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Mexico: Arrangement Under the Flexible Credit Line—Staff Report; Staff Supplement; and Press Release on the Executive Board Discussion

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

- The staff report on the arrangement for Mexico under the Flexible Credit Line, prepared by a staff team of the IMF, based on information available as of April 7, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff supplement of April 7, 2009, on the assessment of the impact of the proposed Flexible Credit Line arrangement on the Fund's finances and liquidity position.
- A Press Release summarizing the views of the Executive Board as expressed during its April 17, 2009 discussion of the staff report that completed the request.

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INTERNATIONAL MONETARY FUND

MEXICO

Arrangement Under the Flexible Credit Line

Prepared by the Western Hemisphere Department
(In Consultation with other Departments)

Approved by David J. Robinson and Philip Gerson

April 7, 2009

- ***Background***. Mexico has pursued sound policies, maintained macroeconomic stability and substantially reduced vulnerabilities. It has achieved a high level of credibility in the institutional framework supporting macro policy formulation, and has a sustained track record of implementing very strong policies, as acknowledged by the Board in the recent 2008 Article IV consultation.

- ***Outlook***. The global crisis is clouding the outlook. Mexico's macroeconomic fundamentals are expected to remain very strong. However, its open capital account and close global financial linkages—on top of close trade links with the United States—have exposed the country to spillovers from the global financial crisis and deleveraging that are beyond the authorities' control.

- ***FCL***. In this context, the authorities believe that access under an FCL arrangement of SDR 31.528 billion (1,000 percent of quota) would support their macroeconomic strategy and help bolster confidence. They have indicated they do not intend at this time to make a drawing under the FCL and would treat it as precautionary. Staff likewise believe that Mexico would benefit from support under the FCL, and that Mexico meets the qualification criteria for assistance under the FCL, and so recommends approval of the arrangement.

- ***Fund liquidity***. The proposed commitment of SDR 31.528 billion would have a very substantial impact on Fund liquidity.

- ***Process***. An informal meeting to consult with the Executive Board on a possible FCL arrangement for Mexico was held on April 3, 2009.

- ***Team***. This report was prepared by a staff team led by Vikram Haksar and comprising Kornélia Krajnyak, Geremia Palomba, Marcos Souto, and Volodymyr Tulin.

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I. CONTEXT

Very strong fundamentals

1. ***Mexico has had a very strong macroeconomic performance for over a decade*** (Figure 1). Inflation has been generally low with well anchored expectations. Public debt levels have been reduced, including for public external debt. Corporate sector balance sheets have likewise been further strengthened, with low leverage and strong cashflow in most cases. The external current account deficit has been contained, while reserves have been built to comfortable levels. Meanwhile, the banking system is highly profitable and well-capitalized, with low foreign borrowing and little exposure to structured financial products.

2. ***Underpinning this success has been a high level of policy credibility***. Banxico's inflation targeting regime has worked well and the central bank has developed very strong anti-inflation credentials. This has allowed the flexible exchange rate to work as a key shock absorber. Fiscal policy has been guided by the balanced budget rule, as well as the demonstrated commitment of the authorities to take measures to bolster the structural fiscal position, including a major tax reform in 2007. Meanwhile, the 2006 FSAP update acknowledged the strength and sophistication of the financial sector supervisory framework.

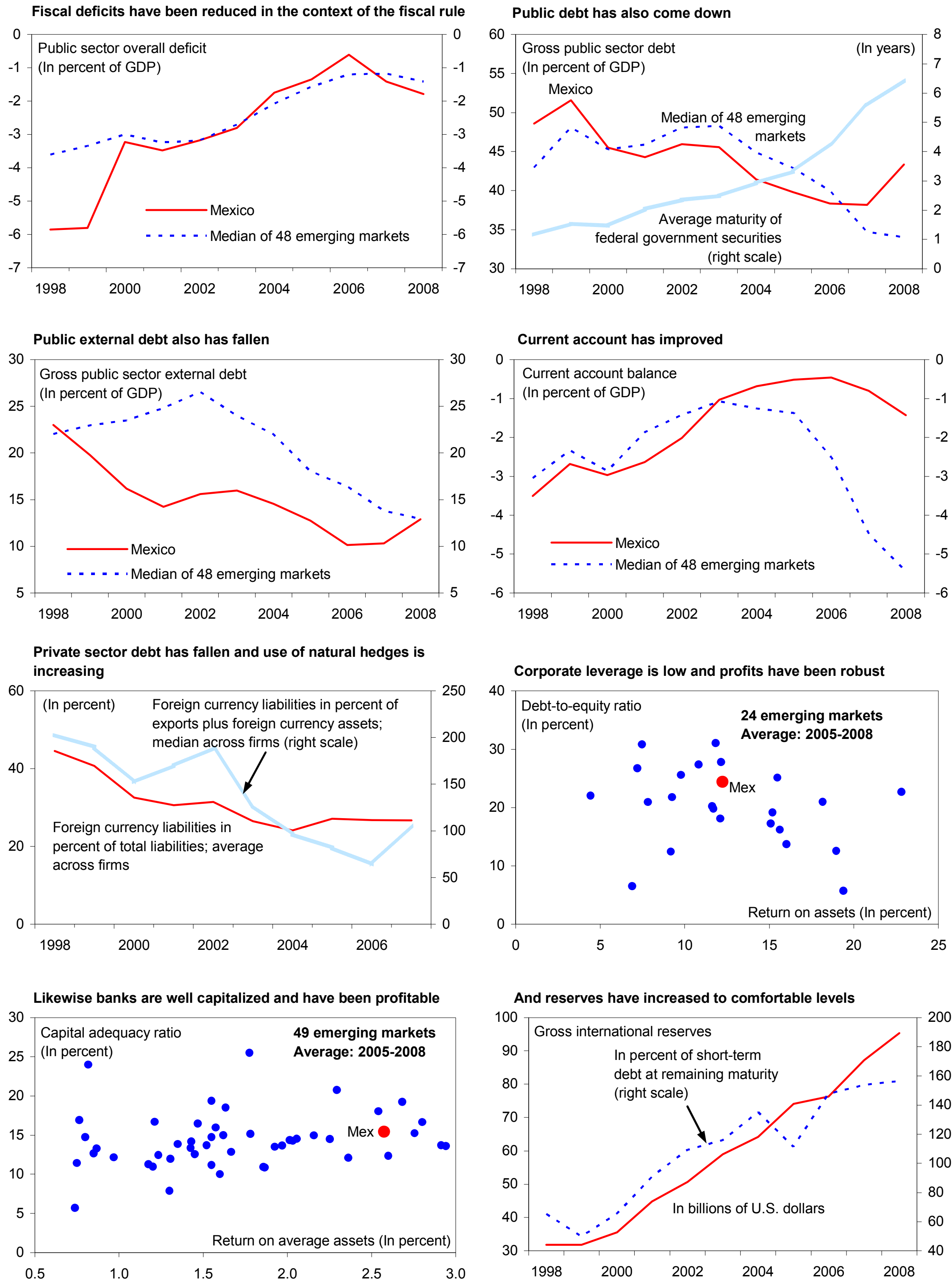
3. ***These broad strengths were recognized by the Board in the 2008 Article IV consultation concluded on February 6, 2009*** (see IMF Country Report 09/53). Directors welcomed the very strong macroeconomic performance and the timely and appropriate policy response to the challenges posed by the global economic crisis. They commended the sustained strengthening of balance sheets and the macroeconomic policy framework and the authorities' commitment to the flexible exchange regime and to rules-based fiscal and monetary policies. They noted too the robustness of the banking system and regulatory framework.

Deteriorating external environment

4. ***However, very strong domestic fundamentals have been clouded by the unprecedented global financial shock and deteriorating near term outlook*** (Figure 2). Mexican asset prices have fallen sharply in line with the global market sell-off. From early September 2008 through late March, the peso weakened by about 30 percent against the U.S. dollar, the stock market fell 25 percent, and spreads on external bonds rose some 170 bp for the sovereign, and about 800 bp for corporates. Volatility in the yields on the government's local currency bonds has also risen, as also for most other asset classes.

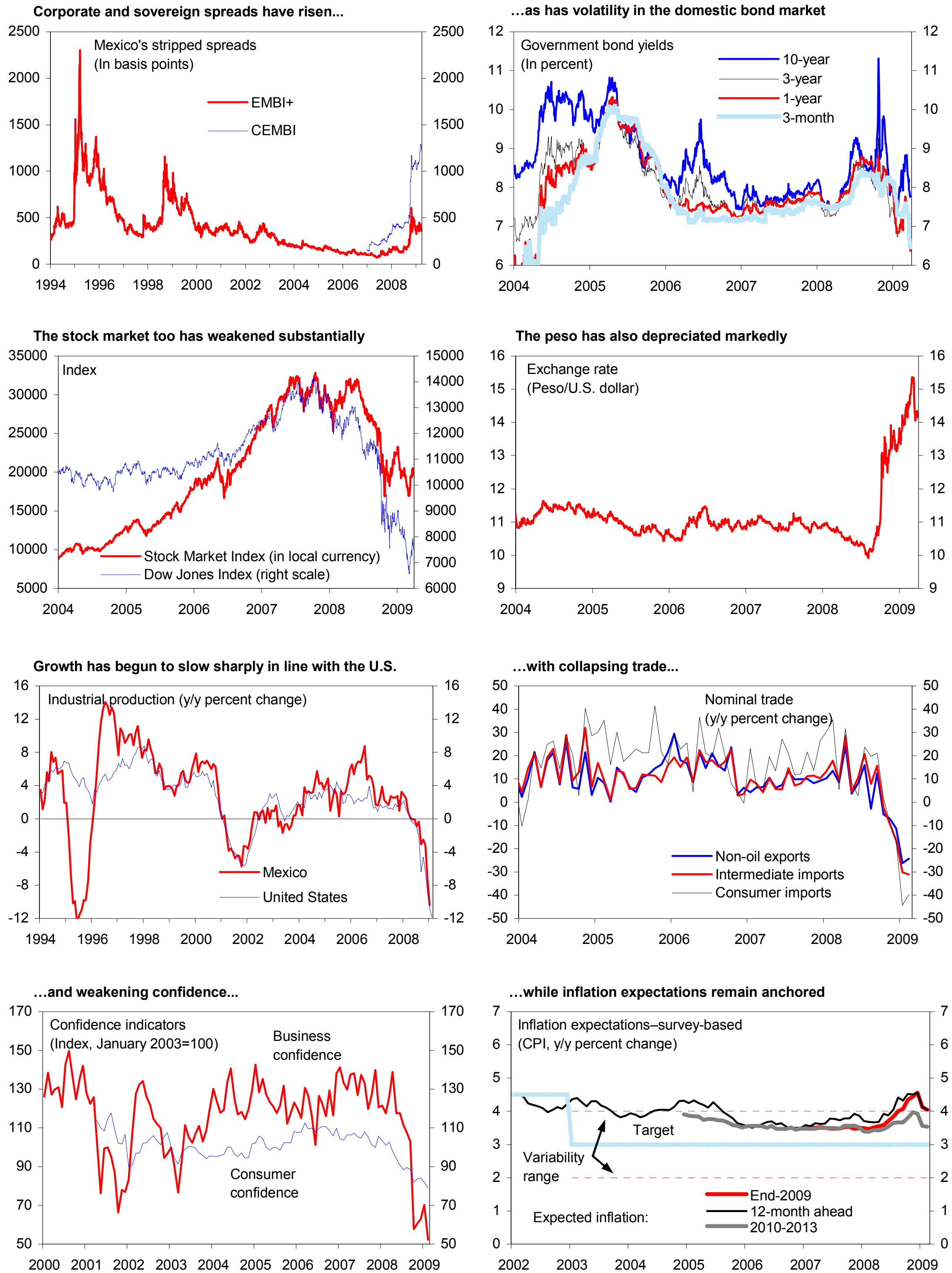
5. ***Strains have risen on corporate financing***. The Mexican corporate sector entered this period of stress with strong balance sheets, and reduced on-balance sheet exchange rate

Figure 1. Mexico: Strong Performance: 1998–2008



Sources: EMED; Haver Analytics; National authorities; and IMF staff calculations.

Figure 2. Mexico: Recent Developments



Sources: Datastream; Bloomberg L.P.; EMED; Haver Analytics; and IMF staff calculations.

exposure.[1] Nonetheless, some large Mexican corporates that face substantial external refinancing needs this year have had difficulty in rolling over debt falling due. Meanwhile, corporate losses on exposure to complex derivative structures in the fourth quarter of 2008 amounted to about US$5½ billion. Following a full investigation—and a tightening of reporting requirements—the authorities assess that the bulk of the speculative exposure has now been wound down. Nonetheless, this has added to pressures on the cashflow of the corporates concerned.

6. ***Liquidity pressures have emerged in some market segments, while credit quality is also under strain in the consumer banking portfolio***. The securitized housing finance and corporate paper markets, while small at about 6 percent of GDP, have been disrupted. This has necessitated support from development banks through the provision of liquidity and credit guarantees. The banking system remains liquid and direct exchange rate exposure is contained by strict net open foreign exchange positions regulations,[2] but delinquency rates on consumer lending (which account for about ¼ of the total lending portfolio) have been drifting up, reaching 8 percent of all consumer loans on a net basis by February 2009. Meanwhile, credit growth has continued to slow markedly, reflecting in part actions by subsidiaries of global banks to contain or shrink their balance sheets in Mexico, as in other emerging markets.

7. ***Mexico is projected to experience a sharp slowdown, in tandem with the recession in the U.S.*** (Table 1). After rising by about 1.3 percent in 2008, GDP is expected to fall by about 3¾ percent in 2009, reflecting especially the close linkages with the U.S., tighter financial conditions, and falling confidence.[3] The external current account balance is expected to deteriorate mainly on account of a weaker oil export balance and lower remittances (Table 2). On the balance of payments financing side, however, a sharp fall in private inflows is projected to be offset by revenues from a successful oil price hedge and higher public sector external borrowing—including from multilateral development banks (see ¶12)—such that reserves would remain stable. Meanwhile, inflation is expected to slow

[1] As seen in Figure 1, the median firm had foreign assets and earnings that exceed foreign currency liabilities. But this does not rule out individual firms having larger mismatches.

[2] Indeed, the banking system's foreign exchange assets were US$1.5 billion higher than total liabilities; i.e. the net open forex position was about +0.5 percent of bank liabilities, as of February 2009.

[3] The substantial revision to the growth outlook for 2009 compared to the January WEO projection of -0.3 percent growth reflects the much larger than expected decline in output in the fourth quarter of 2008 (when GDP fell by 10.3 percent on a SAAR basis), as well as further downward revisions to the outlook for external demand—especially in the United States—and for global financial conditions.

towards 3 percent on the back of the widening output gap, the sharp depreciation notwithstanding.[4]

Policy response

8. ***The authorities have responded to the financial shocks with steps to maintain orderly functioning of markets***. Banxico has intervened in the foreign exchange market in a discretionary fashion for the first time in over a decade. Together with rules based mechanisms, cumulative intervention thus far has amounted to about US$20 billion.[5] NIR has declined by much less, from about US$85 billion in mid-2008 to about US$80 billion currently.[6] Additional steps have been taken by the authorities—including through development banks—to strengthen liquidity facilities for commercial banks, support the mortgage market, and maintain orderly conditions in local bond markets. Guarantees of domestic corporate paper issuances have helped ease the strain on corporate financing.

9. ***Steps are underway to facilitate the refinancing of corporate external debt, as alerted in the Article IV consultation, including through use of the US$30 billion Fed swap line***. The authorities last week announced they would conduct a dollar credit auction with banks of US$4 billion later in April, using resources from the Fed line. The credit auctions are to have a tenor of 264 days. The forex resources injected into the financial system will facilitate the refinancing of maturing corporate external debt obligations; more generally, the introduction of a facility that can be used to provide foreign exchange liquidity where needed is expected to boost market confidence.

10. ***Substantial policy stimulus is helping cushion the impact of the external demand shock***. Reflecting the important gains in policy credibility, for the first time ever Mexico is in a position to apply counter-cyclical policies. Fiscal policy is set to deliver a stimulus of up to 1½ percent of GDP in 2009, mainly through increased investment spending, a temporary energy price reduction (in the case of oil products, reducing the now positive gap with

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[4] The staff's analysis, including based on an application of the GPM to Mexico, suggests that the widening domestic and U.S. output gaps are outweighing pass-through from the weaker exchange rate. This is reflected in part in the striking stability of non-tradable services prices in Mexico thus far in the face of the weaker exchange rate.

[5] The cumulative intervention includes both US$11 billion of discretionary sales and US$9.1 billion of rules based sales since September 2008. Banxico intervention does not aim to target any specific level of the exchange rate. This has helped ensure orderly markets, while preserving the most essential benefits of the fully flexible exchange rate regime. Through early-June, the authorities are auctioning US$100 million daily at the market rate, to guarantee that a significant part of the expected public sector foreign exchange surplus is sold onto the market. Additionally, to help ensure orderly markets, an additional US$300 million is on offer at a rate 2 percent weaker than the previous day's close. Exceptional foreign currency interventions have been undertaken on a few occasions of sharply lower liquidity in the forex market.

[6] The impact of intervention was partially offset by the normal sale of oil export proceeds by PEMEX directly to Banxico.

respect to international prices), as well as increased social spending. The stimulus will in part be financed by resources from the oil price hedge and higher public sector external borrowing. Banxico has also started easing monetary policy, with a cumulative 150 bp reduction in interest rates since January. Adjustment in the flexible exchange rate has provided an added and crucial buffer.

II. Role of the Flexible Credit Line and Access

11. ***Mexico's very strong fundamentals and robust policy response notwithstanding, the deteriorating external environment poses risks***. Downside risks to growth loom large, given that the outlook is heavily dependent on developments in the U.S., and the expectation of continued tight financing conditions. These are likely to weigh also on financial sector performance and balance sheets, as credit quality worsens with the down-cycle in the real economy. With Mexico's open capital account, the balance of payments outlook could be affected by tail risks, including the scope for pressures on confidence and capital flows. Risks remain that the flight of capital from emerging markets to industrial countries could pick up again until global markets are more fully stabilized.

Strategy

12. ***Against this backdrop, the authorities would like the Fund to approve an FCL arrangement, which they intend to treat as precautionary***. They believe that access to FCL resources could play a positive role to support their macroeconomic strategy and bolster confidence until external conditions improve, and complement financing from the Fed (US$30 billion swap line, expiring this October), as well as other multilaterals (US$5 billion in 2009 from the World Bank and IDB).[7]

13. ***The authorities' strategy is underpinned by three key inter-connected ideas on the need for insurance, its size, and the implication of size for the likelihood of use***. First, their fundamental aim is to insulate the economy from potential tail risks that could arise from the ongoing global financial turbulence. Second, for that to work and be credible, they assess that the size of this protection must be substantial. And third, that with sufficiently large protection, there will be no need to actually use the insurance and draw the facility. As such, a high level of access under a precautionary FCL arrangement would provide assurances to financial markets that Mexico would have recourse to sufficient resources to maintain orderly conditions in the foreign exchange and financial markets under even the most extreme near-term scenarios of exogenous shocks.

[7] The authorities currently expect to borrow US$5.3 billion from multilateral development banks in 2009—in practice, the amount could be somewhat higher, with US$4 billion from the World Bank—including operations to support the contingent cash transfer program *Oportunidades*, as well as the housing and financial sectors—combined with US$2.2 billion from the IDB.

Access

14. ***Accordingly, the authorities are requesting access of 1,000 percent of quota (SDR 31.528 billion, some US$47 billion), in the context of a 1-year arrangement***. In this connection, three interrelated risks bear considering:

- **Mexico has lower reserves than other key emerging markets**. Reserve cover, while adequate for normal times (see ¶17), is lower than in some key emerging market peers (Figure 3). Notwithstanding the clear commitment to the flexible exchange rate, and the Fed swap line, this has adversely affected sentiment.

- **Deep financial market with large foreign investor positions**. Mexico's financial markets are the second largest in Latin America in absolute terms (Text Table). In normal times, this has been a source of resilience. However, this is a source of potential risk in exceptional circumstances, given the highly open capital account in Mexico. Moreover, non-resident investors are estimated to continue to have a large direct exposure to Mexican assets (preliminarily estimated by staff at about US$180 billion at end-2008, of which more than half in debt securities and the rest in equities).[8] Further exposures potentially arise in the context of OTC positions of non-resident investors in derivatives linked to Mexican debt instruments.

Financial Sector Size Comparison in Latin America 1/
(In billions of U.S. dollars)

	Mexico	Brazil	Chile	Colombia	Peru
Broad money, end-2008 2/	**488**	816	141	82	36
Mutual funds assets	**90**	558	28	…	3
Pension funds assets	**88**	283	106	36	17
Stock market capitalization, end-2008	**238**	588	132	88	38
Domestic government bond market	**280**	778	23	70	8
Corporate bond markets	**35**	143	20	1	1

Source: IMF Staff calculations; national authorities.
1/ End-June 2008, unless otherwise indicated.
2/ Corresponds to M3.

- **Gross external financing needs** for 2009 under the baseline scenario of about US$80 billion are expected to be covered, assuming a rollover rate for private debt of some 75 percent (Tables 3 and 4).[9] However, the possibility of a weaker capital account, including from a reduction in the rollover rate on private sector debt to 30 percent—similar to levels seen in capital account crisis cases—from lower net FDI, and some portfolio outflows, coupled with a larger current account deficit (from

[8] Non-resident holdings of Mexican assets, per the IIP (including both domestic and externally issued assets), amounted to over US$270 billion at end-2007. However the value of these holdings has fallen, on account of the weaker exchange rate and asset prices, as well as some capital outflows.

[9] Gross international reserves cover the currently projected gross external financing requirement for 2009.

slower adjustment in the non-oil trade balance in the face of downside risks to external demand—particularly from the U.S.—weaker oil production and remittances), could result in a shortfall in external financing of about US$25−30 billion in a downside scenario.

Against this background, the staff believes that access of 1,000 percent of quota would be sufficient to bring Mexico's key reserve coverage ratios closer to the level of key emerging market peers (Figure 3), and would provide substantive insurance commensurate with the potential tail risks to the balance of payments identified above, in an environment of extreme global risk aversion.

15. ***The access being requested under the FCL arrangement is not out of line compared with other recent high access cases***. The table below compares the access level being requested by Mexico under the FCL to the broader experience of other high access cases in the Fund, across an array of metrics. Access for Mexico at the 1,000 percent level is at or below the median of high access cases on many measures, including as a share of GDP, trade, and broad money.

Mexico: Comparison of Proposed Access with Other High Access Cases, 2009

		High-Access Cases 1/				
	Proposed Arrangement	Proposed Arrangement (Percentile)	20th Percentile (Ratio)	80th Percentile	Average	Median
Access						
In millions of SDRs	31,500	100	1,560	12,943	8,197	6,782
Average annual access	1,000	100	141	459	303	239
Total access in percent of: 2/						
Actual quota	1,000	84	300	901	630	503
Calculated quota	671	70	268	947	598	541
Gross domestic product	6	50	3	9	8	6
Gross international reserves	49	47	27	89	83	50
Exports of goods and nonfactor services	19	41	11	39	31	21
Imports of goods and nonfactor services	17	42	11	47	30	20
Total debt stock						
Public	10	37	7	31	21	12
External	24	92	6	17	13	12
Short-term 3/	77	79	20	82	100	33
M2	10	28	7	25	26	13

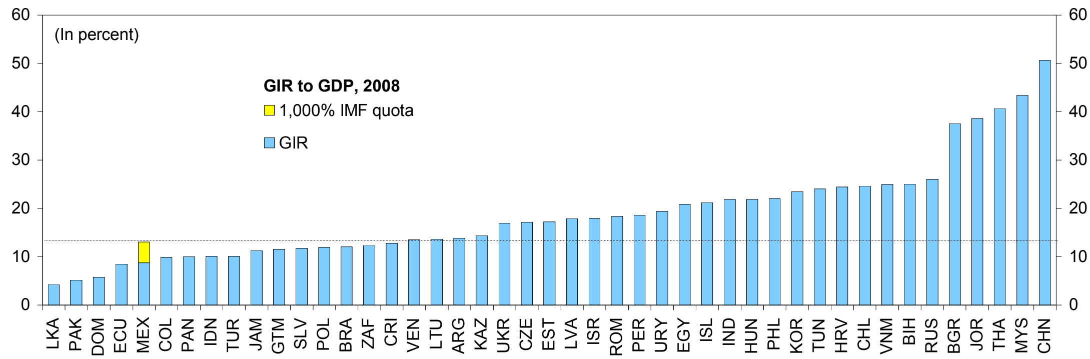
Source: Executive Board documents, MONA database, and Fund staff estimates.

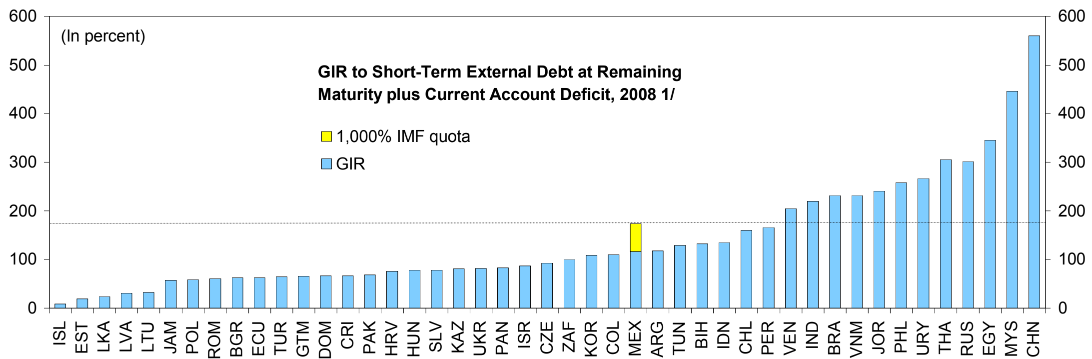
1/ High access cases include available data at approval and on augmentation for all the requests to the Board since 1997 which involved the use of the exceptional circumstances clause or SRF resources. Exceptional access augmentations are counted as separate observations. For the purpose of measuring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

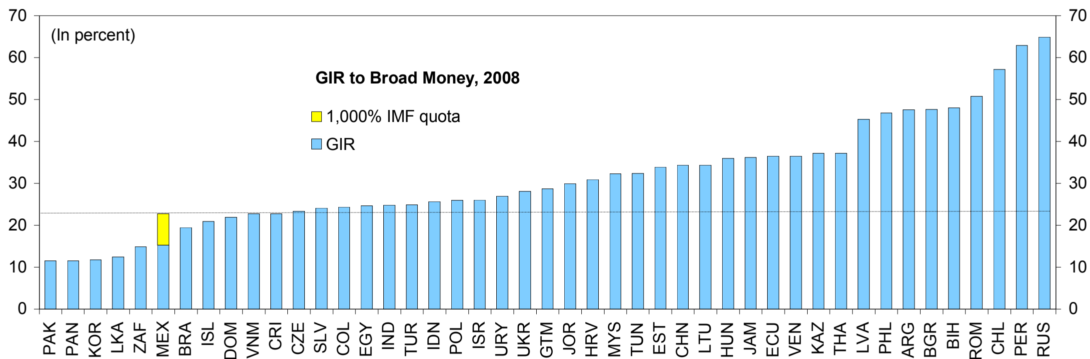
2/ The data used to calculate ratios is the actual value for the year prior to approval for public and short-term debt, and the projection at the time of program approval for the year in which the program was approved for all other variables.

3/ Refers to residual maturity.

Figure 3. Mexico: Reserve Coverage in International Perspective







Sources: Haver Analytics; World Economic Outlook; and IMF staff estimates.
1/ GIR at the end of 2008 in percent of ST debt at original maturity at the end of 2008 plus amortization of MLT debt and current account deficit in 2009. The current account is set to zero if it is in surplus.

Qualification criteria

16. ***The staff views that Mexico qualifies for assistance under the FCL***. The authorities have put in place a solid policy framework as indicated in ¶2. The central bank has been a successful inflation targeter over the last decade. The rules-based fiscal framework has been a key support. Steps in recent years to increase non-oil revenues, as well as the approval of politically difficult PEMEX reforms last year are further demonstrations of the authorities' resolve to maintain very strong policies in the future. This was acknowledged by the Board in its favorable assessment of policy implementation in the context of the 2008 Article IV consultation. Moreover, the agile response to managing near term pressures since the onset of the global crisis demonstrates the authorities' commitment to deal appropriately with any additional financial market strains that might arise ahead and maintain their close monitoring of financing conditions for both the public and private sectors.

17. ***In particular, the staff believes that Mexico meets the qualification criteria identified in (i)-(ix) of paragraph 2 of the FCL decision*** (see Box for a summary as also Figure 4):

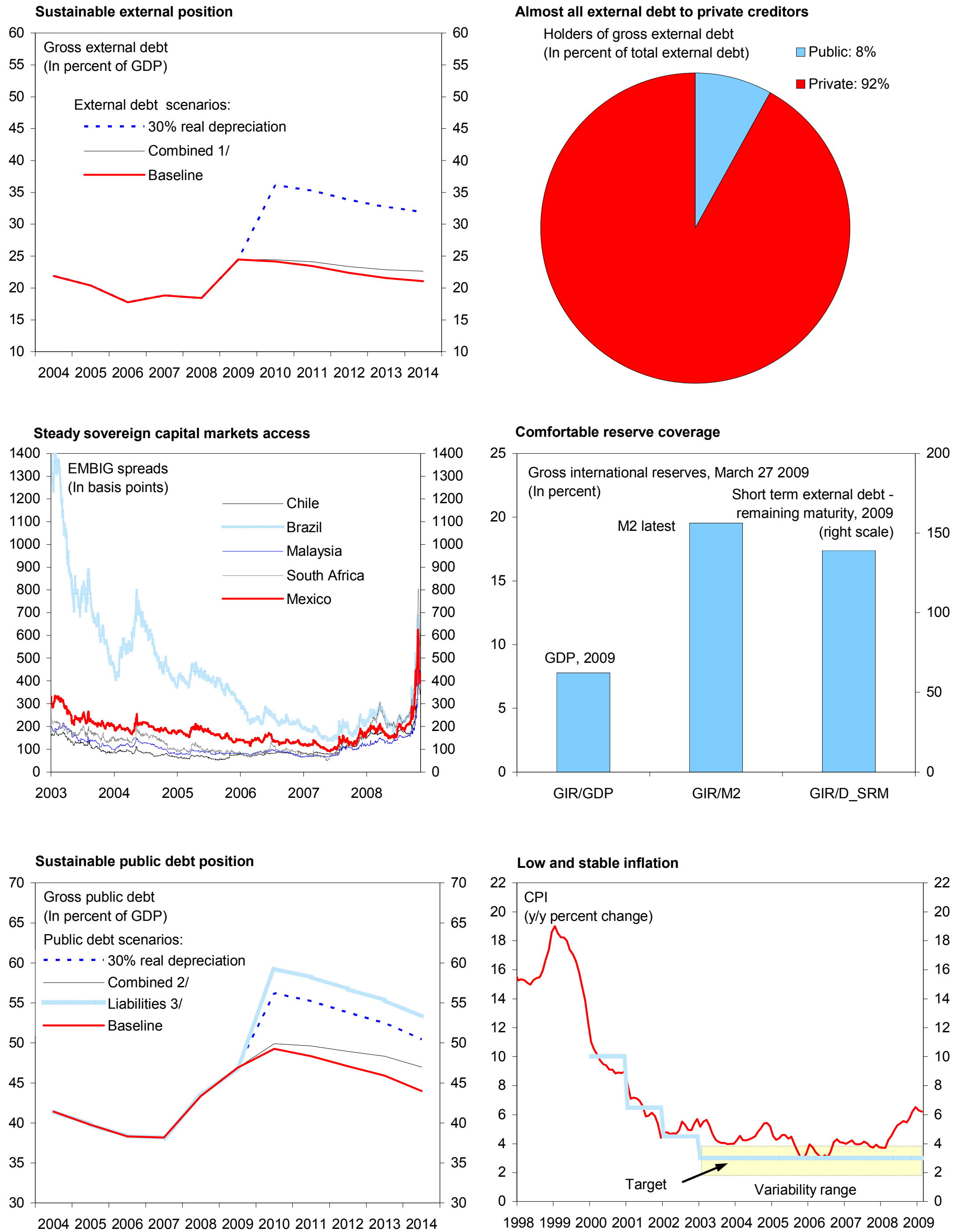
- **Sustainable external position**. External debt levels are expected to rise in 2009[10] and then remain at moderate levels below 25 percent of GDP over the medium term with public external debt remaining low as well. This reflects a gradual fall in the external current account deficit to about 1½ percent of GDP. These findings are generally robust to a range of shocks considered in the updated external debt sustainability analysis (DSA) (Tables 6–7 and Figure 5). International reserves are expected to remain stable over the medium term.

- **Capital account position dominated by private flows**. The overwhelming majority of debt financing in Mexico's balance of payments is from private creditors—official creditors accounted for less than 10 percent of the total of such flows in 2008.

- **Steady sovereign external access at favorable terms**. Mexico is among the highest rated emerging markets, which has been reflected in a track record of low sovereign external borrowing spreads, including during periods of stress such as during the 2001 recession. While external sovereign spreads have increased in the last year—broadly in line with other highly rated emerging markets—Mexico has retained access at reasonable terms, even in current stressed conditions with successful placements of US$3½ billion during December 2008−February 2009.

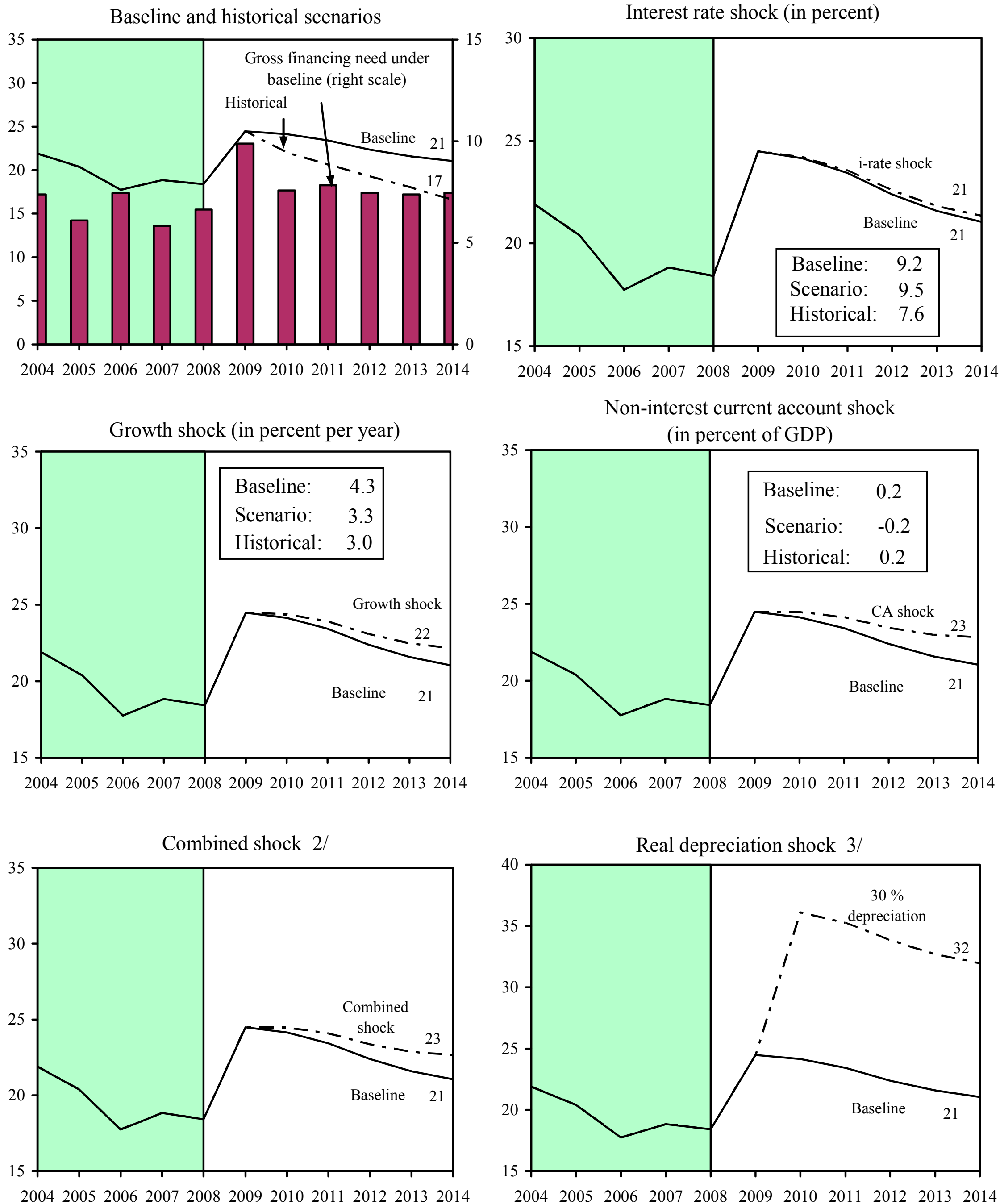
[10] The increase in the external debt-to-GDP ratio in 2009 reflects mainly the impact of the weaker exchange rate on dollar GDP, but partly also the wider current account deficit and weaker real GDP growth.

Figure 4. Mexico: Qualification Criteria



Sources: Bloomberg L.P.; Datastream; EMED; Haver Analytics; and IMF staff calculations.
1/ Combined permanent 1/4 standard deviation shocks applied to interest rate, growth, and primary current account balance.
2/ Combined permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time 10 percent of GDP increase in debt-creating flows.

Figure 5. Mexico: External Debt Sustainability: Bound Tests 1/
(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/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
3/ One-time real depreciation of 30 percent occurs in 2010.

Box 1. Qualification Criteria for Access to Fund Resources Under an FCL Arrangement

As specified in ¶2 of the Decision establishing the FCL, "an FCL arrangement shall be approved upon request in cases where the Fund assesses that the member has very strong economic fundamentals and institutional policy frameworks, is implementing—and has a sustained track record of implementing—very strong policies, and remains committed to maintaining such policies in the future, all of which give confidence that the member will respond appropriately to the balance of payments difficulties that it is encountering or could encounter." The member's policies must have been assessed very positively by the Executive Board in the context of the most recent Article IV consultations.

The relevant qualification criteria for an FCL arrangement include:

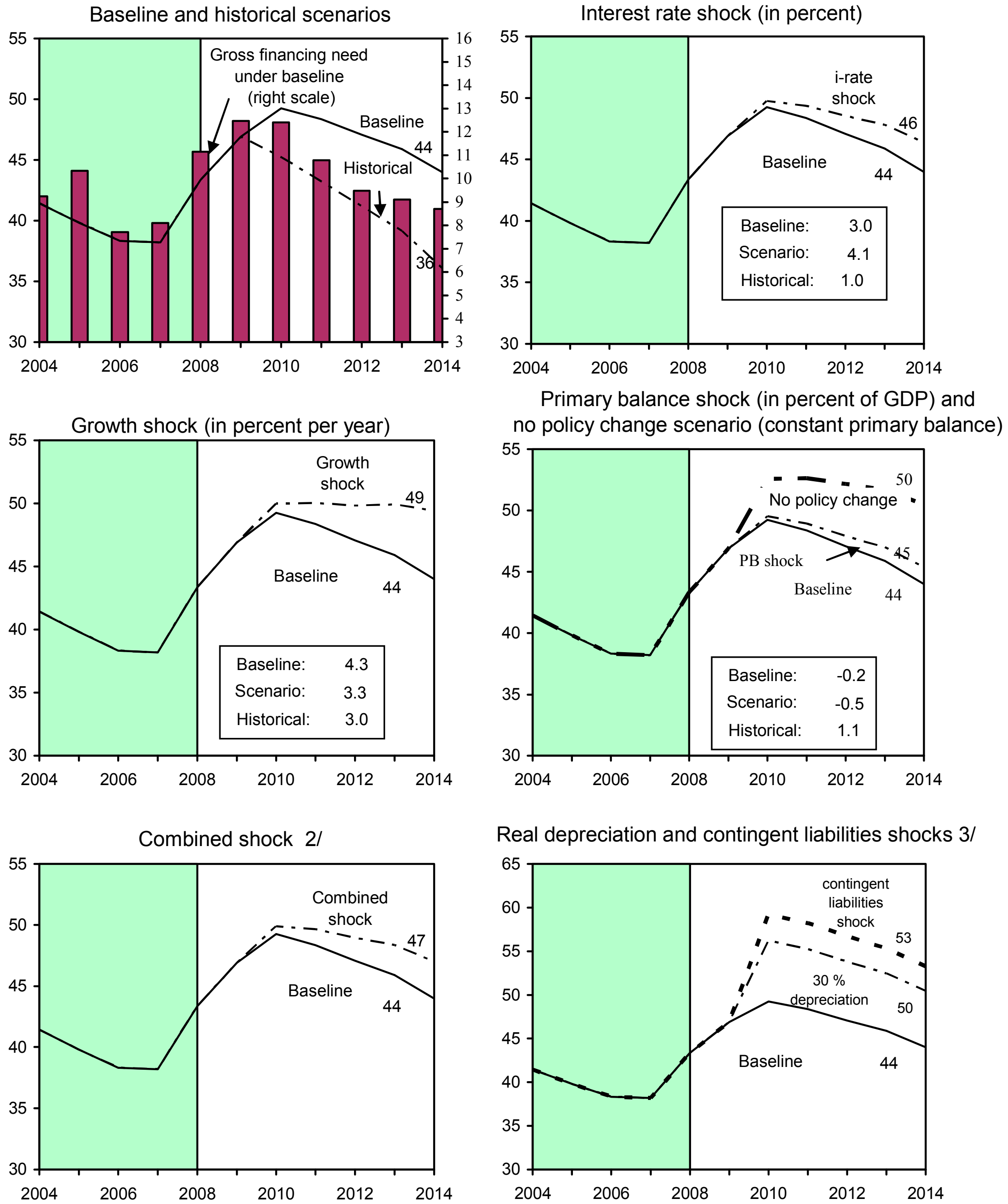
(i) a sustainable external position;
(ii) a capital account position dominated by private flows;
(iii) a track record of steady sovereign access to international capital markets at favorable terms;
(iv) a reserve position that is relatively comfortable when the FCL is requested on a precautionary basis;
(v) sound public finances, including a sustainable public debt position;
(vi) low and stable inflation, in the context of a sound monetary and exchange rate policy framework;
(vii) the absence of bank solvency problems that pose an immediate threat of a systemic banking crisis;
(viii) effective financial sector supervision; and
(ix) data transparency and integrity.

- **Relatively comfortable reserve position**. Mexico's reserves more than cover short term debt falling due and are considered comfortable for "normal" times.[11] This view was reflected in the 2007 Article IV consultation when the Executive Board noted that "the level of international reserves appears adequate," dovetailing with staff analysis based on the Jeanne-Rancierre optimal reserves model. Nonetheless, related concerns on reserve coverage in the current conjuncture are discussed in ¶14.

- **Sustainable public debt and sound finances**. Fiscal policy is underpinned by the balanced budget rule as well as the authorities' commitment to keep the augmented public sector deficit (including development banks and other levels of government) at a level that stabilizes the overall public debt. While public debt has increased substantially in 2007-08, with further increases projected in 2009−10 on the back of the weaker economy and fiscal stimulus, the staff's public sector DSA (Tables 8–9 and Figure 6) shows public debt in Mexico remaining manageable under all scenarios, with public sector gross financing requirements set to continue their trend decline as a share of GDP. No significant contingent liabilities have been incurred thus far in the crisis, with credit guarantees extended by public banks amounting to

[11] Reserve cover meets the Greenspan-Guidotti criterion of 100 percent coverage of debt falling due.

Figure 6. Mexico: Gross Public Debt Sustainability: Bound Tests 1/
(Gross public debt in percent of GDP)

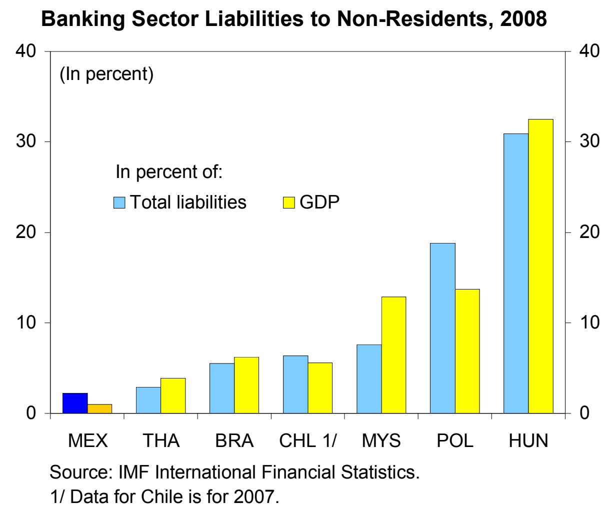


Sources: International Monetary Fund, country desk data, and staff estimates.
1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and primary balance.
3/ One-time real depreciation of 30 percent and 10 percent of GDP shock to contingent liabilities occur in 2010, with real depreciation defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

only about 1 percent of GDP. Looking forward, and as discussed in the 2008 Article IV consultation, the fiscal rule will require an important fiscal effort in the years ahead to compensate for the expected decline in oil revenues and create room for needed public investment. However, the authorities have clearly demonstrated their capacity to undertake such difficult reforms.

- **Low and stable inflation**. Inflation has fallen on a sustained basis in Mexico, including since the introduction of the inflation targeting framework, in the context of a floating exchange rate regime. While headline inflation has been above target in the recent period, reflecting especially the impact of external supply shocks, inflation expectations have remained low and well anchored, despite the sharp depreciation of the currency. This reflects the substantial credibility gained by Banxico in implementing a transparent inflation targeting framework in Mexico.

- **Absence of bank solvency problems**. The banking system remains well capitalized. There are no bank solvency problems that pose an imminent systemic threat. Profitability has been high, though is now set to decline in line with the economic cycle. Banks remain liquid and the system has experienced buoyant growth in recent years reflecting a recovery from previous lower levels of financial development. While global banks account for about ¾ percent of the system, their franchises are well-developed and have been profitable. That said, pressures from overseas parents have curtailed credit expansion by a number of global bank subsidiaries. Nonetheless, the banking system has low exposure to external finance (Text Chart), and domestic deposits comprise the bulk of bank funding. Recent stress tests conducted by the authorities based on data as of January 2009, show that the system remains well placed to cope with a range of shocks to credit and market risk, though credit risk is likely to weigh on bank balance sheets as the cycle progresses. This updates and confirms analysis by Banxico in its 2008 Financial Stability Report, and echoes as well the findings of the 2006 FSAP update.



Source: IMF International Financial Statistics.
1/ Data for Chile is for 2007.

- **Effective financial sector supervision**. The 2006 FSAP update noted the underlying strength of the regulatory framework and supervisory authorities in Mexico, as well as the substantial progress made since the original FSAP in 2002. The authorities have taken further steps to improve crisis coordination modalities, and strengthen the

framework for bank resolution, as discussed in the 2008 Article IV report. The monitoring of derivative positions of corporates has also been substantially strengthened.

- **Data transparency and integrity**. The overall quality of Mexican statistics is good, as acknowledged by the 2003 data ROSC. Mexico has been a subscriber to the SDDS since 1996 and the authorities provide a wealth of data to the public over the internet, with periodicity and timeliness exceeding SDDS requirements in a number of cases.

18. ***The authorities' letter (Attachment) highlights their continued commitment to implementing very strong economic policies***. The authorities welcome the creation of the Fund's new liquidity facility which they view as providing useful support for countries with very strong policy track records and economic fundamentals like Mexico. Their letter stresses that the authorities will continue their robust, yet flexible, policy response—positively received by the Board at the 2008 Article IV consultation earlier this year—as the impact of the global crisis transmits more fully to Mexico.

19. ***The policy strategy for the period ahead encompasses the following considerations, as foreshadowed in the 2008 Article IV consultation discussions***. The authorities have sought to maximize their flexibility to respond to the shocks confronting Mexico, while seeking to limit the domestic impact of the global financial crisis, to maintain macroeconomic and financial sector stability, while continuing to lay the basis for strong and sustainable medium term growth.

- **Fiscal policy**. Stimulus already implemented will provide support to demand in 2009 consistent with orderly financing and preserving credibility of the framework.[12] A combination of options is available to smooth over time the withdrawal of stimulus in 2010 as the economy begins to recover, including tapping the stabilization funds. The authorities remain committed to ensuring that public debt remains broadly stable, and recognize that this will require some additional adjustment, starting from 2010 onwards, as lower oil revenues and desired expenditure levels are taken into consideration. Indeed, they have just announced their intent to seek measures worth about 0.7 percent of GDP in the 2010 budget. Again, a range of options is available as discussed in past Article IV consultations; including additional revenue measures and steps to refocus subsidies.[13] The staff have continued to discuss with the authorities moving from the current balanced budget fiscal rule, towards a structural fiscal rule, which would help boost savings as the recovery takes hold.

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[12] Staff projects that the augmented fiscal deficit is expected to widen further in 2009 as revenues fall in line with weaker activity, with the additional shortfall financed out of oil stabilization fund reserves.

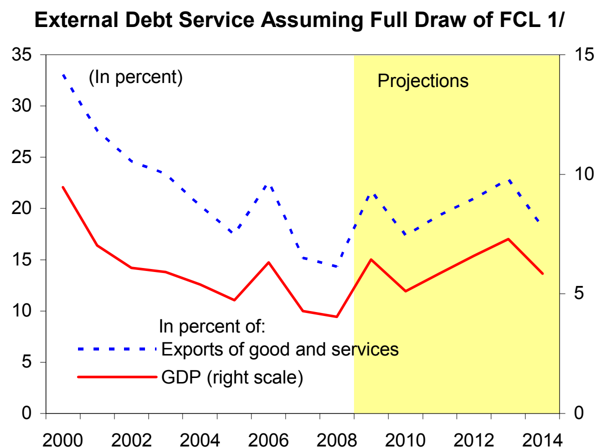
[13] The authorities have also recently approved of a measure to substantially streamline the legal appeals process involved in tax cases, which is expected to be an important support for tax administration efforts.

- **Monetary and exchange rate policy**. Policy will continue to be guided by the inflation targeting framework. In its most recent communiqué, Banxico indicates that it views that the balance of risks have deteriorated substantially more with regards activity as compared to inflation, given the deteriorating global economic situation, and the resulting weakening of the domestic economy. The staff view that while pass through from the exchange rate depreciation could exert some near term upward pressure on inflation, wage growth remains stable, expectations anchored, while the output gap is set to widen substantially. The flexible exchange regime will continue to act as a key shock absorber. Intervention has been aimed at providing liquidity to currently thin markets to dampen volatility, and has been based on recycling public sector foreign currency surpluses to the private sector. The rules-based intervention mechanism currently in operation will be reviewed this coming June.

- **Financial stability**. Potential risks in the corporate and financial systems are closely monitored. The liquidity position of the domestic subsidiaries of global banks continues to be closely monitored. In this connection, regulations on related-party lending have been tightened. The authorities continue close coordination with home market supervisors of global banks active in Mexico. A rapidly slowing economy will weaken bank balance sheets, but ongoing stress tests suggest that strains on the financial system will remain manageable and systemic risks are considered low. Support to facilitate the normal functioning of markets has been extended through development banks in the housing finance and commercial paper segments. Increasing pressures on the financing of some corporates is requiring further policy steps, including through activation of the Fed swap line to facilitate refinancing through domestic banks of corporate foreign currency obligations, in some cases.

III. Impact on Fund Finances, Risks, and Safeguards

20. ***Access under the proposed FCL for Mexico of 1,000 percent of quota (SDR 31.528 billion) is large but manageable***. The Fund's liquidity is expected to remain adequate after approval of an FCL arrangement for Mexico, as further discussed in the supplement assessing the impact on the Fund's finances and liquidity position.



Source: IMF staff calculations.
1/ The projections assume that the full amount of access under the FCL is drawn in 2009.

21. ***Risks to the Fund are expected to be low***. The authorities have given clear indications that they intend to treat the facility as precautionary. Even were a full drawing under the facility to be made on

approval, Mexico's external debt would remain below 31 percent of GDP, and at 23 percent of GDP in 2013 when debt service peaks (Table 10). Further, as the Text Chart shows, even peak debt service ratios are lower than in the last years, and are well within the range seen in other emerging market countries. Moreover, Mexico has a demonstrated excellent track record of meeting its obligations to the Fund.

22. ***The authorities have indicated they will provide staff with the information needed under the Fund's safeguards policy for the FCL***. Banxico already publishes its balance sheet. All needed additional financial statement and audit information regarding Banxico is being made available to staff.

IV. Staff Appraisal

23. ***An FCL arrangement could help bolster confidence in Mexico at a critical juncture***. While Mexico's underlying fundamentals are very strong, the deterioration of the global situation—in the context of Mexico's large and open capital markets and close linkages to the U.S.—are potential sources of risk. As discussed above, a high access FCL arrangement of 1,000 percent of quota would provide an important boost to insurance against a further deterioration of global market conditions, and reassure markets with regards to Mexico's room for maneuver in the period ahead. From a domestic policy perspective, this additional insurance to the balance of payments should give the central bank greater room for maneuver, and reduce the burden on fiscal policy to provide support to demand.

24. ***The staff assess that Mexico meets the qualification criteria set out for access to FCL resources and recommends approval of an FCL arrangement of SDR 31.528 billion for a period of 12 months.*** The authorities have reacted flexibly and appropriately in response to the effects on Mexico of the global financial crisis. Their letter reaffirming a commitment to maintaining such policies in the future, and their track record, provide very strong reassurance that they would react appropriately to any future balance of payments difficulties. Risks to the Fund are contained by the very strong policy setting, the authorities' intent to treat the FCL arrangement as precautionary, Mexico's very strong repurchase track record with the Fund, as well as the manageable external debt service profile even if the authorities were to draw the full amount available up-front. Moreover, as explained in ¶16 and ¶17, Mexico meets the qualification criteria for use of FCL resources, which dovetails with the very positive assessment of policies by the Executive Board in the context of the 2008 Article IV consultation with Mexico.

Table 1. Mexico: Selected Economic, Financial, and Social Indicators, 2004–2010

I. Social and Demographic Indicators

GDP per capita (U.S. dollars, 2007)	9,691	Households below the poverty line (percent, 2002)	33.0
Population (millions, 2007)	106	Income share of highest 20 percent / lowest 20 percent	12.8
Life expectancy at birth (years, 2006)	75	Adult illiteracy rate (2005)	8.4
Under 5 mortality rate (per thousand, 2006)	35.3	Gross primary education enrollment rate (2006)	112.7

II. Economic Indicators

	2004	2005	2006	2007	2008	Proj. 2009	Proj. 2010
(Annual percentage change, unless otherwise indicated)							
National accounts in constant prices							
Real GDP	4.0	3.2	5.1	3.3	1.3	*-3.7*	*1.0*
Net exports (contribution)	0.0	-0.6	-0.7	-0.6	-1.0	*1.6*	*0.2*
Total domestic demand	3.9	3.7	5.7	3.8	2.3	*-5.1*	*0.8*
Private consumption	5.6	4.8	5.7	3.9	1.5	*-3.1*	*0.0*
Public consumption	-2.8	2.4	1.7	2.1	0.6	*2.0*	*2.1*
Gross fixed investment	8.0	7.5	9.8	7.2	4.9	*-9.1*	*2.5*
Change in business inventories (contribution)	-1.0	-1.2	-0.3	-0.5	0.1	*-1.2*	*0.1*
External sector							
Exports, f.o.b.	14.1	14.0	16.7	8.8	7.2	*-20.3*	*5.1*
Export volume	2.1	5.3	8.5	3.5	-2.3	*-5.3*	*1.6*
Imports, f.o.b.	15.4	12.7	15.4	10.1	9.5	*-19.2*	*3.3*
Import volume	9.3	7.3	10.4	4.4	0.9	*-10.0*	*0.4*
Petroleum exports (percent of total exports)	12.6	14.9	15.6	15.8	17.4	*11.3*	*13.5*
Terms of trade (deterioration -)	5.8	3.0	2.9	-0.3	1.2	*-6.3*	*0.5*
Exchange rates							
Nominal exchange rate (US$/Mex$)							
(average, depreciation -)	-4.6	3.4	0.0	-0.3	-1.8	...	...
Real effective exchange rate (CPI based) 1/							
(average, depreciation -)	-3.8	4.1	0.5	-0.1	-0.5	...	...
Employment and inflation							
Consumer prices (end of year)	5.2	3.3	4.1	3.8	6.5	*3.5*	*3.1*
Formal sector employment (annual average)	2.0	3.2	4.7	4.2	2.1	...	...
Formal sector unemployment rate (annual average)	3.9	3.6	3.6	3.7	4.0	*5.0*	*4.7*
Real manufacturing wages (annual average)	0.3	-0.2	0.4	1.0	0.9	...	...
Money and credit							
Broad money (M4a)	12.6	15.0	12.8	11.5	13.4	*2.6*	*5.1*
Treasury bill rate (28-day cetes, in percent, annual average)	6.8	9.2	7.2	7.2	7.7	...	...
(In percent of GDP)							
Nonfinancial public sector							
Augmented balance 2/	-1.7	-1.3	-0.6	-1.4	-1.8	*-3.6*	*-3.7*
Augmented primary balance	1.2	1.6	2.2	1.3	0.8	*-0.9*	*-0.9*
Traditional balance 3/	-0.2	-0.1	0.1	0.0	-0.1	*-1.9*	*-1.9*
Gross public sector debt	41.4	39.8	38.3	38.2	43.3	*46.9*	*49.3*
Net public sector debt	36.8	35.2	32.4	31.4	35.8	*39.4*	*42.0*
Savings and investment							
Gross domestic investment	24.8	24.4	26.1	25.8	26.4	*23.9*	*23.5*
Public investment	4.3	4.6	4.3	4.7	5.5	*6.3*	*6.4*
Private investment	15.4	15.6	16.5	16.7	16.6	*15.3*	*15.5*
Change in inventories	5.1	4.2	5.3	4.5	4.2	*2.3*	*1.6*
Gross national saving	24.1	23.8	25.7	25.0	24.8	*21.4*	*21.3*
Public saving 4/	2.6	3.2	3.7	3.3	3.7	*2.7*	*2.6*
Private saving	21.6	20.6	22.0	21.7	21.2	*18.7*	*18.7*
External current account balance	-0.7	-0.5	-0.5	-0.8	-1.5	*-2.5*	*-2.2*
Non-oil external current account balance	-2.3	-2.3	-2.5	-2.5	-2.8	*-3.1*	*-3.0*
Net foreign direct investment	2.5	1.8	1.4	2.6	1.7	*2.0*	*2.2*
(In percent of exports of goods, nonfactor services, and transfers)							
Public external debt service 5/	14.2	9.4	14.3	7.5	6.8	*10.1*	*9.0*
(In billions of U.S. dollars, unless otherwise indicated)							
Net international reserves	61.5	68.7	67.7	78.0	85.4	*85.4*	*85.4*
Gross official reserves in percent of short-term debt 6/	135.3	111.4	147.8	153.9	*156.6*	*204.2*	*169.1*
Gross external debt (in percent of GDP, end of period)	21.9	20.4	17.8	18.8	18.2	*24.5*	*24.2*
Crude oil export price, Mexican mix (US$/bbl)	31.0	42.8	53.1	61.7	84.4	*45.8*	*55.0*

Sources: National Institute of Statistics and Geography; Bank of Mexico; Secretariat of Finance and Public Credit; Ministry of Labor and Social Insurance; and IMF staff estimates.

1/ IMF staff estimates.
2/ Includes adjustments for development banks, Pidiregas, oil stabilization fund, IPAB.
3/ The break in the series in 2009 is due to definitional and accounting changes.
4/ Estimated as the difference between the augmented fiscal balance, as reported by SHCP, and public investment, as reported in the national accounts.
5/ Debt service on gross external debt of the federal government, development banks and nonfinanical public enterprises (adjusted for Pidiregas).
6/ In percent of short-term debt by residual maturity. Historical data include all prepayments.

Table 2. Mexico: Summary Balance of Payments, 2005–2013

	2005	2006	2007	2008	2009	2010	2011	2012	2013
				Projections					
	(In billions of U.S. dollars)								
Current account	-4.4	-4.4	-8.2	-16.0	-20.8	-18.8	-15.2	-17.2	-18.5
Merchandise trade balance, f.o.b.	-7.6	-6.1	-10.1	-17.3	-16.9	-13.3	-12.4	-17.9	-20.6
Exports	214.2	249.9	271.9	291.3	232.4	244.3	265.0	290.2	316.9
Imports	-221.8	-256.1	-281.9	-308.6	-249.3	-257.6	-277.4	-308.1	-337.5
Factor income	-14.2	-18.5	-18.2	-17.2	-21.3	-22.7	-21.7	-20.3	-21.1
Net services	-4.7	-5.7	-6.3	-7.0	-4.7	-4.5	-4.9	-5.3	-5.8
Net transfers	22.1	25.9	26.4	25.5	22.1	21.7	23.8	26.4	29.0
of which Remittances	21.7	25.6	26.1	25.1	21.2	20.7	22.8	25.6	27.7
Financial account	14.8	-2.1	20.8	21.0	20.8	18.8	18.6	19.7	20.9
Public sector 1/	2.0	-11.3	15.3	15.7	20.1	9.3	1.7	2.1	2.8
Medium- and long-term borrowing	-7.3	-20.5	-5.1	-1.1	10.9	6.8	-2.0	-1.9	-1.5
Disbursements	6.8	9.8	6.6	10.0	23.3	20.9	15.3	15.3	15.6
Amortization 2/	14.1	30.3	11.7	11.1	12.4	14.1	17.3	17.2	17.1
Pidiregas, net 3/	8.7	7.0	13.2	12.9	0.0	0.0	0.0	0.0	0.0
Other, including short-term borrowing and change in assets	0.5	2.1	7.2	3.9	9.2	2.5	3.7	4.0	4.3
Of which: oil hedging capital income	…	…	…	…	9.2	…	…	…	…
Private sector	12.8	9.2	5.5	5.3	0.7	9.5	16.9	17.6	18.1
Direct investment, net	15.3	13.4	18.9	18.2	15.7	18.9	18.7	20.3	21.5
Bonds and loans	1.9	5.2	8.8	-0.9	-8.8	-3.5	4.0	4.1	5.9
Equity investments and change in assets abroad	-4.4	-9.4	-22.3	-11.9	-6.2	-6.0	-5.9	-6.9	-9.2
Errors and omissions and valuation adjustments	-3.3	5.5	-2.3	2.4	0.0	0.0	0.0	0.0	0.0
Net international reserves (increase -)	-7.2	1.0	-10.3	-7.5	0.0	0.0	-3.4	-2.5	-2.5
	(In percent of GDP, unless otherwise indicated)								
Memorandum items:									
Current account balance	-0.5	-0.5	-0.8	-1.5	-2.5	-2.2	-1.7	-1.7	-1.7
Nonoil current account balance 4/	-2.3	-2.5	-2.5	-2.8	-3.1	-3.0	-2.0	-1.6	-1.3
Nonoil trade balance 4/	-2.7	-2.6	-2.7	-2.9	-2.6	-2.3	-1.7	-1.7	-1.5
Oil Trade balance	1.8	2.0	1.7	1.3	0.5	0.8	0.4	-0.1	-0.4
Gross international reserves (change, billions of US$) 5/	9.9	2.2	10.9	8.1	0.0	0.0	3.4	2.5	2.5
End-year (billions of US$)	74.1	76.3	87.2	95.3	95.3	95.3	98.7	101.3	103.7
Months of imports of goods and services	3.2	3.0	3.1	4.2	4.1	3.8	3.6	3.3	3.1
Months of imports plus interest payments	2.9	2.8	2.9	3.9	3.7	3.5	3.3	3.1	2.9
Percent of short-term debt (by residual maturity) 6/	111.4	147.8	153.9	156.6	204.2	169.1	175.5	169.4	160.4
Gross total external debt	20.4	17.8	18.8	18.2	24.5	24.2	23.4	22.4	21.6
Of which: Public external debt	12.3	9.8	10.0	10.2	14.9	15.1	14.0	12.8	11.7
Gross total external debt (billions of US$)	173.1	169.0	193.1	200.4	202.5	208.4	214.1	220.4	229.1
Of which: Public external debt 7/	104.9	93.1	102.6	112.2	123.1	129.9	127.9	126.0	124.5
Public external debt service (in percent of exports of goods, services, and transfers) 8/	9.4	14.3	7.5	6.8	10.1	9.0	9.1	8.3	7.6

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

1/ Including the financing of Pidiregas.
2/ Includes pre-payment of external debt.
3/ Break in the series in 2009 due to accounting changes.
4/ Excluding oil exports and petroleum products imports.
5/ Excludes balances under bilateral payments accounts.
6/ In percent of short-term debt by residual maturity. Historical data include all prepayments.
7/ Includes gross external debt of the federal government, development banks and nonfinanical public enterprises, and is adjusted for Pidiregas.
8/ Includes amortization on medium and long-term bonds and debt, and interest payments.

Table 3. Mexico: External Financing Requirements and Sources, 2003-09

(In billions of U.S. dollars)

	2003	2004	2005	2006	2007	2008	2009 Proj.
Gross financing requirements	69.6	60.1	59.0	69.9	70.1	80.1	81.7
Current account deficit	7.2	5.2	4.4	4.4	8.2	16.0	20.8
Public sector medium and long term amortization 1/	17.5	18.2	16.4	33.3	15.2	14.4	17.5
Public sector bonds 2/	8.8	7.5	8.8	13.8	8.8	6.9	3.7
Public sector MLT debt	7.1	8.6	5.3	16.5	2.9	4.2	8.7
Pidiregas 3/	1.6	2.1	2.3	3.0	3.5	3.2	5.1
Private sector medium and long term amortization 4/	12.2	11.5	11.5	12.8	13.9	15.5	17.7
Private sector bonds 4/	5.1	4.6	4.6	5.7	5.9	6.7	6.0
Private sector medium and long term debt	7.2	6.9	6.9	7.1	8.0	8.8	11.7
Short term financing	23.2	21.2	19.5	20.4	22.6	26.8	25.6
Public sector 2/	7.9	6.5	6.3	6.7	7.0	9.4	7.1
Private sector 4/ 5/	6.3	6.2	4.4	5.8	6.2	7.1	6.9
Trade credit 6/	8.9	8.5	8.9	7.9	9.4	10.2	11.6
Change in international reserves	9.5	4.1	7.2	-1.0	10.3	7.5	0.0
Available financing	69.6	60.1	59.0	69.9	70.1	80.1	81.7
FDI, net	15.2	19.2	15.3	13.4	18.9	18.2	15.7
Public sector MLT flows 1/	24.3	26.5	21.3	23.5	32.3	32.9	28.4
Public sector bonds 2/	7.7	8.2	2.1	3.3	3.3	3.5	5.8
Public sector MLT debt	7.9	5.2	4.7	6.6	3.3	6.5	17.5
Pidiregas 3/	7.8	8.0	11.1	10.0	16.7	16.1	5.1
Net change in nonresidents' holdings of peso denominated debt	0.9	5.2	3.3	3.7	9.1	6.7	0.0
Private sector MLT flows 4/ 7/	9.6	10.1	12.9	16.1	21.0	13.4	12.7
Private sector bonds	3.2	4.2	7.6	6.5	8.9	4.1	2.6
Private sector MLT debt	6.4	6.0	5.3	9.6	12.0	9.3	10.0
Short-term financing 7/	18.6	18.0	17.2	20.7	22.5	25.1	21.9
Public sector 2/	3.9	4.8	3.5	5.1	5.2	6.6	7.1
Private sector 4/ 5/	6.2	4.4	5.8	6.2	7.1	6.9	3.2
Trade credit 6/	8.5	8.9	7.9	9.4	10.2	11.6	11.6
Other flows	1.9	-13.8	-7.7	-3.8	-24.6	-9.4	3.0
of which:							
Increase in portfolio and other investment assets	4.7	-7.3	-7.7	-12.2	-21.8	-7.9	5.2
of which: Oil price hedge							9.2

Sources: Mexican authorities and IMF staff estimates.

1/ Including Pidiregas.

2/ On a BoP basis.

3/ Includes bonds and loans. For 2003-08, staff estimates based on the stock of debt at original maturity, estimated duration, and net financing data from the Balance of Payments.

4/ Gross financing figures for 2003-08 are staff estimates based on data on the stock of debt by residual maturity, estimated duration, and net financing data from the Balance of Payments.

5/ Loans and money market instruments, estimates on original maturity basis.

6/ Includes accounts payable to suppliers and long-term trade credit.

7/ 2009 estimates for available financing for the private sector are based on the following assumptions (i) rollover rate for medium-and long-term bonds and loans at 70 percent; rollover rate for short-term debt at 45 percent; and (iii) rollover rate for trade credit at 100 percent, yielding an aggregate rollover rate of 75 percent.

Table 4. Mexico: Structure of External Debt
(In billions of U.S. dollars)

	2004	2005	2006	2007	2008
Adjusted gross external debt	166.2	173.1	169.0	193.1	200.4
Gross external debt	130.9	128.2	116.7	124.4	125.2
Federal government	60.1	58.4	41.9	42.3	41.7
Banking sector (incl. development banks)	11.4	10.7	11.2	10.0	9.1
Other sectors (incl. nonfinancial public sector)	59.4	59.2	63.6	72.2	74.4
Adjustments	35.3	44.9	52.3	68.7	75.2
Pidiregas	26.1	33.2	38.4	47.2	55.3
Non-residents' holdings of peso denominated debt	7.1	10.2	12.5	20.1	18.8
Other adjustments	2.2	1.4	1.4	1.4	1.1
Adjusted gross external debt, by sector					
Public sector 1/	112.4	115.1	105.7	122.7	131.0
Private sector 2/	53.9	58.0	63.3	70.4	69.4
Private sector debt, by maturity 3/	51.7	56.6	61.9	69.1	68.3
Debt securities	15.8	20.2	20.4	23.6	20.9
Medium- and long term debt 4/	18.9	19.1	21.0	23.3	24.1
Short-term debt 4/ 5/	8.1	9.4	11.0	12.0	11.7
Trade credit	8.9	7.9	9.4	10.2	11.6

Source: Banco de Mexico.

1/ Includes federal goverment, development banks, nonfinancial public enterprises, and adjustment for Pidiregas and non-residents' holdings of peso-denominated debt.
2/ Includes "Other adjustments".
3/ Unadjusted.
4/ Residual maturity
5/ Does not include money market instruments.

Table 5. Mexico: Financial Operations of the Public Sector, 2005–2013

(In percent of GDP)

	2005	2006	2007	2008	2009		2010	2011	2012	2013
					Budget	Proj.	Proj.	Proj.	Proj.	Proj.
Budgetary revenue, by type	**21.1**	**21.8**	**22.2**	**23.6**	**21.7**	**22.9**	**22.8**	**21.7**	**21.4**	**21.3**
Oil revenue	7.9	8.3	7.9	8.7	7.9	8.2	7.7	7.3	6.8	6.4
Non-oil tax revenue 1/	8.6	9.0	9.3	10.0	9.8	10.0	10.2	10.4	10.6	10.8
Non-oil non-tax revenue	4.6	4.5	5.0	4.9	4.0	4.8	4.9	4.1	4.1	4.1
Budgetary revenue, by entity										
Federal government revenue	15.3	15.0	15.3	16.9	14.9	17.5	17.3	16.5	16.3	16.2
Tax revenue, *of which:*	8.8	8.6	8.9	8.2	9.0	11.1	10.9	11.0	11.1	11.3
excises (including fuel)	0.5	-0.1	-0.1	-1.4	-0.5	1.5	1.1	1.0	1.0	1.0
Nontax revenue	6.5	6.4	6.3	8.7	5.9	6.4	6.4	5.5	5.2	4.9
Public enterprises	5.8	6.8	6.9	6.7	6.8	5.4	5.5	5.3	5.1	5.1
PEMEX	2.0	3.1	3.3	3.0	3.2	2.1	2.1	1.9	1.7	1.7
Other	3.8	3.7	3.6	3.7	3.6	3.4	3.4	3.4	3.4	3.4
Budgetary expenditure	**21.2**	**21.7**	**22.2**	**23.7**	**23.4**	**24.8**	**25.1**	**25.1**	**25.0**	**24.8**
Primary	18.9	19.3	20.0	21.8	21.2	22.4	22.6	22.6	22.5	22.4
Programmable	15.8	16.0	16.9	18.2	17.8	18.9	19.0	19.0	18.9	18.8
Current	12.7	12.7	13.3	13.8	13.2	14.0	14.3	14.3	14.3	14.2
Wages	6.0	5.9	5.8	5.9	6.1	6.5	6.6	6.4	6.1	5.9
Pensions	1.9	1.9	2.1	2.1	2.0	2.1	2.3	2.4	2.4	2.5
Subsidies and transfers	2.2	2.2	2.3	2.7	2.3	2.4	2.6	2.7	2.8	2.9
Other	2.5	2.8	3.1	3.1	2.8	2.9	2.9	2.9	2.9	2.9
Capital	3.1	3.2	3.6	4.4	4.6	5.0	4.7	4.7	4.7	4.6
Physical capital	2.5	2.6	3.0	3.4	4.2	4.8	4.4	4.4	4.4	4.4
Financial capital	0.6	0.6	0.6	1.0	0.4	0.2	0.2	0.2	0.2	0.2
Nonprogrammable	3.1	3.4	3.1	3.6	3.4	3.5	3.6	3.6	3.6	3.6
Of which: revenue sharing	3.0	3.2	3.0	3.5	3.3	3.4	3.5	3.5	3.5	3.5
Interest payments 2/	2.3	2.4	2.1	1.9	2.3	2.4	2.5	2.5	2.5	2.4
Additional measures required (after stabilization funds) 7/							**0.5**	**1.5**	**1.7**	**1.6**
Traditional balance 3/	**-0.1**	**0.1**	**0.0**	**-0.1**	**-1.8**	**-1.9**	**-1.9**	**-1.9**	**-1.9**	**-1.9**
Traditional balance for balanced budget rule	…	…	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Adjustments to the traditional balance	**1.2**	**0.7**	**1.5**	**1.7**	**0.8**	**1.7**	**1.9**	**0.9**	**0.9**	**0.8**
PIDIREGAS	0.8	1.1	0.9	1.1	0.2	0.2	0.2	0.2	0.2	0.2
IPAB	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Budgetary adjustments	0.1	0.2	0.4	0.3	0.2	0.3	0.2	0.2	0.1	0.1
PEMEX, oil stabilization fund, FARP (-: net inflows)	-0.1	-0.5	-0.4	-1.0	-0.2	0.3	0.6	-0.2	-0.2	-0.2
FARAC	0.0	0.0	-0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Debtor support	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Development banks	-0.1	-0.5	0.0	0.4	0.4	0.5	0.4	0.4	0.4	0.4
Nonrecurring revenue	0.2	0.3	0.6	0.7	0.0	0.2	0.2	0.2	0.2	0.2
Augmented balance 4/	**-1.3**	**-0.6**	**-1.4**	**-1.8**	**-2.6**	**-3.6**	**-3.7**	**-2.8**	**-2.7**	**-2.7**
Augmented interest expenditure	2.9	2.8	2.7	2.5	2.5	2.7	2.8	2.8	2.7	2.6
Augmented primary balance 5/	1.6	2.2	1.3	0.8	-0.1	-0.9	-0.9	0.0	0.0	-0.1
Memorandum items										
Crude oil export price, Mexican mix (US$/bbl)	42.8	53.1	61.7	84.4	70.0	45.8	55.0	59.4	62.0	63.8
Augmented balance excluding development banks	-1.5	-1.1	-1.5	-1.4	-2.2	-3.1	-3.3	-2.4	-2.4	-2.3
Non-oil augmented balance 6/	-6.4	-5.8	-6.5	-7.4	...	-8.2	-7.8	-6.5	-5.9	-5.5
Non-oil augmented balance excluding development bank	-6.5	-6.3	-6.5	-7.1		-7.6	-7.4	-6.1	-5.5	-5.2
Oil augmented balance	5.0	5.2	5.1	5.6	...	4.6	4.1	3.7	3.2	2.8
Oil-related expenditure	2.8	3.1	2.8	3.1	...	3.6	3.6	3.6	3.6	3.6
Transfers to state and local governments	6.9	6.9	6.7	7.3	...	7.4	7.6	7.6	7.5	7.5
Total investment spending	3.4	3.7	3.9	4.5	4.4	5.0	4.4	4.4	4.4	4.4
Gross public sector debt	39.8	38.3	38.2	43.3	...	46.9	49.3	48.4	47.1	45.9
Domestic (percentage of total debt)	67.9	73.5	73.0	70.3	...	68.3	69.5	71.1	72.8	74.5
External (percentage of total debt)	32.1	26.5	27.0	29.7	...	31.7	30.5	28.9	27.2	25.5
Net public sector debt	35.2	32.4	31.4	35.8	...	39.4	42.0	41.7	40.9	40.2
Nominal GDP (billions of Mexican pesos)	9,253	10,380	11,206	12,111	12,883	12,177	12,647	13,661	14,860	16,157

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

1/ Total tax revenue excluding excise tax on gasoline.
2/ Includes transfers to IPAB and the debtor support programs.
3/ The break in the series in 2009 is due to definitional and accounting changes.
4/ Public Sector Borrowing Requirements excl. nonrecurrent revenue.
5/ Treats transfers to IPAB as interest payments.
6/ Excludes oil revenue (oil extraction rights, PEMEX net income, oil excess return levies, excise tax on gasoline) and PEMEX operational expenditure, interest payments, and capital expenditure.
6/ Transfers to subnational governments include revenue-sharing and earmarked transfers, but excludes decentralization agreements.
7/ Required measures are not cumulative and are calculated on the assumption that main program spending items are held constant as a share of GDP. If program spending items were held constant in real terms, measures would average about 0.7 percent of GDP during 2010-14.

Table 6. Mexico: External Debt Sustainability Framework, 2004-2014
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	**Debt-stabilizing non-interest current account 7/**
Baseline: External debt	21.9	20.4	17.7	18.8	18.4	**24.5**	**24.1**	**23.4**	**22.4**	**21.6**	**21.0**	**-1.7**
Change in external debt	-1.3	-1.5	-2.6	1.1	-0.4	6.1	-0.3	-0.7	-1.0	-0.8	-0.5	
Identified external debt-creating flows (4+8+9)	-3.0	-3.9	-3.4	-2.5	-0.3	2.2	0.3	-1.7	-1.9	-1.6	-1.3	
Current account deficit, excluding interest payments	-0.8	-0.9	-1.0	-0.7	0.1	0.3	0.0	-0.4	-0.2	-0.2	-0.1	
Deficit in balance of goods and services	1.8	1.4	1.2	1.6	2.3	2.6	2.1	1.9	2.4	2.5	2.5	
Exports	26.6	27.1	27.9	28.2	28.4	30.3	30.4	31.0	31.5	31.9	32.3	
Imports	28.4	28.6	29.2	29.8	30.7	32.9	32.4	32.9	33.9	34.4	34.8	
Net non-debt creating capital inflows (negative)	-1.8	-2.1	-1.7	-2.0	-0.7	-1.2	-1.7	-2.3	-2.4	-2.3	-2.1	
Automatic debt dynamics 1/	-0.3	-0.9	-0.7	0.2	0.3	3.1	2.0	1.0	0.8	0.8	0.9	
Contribution from nominal interest rate	1.5	1.4	1.5	1.4	1.3	2.2	2.2	2.1	2.0	1.9	1.9	
Contribution from real GDP growth	-0.9	-0.6	-0.9	-0.5	-0.2	0.9	-0.2	-1.1	-1.2	-1.1	-1.0	
Contribution from price and exchange rate changes 2/	-1.0	-1.7	-1.3	-0.7	-0.8	4.9	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	1.7	2.4	0.8	3.6	-0.1	-1.1	-0.6	1.0	0.8	0.8	0.8	
External debt-to-exports ratio (in percent)	82.3	75.2	63.5	66.7	64.8	80.9	79.5	75.5	71.0	67.7	65.2	
Gross external financing need (in billions of US dollars) 4/	56.1	51.8	70.9	59.8	72.2	81.7	65.4	71.5	73.4	78.3	85.0	
in percent of GDP	7.4	6.1	7.4	5.8	6.6	9.9	7.6	7.8	7.5	7.4	7.5	
Scenario with key variables at their historical averages 5/						**24.5**	**22.0**	**20.6**	**19.3**	**18.0**	**16.6**	**-2.3**
Key Macroeconomic Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.0	3.2	5.1	3.3	1.3	-3.7	1.0	4.7	5.5	5.3	4.9	
GDP deflator in US dollars (change in percent)	4.3	8.3	6.7	4.2	4.7	-21.1	3.3	1.1	2.1	2.4	2.3	
Nominal external interest rate (in percent)	6.9	7.4	8.1	8.8	7.5	9.0	9.4	9.2	9.1	9.2	9.3	
Growth of exports (US dollar terms, in percent) 6/	13.9	14.0	15.6	8.7	7.0	-19.3	4.7	8.2	9.4	9.1	8.6	
Growth of imports (US dollar terms, in percent) 6/	14.8	12.6	14.6	10.0	9.2	-18.5	2.9	7.5	10.8	9.4	8.7	
Current account balance, excluding interest payments	0.8	0.9	1.0	0.7	-0.1	-0.3	0.0	0.4	0.2	0.2	0.1	
Net non-debt creating capital inflows	1.8	2.1	1.7	2.0	0.7	1.2	1.7	2.3	2.4	2.3	2.1	

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

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

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

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

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

6/ Goods and nonfactor services.

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

Table 7. Mexico: External Sustainability Framework--Gross External Debt, 2004-2014

	Actual					Projections					
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
I. Baseline Projections											
Gross external debt in percent of GDP	21.9	20.4	17.7	18.8	18.4	24.5	24.1	23.4	22.4	21.6	21.0
in billions of U.S. dollars	166.2	173.1	169.0	193.1	200.4	202.5	208.4	214.1	220.4	229.1	239.8
II. Stress Tests											
Gross external debt in percent of GDP											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2010-14 1/						24.5	22.0	20.6	19.3	18.0	16.6
B. Bound Tests											
B1. Nominal interest rate is at baseline plus one-half standard deviations						24.5	24.2	23.5	22.6	21.8	21.3
B2. Real GDP growth is at baseline minus one-half standard deviations						24.5	24.4	23.9	23.1	22.5	22.1
B3. Non-interest current account is at baseline minus one-half standard deviations						24.5	24.5	24.1	23.5	23.0	22.8
B4. Combination of B1-B3 using 1/4 standard deviation shocks						24.5	24.5	24.1	23.4	22.9	22.7
B5. One time 30 percent nominal depreciation in 2010						24.5	36.1	35.3	33.8	32.7	32.0
Gross external debt in billions of U.S. dollars											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2010-14 1/						202.5	199.1	203.6	207.8	211.7	213.1
B. Bound Tests											
B1. Nominal interest rate is at baseline plus one-half standard deviations						202.5	208.9	215.3	222.2	231.7	243.2
B2. Real GDP growth is at baseline minus one-half standard deviations						202.5	208.4	214.2	220.5	229.3	240.1
B3. Non-interest current account is at baseline minus one-half standard deviations						202.5	211.4	220.6	230.8	244.2	260.2
B4. Combination of B1-B4 using 1/4 standard deviation shocks						202.5	210.1	217.9	226.5	238.0	251.7
B5. One time 30 percent nominal depreciation in 2010						202.5	208.5	215.5	222.7	232.2	243.4

1/ 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.

Table 8. Mexico: Gross Public Sector Debt Sustainability Framework, 2004-2014
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	**Debt-stabilizing primary balance 11/**
Baseline: Gross public sector debt 1/	41.4	39.8	38.3	38.2	43.3	**46.9**	**49.3**	**48.4**	**47.1**	**45.9**	**44.0**	**-1.0**
o/w foreign-currency denominated 2/	14.6	12.8	10.2	10.3	12.9	14.9	15.0	14.0	12.8	11.7	11.0	
Change in gross public sector debt	-4.1	-1.6	-1.5	-0.1	5.2	3.5	2.4	-0.9	-1.3	-1.2	-1.9	
Identified debt-creating flows (4+7+12)	-5.1	-2.6	-3.8	-2.0	1.0	3.1	1.8	-1.1	-1.4	-1.3	-1.0	
Primary deficit	-1.2	-1.6	-2.2	-1.3	-0.8	0.9	0.9	0.0	0.0	0.1	0.1	
Revenue and grants	19.3	20.8	21.5	21.5	22.7	22.6	22.6	21.5	21.2	21.1	20.6	
Primary (noninterest) expenditure	18.1	19.3	19.3	20.3	22.0	23.5	23.5	21.5	21.2	21.2	20.7	
Automatic debt dynamics 3/	-2.6	-0.8	-1.3	0.0	2.5	2.5	1.1	-0.9	-1.2	-1.2	-0.9	
Contribution from interest rate/growth differential 4/	-2.5	-0.1	-1.6	-0.1	-0.3	2.5	1.1	-0.9	-1.2	-1.2	-0.9	
Of which contribution from real interest rate	-0.9	1.1	0.3	1.0	0.2	0.9	1.5	1.3	1.2	1.1	1.2	
Of which contribution from real GDP growth	-1.6	-1.2	-1.8	-1.2	-0.5	1.6	-0.5	-2.2	-2.4	-2.3	-2.1	
Contribution from exchange rate depreciation 5/	-0.1	-0.7	0.2	0.1	2.8	...	...	...	...	...	...	
Other identified debt-creating flows	-1.3	-0.2	-0.3	-0.6	-0.7	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	
Privatization receipts (negative)	-1.3	-0.2	-0.3	-0.6	-0.7	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes (2-3) 6/	1.0	1.0	2.3	1.8	4.1	0.4	0.6	0.2	0.1	0.1	-0.9	
Gross public sector debt-to-revenue ratio 1/	214.6	191.1	178.2	177.4	190.8	207.8	218.2	224.7	221.8	217.7	213.8	
Gross financing need 7/	9.2	10.3	7.7	8.1	11.1	12.5	12.4	10.8	9.5	9.1	8.7	
in billions of U.S. dollars	70.2	87.8	73.4	83.1	121.3	103.2	107.1	98.7	93.2	96.6	99.2	
Scenario with key variables at their historical averages 8/						**46.9**	**45.2**	**43.2**	**41.2**	**39.1**	**36.1**	**-0.9**
Scenario with no policy change (constant primary balance) in 2009-2014						**46.9**	**52.6**	**52.7**	**52.2**	**51.7**	**50.5**	**-1.1**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	4.0	3.2	5.1	3.3	1.3	-3.7	1.0	4.7	5.5	5.3	4.9	
Average nominal interest rate on public debt (in percent) 9/	7.3	7.6	7.8	7.5	7.2	6.3	6.3	6.1	6.1	6.0	6.0	
Average real interest rate (nominal rate minus change in GDP deflator, in percent)	-1.8	3.0	1.1	3.1	0.6	1.9	3.4	3.0	3.0	2.8	2.9	
Nominal appreciation (increase in US dollar value of local currency, in percent) 10/	0.8	4.8	-1.6	-1.0	-21.1	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	9.1	4.6	6.7	4.5	6.6	4.4	2.8	3.1	3.1	3.2	3.1	
Growth of real primary spending (deflated by GDP deflator, in percent)	-6.9	9.7	5.6	8.3	9.8	3.0	1.1	-4.1	4.1	5.0	2.5	
Primary deficit	-1.2	-1.6	-2.2	-1.3	-0.8	0.9	0.9	0.0	0.0	0.1	0.1	

1/ Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.
2/ External debt is converted in pesos using end of period exchange rates.
3/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).
4/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.
5/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.
6/ For projections, this line includes exchange rate changes.
7/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.
8/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
9/ Derived as nominal interest expenditure divided by previous period debt stock.
10/ Change in end-year exchange rate (FIX) determined by Banco de Mexico.
11/ 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.

Table 9. Mexico: Gross Public Sector Debt Sustainability Framework--Gross Public Sector Debt, 2004-2014
(In percent of GDP, unless otherwise indicated)

	Actual					Projections					
	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
						I. Baseline Projections					
Gross Public Sector Debt	41.4	39.8	38.3	38.2	43.3	46.9	49.3	48.4	47.1	45.9	44.0
in billions of U.S. dollars	318.5	346.4	368.0	392.1	379.5	400.3	420.1	439.5	461.6	485.4	499.6
						II. Stress Tests					
Gross Public Sector Debt											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2009-14 1/						46.9	45.2	43.2	41.2	39.1	36.1
A2. No policy change (constant primary balance) in 2009-14						46.9	52.6	52.7	52.2	51.7	50.5
B. Bound Tests											
B1. Real interest rate is at baseline plus one-half standard deviations						46.9	49.7	49.4	48.5	47.8	46.4
B2. Real GDP growth is at baseline minus one-half standard deviations						46.9	50.0	50.0	49.8	49.9	49.4
B3. Primary balance is at baseline minus one-half standard deviations						46.9	49.5	48.9	47.9	47.0	45.4
B4. Combination of B1-B3 using 1/4 standard deviation shocks						46.9	49.9	49.6	49.0	48.4	47.0
B5. One time 30 percent real depreciation in 2010 2/						46.9	56.2	55.3	53.8	52.5	50.5
B6. 10 percent of GDP increase in other debt-creating flows in 2010						46.9	59.3	58.2	56.7	55.3	53.2
Gross public sector debt in billions of U.S. dollars											
A. Alternative Scenarios											
A1. Key variables are at their historical averages in 2009-14 1/						400.3	393.3	393.8	395.1	396.1	384.9
A2. No policy change (constant primary balance) in 2009-14						400.3	365.3	387.3	413.3	441.6	462.5
B. Bound Tests											
B1. Real interest rate is at baseline plus one-half standard deviations						400.3	424.4	448.6	476.0	505.7	526.6
B2. Real GDP growth is at baseline minus one-half standard deviations						400.3	422.1	445.5	474.1	507.3	534.1
B3. Primary balance is at baseline minus one-half standard deviations						400.3	422.6	444.7	469.9	497.2	515.3
B4. Combination of B1-B3 using 1/4 standard deviation shocks						400.3	423.4	446.6	472.9	501.3	520.6
B5. One time 30 percent real depreciation in 2010 2/						400.3	334.9	350.6	368.4	387.5	400.1
B6. 10 percent of GDP increase in other debt-creating flows in 2010						400.3	505.4	529.2	556.2	585.1	604.8

1/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.
2/ Real depreciation is defined as nominal depreciation (measured by percentage fall in dollar value of local currency) minus domestic inflation (based on GDP deflator).

Table 10. Mexico: Indicators of Fund Credit 2007-2014

			Projections					
	2007	2008	2009	2010	2011	2012	2013	2014
Stocks from prospective drawings 1/								
Fund credit in millions SDR	0	0	31,528	31,528	31,528	23,646	7,882	0
In percent of quota	0	0	1,000	1,000	1,000	750	250	0
In percent of GDP	0	0	6	5	5	4	1	0
In percent of exports of goods and services	0	0	19	18	17	11	3	0
In percent of gross reserves 2/	0	0	50	50	47	34	11	0
Flows from prospective drawings 3/								
Charges (Millions SDR)	0	0	709	940	940	893	424	42
Debt Service due on GRA credit (Millions SDR)	0	0	709	940	940	8,775	16,198	7,924
In percent of quota	0	0	22	30	30	278	514	251
In percent of GDP	0	0	0.1	0.2	0.2	1.3	2.3	1.0
In percent of exports of goods and services	0	0	0.4	0.5	0.5	4.2	7.2	3.2
In percent of gross reserves 2/	0	0	1	1	1	13	23	11
Memo Item:								
Total External Debt, assuming full drawing (% of GDP)	19	19	30	30	29	26	23	21

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

1/ End of period. Assumes full drawings under the FCL upon approval. The Mexican authorities have expressed their intention to treat the arrangement as precautionary. At an SDR/US$ rate of 0.66662 as of April 3, 2009.

2/ Excludes IMF purchases.

3/ Based on the rate of charge as of end-March 2009. Includes surcharges under the system currently in force and service charges.

Mexico City

April 7, 2008

Dear Mr. Strauss-Kahn,

We welcome the approval last week by the International Monetary Fund of a set of fundamental reforms of its policy instruments, including the creation of the Flexible Credit Line (FCL). Following such a decision, you have invited strong performing countries to take advantage of the FCL to further strengthen their current economic position. We believe that the FCL is well suited to support countries like Mexico that have strong policy frameworks and sound economic underpinnings, but are being adversely affected by external shocks. Responding to your invitation, we therefore would like the Fund to approve an FCL arrangement for Mexico in the amount of SDR 31.528 billion (1000 percent of quota), covering a period of 12 months. Such an arrangement—which we intend to treat as precautionary—will complement our overall macroeconomic policy strategy and bolster confidence until external conditions improve.

Mexico faces this global crisis from a much stronger position than in the past, reflecting the substantial progress we have made in strengthening the macroeconomic framework and in increasing our economic resilience in recent years. This has allowed us much greater flexibility to respond to the shocks we face, as we seek to limit the domestic impact of the global financial crisis, to maintain macroeconomic and financial sector stability, while continuing to lay the basis for strong and sustainable medium term growth.

Fiscal policy continues to be underpinned by our balanced budget rule, which has contributed to a steady reduction in public debt. Given the adverse impact of the global crisis on economic activity, we are—for the first time in Mexico's recent history—using the fiscal space, which has been gained through disciplined public finances to provide near term stimulus to the economy of about 1½ percent of GDP (described in detail in the 2009 budget[1] and in the announcement of our stimulus plan this past January).[2] At the same time, we remain committed to maintaining medium term fiscal discipline, while—building on the major tax reform passed by Congress in 2007—ensuring sufficient resources to finance the needed increase in public investment to support long term growth.

Monetary policy has been anchored by our inflation targeting regime, which has facilitated a sustained reduction in inflation and ensured stable inflation expectations. With pressures on inflation decreasing as the domestic economy has slowed, monetary policy has been eased by

[1] See http://www.shcp.gob.mx/FINANZASPUBLICAS/Paginas/CriteriosGeneralesPoliticaEconomica.aspx.

[2]http://www.shcp.gob.mx/SALAPRENSA/sala_prensa_presentaciones/presentacion_acc_perspectivas_itam_090109.pdf

150 basis points since the beginning of the year (as discussed in our recent monetary policy statements and inflation report).[3] Consistent with our monetary framework, we have maintained the fully flexible exchange rate regime, which has proved a key shock absorber in the face of the current global disruptions, while providing liquidity through largely rules based mechanisms as needed to ensure orderly market conditions.

The banking system is well capitalized and profitable, supported—as underscored in the recent FSAP—by a robust regulatory and supervisory framework (see also Banxico's Financial Stability Report).[4] We have taken concrete actions to address emerging pressures in specific market segments, including through expanding the number of Banxico's liquidity facilities, supporting commercial paper and MBS markets through national development banks, increasing the supply of the most liquid Government bonds and strengthening corporate sector monitoring.

Overall, as Executive Directors acknowledged in the recent Article IV consultation discussion, Mexico's economic policies have responded in a timely and appropriate fashion to the deteriorating global economic situation, and we will continue to react as needed to any future shocks that may arise.

Sincerely yours,

/ s /
Agustín Carstens

/ s /
Guillermo Ortiz

[3] See http://www.banxico.org.mx/documents/%7B1E623957-1CC0-5222-E700-E68ABCADC63E%7D.pdf and http://www.banxico.org.mx/documents/%7BD50009EA-11BC-8B37-6D8B-0846CF2D1F3E%7D.pdf.

[4] http://www.banxico.gob.mx/documents/%7BD6DD8AD1-21B0-8693-918B-87E231F56768%7D.pdf

INTERNATIONAL MONETARY FUND

Mexico—Assessment of the Impact of the Proposed Flexible Credit Line Arrangement on the Fund's Finances and Liquidity Position

Prepared by the Finance and Strategy, Policy and Review Departments

(In consultation with other Departments)

Approved by Andrew Tweedie and Philip Gerson

April 7, 2009

1. **This note assesses the impact of the proposed Flexible Credit Line (FCL) arrangement for Mexico on the Fund's finances and liquidity position, in accordance with the policy on the FCL.**[1] The proposed arrangement could cover a 12-month period, and be in an amount of SDR 31.528 billion (1,000 percent of quota). The full amount of access proposed would be available throughout the arrangement period, in one or multiple purchases.[2] The authorities intend to treat the arrangement as precautionary.

I. Background

2. **Mexico had several Fund arrangements in the 1980s and 1990s until it extinguished its remaining outstanding credit in 2000** (Table 1). From 1983 to 2000, Mexico had two arrangements under the Extended Fund Facility (EFF) and three Stand-By Arrangements (SBAs). In February 1995, the Fund approved an SBA equivalent to SDR 12.1 billion (688 percent of quota) to support Mexico's adjustment program to deal with a major financial and economic crisis. Under that arrangement, Mexico made purchases totaling SDR 8.8 billion, and its outstanding credit peaked at SDR 10.6 billion (607 percent of quota) at end-1995 (Figure 1). After regaining access to international capital markets in the second half of 1996, Mexico made sizable advance repurchases. In July 1999, an SBA equivalent to SDR 3.1 billion was approved as the recovery in economic performance was disrupted by unsettled conditions in international capital markets. Solid performance under the program supported by this last SBA allowed Mexico to extinguish all its outstanding obligations to the Fund through a series of advance repurchases before the SBA expired in November 2000.

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[1] See *GRA Lending Toolkit and Conditionality—Reform Proposals* (3/13/09), and *GRA Lending Toolkit and Conditionality—Reform Proposals* (3/24/09).

[2] If the full amount is not drawn in the first six months of the arrangement, subsequent purchases are subject to a review of Mexico's continued qualification for the FCL arrangement.

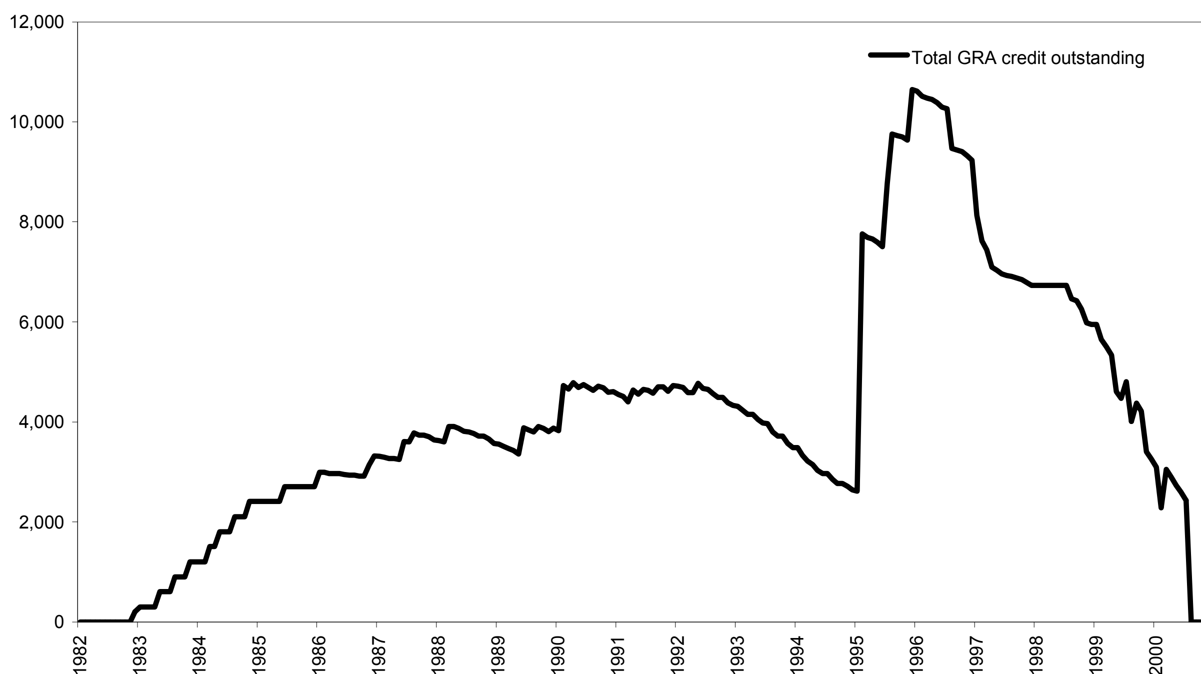
Table 1. Mexico: IMF Financial Arrangements, 1983–2000
(In millions of SDR)

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

Source: Finance Department.

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

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



Source: Finance Department.

3. **Total external debt is moderate.**[3] External debt has been stable around 19 percent of GDP in recent years, but is projected to rise to about 25 percent of GDP in 2009 owing to the depreciation of the peso and the wider current account deficit. Short-term debt on a residual maturity basis accounts for just over one-quarter of this total. Gross public debt has stabilized at just under 40 percent of GDP in recent years, and while some increase is projected in the near-term, sustainability analysis shows debt remaining manageable under a range of scenarios, with no significant contingent liabilities incurred thus far during the crisis. Public external debt is estimated at about 10½ percent of GDP at end 2008.

II. Impact on the Fund's Finances and Liquidity Position

4. **Access under the proposed arrangement would be the largest Fund commitment to date and it could result in a record credit exposure.**[4] In terms of SDRs, the proposed FCL would be the largest General Resources Account (GRA) arrangement in the Fund's history, and more than 2½ times larger than Mexico's SBA in 1995. If the full amount available under the FCL—which the authorities intend to treat as precautionary—were drawn, Mexico's outstanding use of GRA resources would reach SDR 31.5 billion, one-third higher than the Fund's largest credit exposure to date.

5. **In case the full amount available under the proposed FCL is disbursed in 2009:**

- **Mexico's external debt would remain moderate, with Fund credit representing a significant part of this debt:** total external debt would rise to 30 percent of GDP initially, and public external debt would rise close to 21 percent of GDP, with Fund credit being almost 6 percent of GDP (Table 2). At it its peak in 2009, Mexico's outstanding use of GRA resources would account for almost one-fifth of total external debt, just over one-quarter of public external debt, and about one-third of reserves.

- **External debt service would be substantially higher in the medium-term, but this would likely be manageable assuming a recovery in the operation of international financial markets**. Mexico's projected debt service to the Fund would peak in 2013 at about SDR 16.2 billion, or 2.3 percent of GDP.[5] In terms of exports of goods and services, external debt service to the Fund would peak at about 7 percent, accounting for just over 45 percent of total public external debt service, which would increase to 15½ percent of exports of goods and services.

[3] A more detailed description and analysis of external and public debt is provided in the staff report.

[4] The largest GRA commitment in SDR terms has been SDR 27.375 billion (Brazil's 2002 SBA following its augmentation in 2003), while the largest GRA credit exposure was SDR 23.359 billion (to Brazil in 2003).

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

Table 2. Mexico: Capacity to Repay Indicators 1/

	2008	2009	2010	2011	2012	2013	2014
Exposure and Repayments (In SDR millions)							
GRA credit to Mexico	--	31,528.0	31,528.0	31,528.0	23,646.0	7,882.0	0.0
(In percent of quota)	--	(1,000.0)	(1,000.0)	(1,000.0)	(750.0)	(250.0)	(0.0)
Charges due on GRA credit 2/	--	708.7	939.6	939.6	892.8	434.2	41.6
Debt service due on GRA credit 2/	--	708.7	939.6	939.6	8,774.8	16,198.2	7,923.6
Debt and Debt Service Ratios 3/							
In percent of GDP							
Total external debt	18.2	30.2	29.6	28.6	26.0	22.7	21.0
Public external debt	10.2	20.6	20.5	19.2	16.4	12.8	10.8
GRA credit to Mexico	0.0	5.7	5.5	5.2	3.6	1.1	0.0
Total external debt service	4.0	6.6	5.2	6.0	6.5	7.2	5.7
Public external debt service	2.1	3.5	3.1	3.2	4.2	4.9	3.5
Debt service due on GRA credit	--	0.1	0.2	0.2	1.3	2.3	1.0
In percent of Gross International Reserves							
Total external debt	210.3	175.3	179.4	179.1	187.2	208.5	228.1
Public external debt	117.7	119.5	124.3	120.0	118.1	118.0	117.5
GRA credit to Mexico	--	33.1	33.1	32.3	25.9	10.2	0.0
In percent of Exports of Goods and Services							
Total external debt service	14.3	21.7	17.3	19.3	20.6	22.5	17.7
Public external debt service	7.4	11.4	10.3	10.4	13.2	15.5	10.8
Debt service due on GRA credit	--	0.4	0.5	0.5	4.2	7.2	3.2
In percent of Total External Debt							
GRA credit to Mexico	--	18.9	18.5	18.0	13.8	4.9	0.0
In percent of Public External Debt							
GRA credit to Mexico	--	27.7	26.6	26.9	21.9	8.6	0.0

Sources: Mexican authorities, Finance Department, World Economic Outlook, and IMF staff estimates.

1/ Assumes full drawings under the FCL upon approval. The Mexican authorities have expressed their intention to treat the arrangement as precautionary, as balance of payments pressures have not materialized.
2/ Based on the rate of charge as of end-March 2009. Includes surcharges under the system currently in force and service charges.
3/ Staff projections for external debt, GDP, gross international reserves, and exports of goods and services, as used in the staff report that requests the proposed FCL, adjusted for the impact of the assumed FCL drawing.

6. **Reflecting the very high access under the arrangement, the impact on the Fund's liquidity, and on its potential credit risk exposure, would be very substantial:**

- **The proposed arrangement would reduce Fund liquidity by the full amount of available access** (Table 3). Approval of the proposed arrangement would reduce the one-year forward commitment capacity (FCC) by some SDR 31.5 billion. In addition to quota resources included in the FCC the Fund also has supplementary resources under the borrowing agreement with Japan.

- **If the resources available under the FCL were fully drawn, GRA credit to Mexico as a share of total GRA credit would exceed 60 percent.** As a result, the concentration of Fund credit among the top five users of Fund resources would increase markedly to about 93 percent, from 86 percent currently.

- **Potential GRA exposure to Mexico would be very large in relation to the current level of the Fund's precautionary balances.** If the resources available under the

arrangement were fully drawn, Fund credit to Mexico would be equivalent to some 4½ times the Fund's current precautionary balances.

Table 3. FCL for Mexico—Impact on GRA Finances
(In SDR millions, unless otherwise indicated)

	As of 3/30/2009
Liquidity measures	
Current one-year Forward Commitment Capacity (FCC) 1/	96,088
Japan borrowing agreement, available resources	67,111
Reduction in FCC on approval of FCL	31,528
Prudential measures, assuming full FCL drawing	
Fund credit to Mexico	
In percent of total GRA credit outstanding 2/	61.3
In percent of current precautionary balances	454.4
Fund credit outstanding to five largest debtors	
In percent of total GRA credit outstanding, before approval	85.7
In percent of total GRA credit outstanding, upon approval of the FCL 2/	93.4
Memorandum items	
Current precautionary balances (end-April 2008)	6,939
Total FCL commitments, including proposed FCL	31,528
Quota of FTP members with actual and proposed FCLs, in percent of total quota of FTP members	1.8

Sources: Finance Department.

1/ The FCC measures the Fund's capacity to make new credit commitments over the next 12 months.
2/ Based on current Fund credit outstanding plus full drawings under the proposed FCL.

III. Assessment

7. **The proposed record high commitment has a very substantial, but manageable impact on the Fund's liquidity.** While the current liquidity position is sufficiently strong to accommodate the liquidity impact of the proposed arrangement, the liquidity position could change quickly, particularly if there is further demand for large arrangements. This underscores the need for continued close monitoring of liquidity, and to expedite the efforts to bring new borrowing agreements on line to supplement the Fund's resources.

8. **Mexico intends to treat the FCL arrangement as precautionary, but if it did prove necessary to draw, this would become the Fund's largest single credit exposure**. Mexico's overall external debt and debt service ratios are expected to remain moderate even with a drawing under the arrangement. Hence, given Mexico's sustained track record of implementing very strong policies, and commitment to maintaining such policies in future, Mexico's capacity to repay is projected to remain strong. Nonetheless, the scale of the Fund's potential exposure to Mexico—in conjunction with the recent increase in lending to other members and the prospects for further credit expansion in the pipeline—underscores the need to strengthen the Fund's precautionary balances.

Press Release No. 09/130
FOR IMMEDIATE RELEASE
April 17, 2009

International Monetary Fund
Washington, D.C. 20431 USA

IMF Executive Board Approves US$47 Billion Arrangement for Mexico Under the Flexible Credit Line

The Executive Board of the International Monetary Fund (IMF) today approved a one year SDR 31.5 billion (about US$47 billion) arrangement for Mexico under the Flexible Credit Line (FCL). The Mexican authorities have stated they intend to treat the arrangement as precautionary and do not intend to draw on the line.

The arrangement for Mexico is the first commitment under the IMF's FCL, which was created in the context of a major overhaul of the Fund's lending framework on March 24, 2009 (see Press Release No. 09/85 and Public Information Notice 09/40). The FCL is particularly useful for crisis prevention purposes as it provides the flexibility to draw on the credit line at any time. Disbursements are not phased nor conditioned on compliance with policy targets as in traditional IMF-supported programs. This flexible access is justified by the very strong track records of countries that qualify for the FCL, which gives confidence that their economic policies will remain strong.

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

"Today is a historic occasion. The IMF Executive Board has approved the first Flexible Credit Line (FCL) arrangement and, at the same time, the largest financial arrangement in the Fund's history. The approval of this arrangement for Mexico represents the consolidation of a major step in the process of reforming the IMF and making its lending framework more relevant to member countries' needs.

"For over a decade, Mexico's macroeconomic performance has been very strong, exemplified by solid growth with low inflation; a steady reduction in public debt, and strengthened corporate balance sheets; a contained current account deficit; and a profitable and well capitalized banking sector. This has been underpinned by a highly credible and very strong policy framework, including a successful inflation targeting regime that has supported

the commitment to the flexible exchange rate; a rules-based fiscal framework; and strong and sophisticated financial sector supervision.

"However, the current difficult global economic and financial environment poses challenges even for countries with very strong fundamentals. As the global situation has deteriorated, Mexican asset prices have fallen sharply in line with the global market sell off, and GDP growth has slowed sharply. While Mexico's underlying fundamentals remain very strong, and the balance of payments position is manageable, the open capital account and close global financial linkages—on top of close trade links with the United States—could expose the country to potential downside risks.

"The authorities have taken robust and timely measures to respond to the deteriorating global situation, including steps to maintain orderly functioning of domestic markets, and to facilitate the refinancing of corporate external debt; fiscal stimulus to support demand, while simultaneously announcing measures to ensure medium term fiscal sustainability; and monetary policy easing. Looking forward, policies will continue to be underpinned by the rules based macroeconomic framework, accompanied by continued close monitoring of financial and corporate sector developments, and the authorities intend to continue to react as needed to any future shocks that may arise.

"It is against this background that, at the authorities' request, the Executive Board today approved a one year arrangement under the IMF's FCL, which the authorities intend to treat as precautionary. The Executive Board considered that Mexico was an excellent candidate to pioneer this facility. The FCL will play an important role in supporting the authorities' overall macroeconomic strategy and in bolstering confidence until external conditions improve, complementing the previously agreed swap line with the U.S. Federal Reserve, as well as financing from other multilaterals. All told, Mexico's combination of strong macroeconomic policies, institutional policy frameworks, and economic fundamentals, together with the additional insurance provided by the arrangement under the FCL, provides assurance that Mexico is in a very strong position to manage any potential risks and pressures in the event that the global situation were to deteriorate further," Mr. Lipsky said.