17.4	18.3	17.1	15.5	15.5	15.4	15.5	15.5
Tax revenue, *of which:*	9.7	10.5	12.9	13.9	13.2	13.2	13.1	13.1	13.1	13.1
Excises (including fuel)	0.0	0.6	1.9	2.1	2.0	2.0	1.9	1.9	1.9	1.9
Nontax revenue	7.1	6.3	4.5	4.4	3.9	2.4	2.4	2.4	2.5	2.4
Public enterprises	6.8	6.3	6.0	6.5	5.5	5.4	5.3	5.3	5.3	5.3
PEMEX	3.0	2.6	2.4	2.5	2.0	2.0	1.9	1.9	1.8	1.9
Other	3.8	3.8	3.6	4.1	3.4	3.4	3.4	3.4	3.4	3.4
Budgetary expenditure	25.9	26.2	26.8	27.4	23.9	23.0	22.7	22.8	22.8	22.8
Primary	24.0	24.2	24.6	24.9	21.0	20.1	20.0	20.0	20.1	20.1
Programmable	20.6	20.7	21.0	21.3	17.5	16.5	16.5	16.5	16.6	16.6
Current	15.1	15.5	15.8	15.3	14.4	14.0	14.0	14.1	14.2	14.3
Wages	6.0	5.9	5.9	5.7	5.6	5.6	5.5	5.4	5.3	5.2
Pensions 3/	2.9	3.0	3.2	3.3	3.4	3.6	3.8	4.0	4.2	4.4
Subsidies and transfers	3.3	3.6	3.7	3.5	2.8	2.5	2.4	2.4	2.4	2.4
Other	3.0	3.0	3.0	2.7	2.5	2.3	2.3	2.3	2.2	2.2
Capital	5.4	5.2	5.1	6.1	3.1	2.5	2.5	2.4	2.4	2.3
Physical capital	4.6	4.8	4.2	3.7	2.6	2.5	2.4	2.4	2.3	2.3
Financial capital 4/	0.9	0.4	0.9	2.3	0.5	0.1	0.1	0.1	0.1	0.1
Nonprogrammable	3.4	3.5	3.6	3.6	3.5	3.5	3.5	3.5	3.5	3.5
Of which: revenue sharing	3.3	3.4	3.4	3.6	3.4	3.4	3.4	3.4	3.4	3.4
Interest payments	2.0	2.0	2.2	2.4	2.9	2.9	3.1	3.2	3.3	3.4
Traditional balance	-2.3	-3.1	-3.5	-2.6	-1.3	-2.0	-2.0	-2.0	-2.0	-2.0
Adjustments to the traditional balance	-1.4	-1.4	-0.6	-0.3	-0.1	-0.5	-0.5	-0.5	-0.5	-0.5
Public Sector Borrowing Requirements	**3.7**	**4.6**	**4.1**	**2.9**	**1.4**	**2.5**	**2.5**	**2.5**	**2.5**	**2.5**
Memorandum items										
Structural current spending 5/	11.6	12.1	12.2	11.4						
Structural current spending real growth (y/y, in percent)	3.3	6.7	3.1	-4.3						

Sources: Mexican authorities and IMF staff estimates.

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

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

3/ Includes social assistance benefits.

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

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

Table 3. Mexico: Statement of Operations of the Public Sector, GFSM 2001 Presentation 1/

(In percent of GDP)

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Projections					
Revenue	**24.2**	**23.3**	**23.1**	**23.2**	**22.6**	**21.0**	**20.8**	**20.8**	**20.8**	**20.8**
Taxes	**10.3**	**10.7**	**12.9**	**13.9**	**13.2**	**13.2**	**13.1**	**13.1**	**13.1**	**13.1**
Taxes on income, profits and capital gains	5.9	5.6	6.7	7.3	6.8	6.8	6.8	6.8	6.8	6.8
Taxes on goods and services	4.1	4.7	5.8	6.2	5.9	5.9	5.8	5.8	5.8	5.8
Value added tax	3.5	3.9	3.9	4.1	3.9	3.9	3.9	3.9	3.9	3.9
Excises	0.6	0.9	1.9	2.1	2.0	2.0	1.9	1.9	1.9	1.9
Taxes on international trade and transactions	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other taxes	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Social contributions	**1.7**	**1.7**	**1.7**	**1.7**	**1.6**	**1.6**	**1.6**	**1.5**	**1.5**	**1.6**
Other revenue	**12.2**	**10.9**	**8.5**	**7.6**	**7.8**	**6.2**	**6.1**	**6.2**	**6.2**	**6.2**
Property income 2/	7.0	6.2	4.5	4.3	3.9	2.3	2.3	2.4	2.4	2.4
Other	5.1	4.6	4.0	3.2	3.9	3.9	3.8	3.8	3.8	3.8
Total expenditure	**28.0**	**27.9**	**27.2**	**26.0**	**24.0**	**23.5**	**23.3**	**23.3**	**23.3**	**23.3**
Expense	**22.5**	**22.7**	**22.3**	**21.8**	**21.2**	**20.9**	**20.7**	**20.8**	**20.8**	**20.9**
Compensation of employees	6.0	5.9	5.9	5.7	5.6	5.6	5.5	5.4	5.3	5.2
Purchases of goods and services	3.0	3.0	3.0	2.7	2.5	2.3	2.3	2.3	2.2	2.2
Interest 3/	3.0	3.0	3.0	3.4	3.2	3.2	3.3	3.4	3.5	3.6
Subsidies	4.0	3.8	3.7	3.5	2.8	2.5	2.4	2.4	2.4	2.4
o/w fuel subsidy	0.7	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants 4/	3.3	3.4	3.4	3.6	3.4	3.4	3.4	3.4	3.4	3.4
Social benefits 5/	2.9	3.0	3.2	3.3	3.4	3.6	3.8	4.0	4.2	4.4
Other expense 6/	0.4	0.5	0.0	-0.3	0.2	0.2	0.0	-0.1	-0.3	-0.4
Net acquisition of nonfinancial assets 7/	**5.4**	**5.2**	**4.9**	**4.2**	**2.8**	**2.6**	**2.6**	**2.5**	**2.5**	**2.4**
Gross Operating Balance	1.7	0.6	0.8	1.3	1.4	0.1	0.1	0.0	0.0	-0.1
Overall Fiscal Balance (Net lending/borrowing)	**-3.7**	**-4.6**	**-4.1**	**-2.9**	**-1.4**	**-2.5**	**-2.5**	**-2.5**	**-2.5**	**-2.5**
Primary net lending/borrowing	**-0.7**	**-1.6**	**-1.1**	**0.5**	**1.8**	**0.7**	**0.8**	**0.9**	**1.0**	**1.1**
Memo items:										
Primary expenditure	24.9	24.9	24.2	22.6	20.8	20.2	19.9	19.9	19.8	19.7
Current expenditure	22.5	22.7	22.3	21.8	21.2	20.9	20.7	20.8	20.8	20.9
Structural fiscal balance	-4.4	-4.9	-4.7	-4.1	-2.6	-2.3	-2.4	-2.5	-2.5	-2.5
Structural primary balance 8/	-1.3	-1.9	-1.7	-0.7	0.6	1.0	0.9	0.9	1.0	1.1
Fiscal impulse 9/	-0.2	0.5	-0.2	-1.0	-1.3	-0.3	0.1	-0.1	-0.1	-0.1
Gross public sector debt 10/	46.4	49.5	53.7	58.5	54.8	54.8	54.6	54.6	54.4	54.3
In domestic currency (percentage of total debt)	75.8	74.0	70.9	66.3	66.5	64.3	62.8	62.1	61.2	60.9
In foreing currency (percentage of total debt)	24.2	26.0	29.1	33.7	33.5	35.7	37.2	37.9	38.8	39.1
Net public sector debt 11/	40.4	43.1	47.3	50.2	46.5	46.7	46.5	46.5	46.3	46.3

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

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

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

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

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

5/ Includes pensions and social assistance benefits.

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

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

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

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

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

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

Table 4. Mexico: Summary Balance of Payments

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Projections					
	(In billions of U.S. dollars)									
Current account	-31.0	-26.2	-33.3	-27.9	-25.9	-29.6	-32.1	-33.2	-32.9	-33.2
Merchandise goods trade balance	-1.2	-3.1	-14.6	-13.2	-11.2	-14.7	-16.8	-18.8	-18.9	-19.6
Exports	380.0	396.9	380.6	374.2	403.6	434.1	470.0	509.1	554.3	602.3
o/w Manufactures	314.6	337.3	340.0	336.4	366.9	397.8	431.4	467.7	505.5	550.2
o/w Petroleum and derivatives	49.5	42.4	23.2	18.7	22.5	21.6	21.5	22.6	27.2	28.3
Imports	-381.2	-400.0	-395.2	-387.4	-414.9	-448.8	-486.8	-527.9	-573.2	-621.9
o/w Petroleum and derivatives	-40.9	-41.5	-33.3	-31.6	-37.5	-37.9	-38.1	-38.8	-39.9	-40.8
Net other goods 1/	0.3	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net services	-11.0	-12.5	-9.2	-7.8	-7.8	-7.7	-7.6	-7.7	-8.0	-8.5
Net factor income	-40.7	-33.9	-34.0	-33.6	-36.2	-39.9	-43.7	-46.1	-48.5	-51.3
o/w Interest payments	-23.4	-25.7	-25.9	-26.0	-30.2	-35.3	-40.1	-42.2	-44.2	-46.5
o/w Remitted profits	-11.9	-4.4	-5.4	-6.2	-5.6	-5.7	-5.7	-6.5	-6.9	-7.1
o/w Reinvested earnings	-16.8	-15.5	-10.6	-8.2	-9.4	-10.2	-11.2	-11.3	-11.8	-12.6
Net transfers (mostly remittances)	21.7	22.9	24.3	26.7	29.3	32.6	36.0	39.2	42.5	46.1
Financial Account	69.8	61.2	35.2	35.9	27.7	34.1	39.6	41.0	40.6	40.9
Foreign direct investment, net	34.7	20.5	22.4	27.5	19.7	24.4	29.8	30.8	31.8	32.9
Direct investment into Mexico	47.5	27.5	33.2	26.7	26.2	31.3	37.1	38.5	40.0	41.5
Direct investment abroad	-12.9	-7.0	-10.7	0.8	-6.5	-6.9	-7.3	-7.7	-8.1	-8.6
Portfolio investment, net	49.0	46.3	28.0	30.7	22.6	23.2	23.0	24.5	23.6	24.2
Liabilities	51.1	47.1	20.4	28.6	24.9	25.6	25.5	27.2	26.5	27.2
Public Sector	33.2	36.0	16.9	21.4	22.7	21.7	20.7	23.6	21.5	23.1
o/w Local currency domestic-issued bonds	22.0	23.1	1.3	-1.5	9.5	10.8	11.5	13.2	12.9	14.6
Private sector	18.0	11.1	3.5	7.2	2.2	3.9	4.8	3.6	4.9	4.1
Assets	-2.1	-0.7	7.6	2.1	-2.3	-2.4	-2.6	-2.7	-2.8	-3.0
Other investments, net	-13.9	-5.7	-15.2	-22.4	-14.6	-13.5	-13.2	-14.3	-14.8	-16.1
Liabilites	13.4	15.2	-2.3	2.1	0.5	2.6	3.8	3.6	4.1	3.8
Assets	-27.3	-20.9	-12.9	-24.4	-15.1	-16.0	-17.0	-17.9	-18.9	-19.9
Errors and Omissions	-21.1	-18.7	-17.6	-8.2	0.0	0.0	0.0	0.0	0.0	0.0
Change in gross international reserves	13.2	15.5	-18.1	0.4	1.8	4.6	7.6	7.7	7.7	7.7
o/w PEMEX-related transactions	17.3	14.3	2.8	-0.7	0.0	0.0	0.0	0.0	0.0	0.0
o/w Market transactions (incl. interventions)	0.0	-0.2	-24.5	-11.6	0.0	2.5	5.0	5.0	5.0	5.0
Valuation adjustments	4.6	0.8	2.4	-0.6	0.0	0.0	0.0	0.0	0.0	0.0
	(In percent of GDP)									
Current account balance	-2.5	-2.0	-2.9	-2.7	-2.4	-2.6	-2.6	-2.6	-2.4	-2.3
o/w Hydrocarbons trade balance 2/	0.7	0.1	-0.9	-1.2	-1.4	-1.4	-1.4	-1.3	-0.9	-0.9
o/w Petroleum and derivatives exports	3.9	3.3	2.0	1.8	2.1	1.9	1.8	1.8	2.0	2.0
o/w Non-hydrocarbons trade balance	-0.8	-0.3	-0.4	0.0	0.4	0.1	0.0	-0.2	-0.4	-0.5
o/w Manufactures exports	24.9	26.0	29.5	32.2	33.8	34.5	35.3	36.4	37.2	38.4
Net capital inflows	5.5	4.7	3.1	3.4	2.6	3.0	3.2	3.2	3.0	2.9
Net FDI inflows	2.7	1.6	2.0	2.6	1.8	2.1	2.4	2.4	2.3	2.3
Net portfolio inflows	3.9	3.6	2.4	2.9	2.1	2.0	1.9	1.9	1.7	1.7
Net other investment inflows	-1.1	-0.4	-1.3	-2.1	-1.3	-1.2	-1.1	-1.1	-1.1	-1.1
International Investment Position, net	-45.7	-43.1	-48.5	-46.1	-45.4	-43.8	-42.6	-41.7	-40.6	-39.5
Memorandum items										
Hydrocarbons exports volume growth (in percent)	-1.2	-3.9	2.7	2.0	-7.1	-3.7	1.0	5.3	20.7	4.1
Non-hydrocarbons exports volume growth (in percent)	1.8	7.5	9.8	0.1	7.4	8.3	7.2	6.3	6.1	6.2
Hydrocarbons imports volume growth (in percent)	3.4	-4.4	16.0	15.5	17.3	1.9	2.6	2.3	2.9	2.6
Non-hydrocarbons imports volume growth (in percent)	2.5	6.4	9.0	1.0	2.7	5.3	6.1	6.7	6.9	6.8
Crude oil export volume (in millions of bbl/day)	1.2	1.1	1.2	1.2	1.1	1.1	1.1	1.2	1.4	1.5
Gross international reserves (in billions of U.S. dollars)	180.2	195.7	177.6	178.1	179.8	184.4	191.9	199.7	207.4	215.2
Gross domestic product (in billions of U.S. dollars)	1,262	1,298	1,151	1,046	…	…	…	…	…	…

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

1/ Goods procured in ports by carriers.

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

Table 5. Mexico: Financial Soundness Indicators

(In percent)

	2012	2013	2014	2015	2016
Capital Adequacy					
Regulatory capital to risk-weighted assets	15.9	15.6	15.8	15.0	14.9
Regulatory Tier 1 capital to risk-weighted assets	13.8	13.4	13.8	13.3	13.2
Capital to assets	10.6	10.3	10.9	10.4	9.9
Gross asset position in financial derivatives to capital	77.2	73.8	56.1	61.1	91.8
Gross liability position in financial derivatives to capital	76.2	73.0	59.7	65.1	96.5
Asset Quality					
Nonperforming loans to total gross loans	2.4	3.2	3.0	2.5	2.1
Provisions to Nonperforming loans	185.5	147.6	132.7	140.1	157.1
Earnings and Profitability					
Return on assets	1.8	2.0	1.7	1.6	1.7
Return on equity	17.5	18.6	15.9	15.5	16.3
Liquidity					
Liquid assets to short-term liabilities	49.6	47.5	46.5	45.5	42.4
Liquid assets to total assets	36.2	35.9	35.4	34.6	31.4
Customer deposits to total (noninterbank) loans	88.5	88.7	89.5	87.7	88.9
Trading income to total income	4.8	7.5	4.0	3.3	4.4

Sources: Financial Soundness Indicators

Table 6. Mexico: Financial Indicators and Measures of External Vulnerabilities

	2008	2009	2010	2011	2012	2013	2014	2015	2016
Financial market indicators									
Exchange rate (per U.S. dollar, average)	13.5	13.1	12.4	14.0	13.0	13.1	14.7	17.2	18.7
(year-to-date percent change, + appreciation)	-24.6	3.5	5.4	-13.2	7.0	-0.5	-12.6	-16.9	-17.7
28-day treasury auction rate (percent; period average)	7.7	5.4	4.4	4.2	4.2	3.8	3.0	3.0	5.6
EMBIG Mexico spread (basis points; period average)	254	302	187	186	188	189	182	251	304
Sovereign 10-year local currency bond yield (period average)	8.4	8.0	7.0	6.8	5.7	5.6	6.0	6.0	6.2
Stock exchange index (period average, year on year percent change)	-9.8	-5.5	31.6	8.0	10.6	5.6	1.4	3.1	3.8
Financial system									
Financial system credit on non-financial private sector (year on year percent change)	10.5	0.1	8.6	14.2	10.0	9.2	8.7	14.6	16.7
Nonperforming loans to total gross loans	2.7	3.1	2.0	2.1	2.4	3.2	3.0	2.5	2.1
External vulnerability indicators									
Gross financing needs (billions of US$)	71.7	75.5	65.9	98.9	103.2	142.0	154.0	125.8	128.4
Gross international reserves (end-year, billions of US$) 1/	95.2	99.9	120.6	149.2	167.1	180.2	195.7	177.6	178.1
Change (billions of US$)	8.0	4.6	20.8	28.6	17.8	13.2	15.5	-18.1	0.4
Months of imports of goods and services	3.4	4.6	4.4	4.7	5.0	5.2	5.4	5.0	5.1
Percent of broad money	19.1	18.3	19.4	24.4	23.3	23.3	25.9	25.4	27.9
Percent of portfolio liabilities	35.0	41.8	39.6	48.0	38.8	37.9	40.7	39.0	39.1
Percent of short-term debt (by residual maturity)	159.4	245.2	228.1	231.8	179.8	169.2	183.3	209.2	168.8
Percent of ARA Metric 2/	88.8	102.8	99.8	118.8	109.5	107.9	115.1	112.0	113.8
Percent of GDP	8.6	11.2	11.5	12.7	14.1	14.3	15.1	15.4	17.2
Gross total external debt (in percent of GDP)	18.2	21.2	23.3	24.1	29.2	31.4	32.9	36.3	39.4
Of which: In local currency	1.8	2.7	4.6	6.0	10.2	11.1	11.1	10.7	9.8
Of which: Public debt	11.7	13.1	14.7	15.6	20.4	21.4	22.1	24.4	26.7
Of which: Private debt	6.4	8.1	8.5	8.4	8.7	10.0	10.8	11.9	12.8
Financial sector	0.4	0.6	1.6	1.4	1.1	1.3	1.4	1.3	1.5
Nonfinancial sector	6.1	7.5	6.9	7.1	7.7	8.7	9.4	10.6	11.3
Gross total external debt (billions of US$)	200.2	190.1	244.4	281.7	345.9	396.8	427.3	417.9	412.0
Of which: In local currency	19.6	24.0	48.5	69.8	121.2	140.3	143.9	123.3	102.1
Of which: Public debt	129.2	117.6	155.0	182.9	242.5	270.1	287.3	281.0	278.7
Of which: Private debt	70.9	72.5	89.4	98.9	103.4	126.6	139.9	136.9	133.4
Financial sector	4.6	5.6	17.4	17.1	13.4	17.3	19.6	16.3	15.5
Nonfinancial sector	66.3	67.0	72.0	81.8	90.1	109.4	120.3	120.7	117.9
External debt service (in percent of GDP)	5.2	8.1	5.2	6.0	7.2	9.2	10.2	11.5	11.8

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

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

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

Table 7. Mexico: Baseline Medium-Term Projections

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022
					Staff projections					
	(Annual percentage change, unless otherwise indicated)									
National accounts (in real terms)										
GDP	1.4	2.3	2.6	2.3	1.7	2.0	2.7	2.7	2.7	2.7
Consumption	2.0	1.8	2.3	2.6	1.4	0.9	1.7	1.9	1.9	2.1
Private	2.1	1.8	2.3	2.8	1.6	1.4	2.1	2.1	2.2	2.3
Public	1.0	2.1	2.3	1.1	0.3	-2.2	-0.9	0.2	0.2	0.5
Investment	-2.0	3.3	3.1	0.1	-1.7	0.5	3.7	5.4	5.5	4.8
Fixed	-1.6	3.0	4.2	0.4	-1.7	0.5	3.8	5.5	5.6	4.9
Private	-1.6	5.0	8.0	2.2	1.6	1.4	4.0	5.9	5.9	5.2
Public	-1.3	-5.0	-12.0	-9.2	-21.3	-5.7	1.4	2.1	2.3	2.4
Inventories 1/	-0.1	0.1	-0.2	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	2.4	7.0	10.3	1.2	7.0	8.0	7.1	6.2	6.4	6.2
Oil exports	-1.2	-3.9	2.7	2.0	-7.1	-3.7	1.0	5.3	20.7	4.1
Non-oil exports	2.5	7.3	10.5	1.2	7.4	8.3	7.2	6.3	6.1	6.2
Imports of goods and services	2.6	6.0	8.6	1.1	3.0	5.2	6.0	6.6	6.8	6.7
Oil imports	3.4	-4.4	16.0	15.5	17.3	1.9	2.6	2.3	2.9	2.6
Non-oil imports	2.6	6.3	8.5	0.7	2.5	5.3	6.2	6.7	6.9	6.8
Net exports 1/	-0.1	0.3	0.6	0.0	1.4	1.1	0.6	0.1	0.1	0.0
Consumer prices										
End of period	4.0	4.1	2.1	3.4	5.1	3.3	3.0	3.0	3.0	3.0
Average	3.8	4.0	2.7	2.8	5.2	3.4	3.0	3.0	3.0	3.0
External sector										
Current account balance (in percent of GDP)	-2.5	-2.0	-2.9	-2.7	-2.4	-2.6	-2.6	-2.6	-2.4	-2.3
Non-hydrocarbon current account balance (in percent of GDP)	-3.1	-2.1	-2.0	-1.4	-1.0	-1.2	-1.3	-1.3	-1.5	-1.4
Exports of goods, f.o.b.	2.5	4.4	-4.2	-1.8	7.9	7.5	8.3	8.3	8.9	8.7
Imports of goods, f.o.b.	2.8	4.9	-1.2	-2.1	7.1	8.2	8.5	8.4	8.6	8.5
Terms of trade (improvement +)	0.4	-1.3	-3.4	1.4	-3.1	-3.2	-1.2	0.2	0.6	0.6
Crude oil export price, Mexican mix (US$/bbl)	98.8	87.7	44.3	35.8	46.6	46.4	45.6	45.5	45.8	45.8
	(In percent of GDP)									
Non-financial public sector										
Overall balance	-3.7	-4.6	-4.1	-2.9	-1.4	-2.5	-2.5	-2.5	-2.5	-2.5
Primary balance	-1.2	-2.0	-1.1	0.2	1.8	0.6	0.6	0.8	0.9	1.1
Saving and investment 2/										
Gross domestic investment	21.7	21.6	22.9	23.3	22.4	22.4	22.9	23.8	24.7	25.6
Fixed investment	21.1	21.0	22.5	22.9	22.3	22.2	22.8	23.7	24.6	25.4
Public	4.5	4.1	3.6	3.3	2.6	2.4	2.4	2.4	2.5	2.5
Private	16.6	16.9	18.9	19.6	19.7	19.8	20.3	21.3	22.1	22.9
Gross domestic saving	19.2	19.6	20.0	20.6	20.0	19.8	20.3	21.3	22.3	23.2
Public	0.8	-0.5	-0.5	0.5	1.2	-0.1	-0.1	-0.1	0.0	0.0
Private	18.5	20.0	20.5	20.1	18.9	19.9	20.4	21.3	22.4	23.3
	(Percent growth, unless otherwise indicated)									
Memorandum items										
Financial system credit to non-financial private sector	9.2	8.7	14.6	16.7	14.1	11.7	11.7	11.3	11.7	…
Output gap (in percent of potential GDP)	-0.3	-0.4	-0.2	-0.3	-0.8	-0.8	-0.3	-0.1	0.0	0.0
Total population	1.1	1.1	1.1	1.0	1.0	1.0	1.0	0.9	0.9	0.9
Working-age population 3/	1.9	1.9	1.8	1.6	1.6	1.5	1.4	1.3	1.3	1.2

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

1/ Contribution to growth. Excludes statistical discrepancy.

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

3/ Based on United Nations population projections.

Table 8. Mexico—Capacity to Repay Indicators 1/

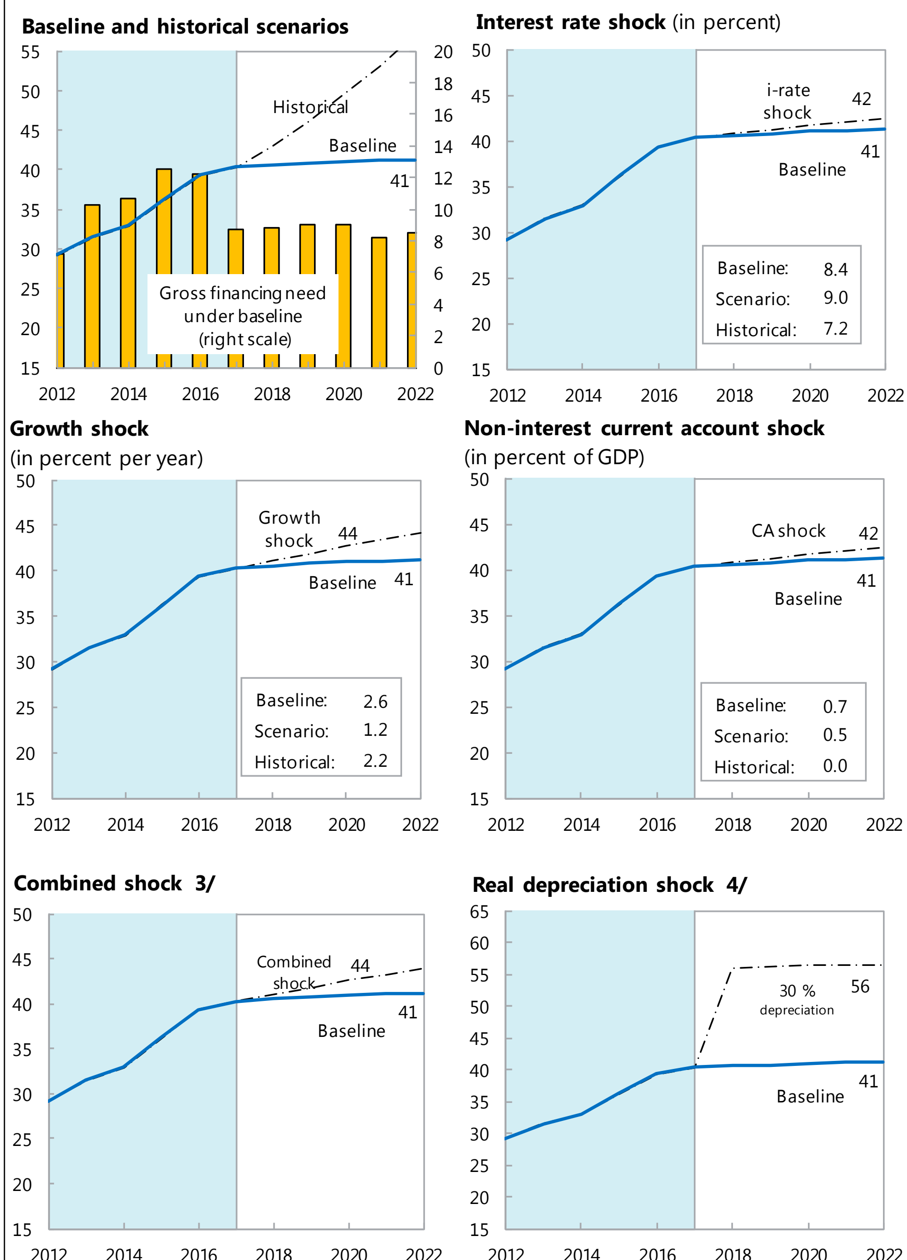
	2017	2018	2019	2020	2021	2022
Exposure and Repayments (In SDR millions)						
GRA credit to Mexico	62,388.9	62,388.9	62,388.9	46,791.7	15,597.2	--
In percent of quota	700.0	700.0	700.0	525.0	175.0	--
Charges due on GRA credit 2/	1,152.4	1,846.3	1,846.3	1,983.5	1,144.4	116.8
Debt service due on GRA credit 2/	1,152.4	1,846.3	1,846.3	17,580.7	32,338.8	15,714.0
Debt and Debt Service Ratios 3/						
In percent of GDP						
Total external debt	48.0	48.4	48.6	47.0	43.8	
Public external debt	33.4	33.3	33.2	30.9	27.7	
GRA credit to Mexico	7.6	7.2	6.9	4.9	1.5	
Total external debt service	11.5	11.7	12.2	14.2	15.4	
Public external debt service	6.6	6.6	6.5	8.2	9.1	
Debt service due on GRA credit	0.1	0.2	0.2	1.8	3.2	
In percent of Gross International Reserves						
Total external debt	318.0	330.8	340.3	338.0	324.5	
Public external debt	221.5	227.4	232.0	222.7	205.1	
GRA credit to Mexico	50.3	49.6	48.3	35.2	11.4	
In percent of Exports of Goods and Services						
Total external debt service	30.0	29.7	30.0	34.3	37.1	
Public external debt service	17.2	16.7	16.0	20.0	21.8	
Debt service due on GRA credit	0.4	0.5	0.5	4.5	7.7	
In percent of Total External Debt						
GRA credit to Mexico	15.8	15.0	14.2	10.4	3.5	
In percent of Public External Debt						
GRA credit to Mexico	22.7	21.8	20.8	15.8	5.6	
U. S. dollars per SDR (period average)	1.40	1.40	1.40	1.41	1.41	
U. S. dollars per SDR (end of period)	1.40	1.40	1.41	1.41	1.41	

Sources: National authorities, Finance Department, World Economic Outlook, and Fund staff estimates.
1/ Assumes full drawings under the FCL upon conclusion of the review. The Mexican authorities have expressed their intention to treat the arrangement as precautionary.
2/ 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 FCL drawing.

Appendix I. External Debt Sustainability Analysis

Mexico: 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 2016.

Mexico: External Debt Sustainability Framework

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2012	2013	2014	2015	2016			2017	2018	2019	2020	2021	2022	**Debt-stabilizing non-interest current account 6/**
1 **Baseline: External debt**	29.2	31.4	32.9	36.2	39.3			**40.3**	**40.5**	**40.8**	**41.0**	**41.1**	**41.2**	**-1.3**
2 Change in external debt	5.1	2.3	1.5	3.3	3.1			0.9	0.3	0.2	0.3	0.1	0.1	
3 Identified external debt-creating flows (4+8+9)	0.1	-1.6	-1.3	2.7	0.9			-0.1	-0.2	-0.8	-1.0	-1.1	-1.1	
4 Current account deficit, excluding interest payments	-0.3	0.6	0.0	0.7	0.2			-0.4	-0.3	-0.6	-0.8	-0.9	-0.9	
5 Deficit in balance of goods and services	1.2	0.9	1.2	2.1	2.0			1.7	2.1	2.1	2.0	2.0	2.0	
6 Exports	32.7	31.8	32.3	35.1	38.1			39.6	40.1	41.0	42.1	43.4	44.4	
7 Imports	33.8	32.7	33.4	37.2	40.1			41.3	42.2	43.1	44.1	45.4	46.4	
8 Net non-debt creating capital inflows (negative)	-0.7	-2.7	-2.0	-2.3	-3.5			-1.9	-2.2	-2.5	-2.5	-2.4	-2.4	
9 Automatic debt dynamics 1/	1.1	0.4	0.6	4.3	4.2			2.1	2.3	2.3	2.3	2.2	2.2	
10 Contribution from nominal interest rate	1.7	1.9	2.0	2.2	2.5			2.8	3.1	3.3	3.3	3.3	3.3	
11 Contribution from real GDP growth	-1.0	-0.4	-0.7	-1.0	-0.9			-0.6	-0.7	-1.0	-1.0	-1.1	-1.0	
12 Contribution from price and exchange rate changes 2/	0.3	-1.0	-0.6	3.1	2.7			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	5.0	3.9	2.7	0.6	2.2			1.1	0.4	1.0	1.2	1.1	1.1	
External debt-to-exports ratio (in percent)	89.3	99.0	102.0	103.2	103.3			101.8	101.1	99.5	97.4	94.6	92.6	
Gross external financing needs (in billions of US dollars) 4/	85.4	128.8	138.5	143.9	127.9			94.2	101.5	109.6	116.1	111.7	121.2	
in percent of GDP	7.2	10.2	10.7	12.5	12.2	10-Year	10-Year	8.7	8.8	9.0	9.0	8.2	8.5	
Scenario with key variables at their historical averages 5/								**40.3**	**42.9**	**46.0**	**49.5**	**53.1**	**57.1**	**1.4**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	4.0	1.4	2.3	2.6	2.3	2.2	2.7	1.7	2.0	2.7	2.7	2.7	2.7	
GDP deflator in US dollars (change in percent)	-2.6	4.9	0.6	-13.6	-11.2	-0.9	9.3	2.0	4.2	3.2	2.6	2.8	2.7	
Nominal external interest rate (in percent)	7.3	6.8	6.5	6.1	6.2	7.2	1.1	7.3	8.1	8.7	8.6	8.4	8.4	
Growth of exports (US dollar terms, in percent)	6.0	3.4	4.4	-3.5	-1.4	4.8	12.8	7.7	7.6	8.4	8.3	8.8	7.9	
Growth of imports (US dollar terms, in percent)	5.2	2.9	5.1	-1.5	-1.9	4.9	12.7	6.9	8.4	8.2	7.9	8.7	7.8	
Current account balance, excluding interest payments	0.3	-0.6	0.0	-0.7	-0.2	0.0	0.5	0.4	0.3	0.6	0.8	0.9	0.9	
Net non-debt creating capital inflows	0.7	2.7	2.0	2.3	3.5	1.9	0.9	1.9	2.2	2.5	2.5	2.4	2.4	

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 II. Public Debt Sustainability Analysis

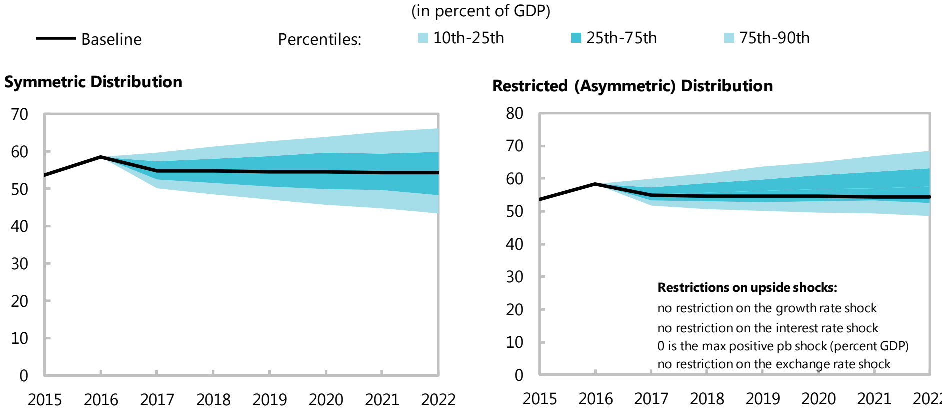
Mexico Public DSA Risk Assessment

Heat Map

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

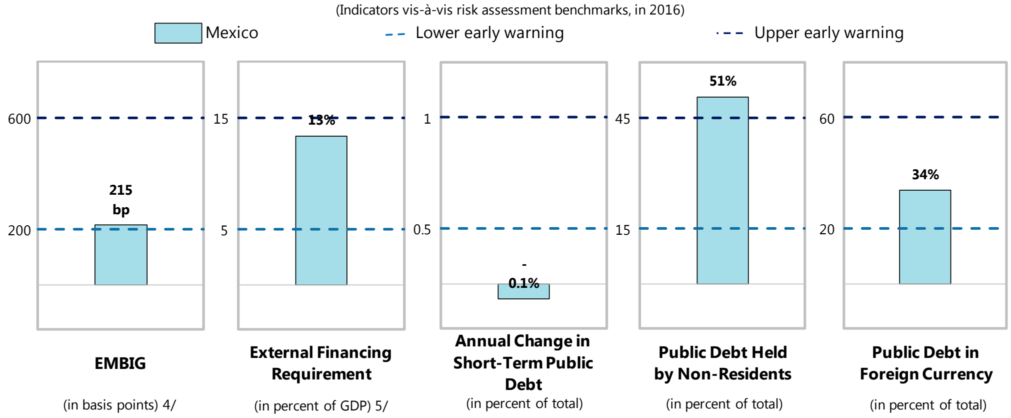
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

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



Source: IMF staff.

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

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

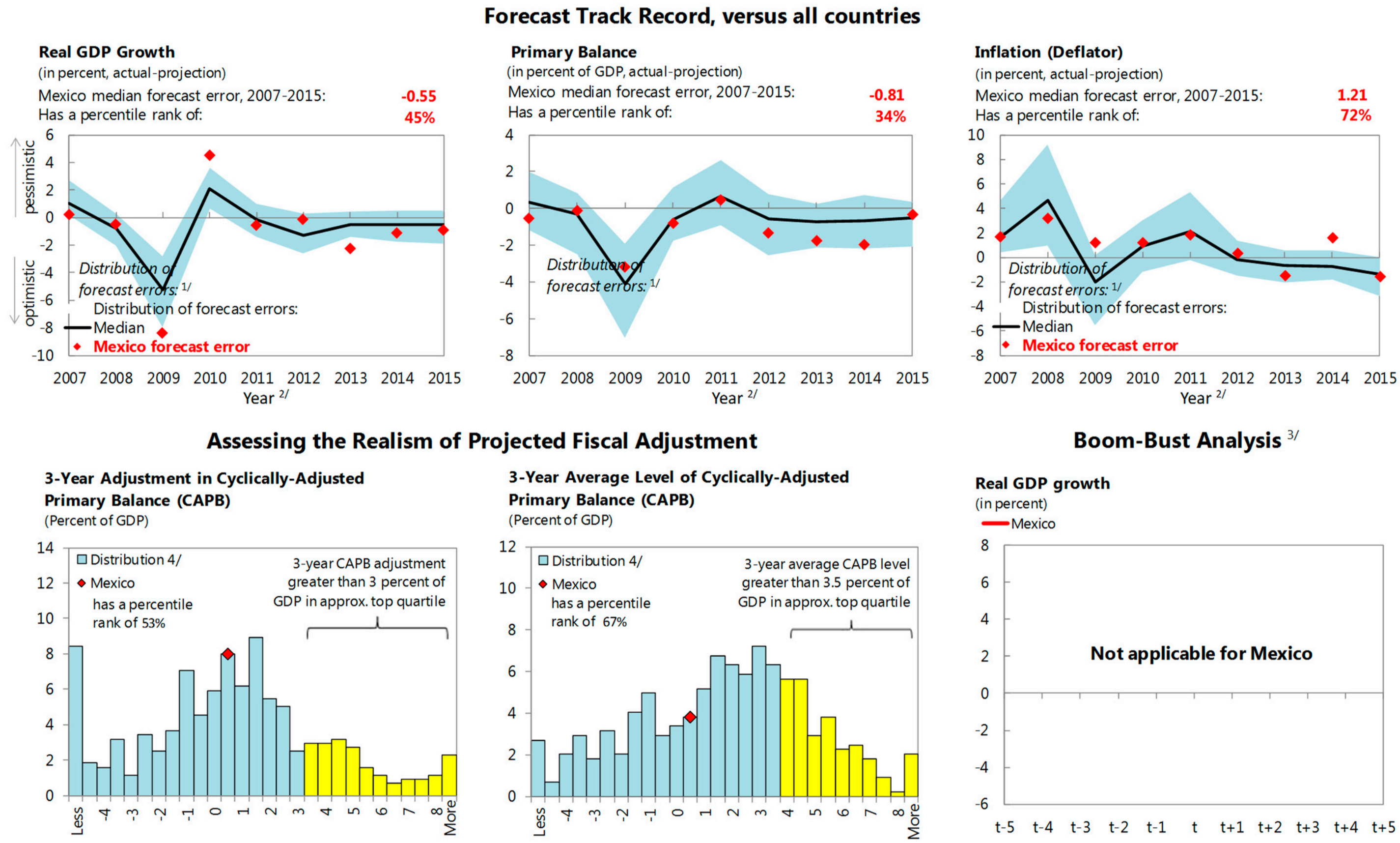
3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant,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

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

4/ EMBIG, an average over the last 3 months, 10-Jan-17 through 10-Apr-17.

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

Mexico Public DSA - Realism of Baseline Assumptions



Source : IMF Staff.
1/ Plotted distribution includes all countries, percentile rank refers to all countries.
2/ Projections made in the spring WEO vintage of the preceding year.
3/ Not applicable for Mexico, as it meets neither the positive output gap criterion nor the private credit growth criterion.
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis.

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

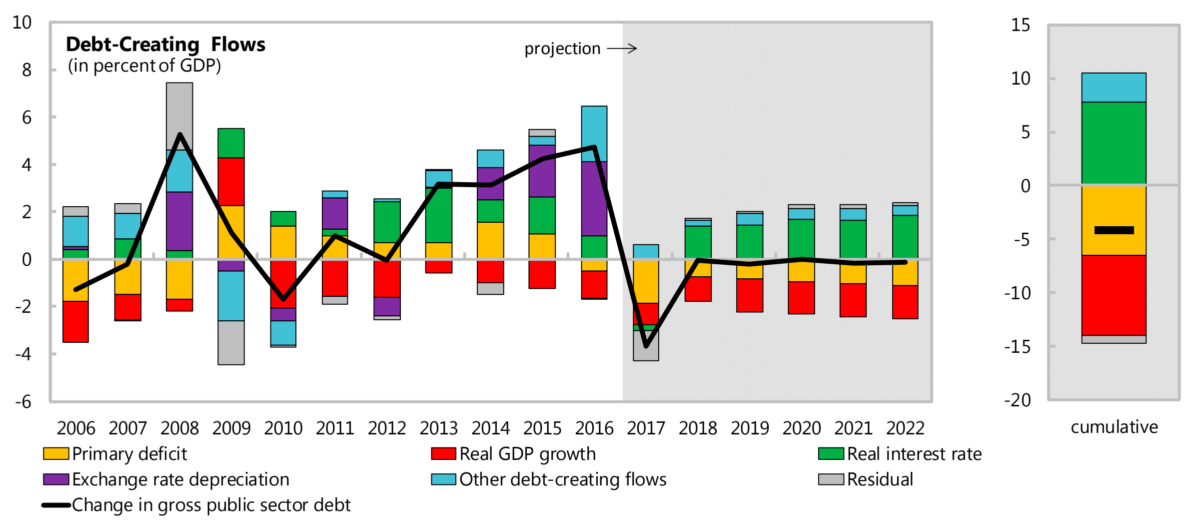
(in percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of April 10, 2017		
	2006-2014 [2/]	2015	2016	2017	2018	2019	2020	2021	2022	Sovereign Spreads		
Nominal gross public debt	42.9	53.7	58.5	54.8	54.8	54.6	54.6	54.4	54.3	EMBIG (bp) 3/	199	
Public gross financing needs	11.0	12.7	14.0	9.2	10.5	11.2	10.4	10.5	10.1	5Y CDS (bp)	127	
Real GDP growth (in percent)	2.4	2.6	2.3	1.7	2.0	2.7	2.7	2.7	2.7	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	4.5	3.0	4.6	6.3	3.5	3.6	3.3	3.6	3.4	Moody's	A3	A3
Nominal GDP growth (in percent)	7.0	5.7	7.0	8.1	5.5	6.4	6.1	6.4	6.2	S&Ps	BBB+	A
Effective interest rate (in percent) [4/]	7.0	6.4	6.7	6.0	6.2	6.4	6.7	6.9	7.1	Fitch	BBB+	A-

Contribution to Changes in Public Debt

	Actual			Projections							
	2006-2014	2015	2016	2017	2018	2019	2020	2021	2022	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	1.2	4.2	4.8	-3.7	0.0	-0.2	0.0	-0.2	-0.1	-4.2	
Identified debt-creating flows	1.1	4.0	4.8	-2.4	-0.1	-0.3	-0.2	-0.3	-0.2	-3.5	
Primary deficit	0.3	1.1	-0.5	-1.8	-0.7	-0.8	-0.9	-1.0	-1.1	-6.5	0.9
Primary (noninterest) revenue and gra	23.4	23.1	23.2	22.6	21.0	20.8	20.8	20.8	20.8	126.8	
Primary (noninterest) expenditure	23.7	24.2	22.6	20.8	20.2	19.9	19.9	19.8	19.7	120.3	
Automatic debt dynamics [5/]	0.5	2.5	3.0	-1.2	0.4	0.0	0.3	0.2	0.5	0.3	
Interest rate/growth differential [6/]	0.1	0.3	-0.2	-1.2	0.4	0.0	0.3	0.2	0.5	0.3	
Of which: real interest rate	1.0	1.5	1.0	-0.2	1.4	1.4	1.7	1.7	1.8	7.8	
Of which: real GDP growth	-0.9	-1.2	-1.2	-0.9	-1.0	-1.4	-1.4	-1.4	-1.4	-7.5	
Exchange rate depreciation [7/]	0.4	2.2	3.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	0.3	0.4	2.3	0.6	0.2	0.5	0.5	0.5	0.4	2.7	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Asset changes	0.3	0.4	2.3	0.6	0.2	0.5	0.5	0.5	0.4	2.7	
Residual [8/]	0.1	0.3	0.0	-1.3	0.1	0.1	0.2	0.2	0.1	-0.7	



Source: IMF staff.

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

2/ Based on available data.

3/ EMBIG.

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

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

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

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

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

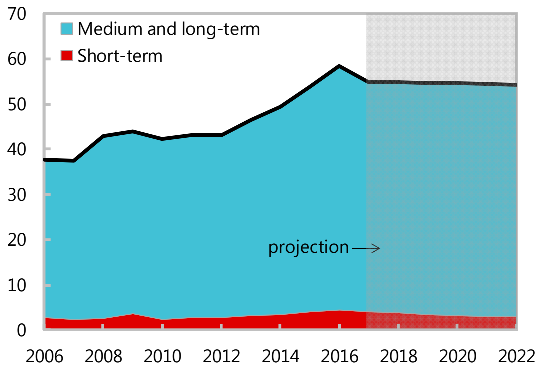
9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Mexico Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

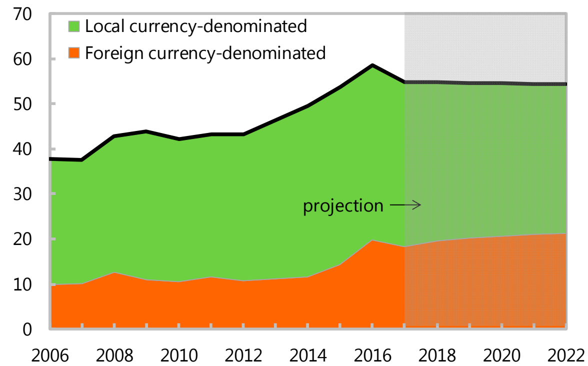
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

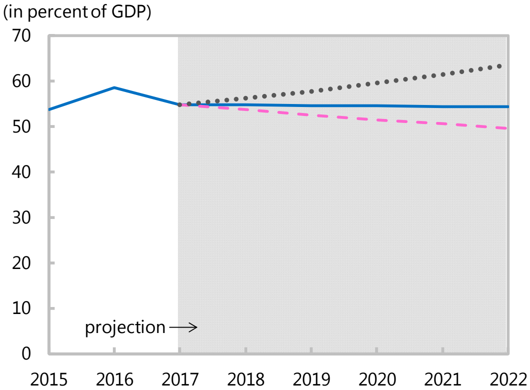


Alternative Scenarios

Baseline Historical Constant Primary Balance

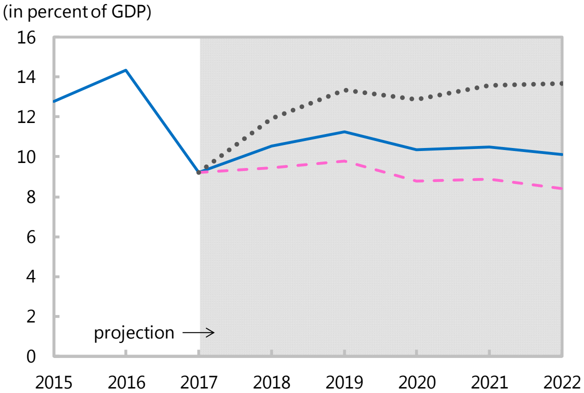
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

Baseline Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	1.7	2.0	2.7	2.7	2.7	2.7
Inflation	6.3	3.5	3.6	3.3	3.6	3.4
Primary Balance	1.8	0.7	0.8	0.9	1.0	1.1
Effective interest rate	6.0	6.2	6.4	6.7	6.9	7.1
Constant Primary Balance Scenario						
Real GDP growth	1.7	2.0	2.7	2.7	2.7	2.7
Inflation	6.3	3.5	3.6	3.3	3.6	3.4
Primary Balance	1.8	1.8	1.8	1.8	1.8	1.8
Effective interest rate	6.0	6.2	6.4	6.6	6.8	7.0

Historical Scenario	2017	2018	2019	2020	2021	2022
Real GDP growth	1.7	2.2	2.2	2.2	2.2	2.2
Inflation	6.3	3.5	3.6	3.3	3.6	3.4
Primary Balance	1.8	-0.7	-0.7	-0.7	-0.7	-0.7
Effective interest rate	6.0	6.2	6.4	6.6	6.8	7.0

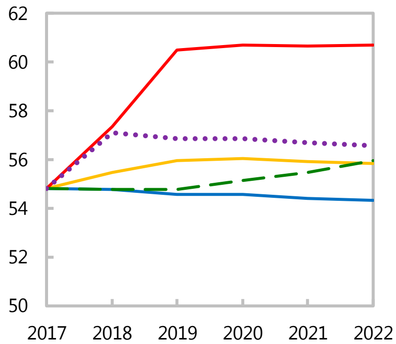
Source: IMF staff.

Mexico Public DSA - Stress Tests

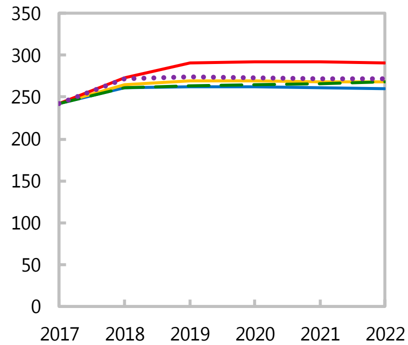
Macro-Fiscal Stress Tests

Baseline
Real GDP Growth Shock
Primary Balance Shock
Real Exchange Rate Shock
Real Interest Rate Shock

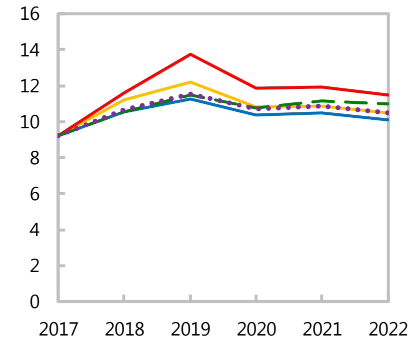
Gross Nominal Public Debt
(in percent of GDP)



Gross Nominal Public Debt
(in percent of Revenue)



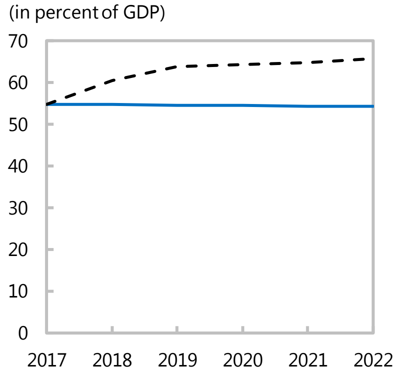
Public Gross Financing Needs
(in percent of GDP)



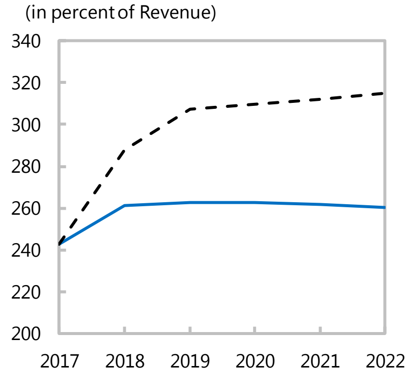
Additional Stress Tests

Baseline
Combined Macro-Fiscal Shock

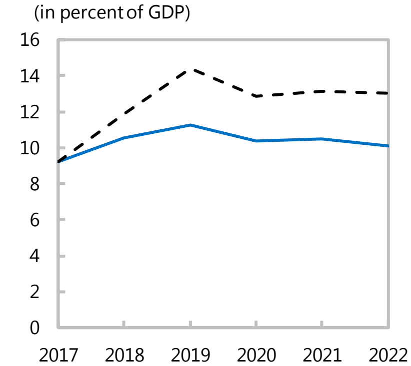
Gross Nominal Public Debt
(in percent of GDP)



Gross Nominal Public Debt
(in percent of Revenue)



Public Gross Financing Needs
(in percent of GDP)



Underlying Assumptions
(in percent)

Primary Balance Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	1.7	2.0	2.7	2.7	2.7	2.7
Inflation	6.3	3.5	3.6	3.3	3.6	3.4
Primary balance	1.8	0.1	0.1	0.9	1.0	1.1
Effective interest rate	6.0	6.2	6.5	6.8	7.0	7.1
Real Interest Rate Shock						
Real GDP growth	1.7	2.0	2.7	2.7	2.7	2.7
Inflation	6.3	3.5	3.6	3.3	3.6	3.4
Primary balance	1.8	0.7	0.8	0.9	1.0	1.1
Effective interest rate	6.0	6.2	6.8	7.4	7.8	8.2
Combined Shock						
Real GDP growth	1.7	-0.7	0.0	2.7	2.7	2.7
Inflation	6.3	2.8	2.9	3.3	3.6	3.4
Primary balance	1.8	0.1	-0.5	0.9	1.0	1.1
Effective interest rate	6.0	6.5	6.8	7.4	7.8	8.2

Real GDP Growth Shock	2017	2018	2019	2020	2021	2022
Real GDP growth	1.7	-0.7	0.0	2.7	2.7	2.7
Inflation	6.3	2.8	2.9	3.3	3.6	3.4
Primary balance	1.8	0.1	-0.5	0.9	1.0	1.1
Effective interest rate	6.0	6.2	6.5	6.8	7.0	7.2
Real Exchange Rate Shock						
Real GDP growth	1.7	2.0	2.7	2.7	2.7	2.7
Inflation	6.3	4.6	3.6	3.3	3.6	3.4
Primary balance	1.8	0.7	0.8	0.9	1.0	1.1
Effective interest rate	6.0	6.5	6.4	6.6	6.8	7.0

Source: IMF staff.