Euler Hermes Economic Research

Country Risk Analysis

Mexico

Sound policies, more solid growth

General Information

GDP	USD1153,3bn (World ranking 14, World Bank 2011)
Population	114.79 million (World ranking 11, World Bank 2011)
Form of state	Federal Republic
Head of government	Enrique PENA NIETO (PRI)
Next elections	2018, presidential

Strengths

- Pro-business, sound macro-policy framework.
- Moderate debt ratios
- Strong external balance
- Support from IFIs very likely if needed
- Structural Business Environment above average
- Durable political framework, with stable handovers of power.

Weaknesses

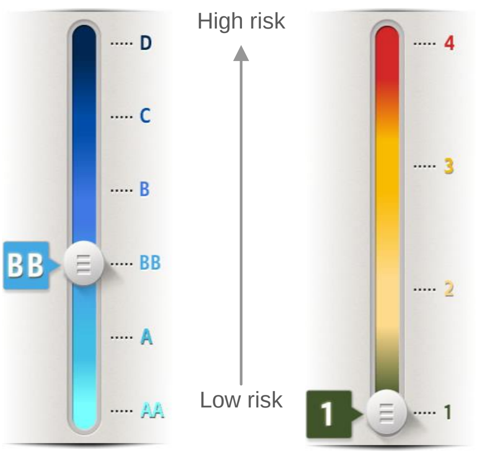
- Fiscal position sensitive to oil prices.
- Sensitive to US business cycle (75% of exports).
- Low medium-term growth
- Skewed income distribution (geographically as well as among socio-economic groups) high poverty levels
- Security issues relating to drug-trafficking
- Rule of Law and control of corruption are below average

Country Rating

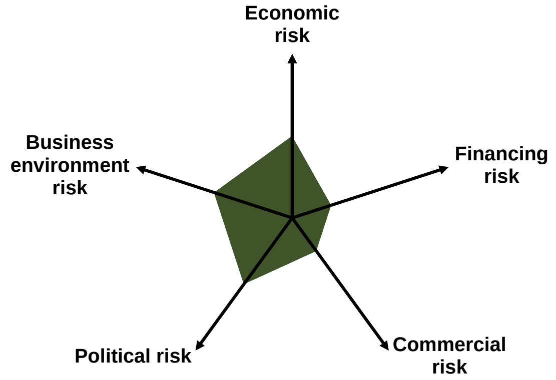
BB1

Country Grade

Country Risk Level

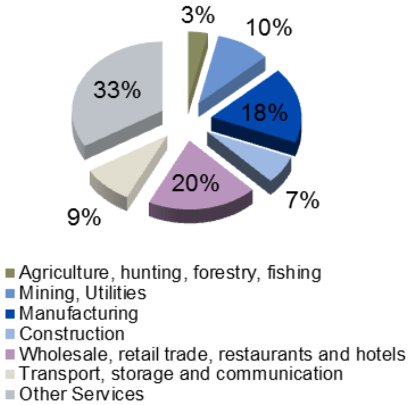


Risk Dimensions



Economic Structure

GDP breakdown (% of total, 2010)



Trade structure (% of total, 2010)

By destination/origin

Exports		Rank		Imports
United States	75%	1	52%	United States
Canada	7%	2	14%	China
Other America	2%	3	4%	South Korea
China	2%	4	4%	Japan
Germany	1%	5	4%	Germany

By product

Exports		Rank		Imports
Crude Oil	11%	1	7%	Telecommunications Equipment
Cars And Cycles	8%	2	7%	Refined Petroleum Products
Telecommunications Equipme	7%	3	6%	Electrical Apparatus
Electrical Apparatus	7%	4	6%	Vehicles Components
Consumer Electronics	7%	5	5%	Plastic Articles

Sources: Chelem, UnctadStat, IHS Global Insight, Euler Hermes

Economic Forecast

	Average 2000-08	2009	2010	2011	2012	2013f	2014f
GDP growth (% change)	2.6	-6.0	5.3	3.9	3.9	3.0	3.8
Inflation (%, end-year)	5.1	3.6	4.4	3.8	3.6	3.9	3.5
Fiscal balance (% of GDP)	-2.0	-4.7	-4.4	-3.4	-3.7	-3.1	-3.0
Public debt (% of GDP)	41.7	44.5	42.9	43.7	43.5	43.5	43.8
Current account (% of GDP)	-1.5	-0.6	-0.2	-0.8	-0.8	-1.5	-1.7
External debt (% of GDP)	21.2	22.6	23.6	24.8	30.5	32.1	34.8

Sources: IHS Global Insight, National sources, Euler Hermes

Economic Growth

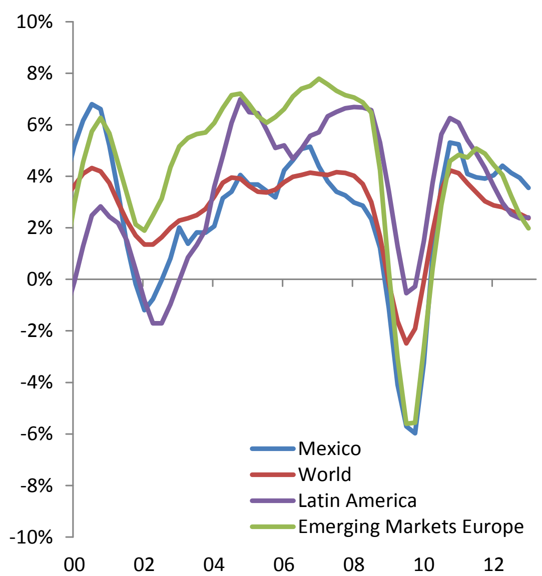
Economic liberalisation

Economic liberalisation, including entry into NAFTA, has brought substantial diversification and structural change. An important development in recent years has been the growth of the automotive sector. The energy sector has declined in importance in terms of exports but is still important for fiscal revenues (around 30% of total revenue). Moreover, As NAFTA partners—the US and Canada—account for almost 80% of exports—the economy is closely tied to the US economic cycle. Annual average growth of real GDP per capita during the past ten years was a modest 1.1%. A key issue is to continue with reforms to ensure international competitiveness—which has improved markedly already. Reforms are also required in the politically sensitive energy sector to raise production. The new administration has made a good start in these areas.

Growth solid but slower in 2013

After a weak Q1, annual growth can be expected to slow to 3% in 2013 from 3.9% in 2012, before picking up to 3.8% in 2014. Domestic demand should continue to support growth, as will strengthening demand from the US.

GDP growth (y/y, 4 qtrs cumulated %)



Sources: IHS Global Insight, Euler Hermes

Economic Policies

Macroeconomic Policies are generally prudent reflected in moderate fiscal deficits, moderate inflation, a strong external balance and low debt ratios. Overall sound policies have been reflected in Mexico's eligibility for an IMF FCL. This precautionary credit line, which is free of conditionality, is granted only to the strongest economies. The current FCL runs to January 2015. Medium-term policy is generally pro-business, but structural reforms are needed to address the low tax base, raise oil output and improve labour markets. The new administration of President Pena-Nieto (PRI) has made a good start in these areas, building on a consensus in congress.

Inflation target

Monetary policy is based on inflation targeting and a floating exchange rate. The target band is 2-4%, though the aim is the mid-point 3%. Inflation has tended to be towards the top end of the range or above, but has not threatened to get out of control. At end-2012 the rate had eased to 3.6% y/y but rose to 4.65% in April 2013, though core inflation has remained around 3%.

The policy interest rate was kept unchanged from mid-2009 until March 2013 when it was lowered by 50bps to 4%. Credit growth is moderate and the real effective exchange rate is not seriously mis-aligned. With economic growth slowing and inflation likely to ease back to the top end of the range by year-end there is scope, if modest, to lower interest rates further. Interest rate policy may also be influenced by trends in global liquidity if central banks in the major advanced economies continue to reinforce already ultra-loose monetary policies.

Banking sector indicators are robust. The Tier 1 capital ratio is 14.8%, non-performing loans are 2.5% and fully covered by provisions, though the net open FX position is relatively large.

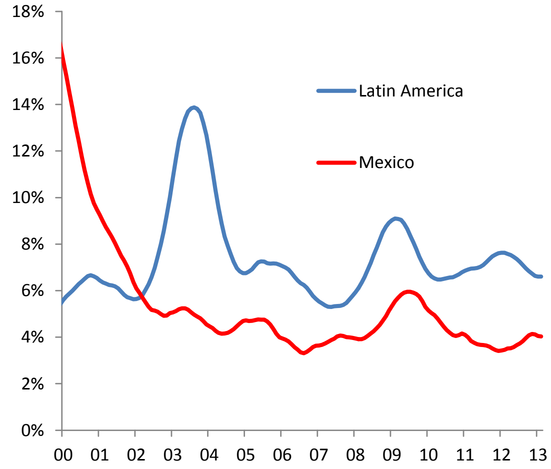
Fiscal balance moderate

The fiscal deficit is moderate, standing at -2.6% of GDP in 2012 (-2.5% 2011) measured by the traditional balance, which is targeted to fall to -2% in 2013, though the outcome probably will be closer to -2.5%. The IMF estimates the general government balance at -3.7% in 2012, narrowing to -3.1% in 2013. Since increasing in 2009 (recession and global financial crisis) however, the trend has been towards reduction on either measure.

The public debt-GDP ratio is low and the trend is flat. General government debt (IMF data) as a % of GDP was 43.5% at end-2012 and is expected to continue at around this level in 2013-14.

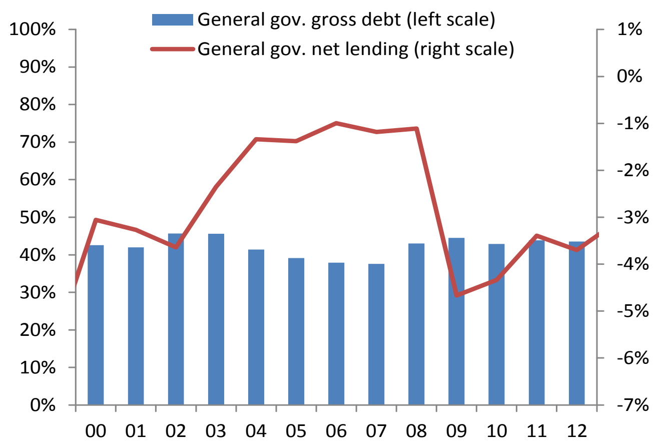
In the medium-term there is a need to reduce reliance on oil for tax revenues and raise the non-oil tax revenue which remains low as a proportion of GDP (10-11%).

Inflation (%)



Sources: IHS Global Insight, Euler Hermes

Fiscal balance and debt (% of GDP)



Sources: IHS Global Insight, IMF, Euler Hermes

Current account balance

The external current account balance is in small deficit, at -0.8% of GDP in 2012 (after -0.8% in 2011 and -0.2% in 2010. The deficit is likely to widen slightly in 2013 and 2014 to -1.5% and -1.7% of GDP, as oil prices remain flat and US economic growth subdued. FDI inflows in 2012 were affected by one-off factors and should return to more normal patterns in 2013-14, in which case net FDI should cover almost 70% of the current account deficit

Mexico has access to international financial markets and importantly from a financing perspective has access to an IMF FCL, a precautionary credit line given only to economies with sound policies and sustainable debt indicators. The current FCL runs until January 2015.

Short term capital flows have injected some volatility into the exchange rate, which is likely to continue given global liquidity and US-Mexico interest rate differentials.

External debt

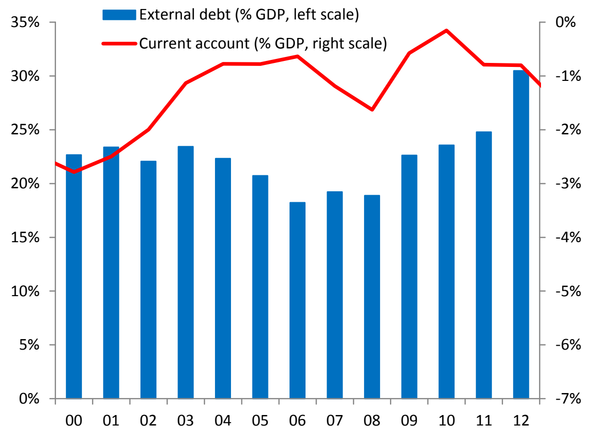
External debt is moderate. External debt is 31% of GDP, 88% of exports of goods and services and interest payments are 4% of exports of goods and services. Debt ratios increased noticeably in 2012, as ST debt and resident holdings of peso-denominated debt increased.

Foreign exchange reserves increase

Foreign exchange reserves have increased steadily to provide a comfortable 4.5 months cover of imports of goods and services and are more than 5 times the amount of external debt falling due (including ST) in 2013. M2 as a proportion of FX reserves is moderate.

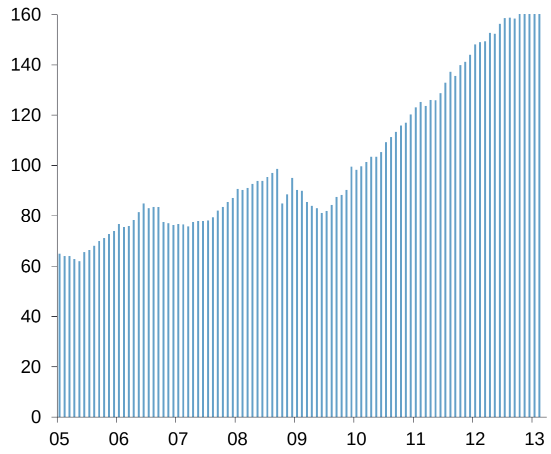
Overall, the external balance is sound.

Current account and external debt (% of GDP)



Sources: IHS Global Insight, Euler Hermes

FX reserves (USDbn)



Sources: IHS Global Insight, Euler Hermes

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