

## Resilient economy amid persistent US policy uncertainty

### General Information



<b>GDP</b>	USD1143.793bn (World ranking 15, World Bank 2015)
<b>Population</b>	127.02mn (World ranking 10, World Bank 2015)
<b>Form of state</b>	Federal Republic
<b>Head of government</b>	Enrique PEÑA NIETO (PRI)
<b>Next elections</b>	2018, presidential



### Strengths

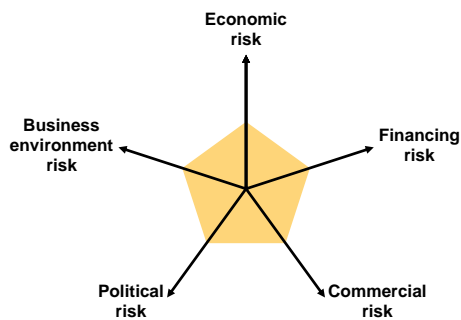
- Sound macro-policy framework
- Moderate debt ratios
- Strong, pro-business reform dynamics
- Structural business environment exceeds Latin American average
- Durable political framework with stable handovers of power
- Member of OECD
- Easy access to capital markets
- Support from IFIs likely if needed

### Weaknesses

- Fiscal position highly sensitive to oil price (30% of public revenues)
- Sensitive to US business cycle (around ¾ of exports)
- Skewed income distribution (geographically as well as among socio-economic groups), still high poverty levels
- Security issues related to drug-trafficking
- Rule of Law and control of corruption below Latin America's average

### Country Rating

BB2



Source: Euler Hermes

### Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
United States	74% 1	52% United States
Canada	6% 2	18% China
China	2% 3	3% Germany
Miscellaneous	2% 4	3% South Korea
Germany	1% 5	3% Japan

By product (% of total)

Exports	Rank	Imports
Crude Oil	40% 1	11% Refined Petroleum Products
Coals	11% 2	6% Cars And Cycles
Other Edible Agricultural Prod	10% 3	6% Telecom Equipment
Non-Monetary Gold	5% 4	4% Plastic Articles
Plastic Articles	3% 5	4% Pharmaceuticals

Source: Chelem (2015)



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## Economic Overview

### Resilience despite uncertainty

In 2016, Mexico's real GDP expanded by a moderate +2.3% after +2.6% in 2015. Recent performance figures have calmed nerves frayed by the election of Donald Trump. The economy accelerated to +2.6% y/y in Q1 (+0.7% q/q).

With +3.8% y/y growth, the services sector performed well. This was a remarkable figure, taking into account the surge in consumer prices due to the increase in gasoline prices and the delayed effect of the MXN depreciation in H2 2016. Along with agriculture (+6.3% y/y), services compensate for the fall in industrial output (-1.1% y/y) recorded for the fifth consecutive quarter.

In spite of internal and external policy uncertainties, Euler Hermes expects the Mexican economy to grow by +2.3% in 2017 and 2018. Although private consumption has exhibited dynamism in Q1 2017, fixed investment's sluggishness intensified, limiting a further acceleration of activity.

Mexico enjoys a relative sound financial position. Household debt stands at a reasonable level (around 15% of GDP). Corporate debt is lower than in other emerging economies at 35% of GDP. The banking sector has proven to be resilient to external shocks as shown by stress tests conducted by the IMF in late 2016.

### Policies heading in the right direction although structural weaknesses remain

Mexico is the only Latin American country to have tightened its monetary policy, hiking its key rate by 150bps since the US Presidential election. It now stands at 6.75%, the highest level in 8 years after a sixth consecutive rise in May. Although Banxico's stance has been interpreted as "hawkish", it pursues three goals: (i) anchoring inflation expectations so they converge towards the 3% target, (ii) aligning with the Fed's tightening momentum and (iii) smoothing effects on the currency due to uncertainties related to Trump's economic policy. Further hikes are expected in H2 2017.

The government has also addressed fiscal challenges to lower the debt burden, planning to reduce the fiscal deficit to -2.5% of GDP by 2018, from -4% in 2015. This should be achieved thanks to reforms in PEMEX (the state-owned oil company) aimed at turning it into a profitable enterprise by 2020.

Mexico's business environment has slightly deteriorated compared to 2016 according to the World Bank Doing Business survey. Yet Mexico remains better ranked (47th out of 189) than the average Latin American country.

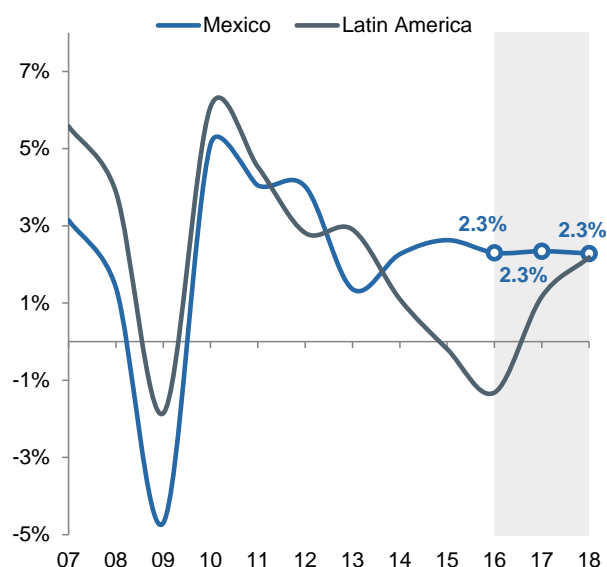
A recent reform made registering property easier and more efficient by digitizing land records and improving the quality of the Land Registry infrastructure. Future challenges include improvements to the tax system and raising the female labor participation rate which is lower than the Latin American and OECD averages. President Enrique Peña Nieto has failed to curb escalating corruption and crime that stifle economic and social outcomes.

### Key economic forecasts

	2015	2016	2017	2018
GDP growth (% change)	2.6	2.3	2.3	2.3
Inflation (% , yearly average)	2.7	2.8	5.6	4.6
Fiscal balance* (% of GDP)	-4.0	-2.9	-2.9	-2.5
Public debt* (% of GDP)	53.7	58.1	56.8	56.3
Current account (% of GDP)	-2.9	-2.7	-2.5	-2.2
External debt (% of GDP)	37.0	41.1	41.0	41.9

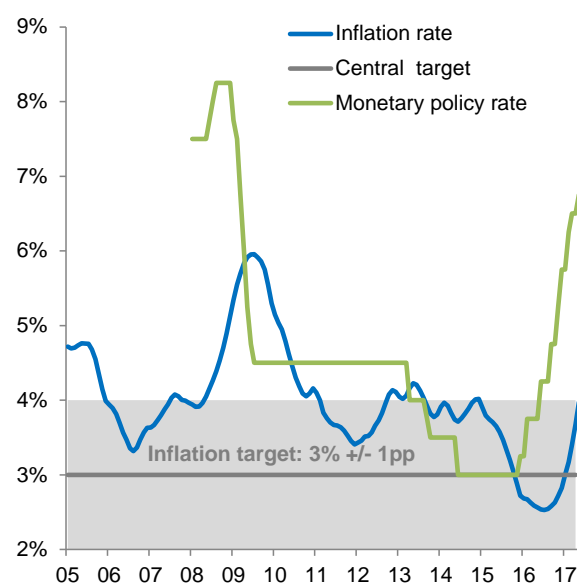
Sources: National statistics, IHS, Euler Hermes

### GDP growth in Mexico and Latin America (%)



Sources: National statistics (INEGI), Euler Hermes

### Monetary policy interest rate (%), inflation rate (y/y, %), and target inflation rate (%)



Sources: National statistics (INEGI and Banxico), Euler Hermes

## External conditions are gradually improving but volatility is expected

After more than two years of contractions, exports have been growing steadily since last November. They are expected to accelerate further. Two main factors have benefited Mexico's external position: (i) increasing commodity prices, as crude oil exports account for 5 to 6% of total exports (10% in 2014); (ii) the recovery of global trade, boosting exports to the US, Mexico's first trade partner (receiving 74% of the country's exports).

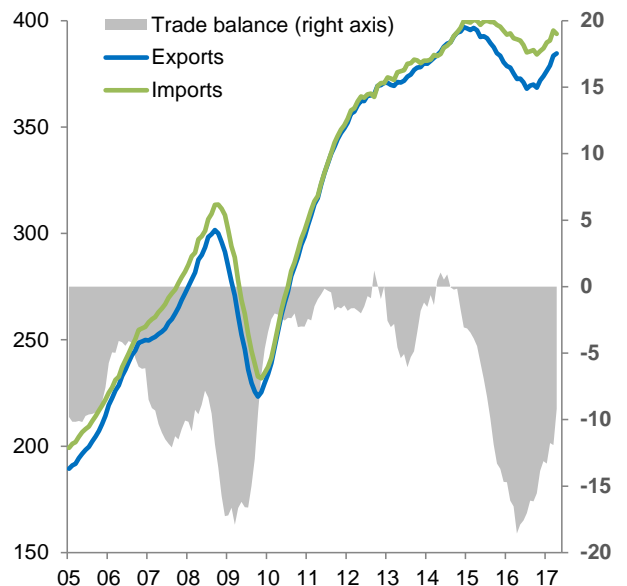
The trade deficit has halved to -USD10bn over 12 months in April, from -USD20bn mid-2016. At the same time, remittances climbed to USD27.5bn over 12 months (2.7% of GDP). Accordingly, the current account deficit narrowed to -2.1% of GDP in Q1, from -3% in Q3-2016.

External financing is not at risk despite recent peso volatility. The current account deficit is entirely covered by FDI inflows and Mexico benefits from easy access to capital markets and enjoys a Flexible Credit Line from the IMF. FX reserves diminished to USD171bn in April, down from USD193bn two years ago, as the Central Bank has intervened in the FX markets to support the peso. Import cover stands now at 4.7 months, still a comfortable level.

Moreover, US President Trump's protectionist stance has moderated as he called for a renegotiation - rather than a termination - of the North American Free Trade Agreement (NAFTA). Talks could start in September 2017. The construction of a border wall is also being called into question. As a consequence, the peso has appreciated since January (+14%), surpassing its pre-US election levels and reaching a 10-month high in June.

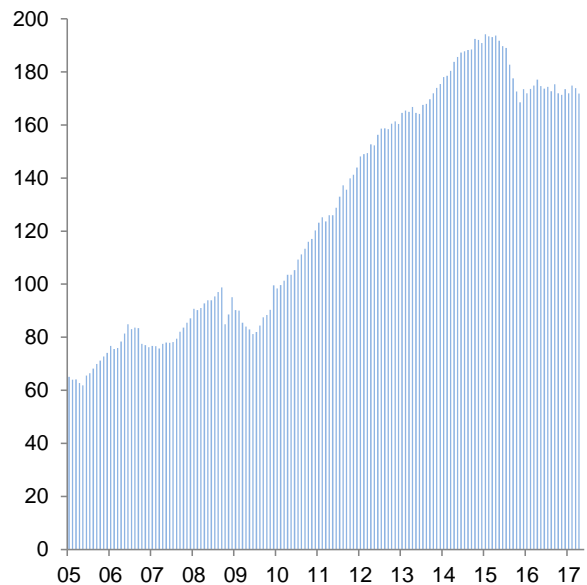
Other factors boosted confidence in the currency. Notably, the "sugar deal" struck in June on Mexico's sugar exports to the US shows dialogue between the two countries is still possible. Also, the president's Institutional Revolutionary Party (PRI) victory in the Mexico state governorship election. Still, the domestic political landscape remains heated in the run-up to the presidential election in 2018. The leader of the National Regeneration Movement (MORENA) called for a vote recount due to electoral fraud. More importantly, the US administration's economic and foreign policies continue to be a source of deep uncertainty.

Exports, imports and trade balance (12m, USDbn)



Sources: National statistics (INEGI), Euler Hermes

Foreign exchange reserves (USD bn)



Sources: Banxico, Euler Hermes

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