INTERNATIONAL MONETARY FUND

IMF Country Report No. 16/137

MEXICO

May 2016

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

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

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on May 27, 2016, following discussions that ended on March 18, 2016, with the officials of Mexico on economic developments and policies underpinning the IMF arrangement under the Flexible Credit Line. Based on information available at the time of these discussions, the staff report was completed on May 13, 2016.
- A **Staff Supplement** of May 13, 2016 on the assessment of the impact of the proposed Flexible Credit Line arrangement on the Fund's finances and liquidity position.

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

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Press Release No. 16/250
FOR IMMEDIATE RELEASE
May 27, 2016

International Monetary Fund
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Washington, D. C. 20431 USA

IMF Executive Board Approves New Two-Year US$88 Billion Flexible Credit Line Arrangement with Mexico

The Executive Board of the International Monetary Fund (IMF) today approved a successor two-year arrangement for Mexico under the Flexible Credit Line (FCL) in an amount equivalent to SDR 62.389 billion (about US$88 billion) and canceled the previous arrangement (SDR 47.292, about US$67 billion). The Mexican authorities stated their intention to treat the arrangement as precautionary.

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

Mexico's first FCL arrangement was approved on April 17, 2009 (see Press Release No. 09/130), and successor arrangements were approved on March 25, 2010 (see Press Release No. 10/114), January 10, 2011 (see Press Release No. 11/4), November 30, 2012 (see Press Release No. 12/465), and November 26, 2014 (see Press Release No. 14/543).

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

"Mexico's macroeconomic policies and policy frameworks remain very strong. Monetary policy is guided by an inflation-targeting framework in the context of a flexible exchange rate. Fiscal policy is underpinned by the fiscal responsibility law, and the authorities are committed to a consolidation path that would put the public debt-to-GDP ratio on a downward trajectory over the medium term. The financial regulatory and supervisory framework is strong. Medium-term growth should benefit from a range of ongoing structural reforms.

"The Mexican economy has shown impressive resilience to a slowdown in world growth in recent years. Economic activity is growing at a steady pace, inflation is low and stable, and the financial system is sound. Nevertheless, Mexico's economy remains exposed to external risks, give its close ties with the global economy. Downside risks to global growth have risen, and volatility in global financial markets has increased. The new arrangement under the Flexible Credit Line (FCL), with a higher level of access, will continue to play an important role in supporting the authorities' macroeconomic strategy by providing insurance against greater external risks and bolstering market confidence.

"The authorities remain committed to enhancing Mexico's resilience to external shocks further through steady implementation of the fiscal consolidation plans, continued anchoring of inflation expectations, gradual rebuilding of reserve buffers, and strong oversight of the domestic financial system. The authorities do not intend to make permanent use of the FCL. As global risks facing emerging markets recede, they intend to reduce access under the FCL in the future, with a view to phasing out Mexico's use of the instrument."

INTERNATIONAL MONETARY FUND

MEXICO

May 13, 2016

ARRANGEMENT UNDER THE FLEXIBLE CREDIT LINE AND CANCELLATION OF CURRENT ARRANGEMENT

EXECUTIVE SUMMARY

Context: Mexico continues to grow at a moderate pace. Inflation remains close to the target and medium-term inflation expectations are well anchored. The authorities have taken a number of policy measures to contain the effect of external shocks and remain committed to maintaining prudent policies. Nevertheless, Mexico is susceptible to changes in investor sentiment given its high integration with the global economy.

Risks: Global economic risks have risen since the approval of the current FCL arrangement. Asset-price volatility increased significantly in the second half of 2015 and in early 2016, and capital flows to emerging markets declined markedly. At the same time, geopolitical tensions and the risk of a rise in protectionism in some economies have intensified.

FCL: Authorities are requesting a two-year precautionary FCL arrangement in the amount of SDR 62.3889 billion (700 percent of quota, approximately US$88 billion) and the cancellation of the current arrangement, approved on November 26, 2014 (SDR 47.292 billion, 530 percent of quota, approximately US$67 billion). They consider that, in an environment of rising external risks, an FCL arrangement in the requested amount would help preserve investors' confidence and provide adequate insurance against tail risks in the current environment. Staff agreed with the authorities that global developments and risks warrant greater access under the FCL. Conditional on a reduction of relevant external risks facing Mexico, the authorities intend to cut access to Fund resources with a view to phasing out Mexico's use of the instrument. In the staff's assessment, Mexico continues to meet the qualification criteria for access under the FCL arrangement.

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

Process: An informal meeting to consult with the Executive Directors on a possible new FCL arrangement for Mexico was held on May 11, 2016.

Approved By
Robert Rennhack (WHD) and Vivek Arora (SPR)

This report was prepared by a team comprising Dora Iakova (head), Alexander Klemm, Damien Puy, Fabian Valencia (all WHD); Julian Chow (MCM); Marina Marinkov (FAD); and Juliana Araujo (SPR). Alexander Herman provided outstanding research assistance.

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CONTEXT

1. The Mexican economy has shown resilience in a complex global environment. The global recovery has weakened further amid increasing financial turbulence and falling asset and commodity prices. Activity in the advanced economies remained soft in the second half of 2015, several large emerging market economies were in recession or under financial stress in an environment of lower capital flows to emerging markets. The April 2016 World Economic Outlook noted that uncertainty and risks of weaker global growth have increased. Despite the sharp increase in global financial volatility and the rise in emerging market risk spreads, economic activity in Mexico continued to grow at a steady pace, and inflation has been low and stable.

2. Mexico's macroeconomic policies and policy frameworks remain very strong. Monetary policy is guided by an inflation-targeting framework while the flexible exchange rate has helped the economy adjust to external shocks. Fiscal policy is guided by the fiscal responsibility law, and the authorities are committed to a consolidation path that would lead to a gradual reduction of the public debt-to-GDP ratio over the medium term. The financial regulatory and supervisory framework is strong. Medium-term growth should benefit from a range of structural reforms adopted over the past few years. At the conclusion of the Article IV consultations in 2014 and 2015, Executive Directors expressed confidence in Mexico's very strong economic fundamentals and policy frameworks.

3. Despite sound fundamentals, Mexico remains exposed to external risks. Mexico has close ties with the global economy, and particularly with the U.S., through both trade and financial channels. The stock of foreign portfolio investment in Mexico reached US$456 billion (40 percent of GDP) at end-2015. The strong presence of foreign investors in Mexico reflects their confidence in the strength of the economic policy framework, and the depth and liquidity of its foreign exchange and bond markets. Based on BIS data, the Mexican peso is the most actively traded emerging market currency in the world, with a daily global trading volume of US$135 billion. Foreign participation in the domestic financial markets brings substantial benefits, such as lower cost of finance and a diversified investor base. However, it also exposes Mexico to abrupt shifts in investor sentiment toward emerging markets.

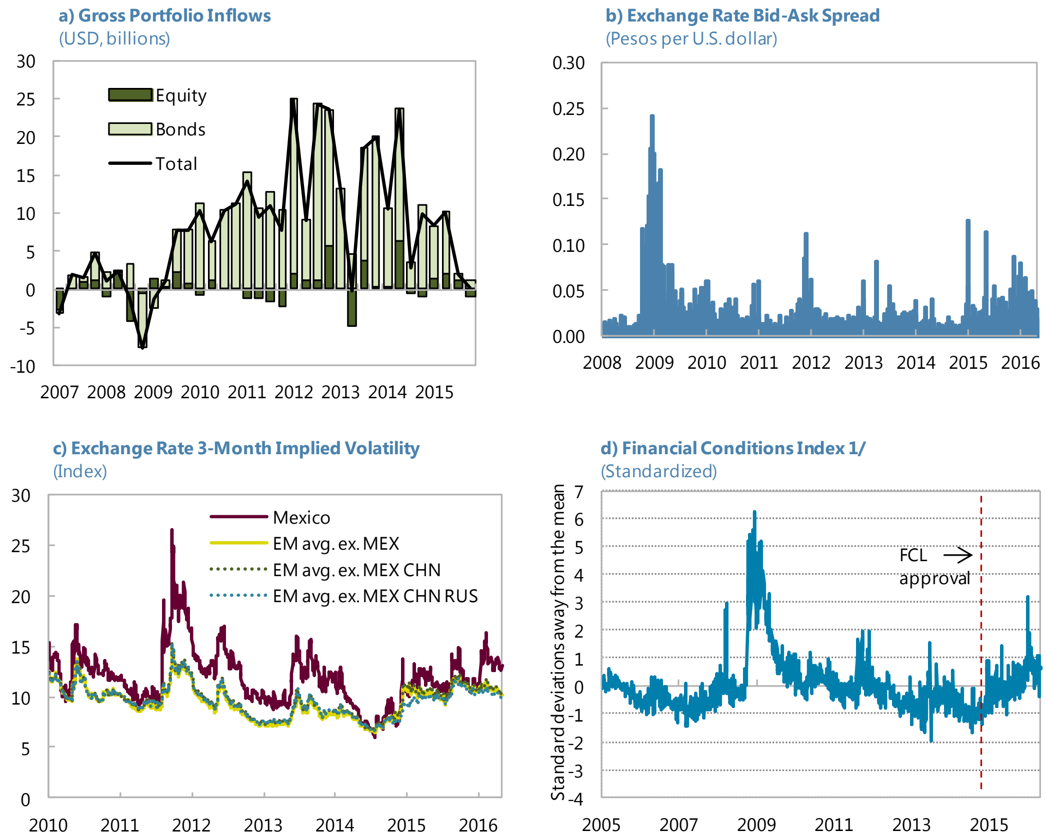
RECENT DEVELOPMENTS AND OUTLOOK

4. The economy continues to grow at a moderate pace. Growth reached 2½ percent in 2015 and is projected to remain at a similar level in 2016. Strong U.S. demand, the significant real depreciation of the peso, and lower electricity prices should support Mexico's manufacturing production and exports, with positive spillovers to domestic demand. Robust private consumption growth has been underpinned by steady wage growth and rising employment (Figure 1 and Table 1). Inflation is low, and is expected to remain close to the 3-percent target over the next year. The implementation of structural reforms remains on track and is expected to raise potential growth over the medium term. External downside risks to the outlook include weaker-than-expected growth in the U.S., deterioration in market sentiment towards emerging markets, and a renewed decline in oil prices. The main domestic risk is a further drop in oil production, which would increase the fiscal consolidation burden.

5. Global financial volatility has increased sharply over the last year, with significant spillovers to Mexico's financial markets. Gross capital flows to emerging market economies turned negative in the latter part of last year for the first time since the global financial crisis. Portfolio capital flows to Mexico, which were robust until 2014, came to a halt in the second half of 2015. A resurgence of volatility in January and February caused further sharp drops in emerging market asset prices (Figure 2), and Mexico was particularly affected. The Mexican peso typically moves broadly in line with the average of other EM currencies, but it depreciated well above that average in early 2016 (unrelated to changes in the underlying fundamentals).[1] Bid-ask spreads increased as the wide-spread use of the peso as a proxy hedge for other risky assets exacerbated exchange rate volatility.[2] A measure of composite financial conditions in Mexico shows that in early 2016 financial stress reached its highest level since the global financial crisis. The recovery in global asset prices since February has reversed some of the losses and asset-price volatility has declined. Nonetheless, new episodes of risk aversion remain likely.

[1] The bilateral exchange rate against the U.S. dollar depreciated by 19 percent in 2015, and by an additional 11 percent by mid-February 2016.

[2] Note that the implied volatility of the peso is usually higher than the average currency volatility of other emerging markets during periods of global financial stress.



Source: National authorities; Haver Analytics; Bloomberg, L.P.; and IMF staff calculations.
1/ The index is constructed as the weighted average of a set of financial indicators with weights given by the inverse of the standard deviation of the corresponding variable. The indicators used to construct the index include the bilateral exchange rate, 3-month option implied volatility, net international reserves, 28-day interbank rate, overnight interbank rate, CEMBI spreads, EMBIG spreads, 5-year sovereign CDS spreads, 5-year PEMEX CDS spreads, IPC stock price index, VIMEX index, 2-year government bond yield, 10-year government bond yield, 10-year government bond yield bid-ask spread, exchange rate bid-ask spread, EPFR bond flows, and EPFR equity flows.

6. **The monetary stance remains appropriate.** The Bank of Mexico increased the policy rate by 25 basis points in December, and an additional 50 basis points in February, to ensure that inflation will remain close to the target over the policy horizon. Year-on-year core and headline inflation have increased from historical lows reached in 2015, but remain near the 3-percent target. The pass-through from the currency depreciation to inflation has been low, and was more than offset by the effects of lower commodity prices and declining communication services' prices related to the telecom reform.[3] Inflation expectations remain well anchored. The small negative output gap is expected to close over the next two years. There has been a modest pickup in overall wage growth reflecting diminishing slack in labor markets.

[3] See Chapter 4 of the April 2016 WHD Regional Economic Outlook.

7. The authorities remain committed to a gradual fiscal consolidation over 2016–18. In the 2014 budget, the authorities announced a plan to reduce the public sector borrowing requirement (PSBR) from 4.6 percent of GDP in 2014 to 2.5 percent of GDP in 2018 (by half a percentage point of GDP per year). The public sector borrowing requirement (PSBR) target for 2015 was met. The authorities announced earlier this year additional expenditure cuts of ¾ percent of GDP for both 2016 and 2017 to ensure that the targets for these years will also be met, despite the significant downward revisions in projected oil production and prices since the last budget.[4] The cuts this year will fall mostly on PEMEX, and are part of a broader restructuring plan, aimed at making it an efficient and viable company in the context of persistently lower oil prices. Adherence to the fiscal consolidation plan is important to set the public debt-to-GDP ratio on a downward path, restore fiscal buffers, and maintain investors' confidence. Despite the sharp depreciation of the currency over the last two years, the yields on local-currency government bonds have increased only modestly, showing continued trust in the creditworthiness of Mexico's government.

8. Mexico's external sector position remains strong. The current account deficit widened to 2.8 percent of GDP in 2015 (from 1.9 percent in 2014), reflecting a reduction in the hydrocarbons trade balance. Non-hydrocarbon exports should benefit from the depreciation of the currency and the strength of U.S. demand going forward. The current account deficit in 2015 was broadly in line with fundamentals and desirable policy settings. The real exchange rate has depreciated further in 2016 relative to its 2015 average, and is currently somewhat weaker than the level consistent with fundamentals. The net international investment liability position is broadly stable at around 36 percent of GDP. Foreign exchange reserves remain adequate according to a range of indicators (Figure 5 and Table 5). The authorities activated two intervention schemes in 2015, including a minimum-price auction triggering FX sales whenever the daily depreciation reached a pre-determined threshold, and daily auctions without minimum price.[5] In mid-February 2016, the rules-based interventions were discontinued. Partly as a result of the interventions, the stock of foreign reserves has declined by US$15 billion since the approval of the current FCL arrangement in 2014. The authorities intend to start rebuilding reserve buffers once pressures on asset prices subside.

9. The financial sector remains sound, and domestic credit growth is close to trend. The commercial banking system remains well capitalized, liquid, and profitable. The authorities' stress tests and staff analysis suggest that banks and the corporate sector would be resilient to negative

[4] There is likely to be an overperformance on the PSBR deficit target of 3.5 percent of GDP for 2016, due to a one-off transfer of foreign exchange reserve valuation gains from the Bank of Mexico to the federal government (in the amount of 1.2 percent of GDP). The overperformance is projected at least 0.9 percentage points of GDP, as 70 percent of the Banxico dividend must be used to reduce debt according to the Fiscal Responsibility Law. The Bank of Mexico is not consolidated in the public sector fiscal accounts.

[5] Mexico introduced rules-based interventions on December 8, 2014. The first scheme triggered sales of US$200 million whenever the daily depreciation exceeded 1.5 percent. As of March 11, 2015, the authorities also started auctioning US$52 million every day, increasing the auction amount to US$200 million starting July 30, 2015. On November 19, 2015, the unconditional daily auctions were suspended, but the depreciation-based mechanism was augmented so that US$200 million was offered first when daily depreciation exceeded 1 percent, and then again if it reached 1.5 percent. As of February 17, 2016, all rules-based interventions were terminated, and replaced by the use of discretionary intervention (which has been used only once through the end of April).

shocks to growth, interest rates, and asset prices. Annual nominal growth of financial system credit to the nonfinancial private sector was around 14 percent in 2015, consistent with trend financial deepening.

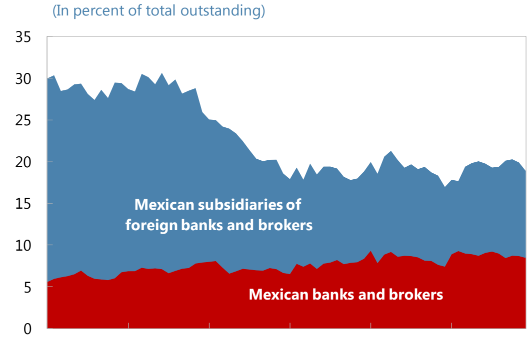
THE ROLE OF THE FLEXIBLE CREDIT LINE

10. **The FCL has served the Mexican economy well.** The previous FCL arrangements provided valuable insurance in the immediate aftermath of the 2008–09 global financial crisis, during the euro area crisis (Mexico has strong financial linkages with the euro area as a host of large subsidiaries of several European banks), and the recent turbulent period in the run-up to the start of U.S. monetary policy normalization.

11. **In justifying their request for an increase in access from 530 to 700 percent of quota, the authorities emphasized that external risks have increased significantly since the current arrangement was approved.** The authorities pointed out that risks to the global economic outlook have shifted further to the downside. Downside risks have increased particularly for the emerging economies' universe: the fall in commodity prices has pushed some economies into a recession, capital flows to EMs have dropped, and sharp currency depreciations have exposed weaknesses in corporate balance sheets. If this triggers a crisis in a large emerging market, spillovers to Mexico through financial channels are likely to be significant. The correlation of asset prices across EMs, independent of any difference in fundamentals, has been very high during recent risk-off episodes. They noted that despite the rebound in asset prices since February, new episodes of heightened investor risk aversion remain highly likely. Mexico could be particularly affected given a large stock of foreign portfolio investment, including in local currency debt instruments, and the wide-spread use of the peso as a hedge for exposure to other emerging market currencies. The authorities also noted that uncertainty about the speed and impact of normalization of monetary policy in the U.S. remains high, and the growing divergence in monetary policy stances among the advanced economies could contribute to a rise in asset-price volatility. They emphasized that a notable new risk factor is a rise in protectionist tendencies in some trading partners, which could affect highly open economies such as Mexico. This risk could cause a temporary increase in capital flow volatility even if it does not materialize.

12. **The authorities noted that changes in the structure of financial markets in recent years have increased the probability of recurrent episodes of reduced liquidity and high asset-price volatility.** These changes include new financial regulations that have diminished the role of banks as market makers, a rise in algorithm-based trading, and the increased role of asset

Banks' Holdings of Government Securities
(In percent of total outstanding)



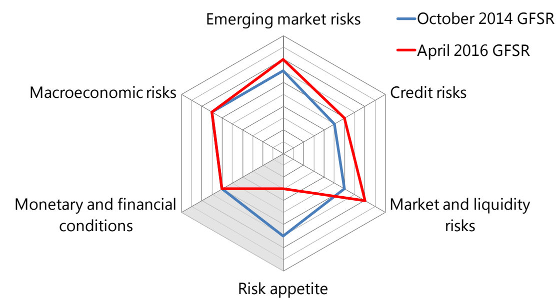
Source: National authorities.

managers and other non-banks, which are more prone to herd behavior than banks.[6]

A. Access Considerations

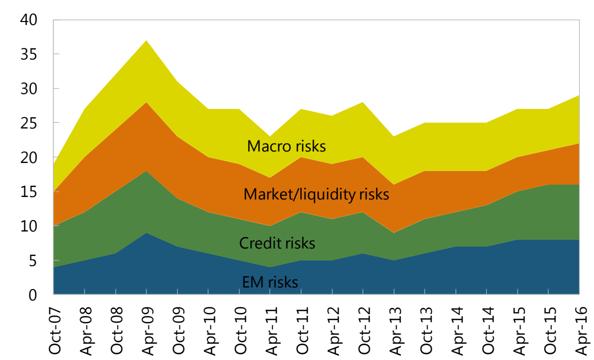
13. In the staff's assessment, external risks have increased since the Board approval of the current FCL arrangement in November 2014. The global growth outlook has been continuously revised down over the last two years. While the world economy continues to expand modestly, growth prospects have weakened across a wide range of countries and downside risks have risen (April 2016 World Economic Outlook). Risks to global financial stability have also increased amid volatility in global asset markets, weaker confidence, and geopolitical tensions. The April 2016 Global Financial Stability Report shows that emerging market, credit, and market and liquidity risks have all increased since the Board approval of the current FCL arrangement in November 2014, and the combination of various risks to stability is at its highest level since the global financial crisis. Despite the recent easing of financial conditions, the risk of new episodes of increased investors' risk aversion remains elevated.

Global Financial Stability Map



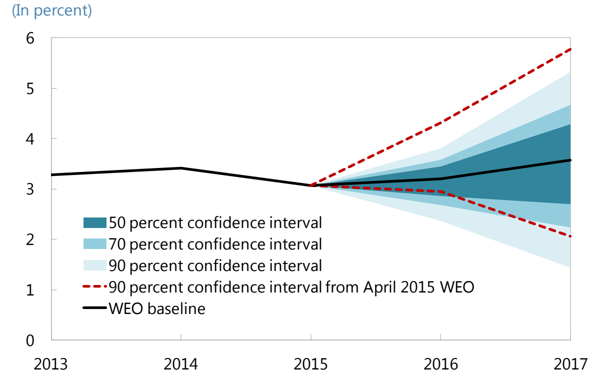
Source: Global Financial Stability Report.
Note: Away from center signifies higher risks, easier monetary and financial conditions, or higher risk appetite.

Global Financial Stability Map Risk Indicators
(Notches)



Source: Global Financial Stability Report

Prospects for World GDP Growth
(In percent)



Source: April 2016 World Economic Outlook.

14. Staff's assessment of potential balance of payment needs for Mexico is based on a tail risk scenario of a sudden disorderly pull-back of capital from emerging market economies. It could be triggered by further rapid deleveraging in China or a crisis in one or more EMs. In addition, there is a risk of a significant increase in protectionism in some economies that could disrupt trade and financial flows. Any of these shocks is likely to trigger

[6] The authorities noted that as a result of changes in global bank regulations, the share of government bonds held by foreign-owned banks in Mexico has declined, reducing their market-making ability. They pointed to the fall in the average ticket size of traded securities as a possible indication that liquidity has diminished, making it more difficult to execute large trades without affecting prices significantly. While the rise in algorithm trading by itself is not necessarily a negative development, high-frequency traders may not be willing to play a market-making role during periods of market turbulence due to risk controls and limited balance-sheet capacity to absorb shocks.

safe-haven capital flows and a sharp retreat from emerging markets, but the impact would be particularly large if these risks were to materialize simultaneously.

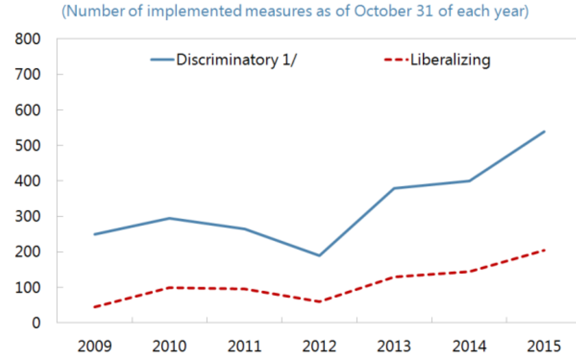
- While both desirable and necessary, China's growth rebalancing is inherently complex. As discussed in the April 2016 GFSR tail risk scenario (called "global market disruption"), the process of balance-sheet deleveraging could turn disorderly, with a potential to generate large spillovers to both emerging markets and advanced economies. The potential for global spillovers from shocks to China's financial markets was demonstrated by the global market ripple effects of the August 2015 change in the central parity of the renminbi and the January 2016 stock market suspension (Figure 2).

- A number of emerging markets came under increasing stress over the last two years due to low commodity prices, slower growth (or recessions in some cases), and weakening corporate balance sheets related to high debt burdens, depreciating currencies, tighening credit conditions, and lower earnings. A sharp slowdown in global growth could put further downward pressure on commodity prices (including oil), lead to further currency depreciation, and amplify existing balance sheet vulnerabilities in emerging markets (as well as in some advanced economies), raising global risk premiums. In such an environment, a crisis in one or several large emerging markets could become very likely. A materialization of this risk could trigger a sudden reversal of portfolio flows to emerging markets.

- A renewed decline in oil prices due to further slowdown in global growth or other factors is likely to reduce FDI inflows into Mexico's oil sector.

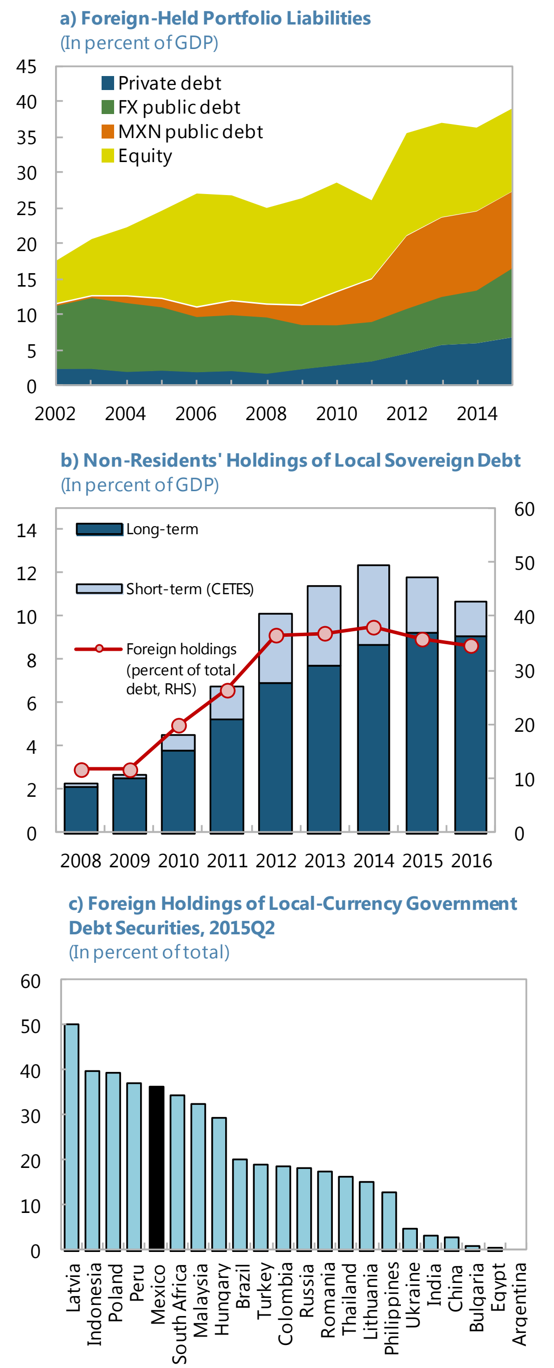
- Finally, there is risk of a move toward greater protectionism in some of Mexico's trading partners. The perception of a rise in this risk by itself can reduces Mexico's attractiveness for FDI and portfolio investors in the short term, and the materialization of this risk—which would be an extreme tail event—could have a major negative impact on both capital and trade flows. This risk could feasibly materialize together and interact with the other tail risks considered above, resulting in a severe shock to Mexico's external balance of payments.

Worldwide Trade Measures
(Number of implemented measures as of October 31 of each year)



Sources: Global Trade Alert.
1/ Trade-distorting measures.

15. The materialization of these risks could affect Mexico disproportionally given its open current and capital accounts, and a sizeable stock of foreign portfolio investment. Portfolio flows to Mexico have increased significantly in the four years after its inclusion in the WGBI in 2010. The increase was particularly pronounced in the local-currency sovereign debt markets, where foreigners now hold 35 percent of local-currency government bonds (11 percent of GDP), among the highest in emerging markets. The high foreign holdings of domestic assets, and the widespread use of the peso as a proxy for a number of risky assets, expose Mexico to shifts in global risk aversion. Staff's analysis suggests that portfolio debt flows to Mexico are highly sensitive to changes in sentiment towards emerging markets (Annex 1). In addition, Mexico's FX and bond markets are among the most liquid in the emerging market universe, which could make it vulnerable to greater outflows during stress periods. Investors facing large redemptions are likely to base their asset divestment not only on fundamentals, but also on market liquidity, which would affect countries with deep markets such as Mexico.[7] A rapid further depreciation of the currency due to an external shock could lead to outflows by unhedged holders of local-currency government bond paper. Mexico's asset management industry and domestic banking system are relatively small and cannot absorb large sales by nonresidents. If a downward spiral in currency and bond prices develops, temporary but disruptive outflows by residents could be triggered as well.



Sources: National authorities; Arslanalp and Tsuda (2015); and IMF staff calculations.

16. Mexico's reserve buffers have declined over the last year, increasing the need for supplementary insurance. Mexico's foreign reserves stood at US$197 billion at the time of the Board approval of the current FCL arrangement in 2014. Consistent with the flexible exchange rate

[7] Mexico was one of the most affected markets in the initial stages of the taper tantrum episode, demonstrating the importance of the liquidity channel (see Box 1 in Mexico's 2014 FCL staff report). Fortunately, worries about an imminent US rate rise subsided quickly during the taper tantrum, and asset prices normalized.

regime, the authorities allowed the currency to depreciate in response to external shocks over the past year, and used intervention only to smooth volatility and prevent disorderly market conditions. As a result of the interventions, foreign reserves have fallen to US$182 billion as of end-April 2016, and have declined from 109 to 106 percent of the ARA metric over the last year. Since external risks have increased, it would be desirable to increase access under the FCL to compensate both for the decline in buffers and maintain adequate protection against greater tail risks over the next two years.

17. The external economic stress index for Mexico (Box 1) shows that external conditions can deteriorate rapidly if risks materialize. The downside scenario illustrated with the index is based on a negative shock to global growth (affecting U.S. growth), lower commodity prices, and stress in financial markets (accompanied by a rise in the emerging market volatility index).

Box 1. The Calculation of the External Economic Stress Index

The external economic stress index for Mexico was initially presented in Mexico's staff report on the arrangement under the Flexible Credit Line, November 2014. Its methodology is explained in *Flexible Credit Line—Operational Guidance Note*, IMF Policy Paper, June 2015. The calculation of the index required three main choices: (i) selection of relevant external risks, (ii) selection of proxy variables capturing these risks, and (iii) choice of weights for these variables. The updated index is presented below using the same model and proxy variables, but with updated weights reflecting the latest data.

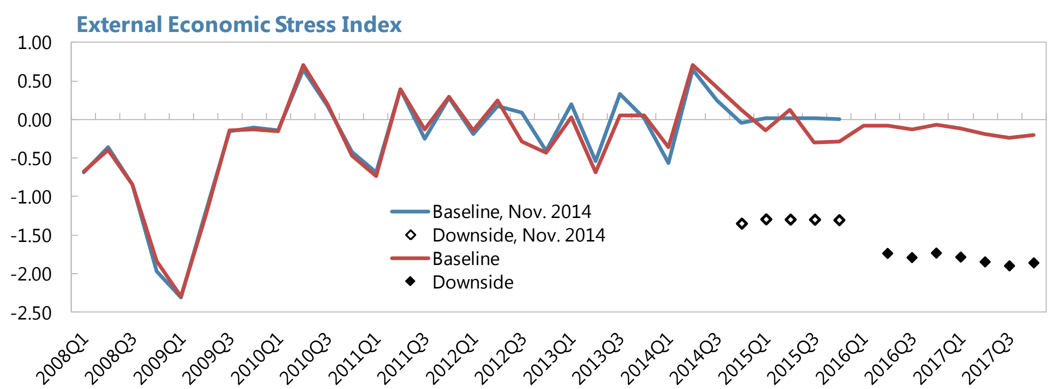
Risks. Mexico's exports, remittances, and inward FDI are closely related to U.S. economic developments. The open capital account and the significant stock of debt and equity portfolio investment expose Mexico to changes in global financial conditions. Finally, oil production and fiscal revenues depend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

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

Weights. The weights were estimated using balance of payment and international investment position data, all expressed in shares of GDP. The weight on U.S. growth (0.47) corresponds to the sum of exports, FDI, and remittances; the weights on the change in the U.S. long-term yield (0.33) and the VXEEM (0.16) correspond to the stocks of foreign debt and equity; and the weight on the change in the oil price (0.04) corresponds to oil exports.

Baseline scenario. This scenario corresponds to the WEO projections for U.S. growth, oil prices, and the U.S. 10-year bond yield. The VXEEM projections are in line with the VIX futures as of March 31, 2016.

Downside scenario. The scenario is based on the global market disruption scenario in the April 2016 GFSR, which is broadly consistent with the tail risks presented in this paper. Specifically, using the results from the simulations in the GFSR scenario, we assume that U.S. growth would be 1.5 percentage points lower than projected in the coming year due to a combination of spillovers from lower global growth, and higher global risk premiums and credit spreads (resulting from withdrawal of capital from emerging market assets and other risky assets). As a result of weaker global growth, oil prices would be about 25 percent lower than the baseline (implying a return close to the low price levels seen in early 2016). The scenario also assumes a surge in global financial market volatility, with the VXEEM rising by 3 standard deviations (for comparison, the VXEEM increased by 4 standard deviations in both 2008Q4 and 2011Q3). The downside scenario is illustrated in the chart by dots, which represent the level to which the index would fall if the described shocks materialized in any given quarter.



B. Adverse Scenario

18. In a global adverse scenario, financing needs would be mostly the result of a turnaround in portfolio flows and a reduction in FDI inflows. The access case is based on a tail risk scenario, in which some of the previously discussed risks materialize. As a result, rollover rates for external debt coming due would decline, and FDI inflows would be lower than projected due to lower oil prices and reduced investment. In addition, foreign holdings of domestic equity would fall, and domestic institutional investors would increase the share of foreign assets in their portfolios.[8]

19. In the staff's view, access at 700 percent of quota can be justified under a plausible tail risk scenario (Box 2). Reflecting the increase in global risks, the shocks are greater than assumed in the current FCL arrangement for Mexico, and further in the tails of the distribution of historical cross-country experiences. The scenarios do not include a current account shock, even though the materialization of some of the external risks may lead to lower exports and remittances. The scenario assumes further drawdown of reserves of US$5 billion. In terms of debt rollover rates, the assumption is 71 percent for local-currency denominated debt securities, and 80 percent for dollar-denominated securities. In addition, FDI inflows decline by 50 percent in the adverse scenario; while non-resident outflows from the stock market, and resident portfolio and other investment outflows, are assumed to rise by 1.6 standard deviations.

C. Exit Strategy

20. Exit Strategy. The authorities reaffirmed that Mexico does not intend to make permanent use of the FCL. Conditional on a reduction of some of the current global risks facing emerging markets during the proposed FCL, including a dissipation of the risk of increased protectionism in some trading partners and a smooth continuation of the process of normalization of U.S. monetary policy, they intend to cut access to Fund resources, with a view to phasing out Mexico's use of the instrument. The authorities are committed to continue enhancing Mexico's resilience to external shocks through steady implementation of the fiscal consolidation plans (which is ongoing), continued anchoring of inflation expectations, gradual rebuilding of reserve buffers, and strong oversight of the domestic financial system.

[8] This is broadly consistent with the behavior of domestic residents during the global financial crisis, when capital outflows (including unrecorded outflows captured in the "errors and omissions" category) intensified for a couple of quarters before returning to normal levels.

Box 2. Illustrative Adverse Scenario

The illustrative adverse scenario shows that access at 700 percent of quota (SDR 62.3889 billion, US$87.8 billion) can be justified under a plausible downside scenario, with rollover rates around or above the 25th percentile of historical experience.

Use of reserves. Despite the reduction of FX buffers over the last year, further use of US$5 billion of reserves is assumed in the downside scenario.

Foreign direct investment. In the baseline, FDI is assumed to rise gradually as a result of structural reforms in the energy and telecommunication sectors (although it would remain below the exceptionally high level achieved in 2013 when a major brewery was taken over). A 50 percent drop in net FDI inflows is assumed in the adverse scenario (smaller that in the 2012 Mexico FCL arrangement). A significant share of FDI is related to export-oriented production facilities, so a slowdown in imports or exports due to higher trade barriers or a negative shock to global growth, would discourage FDI. In the oil sector, a further decline in the oil price could lead to postponement of investment due to a gloomier profit outlook and weak balance sheets of the global oil companies.

Gross equity portfolio inflows. In an environment of heightened risk aversion, foreign investors would reduce their equity holdings. Given the increased risks, a slightly larger shock has been assumed (1.6 standard deviations compared to 1.5 standard deviations in the 2014 request).

Resident portfolio outflows. Uncertainties about the exchange rate could also lead to temporary capital flight by residents. Given the higher risks, a slightly higher shock was assumed (1.6 standard deviations compared to 1.5 standard deviations in the 2014 request). The magnitude of the shock is similar to the experience in mid-2013, when residents increased their foreign asset holdings sharply in response to the taper tantrum. As a share of broad money, the shock remains close to the center of the distribution of past outcomes in emerging markets.

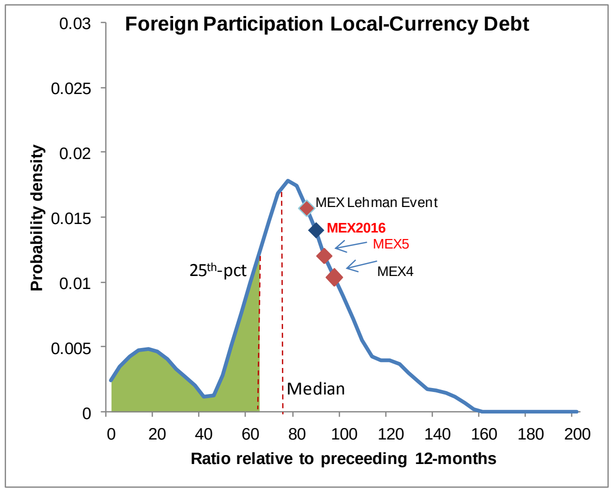
Foreign-currency denominated debt. The assumption is that investors do not fully rollover the debt coming due, though there is no net divestment.

- Investors are assumed to rollover 80 percent of FX debt coming due. The lower rollover rate compared to previous arrangements (90-95 percent rollover rates in the 2014 request) reflects a higher risk of foreign investors reducing exposure to emerging markets. For private debt, the assumed shocks are well within the range of previous FCL arrangements (Figure A). The rollover rate for trade credit is assumed to be the same as for other FX debt.
- For public debt, the combined rollover rates for FX and peso-denominated debt need to be considered to allow comparisons with history (as the data are not available broken down by currency). The combined rate is well above the lower quartile of historical outcomes.

Box 2. Illustrative Adverse Scenario (Continued)

Peso-denominated debt. As with FX debt, no net divestment is assumed. However, given that peso-denominated debt is not only subject to credit risk but also to currency risk, a lower rollover rate is assumed. The peso has already depreciated significantly, and further sharp depreciation could lead to a reduction of foreign investors' holdings of local currency debt (to the extent that they are not hedged).

- The assumed rollover rate is 71 percent. As noted above, the overall rollover rate for public debt remains comparable to previous arrangements. Moreover, the assumed rollover rate results only in a small reduction in the share of foreign ownership in the local-currency debt market. The text chart shows the empirical distribution of the change in the share of foreign ownership in local currency bonds in 21 emerging markets during the global financial crisis (100 means that the average share of foreign ownership did not change between 2007Q4-2008Q3 and 2008Q4-2009Q3).[1] The assumed shock implies a much lower decline in foreign participation that the median outcome for emerging markets during the global financial crisis.



[1] For example, in Mexico, foreign ownership of local currency securities declined by 17 percent in the 4 quarters after the collapse of Lehman compared to the previous 4 quarters.

Box 2. Illustrative Adverse Scenario (Continued)

Table A. Mexico: External Financing Requirements and Sources

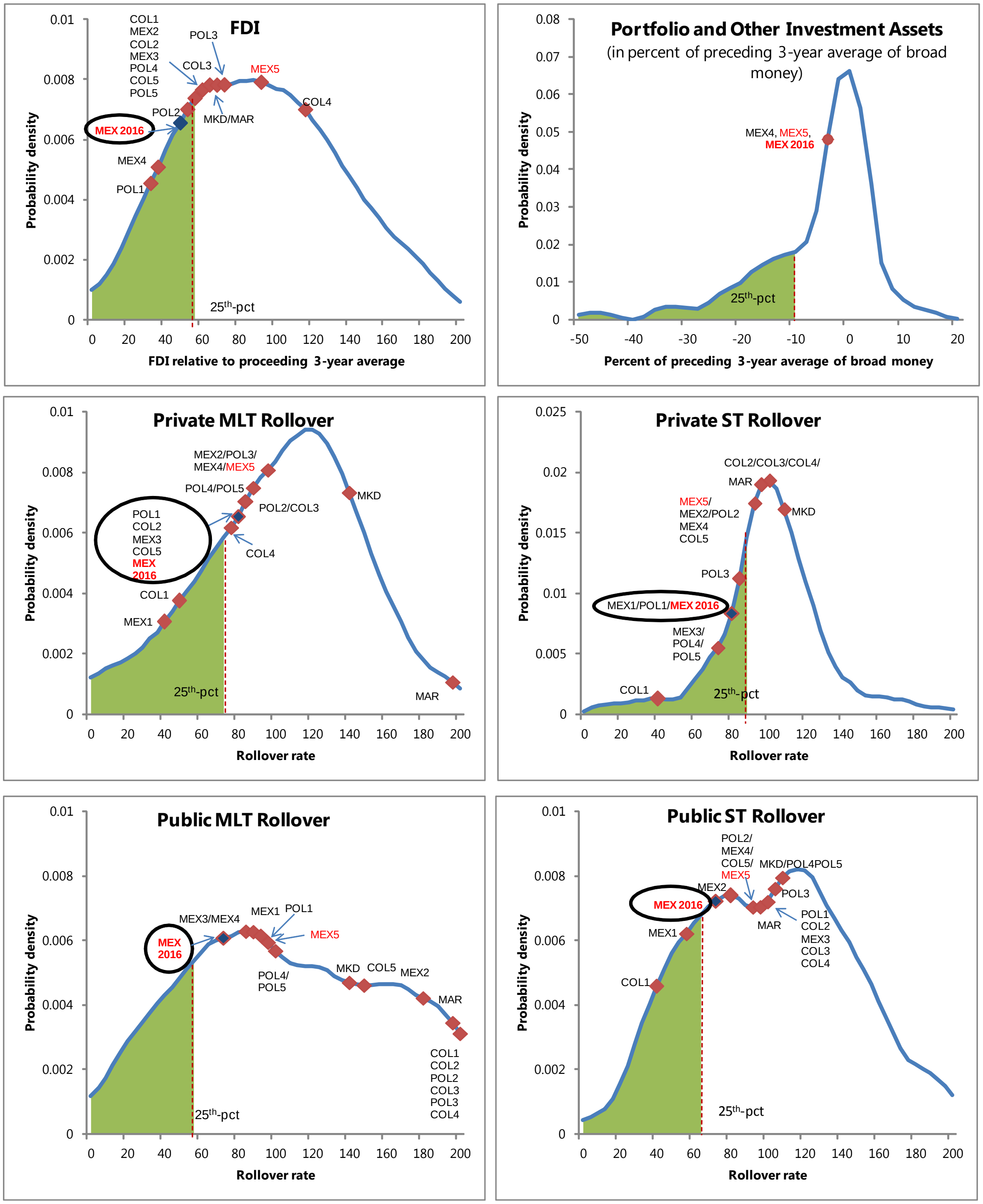
(In billions of U.S. dollars)

	2013	2014	2015	Projection 2016	Projection 2017	Adverse 2016	**Contribution to Gap**	Adverse 2017	**Contribution to Gap**	2016 Rollover /Shock	2014 Rollover /Shock	2012 Rollover /Shock
Gross external financing requirements	**149.8**	**164.5**	**136.2**	**120.3**	**126.8**	**115.3**	**-5.0**	**121.8**	**-5.0**			
Current account deficit	30.3	24.8	32.4	27.9	29.5	27.9		29.5		No net shock	No net shock	$10 bn shock
Amortization of Bonds and Loans	106.3	124.2	121.9	96.6	97.1	96.6		97.1				
Public sector MLT coming due	22.5	22.8	21.3	19.6	17.3	19.6		17.3				
FX denominated bonds	3.9	3.2	2.7	3.3	5.8	3.3		5.8				
Local currency bonds	7.4	10.9	10.3	10.2	9.1	10.2		9.1				
FX Bank Financing	11.2	8.7	8.3	6.1	2.4	6.1		2.4				
Private sector MLT amortization	7.2	9.0	6.9	6.6	6.1	6.6		6.1				
FX denominated bonds	5.4	7.1	4.5	4.1	2.8	4.1		2.8				
Bank Financing	1.7	1.9	2.4	2.6	3.3	2.6		3.3				
Short term debt coming due	76.6	92.4	93.8	70.4	73.6	70.4		73.6				
Public sector	50.0	60.2	58.0	38.4	37.7	38.4		37.7				
FX denominated	3.1	3.5	4.8	3.2	2.5	3.2		2.5				
Local Currency	46.9	56.7	53.2	35.3	35.3	35.3		35.3				
Private sector	15.8	20.4	22.9	21.2	24.1	21.2		24.1				
Trade credit	10.7	11.8	12.9	10.7	11.8	10.7		11.8				
Change in international reserves	13.2	15.5	-18.1	-4.2	0.3	-9.2	-5.0	-4.7	-5.0	USD 5 bn	USD 6-8 bn	No use of reserves
Available external financing	**149.8**	**164.5**	**136.2**	**120.3**	**126.8**	**28.2**	**92.1**	**34.0**	**92.8**			
Net FDI inflows	32.6	17.3	20.3	22.2	25.4	11.7	10.5	10.0	15.4	50%	90%	37%
Gross Equity Portfolio Inflows	-0.9	4.8	3.6	0.6	0.7	-8.9	9.5	-8.8	9.5	1.6 std dev	1.5 std dev	1.9 std dev
Financing through Bonds and Loans	157.9	155.0	112.5	119.3	121.9	72.3		75.5				
Public sector MLT financing	40.2	41.8	34.8	28.1	29.5	13.9		15.1				
FX denominated bonds	14.8	13.6	17.2	10.9	14.4	2.6	8.3	4.6	6.3	80%	95%	86%
Local currency bonds	16.8	17.9	7.7	13.2	11.1	7.3	6.0	6.5	4.6	71%	85%	80%
FX Bank Financing	8.6	10.3	9.9	4.0	4.0	4.0		4.0				
Private sector MLT financing	25.4	19.5	7.2	17.6	15.9	5.3		4.9				
FX denominated bonds	22.3	12.0	2.9	10.0	9.0	3.3	6.7	2.3	6.7	80%	95%	95%
FX Bank Financing	3.0	7.5	4.3	7.6	6.9	2.0	5.6	2.7	4.2	80%	95%	95%
Short-term financing	92.4	93.8	70.4	73.6	76.5	53.1		55.5				
Public sector	60.2	58.0	38.4	37.7	37.0	27.5		26.8				
FX denominated	3.5	4.8	3.2	2.5	1.8	2.5		1.8				
Local Currency	56.7	53.2	35.3	35.3	35.3	25.1	10.2	25.1	10.2	71%	90%	90%
Private sector	20.4	22.9	21.2	24.1	26.5	17.0	7.1	19.2	7.2	80%	90%	90%
Trade credit	11.8	12.9	10.7	11.8	13.0	8.6	3.2	9.4	3.5	80%	90%	90%
Other flows	-39.8	-12.7	-0.2	-21.9	-20.5	-47.0		-45.6				
Residents' foreign portfolio & other investment	-29.4	-21.6	-5.2	-12.9	-18.4	-38.0	25.1	-43.5	25.1	1.6 std dev	1.5 std dev	1.5 std dev
Financing Gap (USD billions)							**87.1**		**87.8**			
SDR (1.40809 USD/SDR, Apr. 26, 2016)							61.9		62.4			
Percent of quota							694		700			

Sources: Mexican authorities and IMF staff estimates.

Box 2. Illustrative Adverse Scenario (Concluded)

Figure A. Comparing Adverse Scenario Assumptions to History, and Current and Previous Arrangements 1/



1/ The countries shown are previous FCL/PCL/PLL arrangements, numbered consecutively by country. MEX5 is thus the current FCL arrangement.

ASSESSMENT OF QUALIFICATION

21. Mexico continues to meet the qualification criteria for an FCL arrangement according to staff's assessment (Figure 3). Mexico has very strong economic fundamentals and institutional policy frameworks. Monetary policy is guided by a credible inflation-targeting framework in the context of a flexible exchange rate regime, and fiscal policy is guided by the fiscal responsibility law.

- **Sustainable external position.** The external current account deficit is broadly in line with medium-term fundamentals and desirable policies. The updated external debt sustainability analysis shows that Mexico's external debt is relatively low, and would rise only moderately over the medium term even under negative shocks (Figure 4 and Table 7).

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

- **Track record of steady sovereign access to international capital markets at favorable terms.** Mexico is among the highest-rated emerging markets. The 10-year sovereign bond (EMBIG) spread has risen to 286 basis points, and five-year CDS spreads have also risen to around 162 basis points (as of end-April, 2016), but both remain lower than the spreads for most other emerging markets. Public debt has average maturity of close to 8 years, and Mexico continues to place successfully sovereign bonds in international capital markets at low yields.[9]

- **Relatively comfortable international reserve position.** Gross international reserves stood at US$182 billion at end-April 2016. This level is comfortable relative to the standard reserve coverage indicators (Figure 5).

- **Sustainable public debt position and sound public finances.** Fiscal policy remains prudent. The authorities have started to reduce the PSBR in 2015, and plan to bring it down further in the coming years, which would put the debt-to-GDP ratio on a downward path. The updated debt sustainability analysis shows that the debt trajectory is overall robust to standard shocks (Figure 7). The debt projection is sensitive to growth and the evolution of oil prices, but debt would remain contained even under severe negative shocks. Mexico's sovereign debt ratings remain high.[10]

- **Low and stable inflation**. Annual inflation is very close to the permanent target of 3 percent, and inflation expectations are firmly anchored.

[9] In February 2016, Mexico issued EUR 2.5 billion at yields of 1.98 (6-year bonds) and 3.42 (15-year bonds), close to all-time lows. In 2015 Mexico successfully placed a 100-year euro bond.

[10] Moody's recently revised the outlook for its sovereign credit rating from stable to negative, citing potential challenges to the fiscal accounts related to lower oil prices. The current sovereign credit rating by Moody's is A3 (one notch above the BBB+ rating of S&P and Fitch).

- **Sound financial system and the absence of solvency problems that may threaten systemic stability.** The capital adequacy ratio for the banking system stood at 15 percent in December 2015. Corporate balance sheets remain resilient to growth and asset price shocks. The broader financial system is also sound. Private pension funds, which hold assets of about 16 percent of GDP, have a conservative investment profile. All insurance companies comfortably satisfy the capital requirements under a Solvency II-type regime adopted in April 2015.

- **Effective financial sector supervision.** The latest FSAP concluded that Mexico's financial sector supervision framework remains effective.[11] Mexico adopted the Basel III capital rules in 2013, and the Basel Committee assessed it as compliant in 2015. Liquidity coverage ratio (LCR) minimum requirements have been in place since January 2015. The regulation of financial groups was enhanced in January 2014 through the implementation of supervision at the group level. The authorities monitor closely the operations of foreign bank subsidiaries—about 70 percent of banking system assets—to ensure compliance with regulatory norms.

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

22. International indicators of institutional quality show that Mexico has above average government effectiveness. The institutional quality of economic policy is underpinned by the inflation-targeting framework (anchored by a strong, independent central bank), the fiscal responsibility law, and the strong prudential and regulatory framework for financial supervision. According to the 2014 World Bank's Governance Indicators, Mexico's government effectiveness ranks at the 61st percentile among all countries. A weaker area is control of corruption, where Mexico stands at the 26th percentile. However, a constitutional reform (adopted in May 2015) further empowers the federal government to investigate, prosecute, and sanction corrupt activity in Mexico. The Reform creates a National Anticorruption System, increases transparency requirements in the use of public funds, and raises the statute of limitations.

IMPACT ON FUND FINANCES, RISKS, AND SAFEGUARDS

23. Access under the proposed FCL arrangement for Mexico of 700 percent of quota or SDR 62.3889 billion would be substantial, but the impact on Fund liquidity is manageable. As with the current arrangement, if drawn, the proposed FCL arrangement would be the Fund's largest single credit exposure by a wide margin. However, the Fund's liquidity is expected to remain adequate after an approval of the proposed FCL arrangement for Mexico.

[11] The latest FSAP assessment for Mexico was done in 2012. An update of the FSAP assessment is scheduled to take place in 2016.

24. The risks to the Fund from a potential large credit exposure to Mexico are mitigated by several factors. The authorities have stated that they intend to treat the arrangement as precautionary. Even if a full drawing under the arrangement were to be made, several factors would mitigate risks to the Fund, including Mexico's adequate buffers and the credibility of its policy framework. Mexico's external debt would remain moderate at about 49 percent of GDP in 2016. Debt service is projected to peak at about 15.7 percent of GDP in 2020 (Table 2 in the Supplement on the Assessment of the Impact of the Proposed Flexible Credit Line Arrangement on the Fund's Finances and Liquidity Position) and the peak debt service ratios would be broadly in line with those in other exceptional access cases in recent years. Moreover, Mexico has a demonstrated excellent track record of meeting its obligations to the Fund.

25. The safeguards procedures for Mexico's 2014 FCL arrangement identified no significant safeguards issues. The external auditor issued an unqualified audit opinion on the Bank of Mexico's 2013 financial statements and no significant issues emerged from staff's conduct of the safeguards procedures. The 2014 financial statements also had an unqualified audit opinion. The Bank of Mexico has agreed to provide the authorizations needed for an update of the safeguards procedures to be conducted in connection with the proposed arrangement.

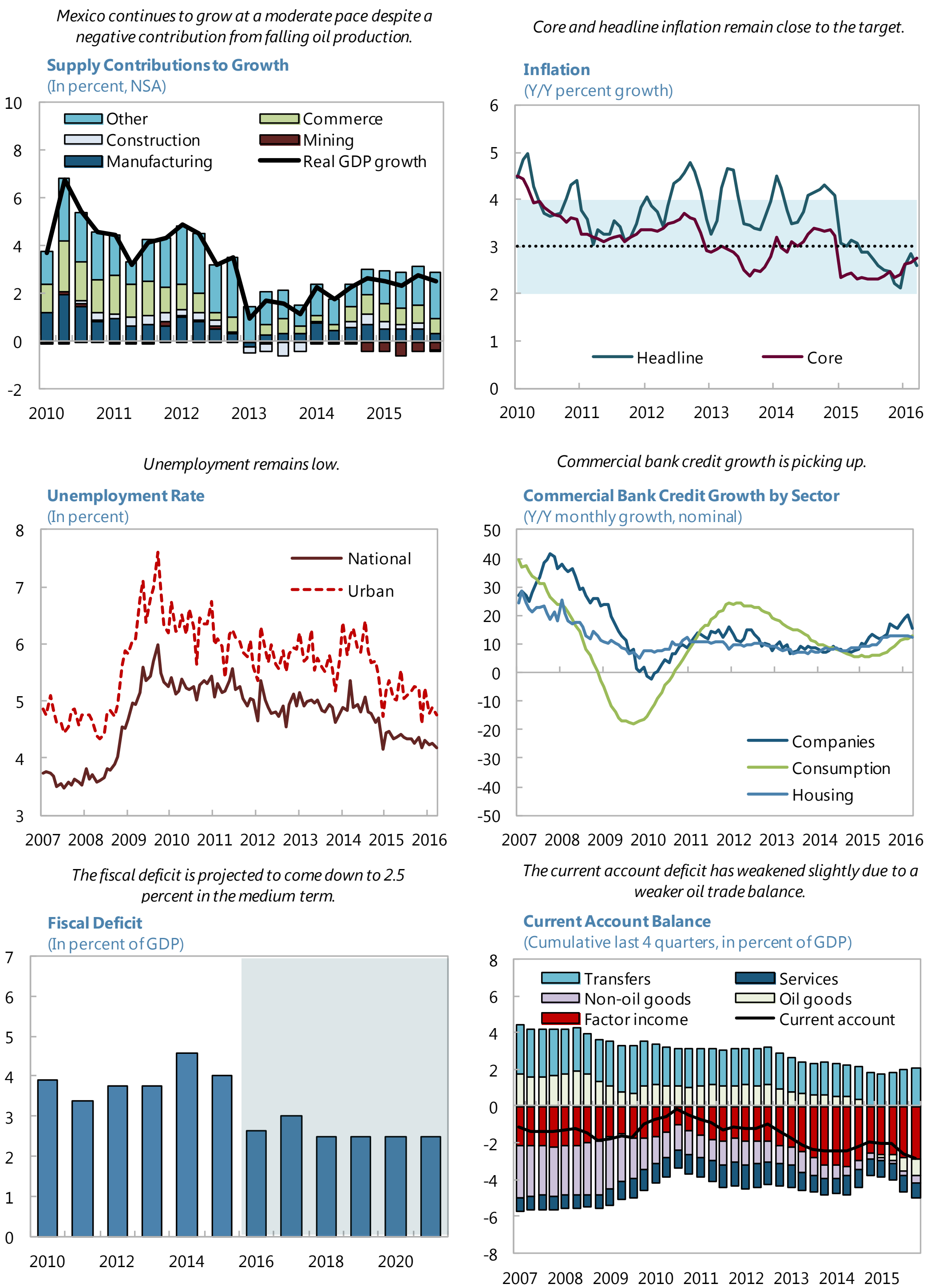
STAFF APPRAISAL

26. In the staff's assessment Mexico continues to meet the qualification criteria for access to FCL resources. As noted in the staff appraisal for the last Article IV, Mexico has a very strong policy framework and economic fundamentals. The authorities have a successful record of sound policy management and are firmly committed to maintaining prudent policies going forward.

27. Staff considers the proposed access level of SDR 62.3889 billion (700 percent of quota) to be appropriate. Uncertainties surrounding the global outlook, including risks related to advanced and emerging market growth, financial market volatility, and commodity prices have risen. Mexico, with its open capital account and significant stocks of foreign portfolio investment is vulnerable to changes in investors' preferences, and plausible downside scenarios would create substantial financing needs. The proposed FCL arrangement would continue to support the authorities' overall economic strategy, and would supplement Mexico's external buffers by providing insurance against tail risks. Staff welcomes the authorities' exit strategy, which foresees a reduction in access in future arrangements, subject to a reduction in global risks affecting Mexico.

28. Staff judges the risks to the IMF arising from the proposed FCL arrangement to be manageable. While the requested amount is substantial, the authorities intend to treat the FCL arrangement as precautionary. Even if fully drawn, Mexico's external debt service profile would remain manageable, and Mexico has a very strong repurchase record with the Fund. Moreover, risks are mitigated by the excellent policy implementation record and the very strong policy frameworks.

Figure 1. Mexico: Recent Economic Developments

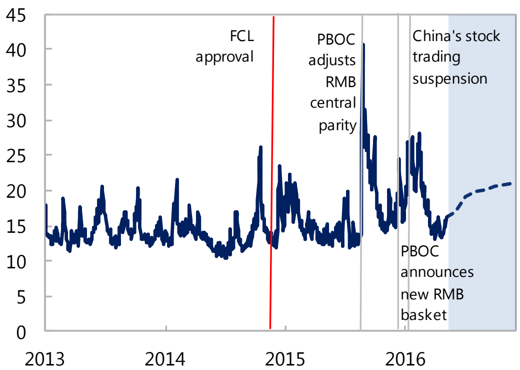


Sources: National authorities; Haver Analytics; Bloomberg; and IMF staff calculations.

Figure 2. Mexico: Recent Financial Developments

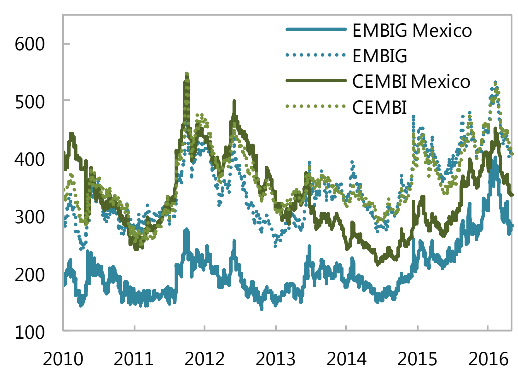
Global financial markets volatility has on average been higher since the FCL approval...

VIX Index and VIX Futures
(Index)



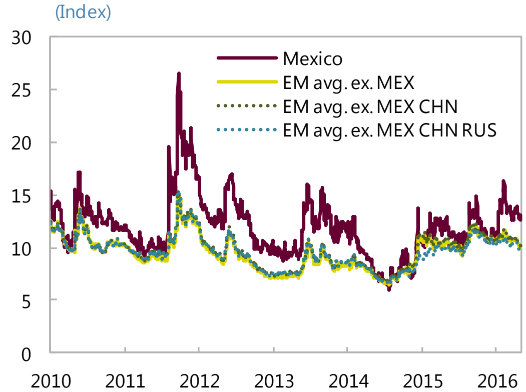
...leading to higher corporate and sovereign risk premiums...

EMBIG and CEMBI Spreads
(In basis points)



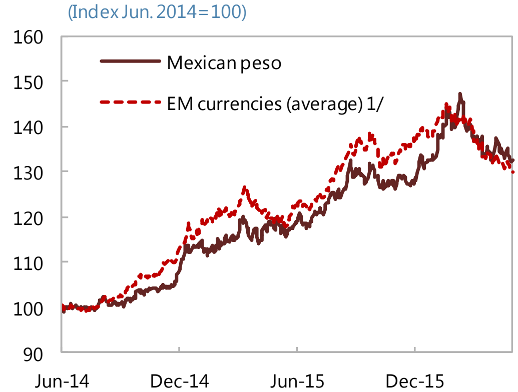
...and heightened volatility in foreign exchange markets, particularly for Mexico.

Exchange Rate 3-Month Implied Volatility
(Index)



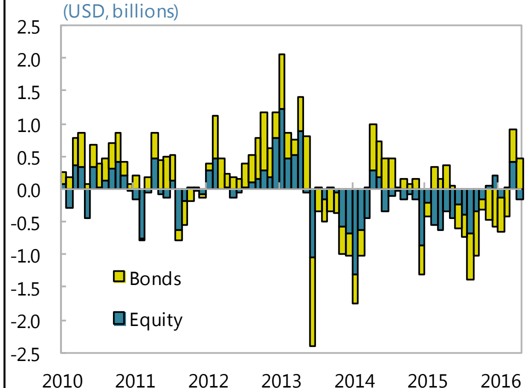
The peso depreciated rapidly in early 2016 before recovering more recently.

Exchange Rates
(Index Jun. 2014=100)



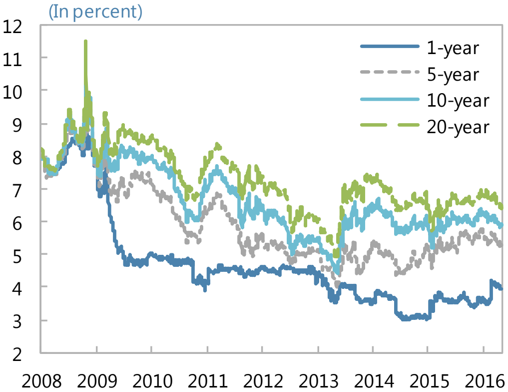
Increased risk aversion triggered outflows by ETFs and mutual funds in 2015 and early 2016...

ETFs and Mutual Fund Flows
(USD, billions)



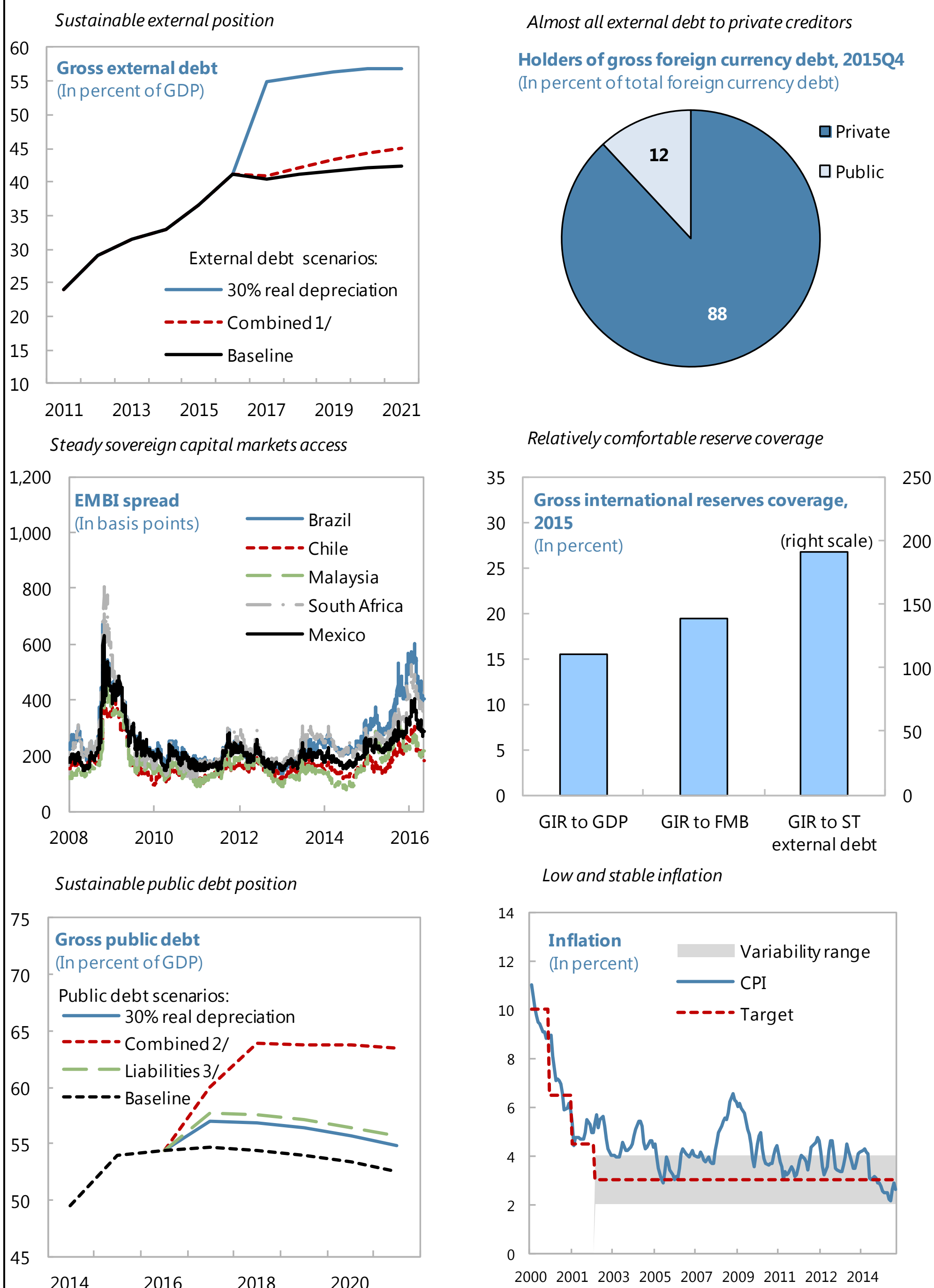
...nonetheless, yields on local-currency government bonds have increased only modestly.

Government Bond Yields
(In percent)



Sources: National authorities; Haver Analytics; EPFR; INS; Bloomberg; and IMF staff calculations.
1/ Includes Brazil, Chile, Colombia, Czech Republic, India, Indonesia, Korea, Poland, Russia, Thailand, and Turkey.

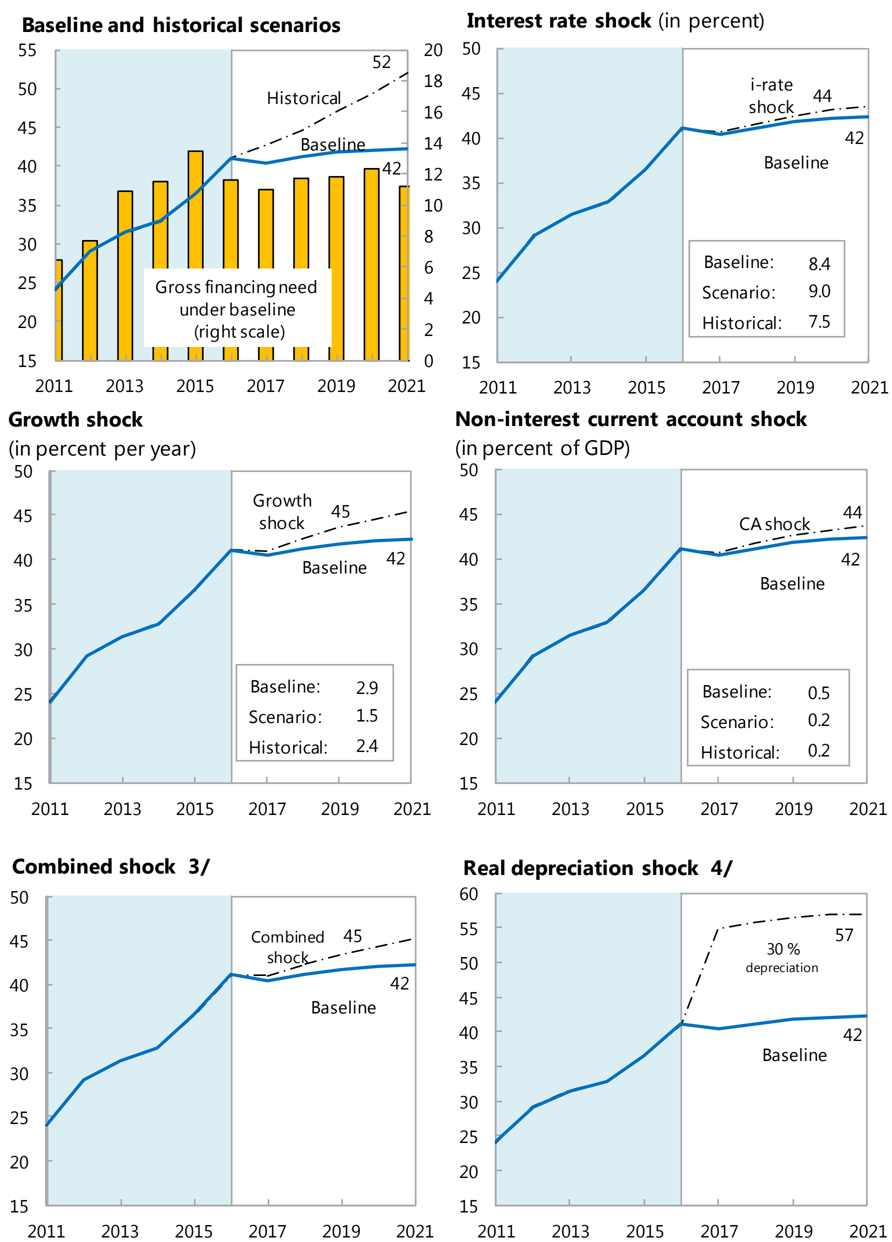
Figure 3. Mexico: Qualification Criteria



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 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 4. Mexico: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)



Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.

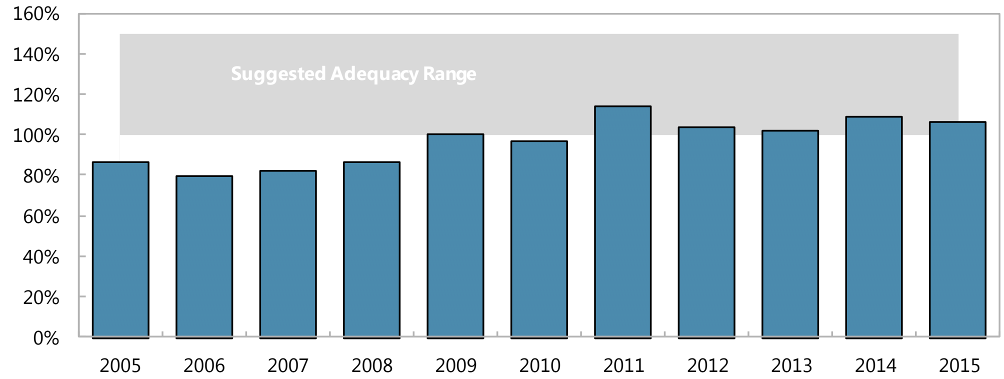
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.

3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.

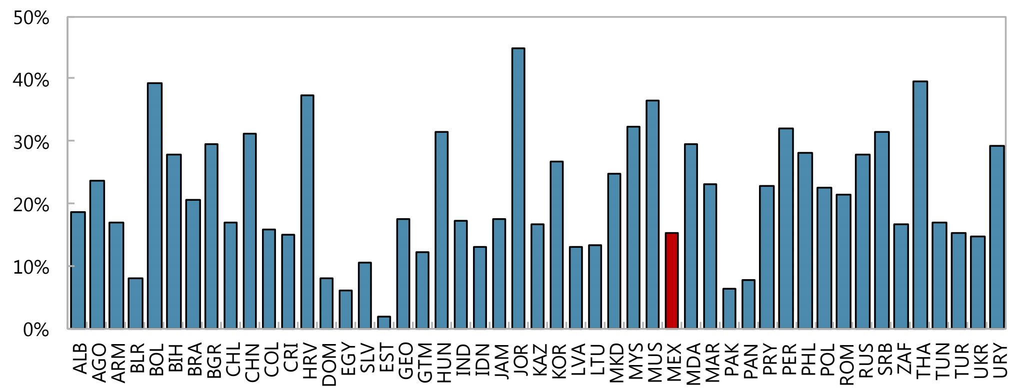
4/ One-time real depreciation of 30 percent occurs in 2016.

Figure 5. Mexico: Reserve Coverage in an International Perspective, 2015 1/

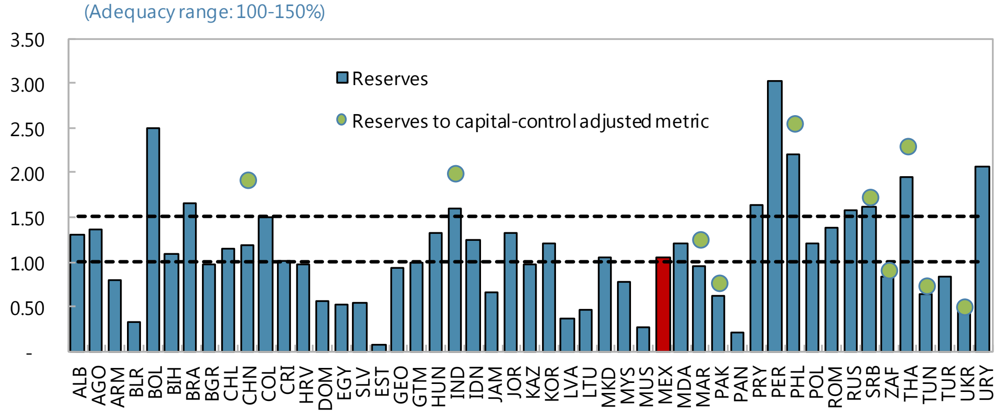
Reserves
(In percent of ARA Metric)



Reserves
(In percent of GDP)



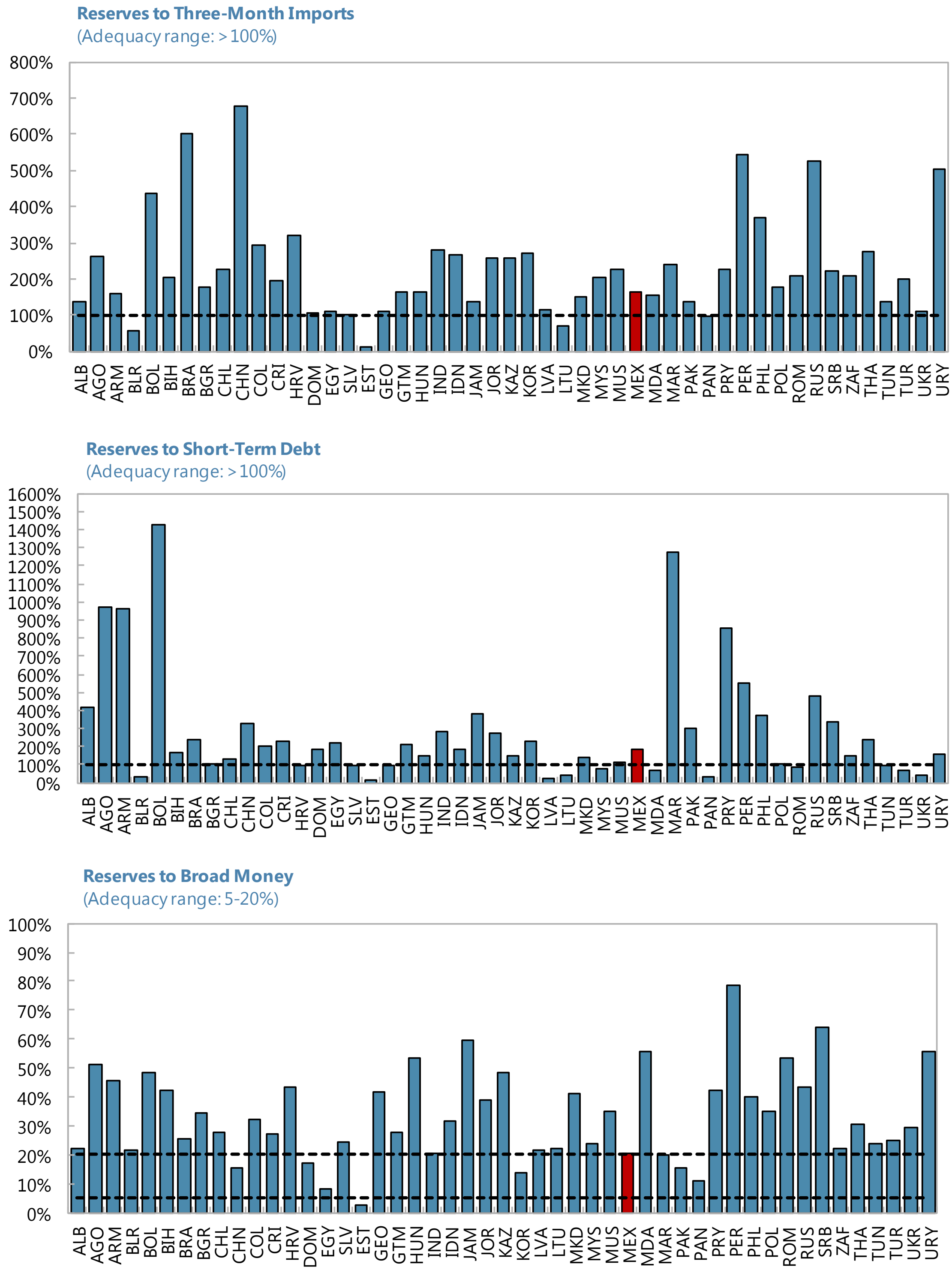
Reserves to ARA Metric
(Adequacy range: 100-150%)



Sources: World Economic Outlook, Balance of Payments Statistics Database, and IMF staff estimates.

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

Figure 5. Mexico: Reserve Coverage in an International Perspective, 2015 (concluded)



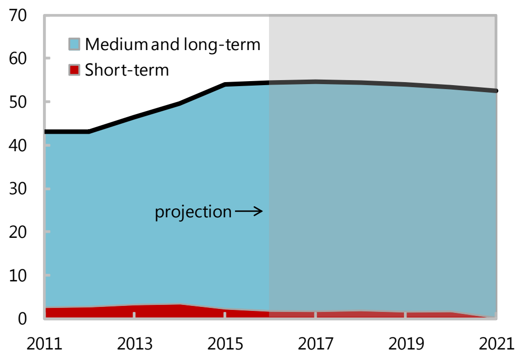
Sources: World Economic Outlook, and IMF staff estimates.

Figure 6. Mexico: Public DSA - Composition of Public Debt and Alternative Scenarios

Composition of Public Debt

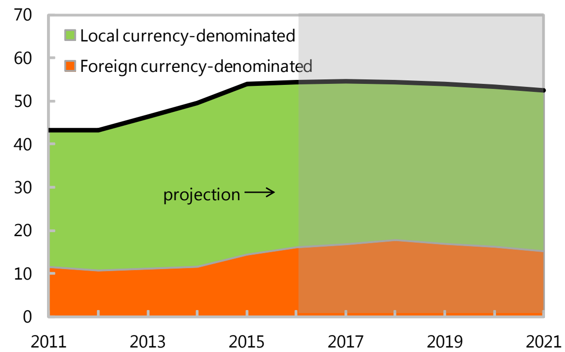
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

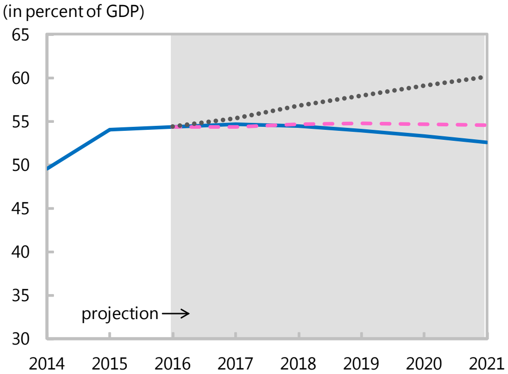


Alternative Scenarios

Baseline   Historical   Constant Primary Balance

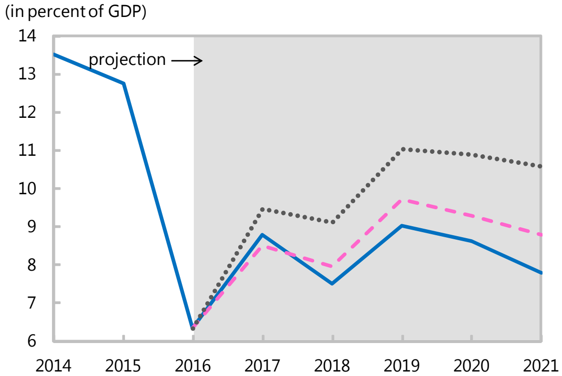
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

(in percent)

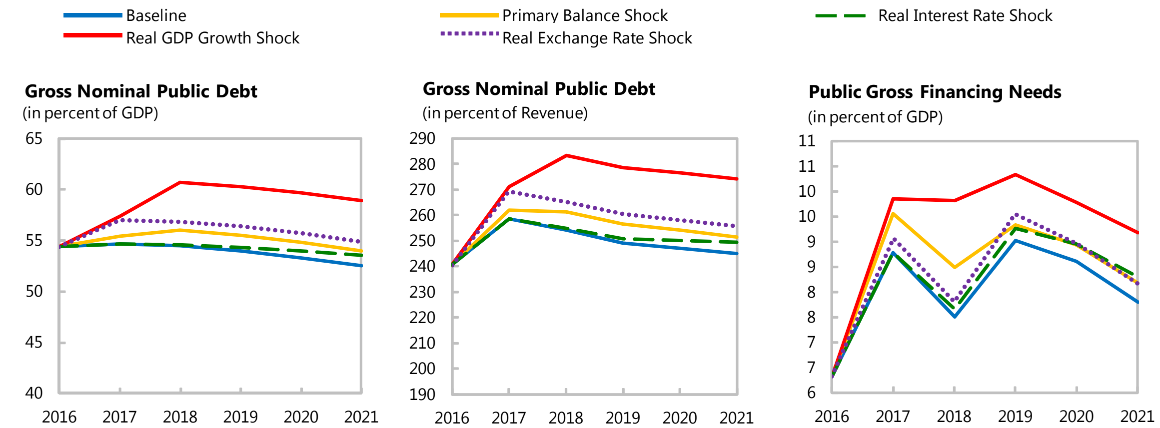
Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.4	2.6	2.8	2.9	3.1	3.1
Inflation	4.2	2.9	2.6	2.9	3.3	3.4
Primary Balance	0.4	0.1	0.9	1.0	1.1	1.1
Effective interest rate	4.6	6.1	6.7	6.8	7.1	7.0
Constant Primary Balance Scenario						
Real GDP growth	2.4	2.6	2.8	2.9	3.1	3.1
Inflation	4.2	2.9	2.6	2.9	3.3	3.4
Primary Balance	0.4	0.4	0.4	0.4	0.4	0.4
Effective interest rate	4.6	6.1	6.7	6.7	6.9	6.9

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	2.4	2.4	2.4	2.4	2.4	2.4
Inflation	4.2	2.9	2.6	2.9	3.3	3.4
Primary Balance	0.4	-0.5	-0.5	-0.5	-0.5	-0.5
Effective interest rate	4.6	6.1	6.6	6.5	6.6	6.5

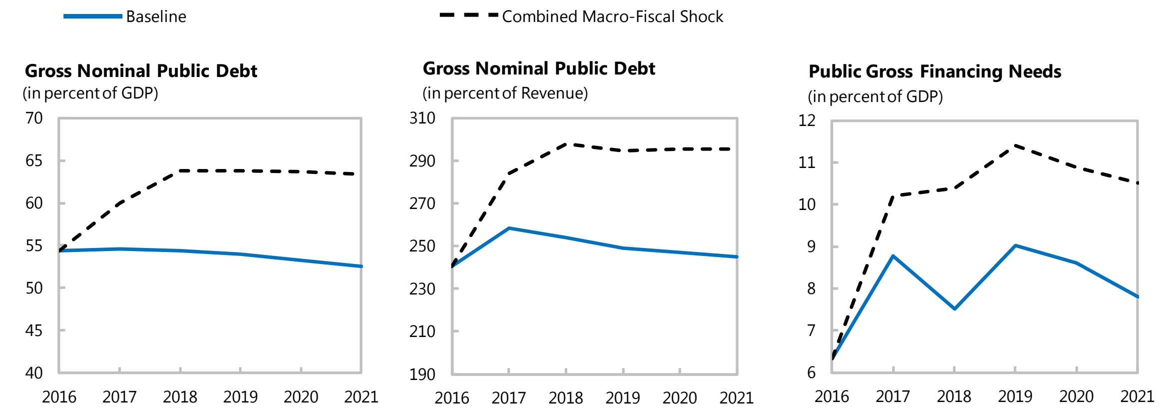
Source: IMF staff.

Figure 7. Mexico: Public DSA - Stress Tests

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

	2016	2017	2018	2019	2020	2021
Primary Balance Shock						
Real GDP growth	2.4	2.6	2.8	2.9	3.1	3.1
Inflation	4.2	2.9	2.6	2.9	3.3	3.4
Primary balance	0.4	-0.7	0.2	1.0	1.1	1.1
Effective interest rate	4.6	6.1	6.8	6.7	6.9	6.9
Real Interest Rate Shock						
Real GDP growth	2.4	2.6	2.8	2.9	3.1	3.1
Inflation	4.2	2.9	2.6	2.9	3.3	3.4
Primary balance	0.4	0.1	0.9	1.0	1.1	1.1
Effective interest rate	4.6	6.1	7.0	7.2	7.6	7.7
Combined Shock						
Real GDP growth	2.4	-0.2	0.0	2.9	3.1	3.1
Inflation	4.2	2.2	1.9	2.9	3.3	3.4
Primary balance	0.4	-0.7	-0.6	1.0	1.1	1.1
Effective interest rate	4.6	6.4	7.0	7.2	7.7	7.8

	2016	2017	2018	2019	2020	2021
Real GDP Growth Shock						
Real GDP growth	2.4	-0.2	0.0	2.9	3.1	3.1
Inflation	4.2	2.2	1.9	2.9	3.3	3.4
Primary balance	0.4	-0.6	-0.6	1.0	1.1	1.1
Effective interest rate	4.6	6.1	6.8	6.8	7.0	6.9
Real Exchange Rate Shock						
Real GDP growth	2.4	2.6	2.8	2.9	3.1	3.1
Inflation	4.2	3.4	2.6	2.9	3.3	3.4
Primary balance	0.4	0.1	0.9	1.0	1.1	1.1
Effective interest rate	4.6	6.4	6.7	6.6	6.8	6.8

Source: IMF staff.

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

I. Social and Demographic Indicators

GDP per capita (U.S. dollars, 2015)	9,457	Poverty headcount ratio (% of population, 2014) 1/	46.2
Population (millions, 2015)	121.0	Income share of highest 20 percent / lowest 20 percent (2012)	11.1
Life expectancy at birth (years, 2015)	74.9	Adult illiteracy rate (2012)	5.8
Infant mortality rate (per thousand, 2015)	12.0	Gross primary education enrollment rate (2012) 2/	105.0

II. Economic Indicators

					Proj.	
	2012	2013	2014	2015	2016	2017
	(Annual percentage change, unless otherwise indicated)					
National accounts (in real terms)						
GDP	4.0	1.3	2.3	2.5	2.4	2.6
Consumption	4.7	2.0	1.9	3.0	1.6	1.5
Private	4.9	2.2	1.8	3.2	2.8	2.3
Public	3.5	1.0	2.4	2.3	-6.0	-4.1
Investment	5.9	-2.0	3.0	3.3	1.8	3.1
Fixed	4.8	-1.6	2.9	3.8	1.9	3.2
Private	9.0	-1.6	4.9	6.3	6.4	4.7
Public	-9.0	-1.3	-4.7	-6.8	-20.3	-6.5
Inventories 3/	0.3	-0.1	0.0	-0.1	0.0	0.0
Exports of goods and services	5.8	2.3	7.0	9.0	7.6	8.0
Imports of goods and services	5.5	2.6	6.0	5.0	5.3	6.4
External sector						
External current account balance (in percent of GDP)	-1.4	-2.4	-1.9	-2.8	-2.6	-2.6
Exports of goods, f.o.b.	6.1	2.5	4.5	-4.2	1.1	7.7
Export volume	5.9	1.7	7.1	8.2	7.9	8.2
Imports of goods, f.o.b.	5.7	2.8	4.9	-1.2	0.5	7.6
Import volume	5.6	2.5	6.2	5.3	5.4	6.4
Net capital inflows (in percent of GDP)	4.6	5.4	4.5	3.0	3.1	2.6
Terms of trade (improvement +)	0.2	0.4	-1.2	-5.6	-1.7	-1.6
Exchange rates						
Real effective exchange rate (CPI based, IFS)						
(average, appreciation +) 4/	-2.8	6.1	-1.0	-10.1	-15.6	...
Nominal exchange rate (MXN/USD)						
(average, appreciation +) 5/	-6.0	3.0	-4.1	-19.2	-12.0	...
Employment and inflation						
Consumer prices (average)	4.1	3.8	4.0	2.7	3.0	3.0
Core consumer prices (average)	3.4	2.7	3.2	2.4	2.7	3.0
Formal sector employment, IMSS-insured workers (average) 6/	4.6	3.5	3.5	4.3	3.7	...
National unemployment rate (annual average)	4.9	4.9	4.8	4.4	4.1	3.9
Unit labor costs: manufacturing (real terms, average) 4/	-2.6	1.0	-1.2	1.7	1.6	...
Money and credit						
Financial system credit to non-financial private sector	10.6	9.0	8.6	14.3	12.0	10.8
Broad money (M4a) 7/	14.5	8.7	11.9	6.3	9.7	8.6
Public sector finances (in percent of GDP) 8/						
General government revenue	23.9	24.3	23.4	23.5	22.6	21.1
General government expenditure	27.7	28.0	27.9	27.6	25.2	24.1
Overall fiscal balance (public sector borrowing requirements)	-3.8	-3.7	-4.6	-4.1	-2.6	-3.0
Gross public sector debt	43.2	46.4	49.5	54.0	54.4	54.6
Memorandum items						
Output gap	0.9	-0.3	-0.6	-0.5	-0.5	-0.4

Sources: World Bank Development Indicators; CONEVAL; National Institute of Statistics and Geography; National Council of Population; Bank of Mexico; Secretariat of Finance and Public Credit; and IMF staff estimates.

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

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

3/ Contribution to growth. Excludes statistical discrepancy.

4/ 2016 based on data available through February 2016.

5/ 2016 based on data available through May 2016.

6/ 2016 based on data available through March 2016.

7/ Includes public sector deposits.

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

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

(In percent of GDP, except where noted)

						Staff Projections					
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Budgetary revenue, by type	**22.5**	**22.5**	**23.6**	**23.1**	**23.5**	**22.6**	**21.1**	**21.4**	**21.6**	**21.6**	**21.5**
Oil revenue	8.6	8.9	8.3	7.1	4.7	3.1	3.3	3.5	3.7	3.7	3.6
Non-oil tax revenue	8.9	8.4	9.7	10.5	13.0	13.1	13.0	13.1	13.1	13.1	13.0
Non-oil non-tax revenue 2/	5.0	5.2	5.5	5.5	5.8	6.4	4.8	4.8	4.8	4.8	4.8
Budgetary revenue, by entity	22.5	22.5	23.6	23.1	23.5	22.6	21.1	21.4	21.6	21.6	21.5
Federal government revenue	15.9	15.7	16.8	16.7	17.5	17.5	16.1	16.3	16.4	16.3	16.3
Tax revenue, *of which:*	8.9	8.4	9.7	10.5	13.0	13.1	13.0	13.1	13.1	13.1	13.0
Excises (including fuel)	*-0.5*	*-0.8*	*0.0*	*0.6*	*2.0*	*2.4*	*2.4*	*2.3*	*2.3*	*2.2*	*2.2*
Nontax revenue	7.1	7.3	7.1	6.3	4.5	4.4	3.1	3.2	3.3	3.3	3.3
Public enterprises	6.5	6.8	6.8	6.3	6.0	5.1	5.0	5.1	5.3	5.2	5.2
PEMEX	2.7	3.0	3.0	2.6	2.4	1.8	1.6	1.8	1.9	1.9	1.8
Other	3.8	3.8	3.8	3.8	3.6	3.4	3.4	3.4	3.4	3.4	3.4
Budgetary expenditure	**25.0**	**25.1**	**25.9**	**26.3**	**27.0**	**24.8**	**23.3**	**23.1**	**23.3**	**23.2**	**23.1**
Primary	23.1	23.1	24.0	24.3	24.7	22.1	20.7	20.3	20.3	20.2	20.2
Programmable	19.7	19.9	20.6	20.7	21.1	18.5	17.1	16.7	16.6	16.6	16.6
Current	14.8	15.1	15.1	15.5	15.9	14.7	13.9	13.4	13.4	13.4	13.3
Wages	5.9	5.9	6.0	5.9	5.9	5.9	5.8	5.8	5.7	5.6	5.5
Pensions 3/	2.7	2.7	2.9	3.0	3.2	3.2	3.3	3.4	3.5	3.6	3.7
Subsidies and transfers	3.0	3.1	3.3	3.6	3.7	3.3	2.9	2.6	2.5	2.5	2.5
Other	3.2	3.3	3.0	3.0	3.0	2.2	1.8	1.6	1.6	1.6	1.6
Capital	4.8	4.7	5.4	5.2	5.2	3.9	3.3	3.3	3.3	3.3	3.3
Physical capital	4.5	4.4	4.6	4.8	4.3	3.3	3.2	3.2	3.2	3.2	3.2
Of which: Pemex	*1.8*	*2.0*	*2.0*	*2.1*	*1.7*	*1.3*	*1.1*	*1.1*	*1.1*	*1.1*	*1.1*
Financial capital 4/	0.4	0.4	0.9	0.4	0.9	0.5	0.1	0.1	0.1	0.1	0.1
Nonprogrammable	3.4	3.3	3.4	3.5	3.6	3.6	3.6	3.6	3.6	3.6	3.6
Of which: revenue sharing	3.3	3.2	3.3	3.4	3.5	3.3	3.4	3.4	3.5	3.5	3.5
Interest payments	1.9	2.0	2.0	2.0	2.3	2.5	2.6	2.7	2.9	2.9	3.0
Traditional balance	**-2.5**	**-2.6**	**-2.3**	**-3.2**	**-3.5**	**-2.2**	**-2.2**	**-1.7**	**-1.7**	**-1.7**	**-1.7**
Adjustments to the traditional balance	**1.0**	**1.2**	**1.4**	**1.4**	**0.6**	**0.5**	**0.8**	**0.8**	**0.8**	**0.8**	**0.8**
Public sector borrowing requirements (PSBR)	**-3.4**	**-3.8**	**-3.8**	**-4.6**	**-4.1**	**-2.6**	**-3.0**	**-2.5**	**-2.5**	**-2.5**	**-2.5**
Memorandum items											
Structural current spending 5/	11.3	11.3	11.6	12.1	12.2	11.3	10.7	10.7	10.6	10.4	10.3
Structural current spending real growth (y/y, in percent) 6/	*7.1*	*3.3*	*1.4*	*7.8*	*2.7*	*-4.2*	*-2.1*	*2.4*	*1.4*	*1.9*	*2.0*
Crude oil production (million barrels per day)	2.6	2.5	2.5	2.4	2.3	2.1	2.0	2.2	2.3	2.4	2.4
Crude oil export price, Mexican mix (US$/bbl)	101	102	99	88	44	29	34	37	39	41	41
Structural Primary Fiscal Balance 7/	-1.9	-2.3	-2.1	-2.5	-1.3	-1.4	-0.2	0.7	0.9	1.0	1.1
Gross public sector debt	43.2	43.2	46.4	49.5	54.0	54.4	54.6	54.4	53.9	53.3	52.5
Domestic (percentage of total debt)	73.2	75.0	75.8	76.5	73.2	70.9	71.9	71.5	70.9	70.7	70.1
External (percentage of total debt)	26.8	25.0	24.2	23.5	26.8	29.1	28.1	28.5	29.1	29.3	29.9
Net public sector debt	37.5	37.7	40.4	43.2	47.6	48.0	48.3	48.0	47.6	46.9	46.2
Nominal GDP (billions of Mexican pesos)	14,550	15,627	16,116	17,252	18,136	19,351	20,435	21,564	22,843	24,317	25,939

Sources: Mexican authorities and IMF staff estimates.

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

2/ Includes revenues from the oil-price hedge for 107.5 billion pesos in 2015 and 78 billion pesos in 2016. It includes also Bank of Mexico's operating surplus transferred to the federal government for 31 billion pesos in 2015 and 239 billion pesos in 2016.

3/ Includes social assistance benefits.

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

5/ The 2014 amendment to the FRL introduced a cap on the real growth rate of structural current spending. This is defined as total budgetary expenditure, excluding: (i) interest payments; (ii) non-programable spending; (iii) cost of fuels for electricity generation; (iv) direct physical and financial investment of the federal government; and expenditure by state productive enterprises and their subsidiaries.

6/ The cap on structural current spending real growth was set at 2.0 percent for 2015 and 2016.

7/ Adjusting revenues for the economic and oil-price cycles.

Table 2b. Mexico: Financial Operations of the Public Sector, GFSM 2001 Presentation 1/

(In percent of GDP, except where noted)

	2011	2012	2013	2014	2015	Staff Projections 2016	2017	2018	2019	2020	2021
Revenue	**23.7**	**23.9**	**24.3**	**23.4**	**23.5**	**22.6**	**21.1**	**21.4**	**21.6**	**21.6**	**21.5**
Taxes	10.1	9.8	10.4	10.7	13.0	13.1	13.0	13.1	13.1	13.1	13.0
Taxes on income, profits and capital gains	5.3	5.1	5.9	5.6	6.8	6.5	6.6	6.6	6.7	6.7	6.7
Taxes on goods and services	4.3	4.3	4.1	4.7	5.9	6.2	6.1	6.1	6.1	6.0	6.0
Value added tax	3.7	3.7	3.5	3.9	3.9	3.8	3.7	3.8	3.8	3.8	3.9
Excises	0.6	0.6	0.6	0.8	2.0	2.4	2.4	2.3	2.3	2.2	2.2
Taxes on international trade and transactions	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.2	0.2
Other taxes	0.3	0.2	0.2	0.2	0.2	0.1	0.1	0.1	0.1	0.1	0.1
Social contributions	**1.7**	**1.8**	**1.7**	**1.7**	**1.7**	**1.6**	**1.6**	**1.6**	**1.6**	**1.6**	**1.6**
Other revenue	**11.9**	**12.3**	**12.2**	**10.9**	**8.7**	**7.9**	**6.5**	**6.7**	**6.9**	**6.9**	**6.8**
Property income 2/	7.0	7.2	7.0	6.2	4.5	4.4	3.0	3.1	3.2	3.2	3.2
Other	4.9	5.1	5.1	4.7	4.3	3.6	3.4	3.6	3.7	3.7	3.6
Total expenditure	**27.1**	**27.7**	**28.0**	**27.9**	**27.6**	**25.2**	**24.1**	**23.9**	**24.1**	**24.1**	**24.0**
Expense	**22.2**	**22.9**	**22.6**	**22.8**	**22.4**	**21.3**	**20.8**	**20.6**	**20.8**	**20.7**	**20.7**
Compensation of employees	5.9	5.9	6.0	5.9	5.9	5.9	5.8	5.8	5.7	5.6	5.5
Purchases of goods and services	3.2	3.3	3.0	3.0	3.0	2.2	1.8	1.6	1.6	1.6	1.6
Interest 3/	2.4	2.5	2.5	2.6	2.8	3.0	3.1	3.4	3.5	3.6	3.6
Subsidies and transfers	4.2	4.6	4.0	3.8	3.7	3.3	2.9	2.6	2.5	2.5	2.5
o/w fuel subsidy	1.1	1.4	0.7	0.2	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Grants 4/	3.3	3.2	3.3	3.4	3.5	3.3	3.4	3.4	3.5	3.5	3.5
Social benefits 5/	2.7	2.7	2.9	3.0	3.2	3.2	3.3	3.4	3.5	3.6	3.7
Other expense 6/	0.5	0.6	0.9	1.0	0.1	0.3	0.4	0.3	0.4	0.3	0.3
Net acquisition of nonfinancial assets 7/	**4.9**	**4.8**	**5.5**	**5.2**	**5.2**	**4.0**	**3.4**	**3.4**	**3.4**	**3.4**	**3.3**
Gross Operating Balance	**1.5**	**1.0**	**1.7**	**0.6**	**1.1**	**1.3**	**0.4**	**0.9**	**0.9**	**0.9**	**0.8**
Overall Fiscal Balance (Net lending/borrowing)	**-3.4**	**-3.8**	**-3.7**	**-4.6**	**-4.1**	**-2.6**	**-3.0**	**-2.5**	**-2.5**	**-2.5**	**-2.5**
Primary net lending/borrowing	*-1.0*	*-1.2*	*-1.2*	*-1.9*	*-1.2*	*0.4*	*0.1*	*0.9*	*1.0*	*1.1*	*1.1*
Memo items:											
Oil revenue	8.6	8.9	8.3	7.1	4.7	3.1	3.3	3.5	3.7	3.7	3.6
Non-oil tax revenue	8.9	8.4	9.7	10.5	13.0	13.1	13.0	13.1	13.1	13.1	13.0
Non-oil non-tax revenue	5.0	5.2	5.5	5.5	5.8	6.4	4.8	4.8	4.8	4.8	4.8
Structural primary balance 8/	-1.9	-2.3	-2.1	-2.5	-1.3	-1.4	-0.2	0.7	0.9	1.0	1.1
Gross public sector debt 9/	43.2	43.2	46.4	49.5	54.0	54.4	54.6	54.4	53.9	53.3	52.5
Net public sector debt 10/	37.5	37.7	40.4	43.2	47.6	48.0	48.3	48.0	47.6	46.9	46.2
Structural current spending 11/	11.3	11.3	11.6	12.1	12.2	11.3	10.7	10.7	10.6	10.4	10.3
Structural current spending real growth (y/y, in percent) 12/	*7.1*	*3.3*	*1.4*	*7.8*	*2.7*	*-4.2*	*-2.1*	*2.4*	*1.4*	*1.9*	*2.0*
Crude oil production (million barrels per day)	2.6	2.5	2.5	2.4	2.3	2.1	2.0	2.2	2.3	2.4	2.4
Crude oil export volume (million barrels)	488	460	434	417	428	346	332	378	431	453	470
Crude oil export price, Mexican mix (US$/bbl)	101	102	99	88	44	29	34	37	39	41	41

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

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

2/ Includes revenues from the oil-price hedge for 107.5 billion pesos in 2015 and 78 billion pesos in 2016, treated as revenues from an insurance claim. It includes also Bank of Mexico's operating surplus transferred to the federal government for 31 billion pesos in 2015 and 239 billion pesos in 2016.

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

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

5/ Includes pensions and social assistance benefits.

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

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

8/ Adjusting revenue for the economic and oil-price cycles.

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

10/ Corresponds to the net stock of PSBR (i.e., gross stock net of public sector financial assets) as published by the authorities.

11/ The 2014 amendment to the FRL introduced a cap on the real growth rate of structural current spending. This is defined as total budgetary expenditure, excluding: (i) interest payments; (ii) non-programable spending; (iii) cost of fuels for electricity generation; (iv) direct physical and financial investment of the federal government; and expenditure by state productive enterprises and their subsidiaries.

12/ The cap on structural current spending real growth was set at 2.0 percent for 2015 and 2016, and equal to potential growth thereafter.

Table 3. Mexico: Summary Balance of Payments

	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
					Projections					
					(In billions of U.S. dollars)					
Current account	-16.6	-30.3	-24.8	-32.4	-27.9	-29.5	-36.4	-38.0	-37.8	-36.1
Merchandise goods trade balance	0.0	-1.2	-2.8	-14.5	-12.1	-12.6	-18.8	-19.7	-20.0	-18.2
Exports	370.8	380.0	397.1	380.8	385.4	415.1	450.0	489.3	522.8	556.4
o/w Manufactures	302.0	314.6	337.3	340.0	357.8	386.7	417.3	452.6	483.4	513.5
o/w Petroleum and derivatives	53.0	49.5	42.6	23.4	11.7	13.3	16.2	19.6	21.3	22.5
Imports	-370.8	-381.2	-400.0	-395.2	-397.5	-427.8	-468.8	-509.0	-542.9	-574.6
o/w Petroleum and derivatives	-41.1	-40.9	-41.5	-33.3	-20.7	-26.4	-29.0	-31.5	-33.4	-35.1
Net other goods 1/	0.3	0.3	0.3	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Net services	-14.0	-11.0	-12.5	-9.4	-9.8	-10.5	-11.5	-12.8	-14.1	-14.9
Net factor income	-25.4	-40.1	-32.7	-32.8	-33.3	-37.0	-40.8	-44.6	-46.9	-50.3
o/w Interest payments	-20.4	-23.4	-25.7	-25.8	-28.5	-33.0	-38.2	-43.6	-46.0	-49.1
o/w Remitted profits	-8.6	-11.9	-4.3	-5.3	-4.7	-5.1	-5.0	-4.7	-5.3	-5.5
o/w Reinvested earnings	-9.5	-16.1	-13.7	-8.7	-8.0	-8.2	-8.7	-9.1	-9.1	-9.6
Net transfers (mostly remittances)	22.6	21.7	22.9	24.3	27.2	30.6	34.6	39.0	43.2	47.2
Financial Account	54.9	67.8	57.9	33.8	33.7	29.7	39.1	43.4	43.0	42.2
Foreign direct investment, net	-2.2	32.6	17.3	20.3	22.2	25.4	27.2	29.2	29.5	29.8
Direct investment into Mexico	20.3	45.7	25.6	28.4	28.7	32.3	34.4	36.8	37.6	38.4
Direct investment abroad	-22.5	-13.1	-8.3	-8.1	-6.5	-6.9	-7.2	-7.6	-8.1	-8.6
Portfolio investment, net	73.3	49.0	46.3	28.0	14.6	15.3	18.3	21.4	21.5	24.0
Liabilities	81.8	51.1	47.1	20.4	16.9	17.7	20.9	24.1	24.3	26.9
Public Sector	56.9	33.2	36.0	16.9	10.6	10.6	18.7	20.2	20.3	22.0
o/w Local currency domestic-issued bonds	46.6	22.0	23.1	1.3	3.0	2.0	10.0	12.1	12.7	13.5
Private sector	25.0	18.0	11.1	3.5	6.3	7.1	2.1	3.8	4.0	4.9
Assets	-8.5	-2.1	-0.7	7.6	-2.2	-2.4	-2.5	-2.7	-2.8	-3.0
Other investments, net	-16.3	-13.9	-5.7	-14.5	-3.2	-11.0	-6.4	-7.2	-8.0	-11.5
Liabilites	-10.0	13.4	15.2	-1.6	7.5	5.1	10.4	10.6	10.8	8.4
Assets	-6.3	-27.3	-20.9	-12.8	-10.7	-16.0	-16.8	-17.8	-18.8	-19.9
Errors and Omissions	-20.8	-19.7	-16.8	-17.1	-10.0	0.0	0.0	0.0	0.0	0.0
Change in net international reserves	17.8	13.2	15.5	-18.1	-4.2	0.3	2.7	5.4	5.1	5.1
o/w PEMEX-related transactions	16.9	17.3	14.3	2.8	0.0	0.0	0.0	0.0	0.0	0.0
o/w Market transactions (incl. interventions)	-0.6	0.0	-0.2	-24.5	-5.5	0.0	2.5	5.0	5.0	5.0
Valuation adjustments	-0.3	4.6	0.8	2.4	0.0	0.0	0.0	0.0	0.0	1.0
					(In percent of GDP)					
Current account balance	-1.4	-2.4	-1.9	-2.8	-2.6	-2.6	-3.0	-3.0	-2.8	-2.5
o/w Hydrocarbons trade balance 2/	1.0	0.7	0.1	-0.9	-0.8	-1.1	-1.1	-0.9	-0.9	-0.9
o/w Petroleum and derivatives exports	4.5	3.9	3.3	2.0	1.1	1.2	1.3	1.5	1.6	1.6
o/w Non-hydrocarbons trade balance	-1.0	-0.8	-0.3	-0.4	-0.3	0.0	-0.5	-0.6	-0.6	-0.4
o/w Manufactures exports	25.5	24.9	26.0	29.7	33.2	33.6	34.6	35.5	35.8	35.9
Net capital inflows	4.6	5.4	4.5	3.0	3.1	2.6	3.2	3.4	3.2	3.0
Net FDI inflows	-0.2	2.6	1.3	1.8	2.1	2.2	2.3	2.3	2.2	2.1
Net portfolio inflows	6.2	3.9	3.6	2.4	1.4	1.3	1.5	1.7	1.6	1.7
Net other investment inflows	-1.4	-1.1	-0.4	-1.3	-0.3	-1.0	-0.5	-0.6	-0.6	-0.8
Memorandum items										
Hydrocarbons exports volume growth (in percent)	-5.7	-1.2	-5.0	2.7	-17.7	-3.9	12.9	13.1	4.5	4.0
Non-hydrocarbons exports volume growth (in percent)	6.3	1.8	7.5	8.4	8.6	8.4	7.6	7.2	5.6	5.3
Hydrocarbons imports volume growth (in percent)	-3.2	3.4	-5.5	16.0	-10.7	11.6	2.6	2.8	2.6	3.2
Non-hydrocarbons imports volume growth (in percent)	5.8	2.5	6.5	5.1	5.8	6.3	7.5	8.0	6.7	5.1
Crude oil export volume (in millions of bbl/day)	1.3	1.2	1.1	1.2	1.0	0.9	1.0	1.2	1.2	1.3
Gross international reserves (in billions of U.S. dollars)	167.1	180.2	195.7	177.6	173.4	173.7	176.4	181.8	186.9	192.0
Gross domestic product (in billions of U.S. dollars)	1,187	1,262	1,298	1,144	1,077	1,149	1,207	1,274	1,349	1,429

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

1/ Goods procured in ports by carriers.

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

Table 4. Mexico: Financial Soundness Indicators

(In percent)

	2010	2011	2012	2013	2014	2015
Capital Adequacy						
Regulatory capital to risk-weighted assets	16.9	15.7	15.9	15.6	15.8	15.0
Regulatory Tier 1 capital to risk-weighted assets	14.9	13.6	13.8	13.4	13.8	13.3
Capital to assets	10.4	9.9	10.6	10.4	10.8	10.4
Gross asset position in financial derivatives to capital	56.5	77.5	77.1	73.5	56.0	61.0
Gross liability position in financial derivatives to capital	55.6	79.6	76.1	72.7	59.6	65.1
Asset Quality						
Nonperforming loans to total gross loans	2.0	2.1	2.4	3.2	3.0	2.5
Provisions to Nonperforming loans	200.6	189.6	185.2	147.5	132.7	140.5
Earnings and Profitability						
Return on assets	1.8	1.5	1.8	2.1	1.7	1.6
Return on equity	16.8	15.5	17.5	19.3	15.9	15.4
Liquidity						
Liquid assets to short-term liabilities	58.2	55.3	49.5	47.7	47.1	45.5
Liquid assets to total assets	43.3	41.7	36.3	36.0	36.0	34.7
Customer deposits to total (noninterbank) loans	94.4	89.7	88.5	88.7	89.5	87.6
Trading income to total income	5.0	3.6	4.8	7.4	4.0	3.2

Sources: Financial Soundness Indicators

Table 5. Mexico: Financial Indicators and Measures of External Vulnerabilities

	2008	2009	2010	2011	2012	2013	2014	2015	2016	Latest available data
Financial market indicators										
Exchange rate (per U.S. dollar, average)	11.2	13.5	12.6	12.4	13.2	12.8	13.3	15.9	17.8	May
(year-to-date percent change, + appreciation)	-2.1	-21.1	6.5	1.5	-5.7	3.0	-4.3	-19.2	-12.0	May
28-day treasury auction rate (percent; period average)	7.7	5.4	4.4	4.2	4.2	3.8	3.0	3.0	3.7	April
EMBIG Mexico spread (basis points; period average)	254	302	187	186	188	189	182	251	319	May
Sovereign 10-year local currency bond yield (period average)	8.4	8.0	7.0	6.8	5.7	5.6	6.0	6.0	6.0	May
Stock exchange index (period average, year on year percent change)	-9.8	-5.5	31.6	8.0	10.6	5.6	1.4	3.1	1.1	May
Financial system										
Financial system claims on non-financial private sector (year on year percent change)	15.9	-0.2	8.1	14.3	10.6	9.0	8.6	14.3	...	December
Nonperforming loans to total gross loans	2.7	3.1	2.0	2.1	2.4	3.2	3.0	2.5	...	December
External vulnerability indicators										
Gross financing needs (billions of US$)	76.2	77.7	69.0	103.6	108.9	149.8	164.5	136.2	120.3	Proj.
Gross international reserves (end-year, billions of US$) 1/	95.2	99.9	120.6	149.2	167.1	180.2	195.7	177.6	182.1	April
Change (billions of US$)	8.0	4.6	20.8	28.6	17.8	13.2	15.5	-18.1	4.5	April
Months of imports of goods and services	3.4	4.6	4.4	4.7	5.0	5.2	5.4	5.0	...	December
Percent of broad money	18.4	17.2	17.5	21.2	19.3	19.2	21.0	21.0	...	December
Percent of portfolio liabilities	35.0	41.8	39.6	48.0	38.8	37.9	40.7	39.0	...	December
Percent of short-term debt (by residual maturity)	161.7	243.4	215.3	217.5	167.7	154.3	168.7	191.4	...	December
Percent of ARA Metric 2/	86.7	99.9	96.5	114.2	103.8	102.0	108.6	106.2	...	December
Percent of GDP	8.6	11.2	11.5	12.7	14.1	14.3	15.1	15.5	...	December
Gross total external debt (in percent of GDP)	18.1	21.2	23.2	24.0	29.1	31.4	32.9	36.5	...	December
Of which: In local currency	1.8	2.7	4.6	6.0	10.2	11.1	11.1	10.8	...	December
Of which: Public debt	11.7	13.1	14.7	15.6	20.4	21.4	22.1	24.6	...	December
Of which: Private debt	6.4	8.0	8.4	8.4	8.7	10.0	10.7	12.0	...	December
Financial sector	0.4	0.6	1.6	1.4	1.1	1.3	1.4	1.4	...	December
Nonfinancial sector	6.0	7.5	6.9	7.0	7.6	8.7	9.3	10.5	...	December
Gross total external debt (billions of US$)	199.5	189.5	243.8	281.0	345.4	396.3	426.4	417.8	...	December
Of which: In local currency	19.6	24.0	48.5	69.8	121.2	140.3	143.9	123.3	...	December
Of which: Public debt	129.2	117.6	155.0	182.9	242.5	270.1	287.3	281.0	...	December
Of which: Private debt	70.3	71.9	88.8	98.1	102.9	126.2	139.1	136.8	...	December
Financial sector	4.6	5.6	17.4	16.8	13.3	17.3	19.2	16.3	...	December
Nonfinancial sector	65.7	66.3	71.4	81.3	89.6	108.9	119.9	120.5	...	December
External debt service (in percent of GDP)	5.3	8.0	5.3	6.3	7.5	9.8	11.0	12.4	11.3	Proj.

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

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

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

Table 6. Mexico: Baseline Medium-Term Projections

						Staff projections					
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
					(Annual percentage change, unless otherwise indicated)						
National accounts (in real terms)											
GDP	4.0	4.0	1.3	2.3	2.5	2.4	2.6	2.8	2.9	3.1	3.1
Consumption	4.5	4.7	2.0	1.9	3.0	1.6	1.5	2.1	2.3	2.5	2.5
Private	4.8	4.9	2.2	1.8	3.2	2.8	2.3	2.3	2.4	2.6	2.6
Public	2.4	3.5	1.0	2.4	2.3	-6.0	-4.1	0.0	1.7	1.7	1.8
Investment	5.4	5.9	-2.0	3.0	3.3	1.8	3.1	4.1	5.2	6.2	4.0
Fixed	7.8	4.8	-1.6	2.9	3.8	1.9	3.2	4.2	5.3	6.4	4.1
Private	12.1	9.0	-1.6	4.9	6.3	6.4	4.7	4.4	5.6	6.7	4.2
Public	-4.1	-9.0	-1.3	-4.7	-6.8	-20.3	-6.5	2.2	3.1	3.4	3.4
Inventories 1/	-0.5	0.3	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	0.0	0.0
Exports of goods and services	8.2	5.8	2.3	7.0	9.0	7.6	8.0	7.7	7.3	5.5	5.3
Oil exports	-4.6	-5.7	-1.2	-5.0	2.7	-17.9	-3.9	12.9	13.2	4.5	4.0
Non-oil exports	8.8	6.3	2.5	7.4	9.2	8.3	8.2	7.6	7.2	5.6	5.3
Imports of goods and services	8.0	5.5	2.6	6.0	5.0	5.3	6.4	7.4	7.9	6.6	5.0
Oil imports	0.0	-3.2	3.4	-5.5	16.0	-10.7	11.7	2.6	2.8	2.6	3.2
Non-oil imports	8.3	5.7	2.6	6.3	4.8	5.7	6.3	7.6	8.1	6.7	5.1
Net exports 1/	0.0	0.1	-0.1	0.3	1.3	0.9	0.7	0.3	0.0	-0.3	0.2
Consumer prices											
End of period	3.8	3.6	4.0	4.1	2.1	3.3	3.0	3.0	3.0	3.0	3.0
Average	3.4	4.1	3.8	4.0	2.7	3.0	3.0	3.0	3.0	3.0	3.0
External sector											
Current account balance (in percent of GDP)	-1.1	-1.4	-2.4	-1.9	-2.8	-2.6	-2.6	-3.0	-3.0	-2.8	-2.5
Non-hydrocarbon current account balance (in percent of GDP)	-2.3	-2.4	-3.1	-2.0	-2.0	-1.8	-1.4	-2.0	-2.0	-1.9	-1.6
Exports of goods, f.o.b.	17.1	6.1	2.5	4.5	-4.2	1.1	7.7	8.4	8.7	6.9	6.4
Imports of goods, f.o.b.	16.4	5.7	2.8	4.9	-1.2	0.5	7.6	9.6	8.6	6.7	5.9
Terms of trade (improvement +)	-0.4	0.2	0.4	-1.2	-5.6	-1.7	-1.6	-1.4	0.7	1.2	0.3
Crude oil export price, Mexican mix (US$/bbl)	100.9	101.8	98.8	87.7	44.3	28.5	33.6	36.5	39.1	40.6	41.5
						(In percent of GDP)					
Non-financial public sector											
Overall balance	-3.4	-3.8	-3.7	-4.6	-4.1	-2.6	-3.0	-2.5	-2.5	-2.5	-2.5
Primary balance	-1.0	-1.2	-1.2	-1.9	-1.2	0.4	0.1	0.9	1.0	1.1	1.1
Saving and investment 2/											
Gross domestic investment	22.3	23.1	21.7	21.5	22.7	22.6	23.0	23.5	24.2	25.2	25.6
Fixed investment	21.7	22.3	21.1	21.0	22.2	22.3	22.6	23.1	23.9	24.8	25.2
Public	5.2	4.6	4.5	4.1	3.9	3.0	2.7	2.7	2.8	2.8	2.8
Private	16.5	17.7	16.6	16.8	18.3	19.3	19.9	20.4	21.1	22.0	22.4
Gross domestic saving	21.1	21.7	19.3	19.6	19.9	20.1	20.4	20.5	21.3	22.4	23.0
Public	1.8	0.8	0.8	-0.4	-0.2	0.3	-0.3	0.2	0.3	0.3	0.3
Private	19.3	20.8	18.5	20.1	20.1	19.7	20.7	20.2	21.0	22.1	22.7
						(Percent growth, unless otherwise indicated)					
Memorandum items											
Financial system credit to non-financial private sector	14.3	10.6	9.0	8.6	14.3	12.0	10.8	10.2	10.4	10.8	11.4
Output gap (in percent of potential GDP)	-0.4	0.9	-0.3	-0.6	-0.5	-0.5	-0.4	-0.1	0.0	0.0	0.0
Total population	1.2	1.2	1.1	1.1	1.1	1.0	1.0	1.0	1.0	0.9	0.9
Working-age population 3/	2.1	2.0	1.9	1.9	1.8	1.6	1.6	1.5	1.4	1.3	1.3

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

1/ Contribution to growth. Excludes statistical discrepancy.

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

3/ Based on United Nations population projections.

Table 7: Mexico: External Debt Sustainability Framework

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2011	2012	2013	2014	2015			2016	2017	2018	2019	2020	2021	Debt-stabilizing non-interest current account 6/
1 **Baseline: External debt**	24.0	29.1	31.4	32.9	36.5			**41.0**	**40.4**	**41.1**	**41.7**	**42.1**	**42.2**	**-1.1**
2 Change in external debt	0.8	5.1	2.3	1.4	3.7			4.5	-0.6	0.7	0.6	0.3	0.2	
3 Identified external debt-creating flows (4+8+9)	-1.5	0.1	-1.5	-1.1	3.0			-0.5	-0.7	-0.4	-0.5	-0.7	-0.9	
4 Current account deficit, excluding interest payments	-0.4	-0.3	0.5	-0.1	0.6			-0.1	-0.3	-0.2	-0.4	-0.6	-0.9	
5 Deficit in balance of goods and services	1.4	1.2	0.9	1.2	2.1			2.0	2.0	2.5	2.5	2.5	2.3	
6 Exports	31.2	32.7	31.8	32.3	35.3			37.9	38.3	39.6	40.9	41.3	41.6	
7 Imports	32.6	33.8	32.7	33.4	37.4			40.0	40.3	42.1	43.4	43.9	43.9	
8 Net non-debt creating capital inflows (negative)	-0.4	-0.6	-2.5	-1.7	-2.1			-2.1	-2.3	-2.3	-2.4	-2.3	-2.2	
9 Automatic debt dynamics 1/	-0.8	1.1	0.4	0.7	4.5			1.7	1.9	2.1	2.3	2.2	2.2	
10 Contribution from nominal interest rate	1.5	1.7	1.9	2.0	2.3			2.6	2.9	3.2	3.4	3.4	3.5	
11 Contribution from real GDP growth	-0.8	-1.0	-0.4	-0.7	-0.9			-0.9	-1.0	-1.1	-1.1	-1.2	-1.2	
12 Contribution from price and exchange rate changes 2/	-1.5	0.3	-1.0	-0.6	3.2			...	...	...	...	...	...	
13 Residual, incl. change in gross foreign assets (2-3) 3/	2.3	5.0	3.8	2.6	0.7			5.0	0.1	1.1	1.1	1.0	1.0	
External debt-to-exports ratio (in percent)	76.9	89.1	98.9	101.8	103.5			108.1	105.6	103.9	102.1	101.8	101.5	
Gross external financing needs (in billions of US dollars) 4/	75.0	91.0	136.6	149.0	154.3			124.5	126.5	140.6	149.7	165.6	159.8	
in percent of GDP	6.4	7.7	10.8	11.5	13.5	10-Year	10-Year	11.6	11.0	11.7	11.8	12.3	11.2	
Scenario with key variables at their historical averages 5/								**41.0**	**42.7**	**44.7**	**47.0**	**49.4**	**52.0**	**0.4**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	4.0	4.0	1.3	2.3	2.5	2.4	2.8	2.4	2.6	2.8	2.9	3.1	3.1	
GDP deflator in US dollars (change in percent)	7.1	-2.6	4.9	0.6	-14.0	0.8	8.8	-8.0	4.0	2.0	2.4	2.6	2.6	
Nominal external interest rate (in percent)	7.3	7.3	6.8	6.5	6.1	7.5	1.2	6.8	7.5	8.2	8.8	8.7	8.7	
Growth of exports (US dollar terms, in percent)	16.4	6.0	3.4	4.5	-3.6	6.5	13.0	1.3	7.7	8.5	8.8	6.9	6.5	
Growth of imports (US dollar terms, in percent)	16.5	5.2	2.9	5.1	-1.5	6.5	12.8	0.7	7.6	9.6	8.7	6.8	5.9	
Current account balance, excluding interest payments	0.4	0.3	-0.5	0.1	-0.6	0.2	0.5	0.1	0.3	0.2	0.4	0.6	0.9	
Net non-debt creating capital inflows	0.4	0.6	2.5	1.7	2.1	1.6	0.7	2.1	2.3	2.3	2.4	2.3	2.2	

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

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

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

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

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

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

Table 8. Mexico: Indicators of Fund Credit

	Projections						
	2016	2017	2018	2019	2020	2021	2022
Stocks from prospective drawings 1/							
Fund credit in millions SDR	62,389	62,389	62,389	46,792	15,597	0	0
In percent of quota	700	700	700	525	175	0	0
In percent of GDP	8	8	7	5	2	0	0
In percent of exports of goods and services	21	20	18	13	4	0	0
In percent of gross reserves	50	50	50	38	13	0	0
Flows from prospective drawings 2/							
Charges in millions of SDR	990	1,569	1,569	1,710	1,010	93	1
Debt service due on GRA credit in millions of SDR	990	1,569	1,569	17,307	32,205	15,691	1
In percent of quota	11.1	17.6	17.6	194.2	361.3	176.0	0.0
In percent of GDP	0.1	0.2	0.2	1.9	3.4	1.6	0.0
In percent of exports of goods and services	0.3	0.5	0.5	4.7	8.2	3.7	0.0
In percent of gross reserves	0.8	1.3	1.3	13.9	26.0	12.7	0.0
Memo Item:							
Total external debt (percent of GDP)	49.1	48.0	48.2	46.3	42.7	41.0	41.0

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

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

2/ Based on the rate of charge as of April 18, 2016. Includes GRA charges, surcharges under the system currently in force and service charges.

Table 9. Mexico: Proposed Access

	Proposed Arrangement FCL	Proposed Arrangement (Percentile)	High-Access Cases 1/ 20th	65th	80th	Median
			Percentile (Ratio)			
Access						
In millions of SDRs	62,389	100	1,449	11,354	15,500	6,901
Average annual access (percent of quota)	350	61	177	401	649	275
Total access in percent of: 2/						
Actual quota	700	57	374	801	1,072	600
Gross domestic product	8	72	2.9	7.3	9.6	5.9
Gross international reserves	50	58	25	54	86	47
Exports of goods and nonfactor services 3/	20	45	11.1	28.6	37.8	22
Imports of goods and nonfactor services	20	55	10.3	23.0	33.9	18
Total debt stock 4/						
Of which: Public	15	62	8	15	28	12
External	20	79	7	15	21	12
Short-term 5/	89	76	20	50	103	36
M2	10	38	6	15	24	12

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

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

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

3/ Includes net private transfers.

4/ Refers to net debt.

5/ Refers to residual maturity.

Appendix I. Letter from the Authorities Requesting an FCL Arrangement

Mexico City, May 6, 2016

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

Dear Ms. Lagarde,

For many years, the United Mexican States (Mexico) has been implementing very strong economic policies that have promoted macroeconomic stability and anchored confidence in the country's economic outlook.

At the same time, Mexico remains prone to tail risks arising from global economic developments given its open capital account and active participation of non-resident investors in its financial markets. These tail risks have increased significantly since the current Flexible Credit Line (FCL) arrangement was approved. Notably, there has been a significant deceleration of economic activity, an increase in vulnerabilities in a number of large emerging markets, and a sharp drop in commodity prices. At the same time, uncertainty about the speed of normalization of monetary policy in the U.S. remains high, and the divergence in monetary policy stances among the advanced economies has become more pronounced, contributing to a rise in asset-price volatility. An additional new risk factor is a rise of protectionist tendencies in advanced economies, which could bring about a further slowdown in trade, labor, and financial flows, affecting highly open economies such as ours. Uncertainties surrounding all of these developments remain high and can affect capital flows to emerging markets, even those with sound fundamentals.

Moreover, changes in the structure of financial markets over recent years have increased the probability of recurrent episodes of reduced liquidity and high asset-price volatility. These changes include new financial regulations that have diminished the role of banks as market makers, a rise in algorithm-based trading, and a greater role for asset managers and other non-banks, which are more prone to herd behavior than banks.

For this reason, we hereby request the cancellation of the current arrangement and request a successor 24-month FCL arrangement for Mexico, with an increase in access from 530 to 700 percent of Mexico's quota, taking into account the conclusion of the Fund's 14th General Quota Review earlier this year. As a result, Mexico's FCL access would amount to SDR 62.3889 billion. We believe that the higher access level will play a critical role in insuring the economy against severe tail risk events and supporting confidence in an environment of increased global risks. As before, we intend to treat the arrangement as precautionary. We do not intend to make permanent use of the FCL. Conditional on a reduction of some of the global risks affecting emerging markets during the proposed FCL, including a dissipation of the risks of increased protectionism in advanced economies, and a smooth continuation of the process of normalization of U.S. monetary policy, we intend to cut access to Fund resources in the future, with a view of phasing out Mexico’s use of the facility.

Our economic policies will continue to preserve economic and financial stability, while strengthening policy buffers.

- On fiscal policy, we are committed to our strategy of reducing the overall fiscal deficit gradually to 2.5 percent of GDP by 2018, with the aim of setting the public debt-to-GDP ratio on a downward path. We met our fiscal target for 2015, and we have taken additional consolidation measures to ensure that the 2016 and 2017 targets will also be met.

- Our monetary policy continues to be underpinned by the inflation-targeting regime, which has effectively anchored medium-term inflation expectations. Inflation is expected to remain close to its 3 percent target this year. The central bank remains fully committed to adjusting the policy interest rate as necessary to keep inflation in line with the target over the medium term.

- The flexible exchange rate regime will continue to act as the key shock absorber during periods of global financial turmoil. We have used foreign exchange interventions over the last year exclusively to smooth excess volatility and prevent disorderly market conditions. In February 2016, we have moved from a rules-based to a discretionary intervention strategy, triggered only under extraordinary circumstances, to maintain effectiveness and minimize the drain on reserve assets. We intend to further build up reserves over the medium term, taking account of market conditions.

- We are implementing structural reforms to support medium-term growth. The auctioning of oil fields under the energy reform is proceeding, despite the lower oil prices.

- The financial sector remains sound, underpinned by a strong regulatory framework. Banks are profitable, well capitalized, liquid and resilient to credit and market risks, as shown by the updated stress tests presented in the latest report of Mexico's Financial System Stability Council. Insurance companies are well capitalized, while pension funds maintain conservative investment profiles. Our adoption of Basel III capital rules has been assessed as compliant by the Basel Committee in 2015. Furthermore, in light of the presence of foreign banks in our financial system, we continue to monitor developments closely, including through home-host supervisory colleges, and active involvement in international regulatory forums for banks and derivatives.

In sum, as Executive Directors acknowledged in the latest Article IV consultation discussion, Mexico's policy framework remains very strong, and economic policies have responded in a timely and appropriate fashion in managing the impact of the global crisis and subsequently to support economic activity. We are maintaining the same strategy, reacting as needed within this framework to any future shocks that may arise. The insurance against risen tail risks, which would be covered by an increased FCL arrangement, will support the continued rebuilding of buffers. The IMF's support through the FCL is thus an integral part of our strategy, and we greatly appreciate this support.

Sincerely yours,

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

Annex I. Mexico's Sensitivity to Global Financial Shocks

Staff's empirical analysis suggests that bond flows to Mexico are highly sensitive to common shocks to capital flows to emerging markets. This annex uses the empirical framework in Cerutti and others (2015) to estimate the sensitivity of Mexico to shifts in capital flows to emerging markets (EMs).[1] Co-movement of EM debt flows is captured by estimating a common factor of gross portfolio debt flows (in percent of GDP) to all emerging markets. The estimated common factor is denoted by *F* in the equation below. Movements in this factor can reflect a generalized increase in risk aversion, changes in commodity prices, or other factors that affect all emerging markets, although not necessarily with the same intensity. The country-specific sensitivity to the common factor is determined by β in the following equation:

$$y_t = \alpha + \beta F_t + \epsilon_t$$

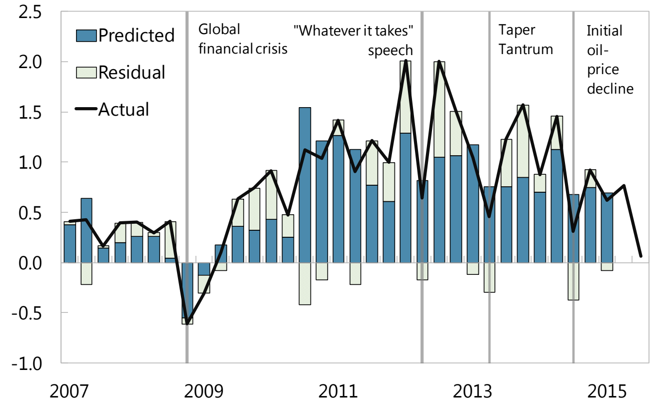
Estimates show that the sensitivity of Mexico to the global factor has increased from 0.5 (based on the pre-crisis sample, 2001-08) to 2 (based on a more recent subsample 2010-15). In addition, after Mexico's inclusion in the WGBI in 2010, the average portfolio debt flows to Mexico above what is explained by the global factor also increased, reflected in a higher value of α (estimated at 0.2 percent of annual GDP over 2001-08, and at 0.9 percent of annual GDP over the 2010–15 sample).

Cross-over funds play a large role in Mexico's local-currency government bond market. The presence of cross-over funds increased significantly after Mexico's inclusion in the WGBI. According to Arslanalp and Tsuda (IMF working paper 15/263), these funds accounted for 75 percent of non-resident holdings of local-government bonds in 2014. Unlike dedicated EM funds, which are restricted in the assets they should hold, cross-over funds can adjust portfolios more flexibly and opportunistically, not only in response to shocks to emerging markets, making their behavior harder to predict. Therefore, Mexico is not only very sensitive to shocks affecting emerging markets specifically, but is also exposed to other financial shocks that may cause global investors to change their portfolio holdings.

[1] Technical details are provided in "Push factors and capital flows to EMs: why knowing your lender matters more than fundamentals." Cerutti, Claessens, and Puy, 2015, IMF working paper 15/127. The capital flows data used in the analysis is gross portfolio debt inflows (net of redemptions).

During times of stress in global financial markets, bond inflows to Mexico have declined more sharply than what is explained by the model above. Three episodes since the global financial crisis stand out: the stress in European sovereign debt markets prior to Draghi's "whatever-it-takes" speech, the Taper Tantrum, and the initial decrease in oil prices (corresponding to 2012Q2, 2013Q2, and 2014Q3). During these quarters, capital flows to Mexico were, on average, ¼ percentage point of annual GDP lower than explained by the model. One interpretation of this evidence is that Mexico could be even more susceptible to capital flow shocks at times of stress than suggested by the model because of the relatively high liquidity of its FX and sovereign bond markets.[2]

Mexico Portfolio Debt Flows: Predicted vs. Actual
(In percent of GDP)



Source: Authors' calculations.

[2] The residuals from the regression were also negative (though smaller) during the global financial crisis, although during that crisis emerging markets were less affected than the advanced economies. Mexico has seen a surge in foreign participation in its bond market since 2010, so a shock to EM capital flows could affect Mexico more severely today compared to several years ago.

INTERNATIONAL MONETARY FUND

MEXICO

May 13, 2016

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

Approved By
Andrew Tweedie and Vivek Arora

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

CONTENTS

INTRODUCTION

1. This note assesses the impact of the proposed Flexible Credit Line (FCL) arrangement for Mexico on the Fund's finances and liquidity position, in accordance with the policy on FCL arrangements.[1] The proposed arrangement would cover a 24-month period and access would be in an amount of SDR 62.389 billion (700 percent of quota). It would succeed the existing FCL arrangement which would be cancelled upon approval of the proposed arrangement. The full amount of access proposed would be available throughout the arrangement period, in one or multiple purchases.[2] The authorities intend to treat the arrangement as precautionary.

BACKGROUND

2. Since the 2008 global economic and financial crisis, Mexico has entered into five FCL arrangements with the Fund on which no drawing has been made. A one-year FCL arrangement equivalent to SDR 31.5 billion was approved on April 17, 2009. This arrangement was succeeded by another FCL arrangement on identical terms approved on March 25, 2010. Subsequently`, three two-year FCL arrangements in the amount of SDR 47.292 billion each were approved. The first, approved on January 10, 2011, was cancelled before its expiration upon approval of a successor FCL arrangement on November 30, 2012. The 2012 arrangement was cancelled on November 26, 2014 when the current arrangement was approved. Mexico's very strong policy framework and fundamentals have helped it weather the sluggish global economic recovery and bouts of stress in global financial markets. In the past couple of years, relatively strong demand from the US to which Mexico's economy is closely connected and robust private consumption growth underpinned by steady wage growth and rising employment have supported Mexico's economic recovery. Nevertheless, Mexico has also been exposed at times to shift in global risk aversion, as discussed in the main staff report (See ¶5). No drawing has been made under the existing FCL arrangement as in all Mexico's previous FCL arrangements. As discussed in Annex I, Mexico has a history of strong performance under earlier Fund arrangements and an exemplary record of meeting its obligations to the Fund.

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

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

3. Total external and public debt levels are moderate and are expected to remain stable over the medium run under the baseline. External debt has increased by nearly 12 percentage points of GDP over the period 2010-2015. Nonetheless, it remains moderate and stands at about 36½ percent of GDP as of end-2015, of which nearly 24¾ percent of GDP is accounted for by public external debt. Gross public debt is estimated to have increased from 49½ percent of GDP at end-2014 to 54 percent of GDP at end-2015 and is projected to fall to 52½ percent of GDP over the medium term. The depreciation of the peso is the main reason behind the estimated increase in the public debt-to-GDP in 2015. Debt sustainability analyses suggest that both external and public debt would remain manageable under a range of scenarios.

Table 1. Mexico: External Debt and Debt Service, 2010-16 1/

	2010	2011	2012	2013	2014	2015	2016 2/
			In billions of US dollars)				
Total external Debt	243.8	281.0	345.4	396.3	426.4	417.8	442.2
Public	155.0	182.9	242.5	270.1	287.3	281.0	287.4
Private	88.8	98.1	102.9	126.2	139.1	136.8	154.7
Total external debt service	55.3	73.8	89.0	123.1	142.5	141.9	121.3
Public	25.4	34.1	49.1	85.8	96.8	92.7	74.5
Private	29.9	39.7	40.0	37.3	45.7	49.2	48.0
			(In percent of GDP)				
Total external Debt	23.2	24.0	29.1	31.4	32.9	36.5	41.0
Public	14.7	15.6	20.4	21.4	22.1	24.6	26.7
Private	8.4	8.4	8.7	10.0	10.7	12.0	14.4
Total external debt service	5.3	6.3	7.5	9.8	11.0	12.4	11.3
Public	2.4	2.9	4.1	6.8	7.5	8.1	6.9
Private	2.8	3.4	3.4	3.0	3.5	4.3	4.5
Memorandum item							
Public external debt service in percent of exports	8.1	9.3	12.7	21.4	23.1	23.0	18.2

Source: Mexican Authorities and IMF Staff Estimates

1/ End of period, unless otherwise indicated.
2/ Assumed potential disbursement under the proposed FCL and related interest are not included.

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

4. The proposed FCL arrangement would be the largest Fund commitment to date and if drawn, it would result in a record high credit exposure in nominal terms. The proposed FCL arrangement is nearly 1.3 times as large as the largest nominal General Resources Account (GRA) arrangement in the Fund's history, i.e., the existing FCL arrangement for Mexico. If the full amount available under the FCL arrangement were drawn, Mexico's outstanding use of GRA resources would reach SDR 62.389 billion, almost 2.7 times as large as the Fund's largest credit exposure to date.[3]

5. If the full amount available under the proposed FCL arrangement were disbursed, Fund exposure to Mexico would be large as noted above and debt ratios would deteriorate while remaining relatively moderate over the medium term.[4]

- Access would be at a record high in Fund's history in absolute terms but moderate in quota terms. In terms of quotas, it would be significantly below recent euro area exceptional access cases such as Greece, Ireland, and Portugal.
- Mexico's external debt would remain moderate, with Fund credit representing a non-trivial share of this debt. Total external debt would rise to about 49 percent of GDP initially, and public external debt would rise to close to 34¾ percent of GDP, with Fund credit representing just over 8 percent of GDP (Table 2). Mexico's outstanding use of GRA resources would account for almost 16½ percent of total external debt, 23⅓ percent of public external debt, and almost 50⅓ percent of gross international reserves.
- External debt service would increase over the medium-term, but remain manageable under staff's medium-term macro projections (Table 2). Mexico's projected debt service to the Fund would peak in 2020 at about SDR 32.2 billion, or about 3½ percent of GDP.[5] In terms of exports of goods and services, debt service to the Fund would peak at about 8¼ percent. Public external debt service would peak at almost 25¼ percent of exports of goods and services and debt service to the Fund would account for about 32½ percent of total public external debt service.[6]

[3] The largest GRA credit exposure has been SDR 23.359 billion to Brazil in 2003.

[4] As for other precautionary arrangements, the baseline indicators should be interpreted with caution. The economic situation could weaken considerably in circumstances where Mexico chooses to draw under its FCL arrangement, and the indicators would be affected in such a scenario.

[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.

[6] External public debt service is boosted by the large presence of foreign investors in peso debt, and in particular short-term debt.

Table 2. Mexico—Capacity to Repay Indicators (2015-21) 1/

	2015	2016	2017	2018	2019	2020	2021
Exposure and Repayments (In SDR millions)							
GRA credit to Mexico	--	62,388.9	62,388.9	62,388.9	46,791.7	15,597.2	--
(In percent of quota)	--	(700.0)	(700.0)	(700.0)	--	--	--
Charges due on GRA credit 2/	--	989.7	1,568.7	1,569.4	1,710.0	1,010.3	93.4
Debt service due on GRA credit 2/	--	989.7	1,568.7	1,569.4	17,307.2	32,204.7	15,690.7
Debt and Debt Service Ratios 3/							
In percent of GDP							
Total external debt	36.5	49.1	48.0	48.4	46.9	43.7	42.2
Public external debt	24.6	34.7	33.4	33.3	31.4	27.7	26.1
GRA credit to Mexico	--	8.1	7.6	7.2	5.2	1.6	--
Total external debt service	12.4	11.4	11.5	11.7	14.0	15.7	13.8
Public external debt service	8.1	7.0	6.6	6.6	8.2	9.8	7.4
Debt service due on GRA credit	--	0.1	0.2	0.2	1.9	3.4	1.6
In percent of Gross International Reserves							
Total external debt	235.2	305.2	318.0	330.8	328.2	314.5	313.1
Public external debt	158.2	216.0	221.5	227.4	219.9	199.2	193.7
GRA credit to Mexico	--	50.3	50.3	49.6	36.2	11.7	--
In percent of Exports of Goods and Services							
Total external debt service	35.1	30.0	30.1	29.6	34.1	38.0	33.2
Public external debt service	23.0	18.5	17.4	16.6	20.2	23.7	17.8
Debt service due on GRA credit	--	0.3	0.5	0.5	4.7	8.2	3.7
In percent of Total External Debt							
GRA credit to Mexico	--	16.5	15.8	15.0	11.0	3.7	--
In percent of Public External Debt							
GRA credit to Mexico	--	23.3	22.7	21.8	16.5	5.9	--

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.
2/ Includes surcharges under the system currently in force and service charges.
3/ Staff projections for external debt ratios (to GDP, gross international reserves, and exports of goods and services) adjusted for the impact of the assumed FCL drawing.

6. **The immediate net liquidity impact of the proposed arrangement would be to lower the Fund's forward commitment capacity (FCC) by SDR 38.74 billion (or 14.2 percent of the FCC).** The cancellation of the existing arrangement would free up SDR 23.65 billion representing half of that arrangement under the 1:1 quota-to-NAB financing mix, whereas approval of the proposed arrangement would reduce the FCC by the full amount of the arrangement (SDR 62.389 billion), as NAB resources are no longer available to finance new arrangements. Other things equal, the net impact of the proposed FCL would be to reduce the FCC from SDR 272.7 billion to SDR 234.0 billion (Table 3).

7. The proposed FCL arrangement with Mexico would have a large impact on the Fund's financing mechanism:

- The current Financial Transactions Plan and Resource Mobilization Plan (RMP) would need to be amended to accommodate a new and enlarged FCL arrangement for Mexico.[7]

- A single drawing by Mexico for the full amount under the new FCL Arrangement (about SDR 62.4 billion) would be by far the largest single purchase in the Fund's history and accordingly represent the largest funding requirement from FTP members. Accordingly, all remaining 50 FTP members would be expected to participate.[8]

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

- Fund credit to Mexico would represent about 130½ percent of total GRA credit outstanding as of April 21, 2016 and just over 56½ percent of GRA credit outstanding after Mexico's purchase. It would be the single largest Fund exposure. The concentration of Fund credit among the top five users of GRA resources would increase to about 90¾ percent, from 86¾ percent as of April 21, 2016.

- Relative to the Fund's current level of precautionary balances, potential GRA exposure to Mexico would be substantial. Fund credit to Mexico would be nearly four times the Fund's current precautionary balances.

- Were Mexico to accrue arrears on charges after drawing under the proposed arrangement, the Fund's burden sharing mechanism would be clearly insufficient. In a low interest rate environment, such as the current one, potential charges for Mexico would substantially exceed the Fund's limited capacity to absorb charges in arrears through the burden-sharing mechanism.

[7] This non-NAB eligible FCL arrangement with potential drawings of up to SDR 62.4 billion would be financed solely with quota resources, compared to the existing (NAB eligible) arrangement of SDR 47.3 billion which is financed equally with quota and NAB resources under the current FTP and RMP plans.

[8] If Mexico were to draw under the FCL it would automatically be excluded from the list of members in the FTP bringing the total number of participants to fifty.

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

	as of 04/21/2016
Liquidity measures	
Forward Commitment Capacity (FCC) before approval 1/	272,701.4
FCC on approval 2/	233,958.5
Change in percent	-14.2
Prudential measures	
Fund GRA commitment to Mexico including credit outstanding	
in percent of current precautionary balances	410.5
in percent of total GRA credit outstanding 3/	130.4
Fund GRA credit outstanding to top five borrowers	
in percent of total GRA credit outstanding 3/	86.8
in percent of total GRA credit outstanding including Mexico's assumed full drawing	90.8
Mexico's projected annual GRA charges for 2016 in percent of the Fund's residual burden sharing capacity	36,505
Memorandum items	
Fund's precautionary balances (FY16)	15,200
Fund's Residual Burden Sharing Capacity 4/	2.7

Sources: Finance Department and IMF staff estimates.

1/ The FCC is defined as the Fund's stock of usable resources less undrawn balances under existing arrangements, plus projected repurchases during the coming 12 months, less repayments of borrowing due one year forward, less a prudential balance. The FCC does not include the figure for the 2012 bilateral pledges from members to boost IMF resources. These resources will only be counted towards the FCC once: (i) individual bilateral agreements are effective and (ii) the associated resources are available for use by the IMF, in accordance with the borrowing guidelines and the terms of these agreements.
2/ Current FCC minus new access plus the quota-financed portion of the expiring program (about SDR 23.7 billion or half of total access under the expiring arrangement based on the current 1:1 NAB-to-quota financing mix).
3/ As of April 21, 2016.
4/ Burden-sharing capacity is calculated based on the floor for remuneration at 85 percent of the SDR interest rate. Residual burden-sharing capacity is equal to the total burden-sharing capacity minus the portion being utilized to offset deferred charges.

ASSESSMENT

9. The proposed FCL arrangement would have a significant but manageable impact on the Fund’s liquidity position. The current liquidity position appears sufficiently strong to accommodate the proposed arrangement, and the cancellation of Mexico’s existing FCL would partially offset the liquidity effect from the proposed new FCL arrangement. The overall impact of the proposed arrangement is to reduce the FCC by just over 14 percent. However, the persistent uncertainty in the global economy and especially downside risks facing the emerging markets universe could result in an increased demand for Fund resources. Therefore, a close monitoring of the Fund’s liquidity position remains important. The proposed FCL arrangement would also have a large impact on the Fund’s financing mechanism and a single drawing for the full amount would be by far the largest single purchase in the Fund’s history.

10. If drawn, Mexico's FCL would become the Fund's largest credit exposure, but risks to the Fund are mitigated by several factors. As has been the case with all its FCL arrangements to date, Mexico intends to treat the proposed FCL arrangement as precautionary. The risks from the Fund's potential credit exposure to Mexico would be mitigated by Mexico's adequate buffers and the credibility of its policy framework. Mexico has a sustained track record of implementing very strong policies, including during the global financial crisis, and the authorities are committed to maintaining implementation of such policies in the future. Also, while Mexico's overall external debt and debt service ratios are expected to deteriorate, they would generally remain in the range of recent exceptional access cases assuming full drawing under the proposed arrangement, though external public debt service relative to exports would be relatively high, reflecting also the large presence of non-residents in the peso debt market. Against this backdrop, Mexico's capacity to repay is projected to remain strong.

Annex I. History of IMF Arrangements

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

Prior to the FCL arrangements approved in April 2009, March 2010, January 2011, in November 2012, and in November 2014, Mexico had several Fund arrangements in the 1980s and 1990s. It fully repaid its remaining outstanding credit in 2000 (Table I.1). Mexico has an exemplary track record of meeting its obligations to the Fund.

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

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

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

Since the global financial crisis, Mexico has had five FCL arrangements under which no drawings have been made. A one-year FCL arrangement equivalent to SDR 31.5 billion was approved on April 17, 2009 to support Mexico's economic policies and bolster confidence during the crisis. A successor FCL arrangement on identical terms was approved on March 25, 2010. This arrangement was cancelled and a new two-year FCL was approved in January 2011 increasing the access to SDR 47.3 billion. On November 30, 2012, a two-year successor FCL arrangement was approved for the same access as the January 2011 FCL. On November 26, 2014, a two-year successor FCL was approved for the same access.

Annex Table I.1. Mexico: IMF Financial Arrangements, 1983-2014

(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
…								
2009	FCL	17-Apr-2009	16-Apr-2010	31,528.0	0.0	0.0	0.0	0.0
2010	FCL	25-Mar-2010	09-Jan-2011	31,528.0	0.0	0.0	0.0	0.0
2011	FCL	10-Jan-2011	09-Jan-2013	47,292.0	0.0	0.0	0.0	0.0
2012	FCL	30-Nov-2012	29-Nov-2014	47,292.0	0.0	0.0	0.0	0.0
2014	FCL	26-Nov-2014	25-Nov-2016	47,292.0	0.0	0.0	0.0	0.0

Source: Finance Department.

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