

**Fitch**Ratings

# **Mexico: A Solid Investment-Grade Sovereign**

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October 2012

# Mexico in the Context of LatAm Sovereign Ratings

Country	IDR Rating	Outlook
Chile	A+	Stable
<b>Mexico</b>	<b>BBB</b>	<b>Stable</b>
Brazil	BBB	Stable
Panama	BBB	Stable
Aruba	BBB	Stable
Peru	BBB	Stable
Colombia	BBB-	Stable
Costa Rica	BB+	Stable
Guatemala	BB+	Stable
Uruguay	BB+	Positive
El Salvador	BB	Negative
Bolivia	BB-	Stable
Suriname	BB-	Stable
Venezuela	B+	Negative
Argentina	B	Stable
Dominican Republic	B	Positive
Ecuador	B-	Stable
Jamaica	B-	Stable

# Mexico 'BBB' Ratings Affirmed with Stable Outlook in May 2012

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## Credit Strengths

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- A good track record of disciplined macroeconomic policies
  - Resilient external accounts and modest external debt burden
  - Banking sector well-capitalized
  - Deft public debt management
  - Broad support from the U.S. and multilaterals
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## Credit Weaknesses

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- Structural weaknesses in public finances
  - Modest medium-term growth prospects
  - Higher violence, rule of law and broader institutional challenges
  - External cushion less significant than peers
  - Inertia towards significant structural reforms
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# Mexico's Comparative Strengths and Weaknesses

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## Summary: Strengths and Weaknesses

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<b>Rating Factor</b>	<b>Macro economic</b>	<b>Public finances</b>	<b>External finances</b>	<b>Structural issues</b>
Status	Strength	Weakness	Neutral	Neutral
Trend	Stable	Stable	Stable	Stable

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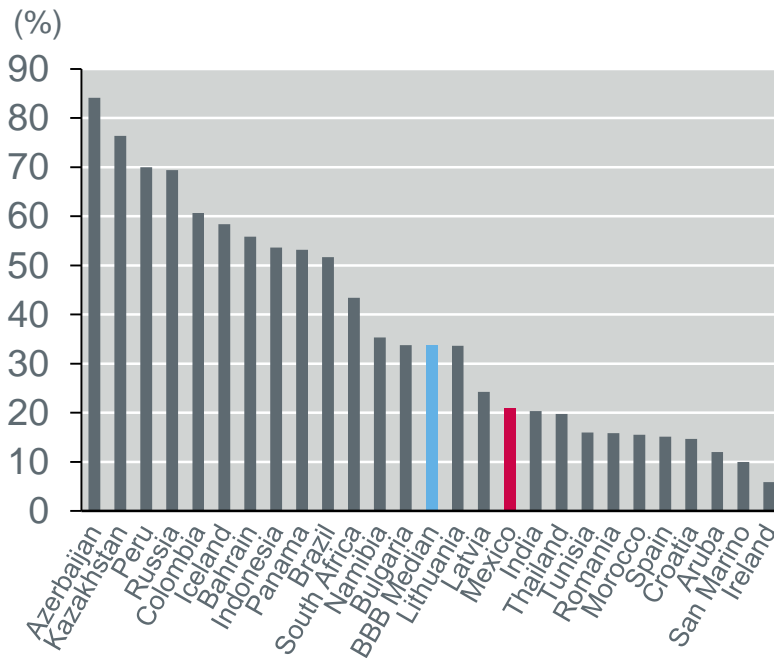
Note: Relative to 'BBB' category (Sovereigns rated 'BBB+', BBB', and BBB-')

Source: Fitch

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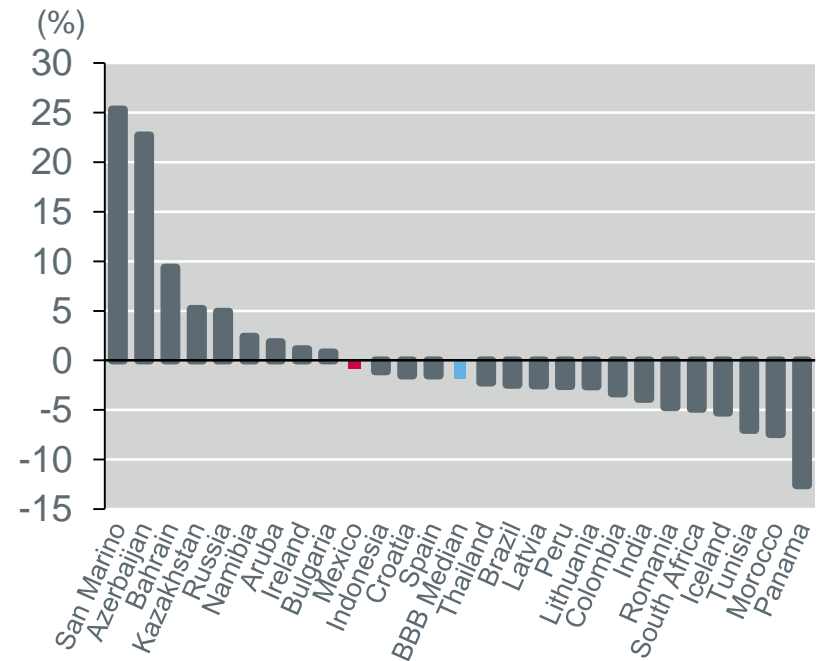
# Mexico's Low Commodity Dependence

## Commodity Dependence



Source: Fitch

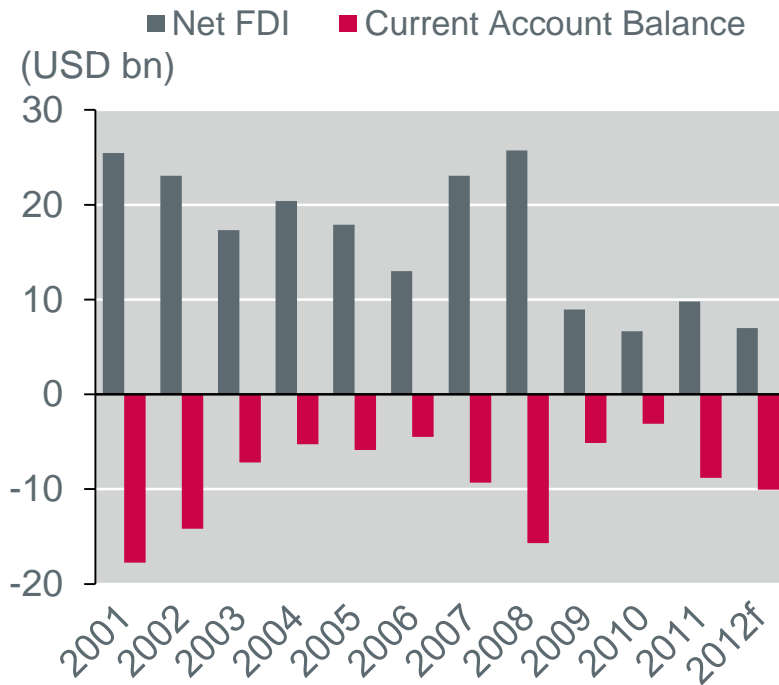
## Current Account Balance, 2012f (% of GDP)



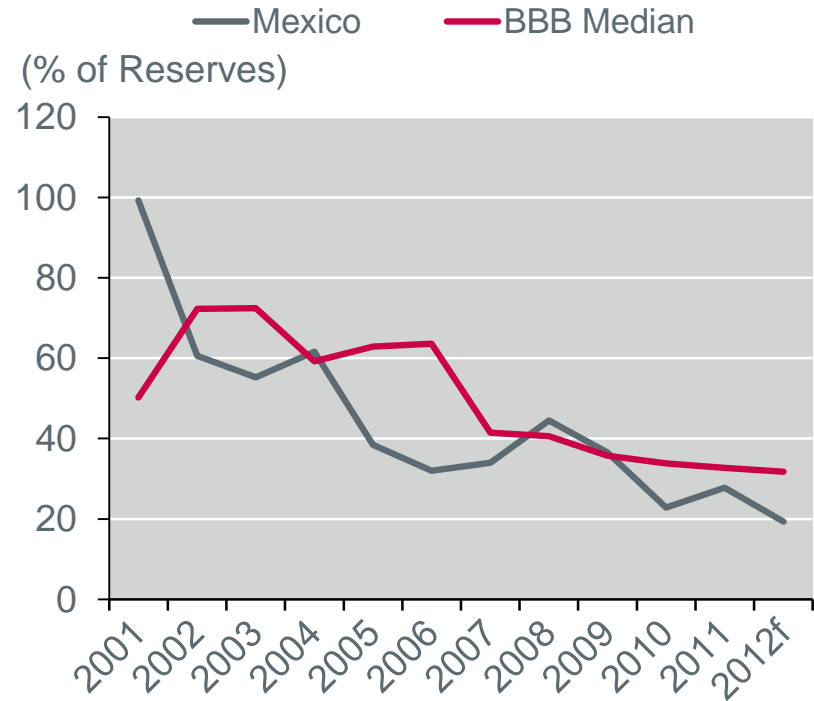
Source: Fitch

# Modest External Imbalances

## Net FDI vs. Current Account Balance



## External Financing Needs



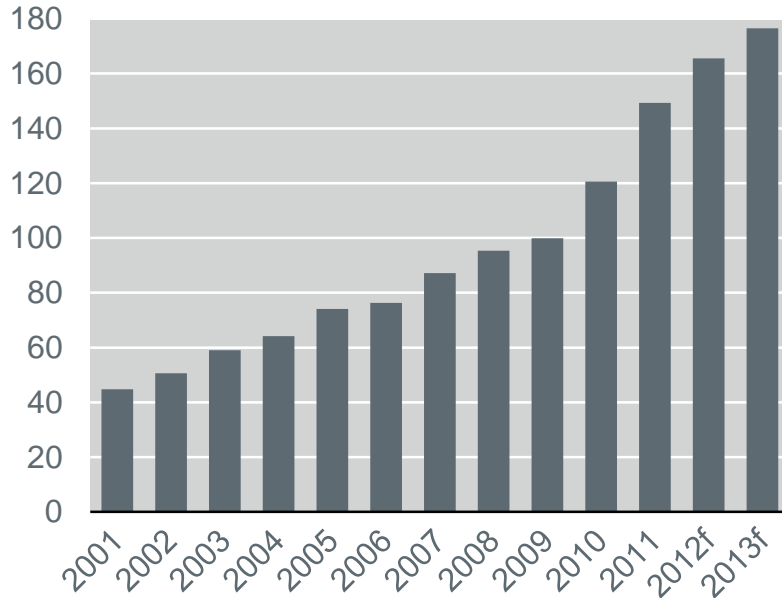
Source: Fitch

Source: Fitch

# Mexico's Enhanced External Buffer

## International Reserves of Mexico Including Gold

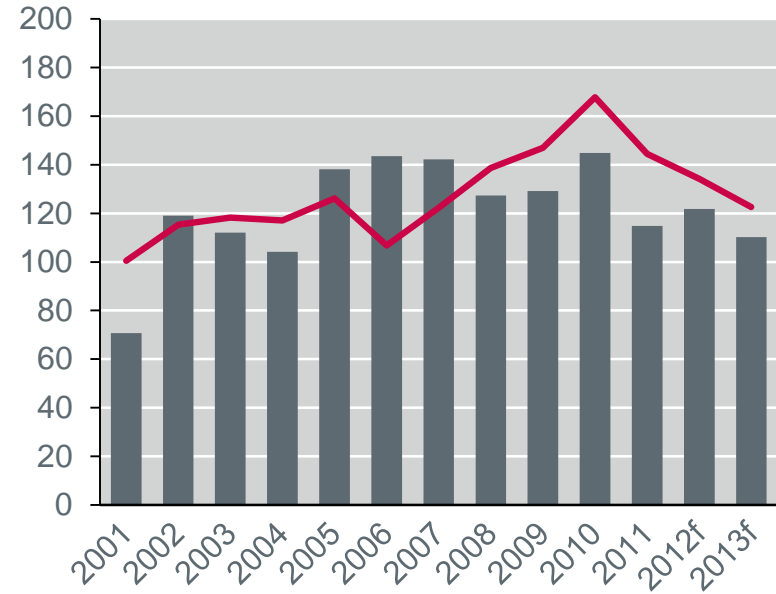
(USD bn)



Source: Fitch Ratings

## International Liquidity Ratio

■ Mexico    — 'BBB' median

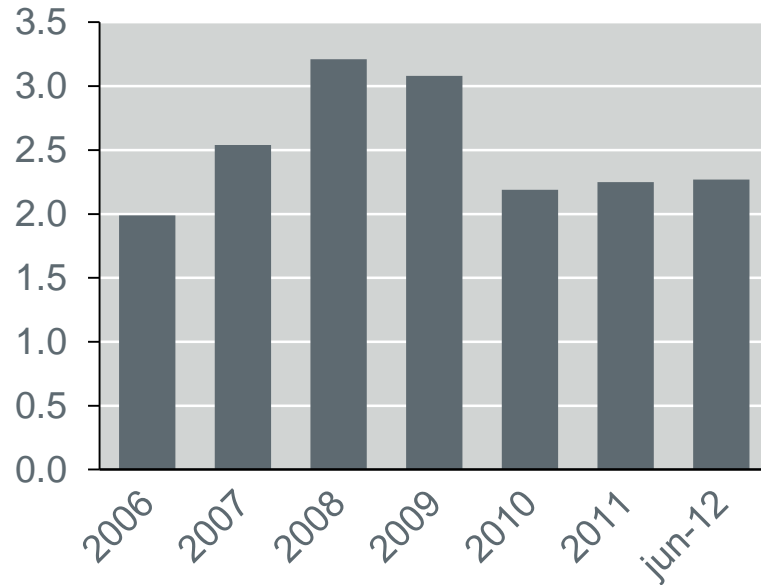


Source: Fitch Ratings

# Banking Sector Resilience

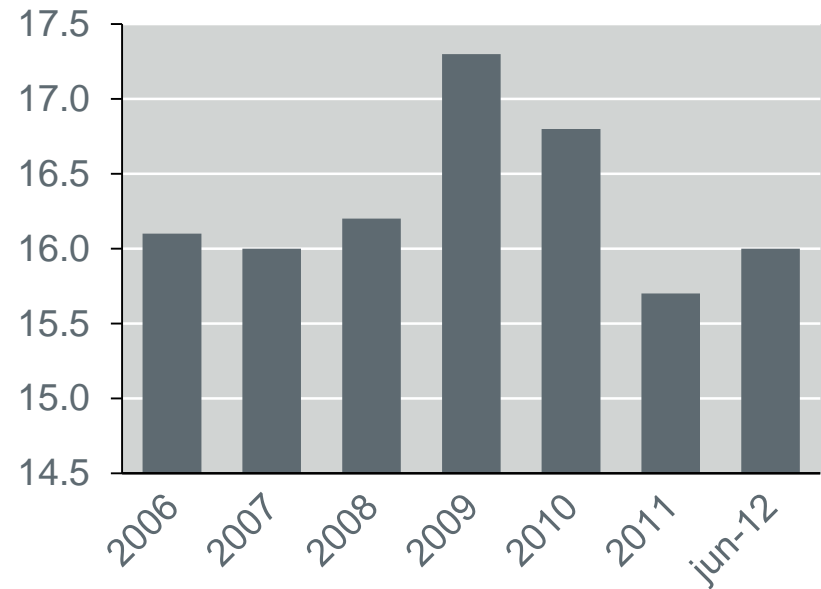
## Non-Performing Loans

(% of Total Loans)



## Capital Adequacy Ratios

(%)

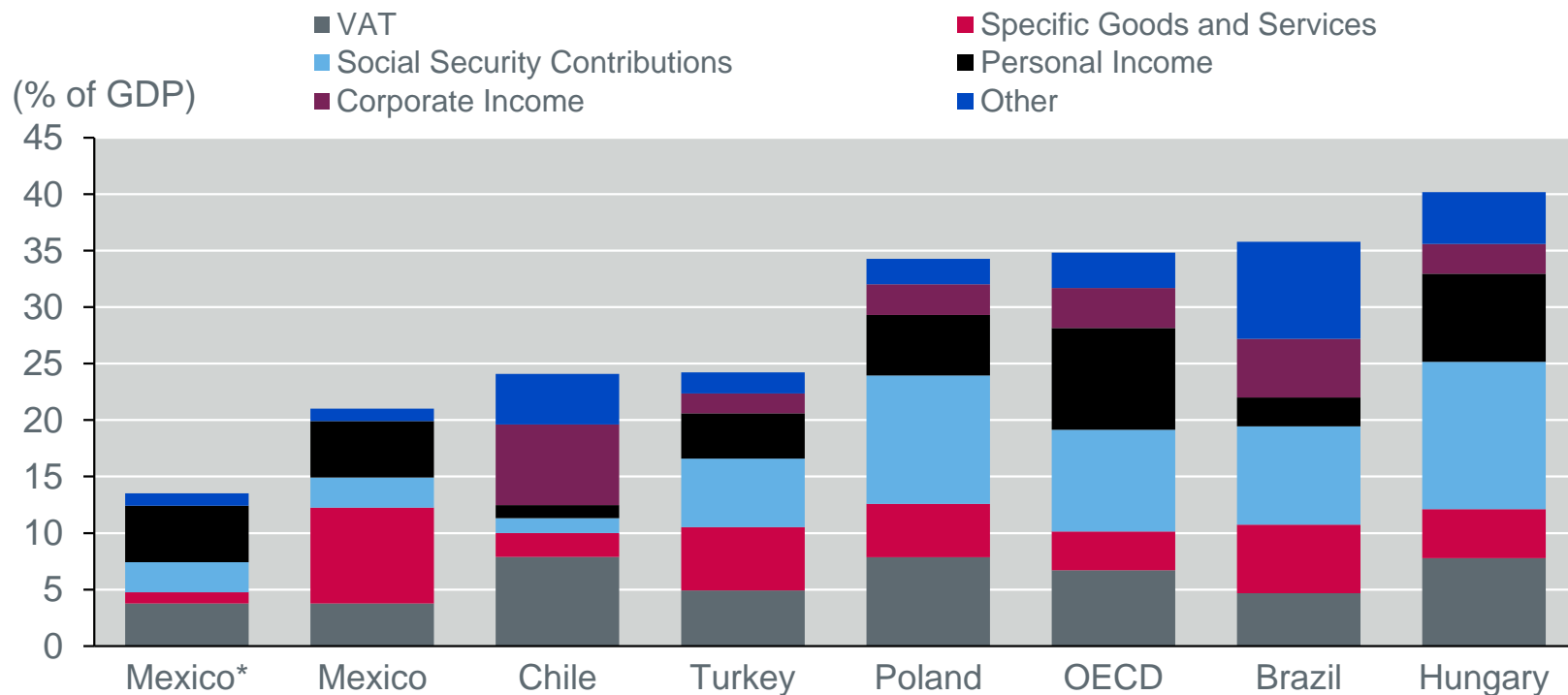


Source: Fitch



# Mexico's Narrow Revenue Base Limits Spending Capacity

## Tax Revenue From Different Sources



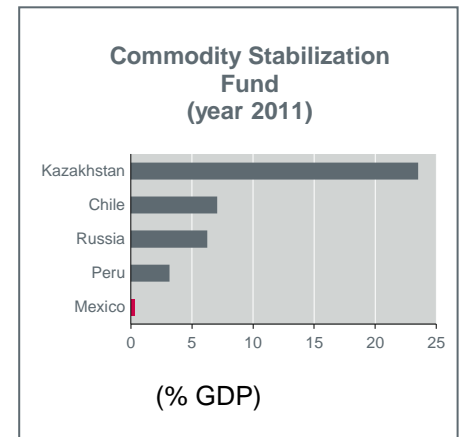
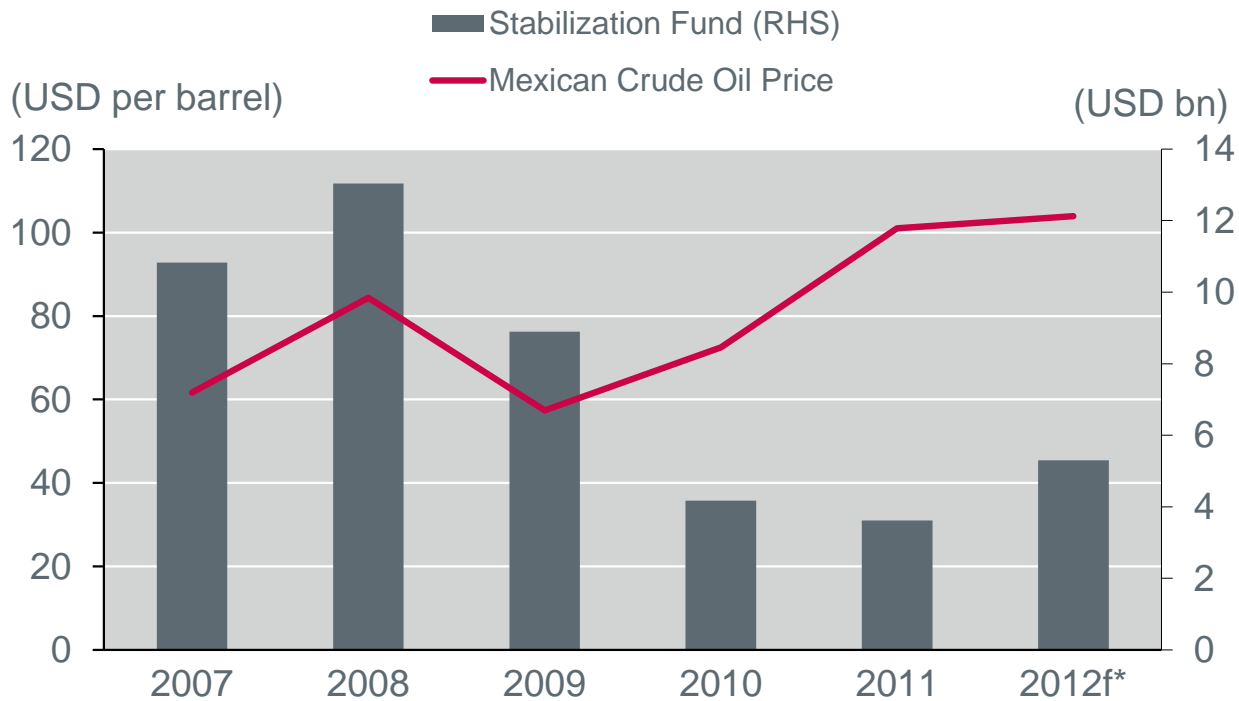
\*Excluding oil revenues

Note: Personal income tax collections include revenue from taxes on corporate income/profits in Mexico

Source: OECD

# Mexico's Fiscal Buffer Is Relatively Modest

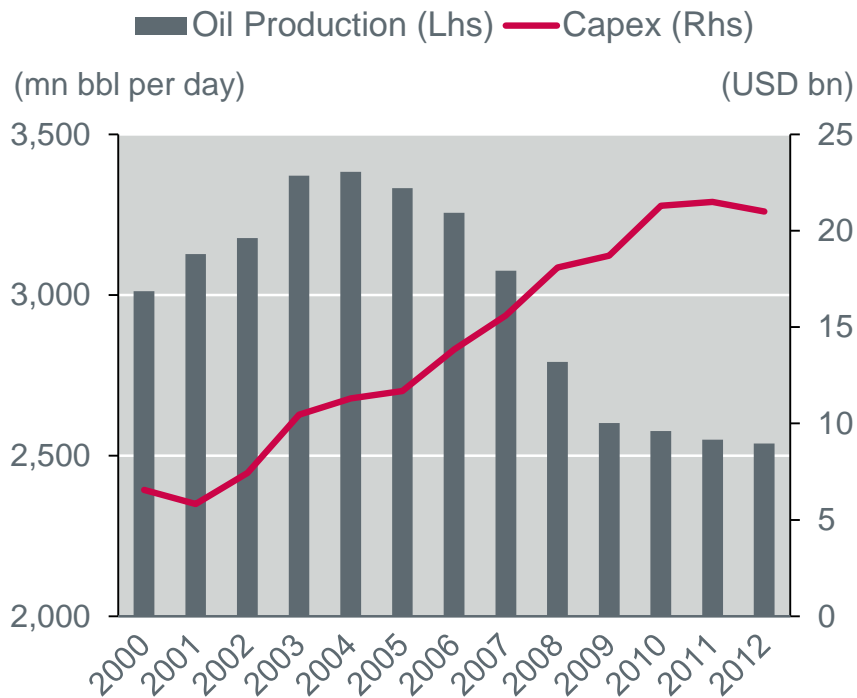
## Oil Prices and Oil Stabilization Fund in Mexico



\* Stabilization Fund balance as of June 2012  
Source: Pemex, SCHP and Fitch

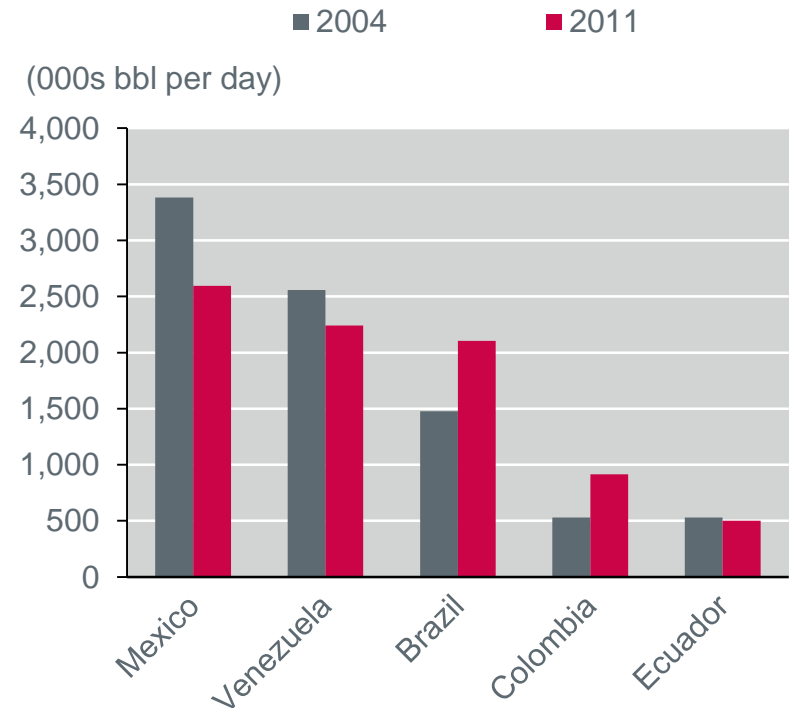
# Reduced Oil Output; Need For Higher Investment

## Oil Sector



Source: Pemex, Fitch

## Oil Production



Source: Department of Energy

# Mexico's Debt Moderate But Not Improving Fast

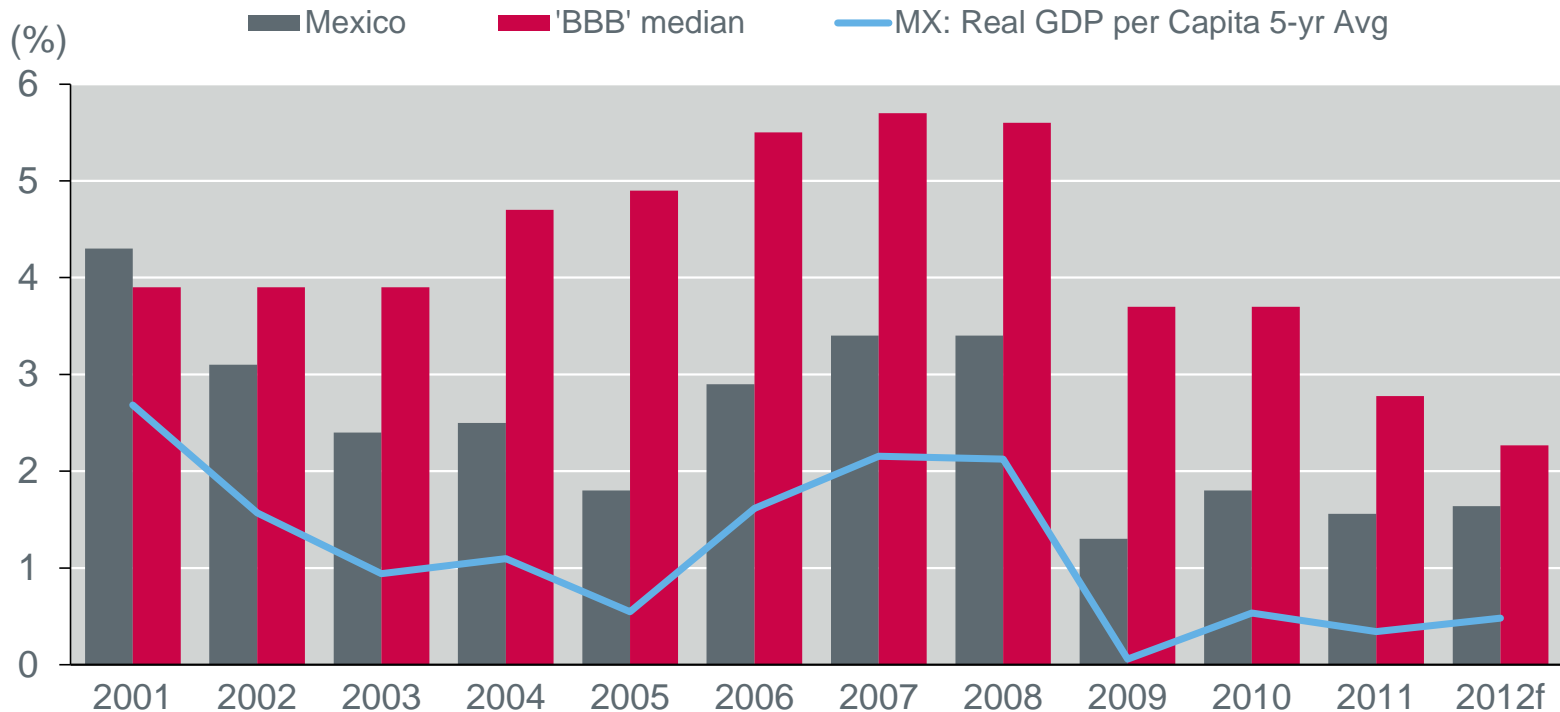
## General Government Debt (% of GDP)



Source: International Monetary Fund

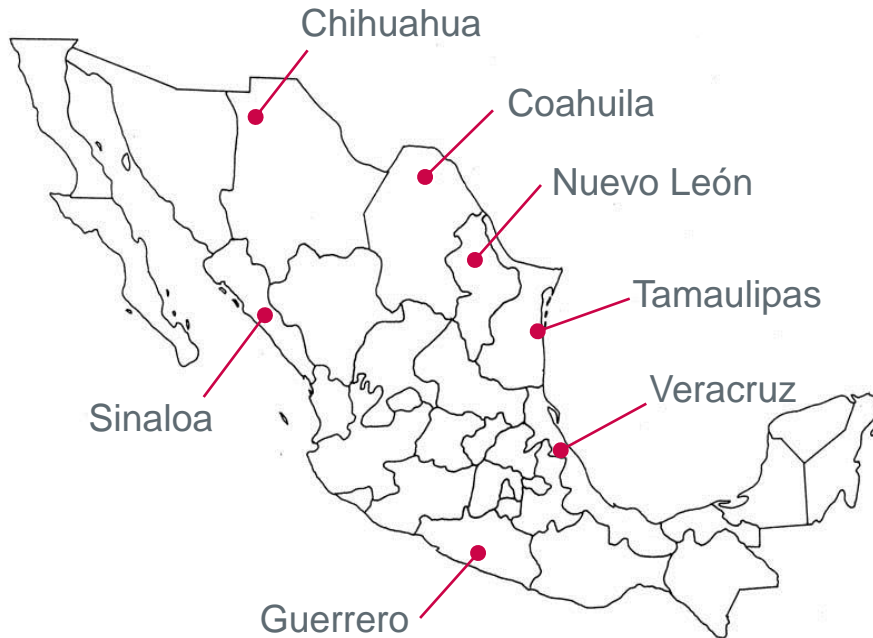
# Mexico's Historical Growth Performance Lagged Peers

## 5-year Average Real GDP Growth



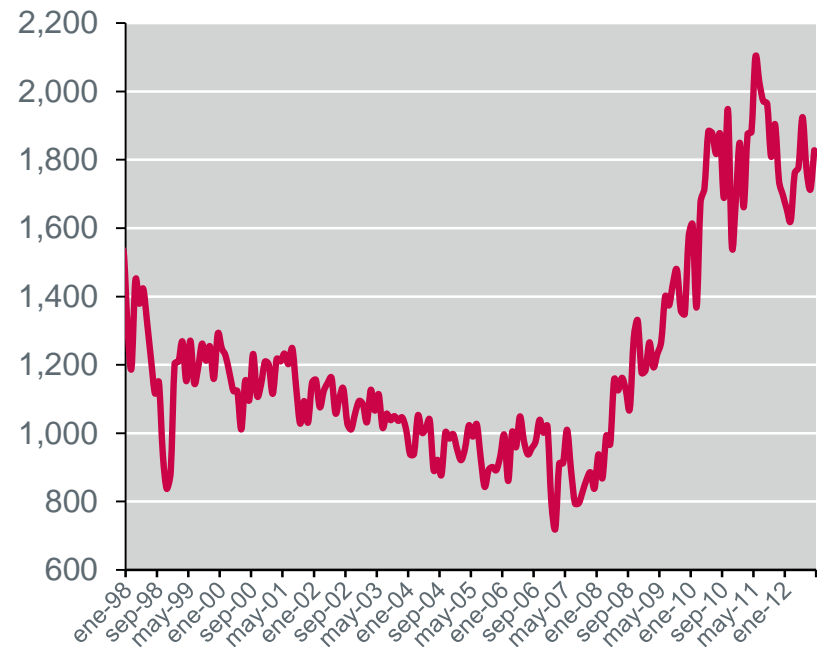
Source: Fitch Ratings

# Drug-Related Violence: A Concentrated Issue ...



Note: These 7 states sum up to 25% of National GDP  
Source: INEGI, Fitch Ratings

## Homicides Per Month



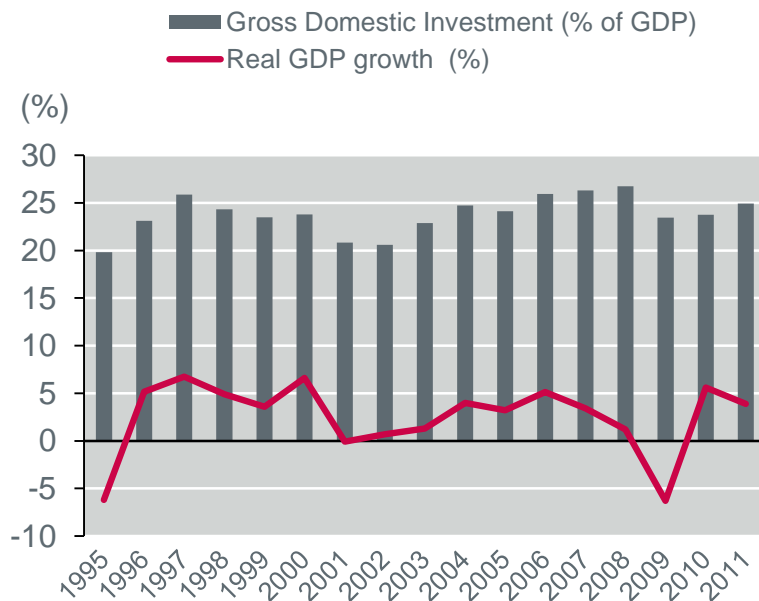
Source: National Secretariat for Public Security

# ... Yet Violence Needs to be Contained

- Affects confidence
- Affects broader economic activity
- Sustained escalation of violence => Reduced investment rate

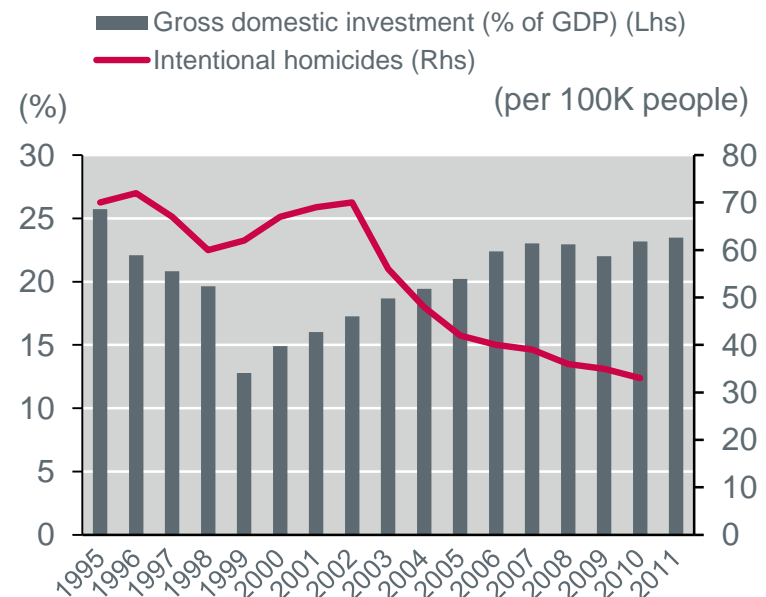
## Gross Domestic Investment to GDP Growth

### Mexico



Source: Fitch Ratings

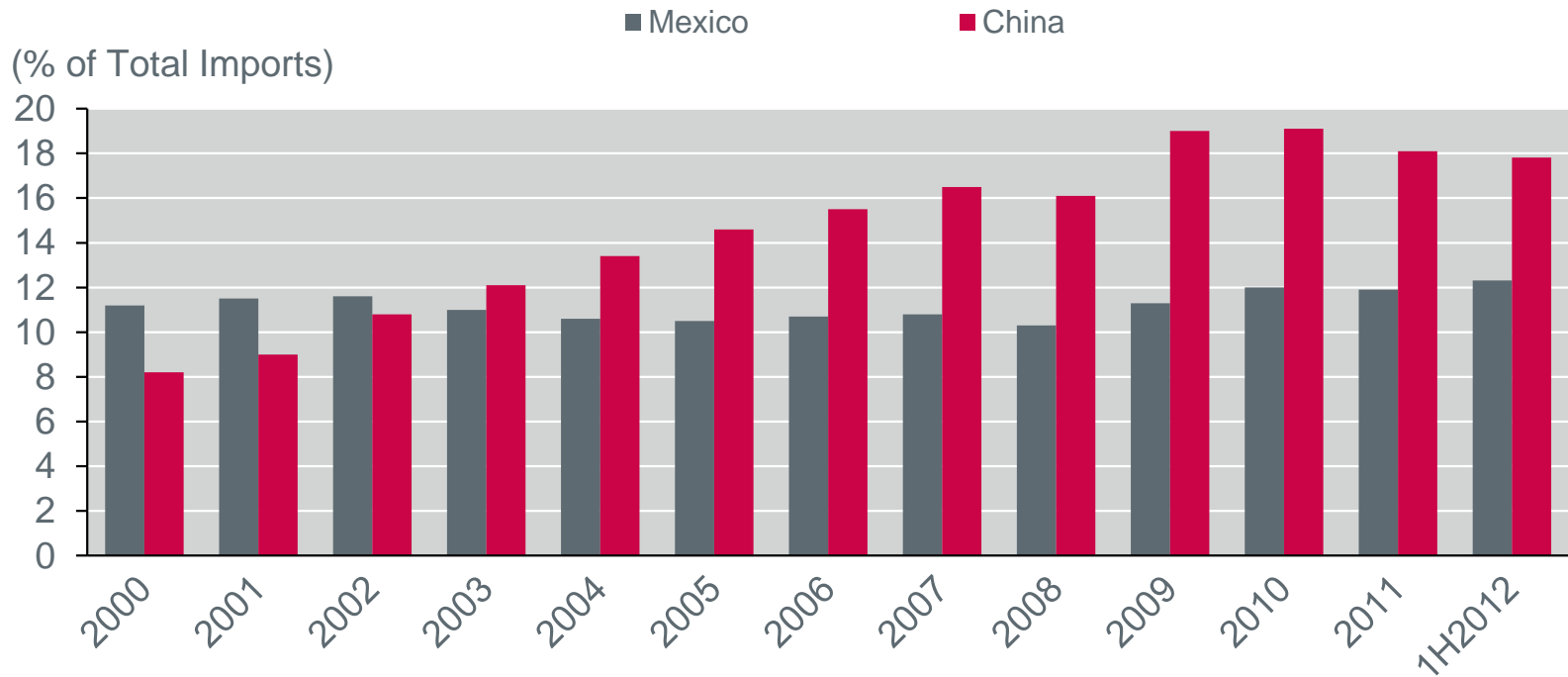
### Colombia



Source: Fitch Ratings

# Mexico Faring Better Against Chinese Competition ...

## U.S. Imports from China and Mexico



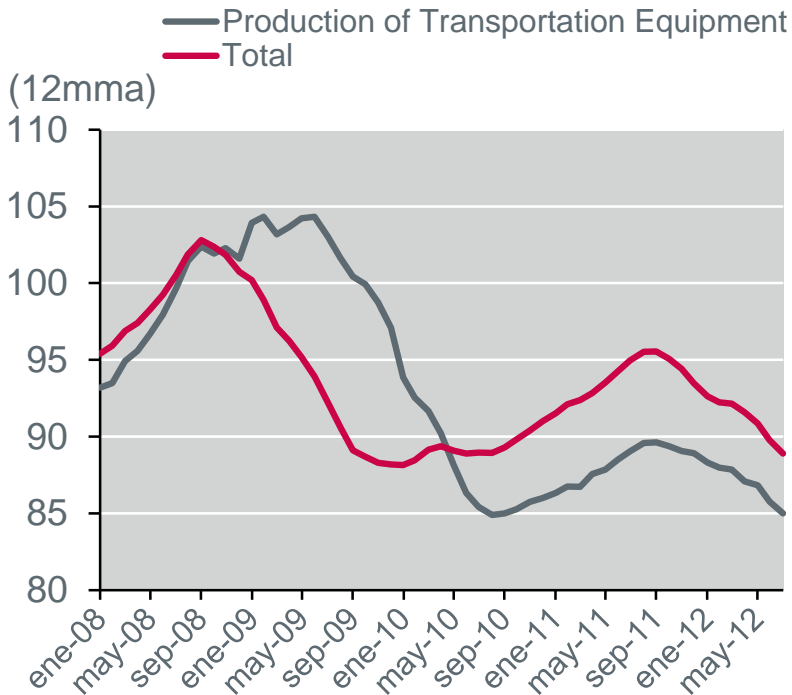
Source: U.S. Census Bureau



# ... and Mexico's Auto Sector Is Resilient

## Unit Labor Costs

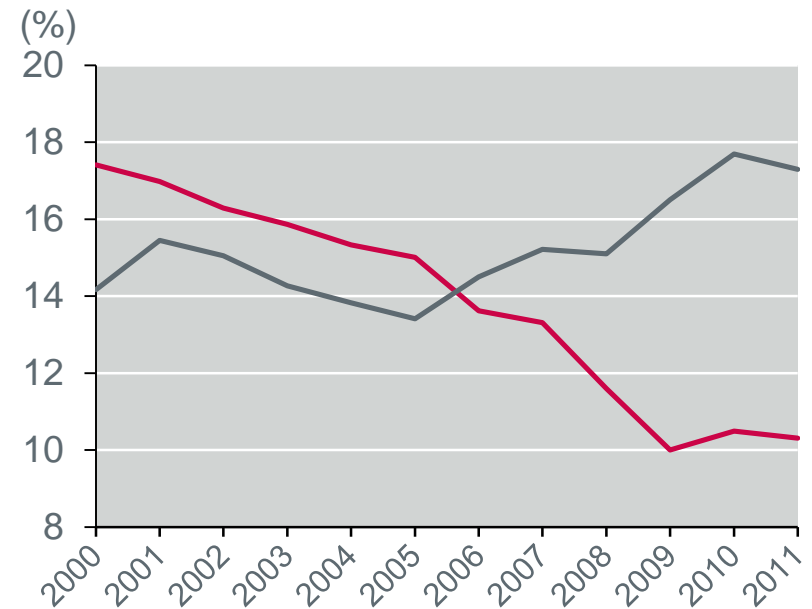
(Index in USD)



Source: INEGI

## Share of U.S. Imports of Transport Equipment

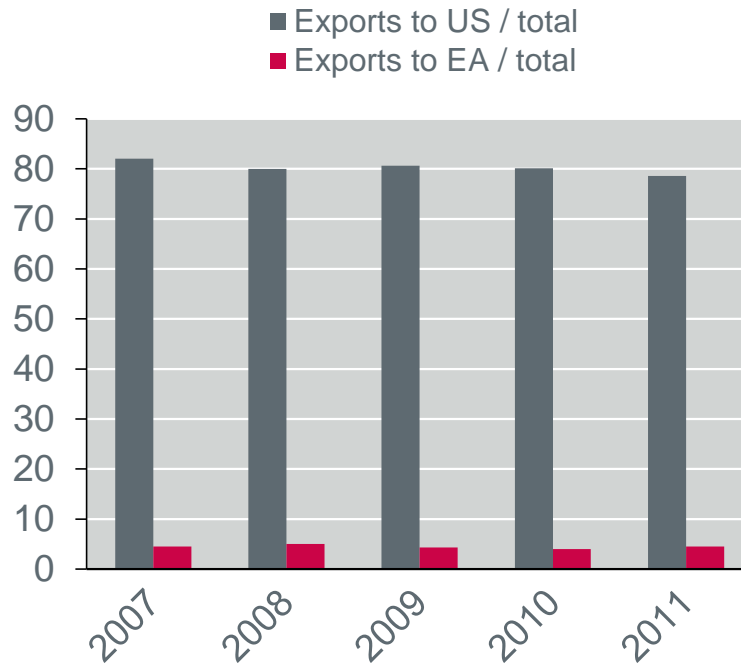
— Canada (red) — Mexico (grey)



Source: UNCTAD

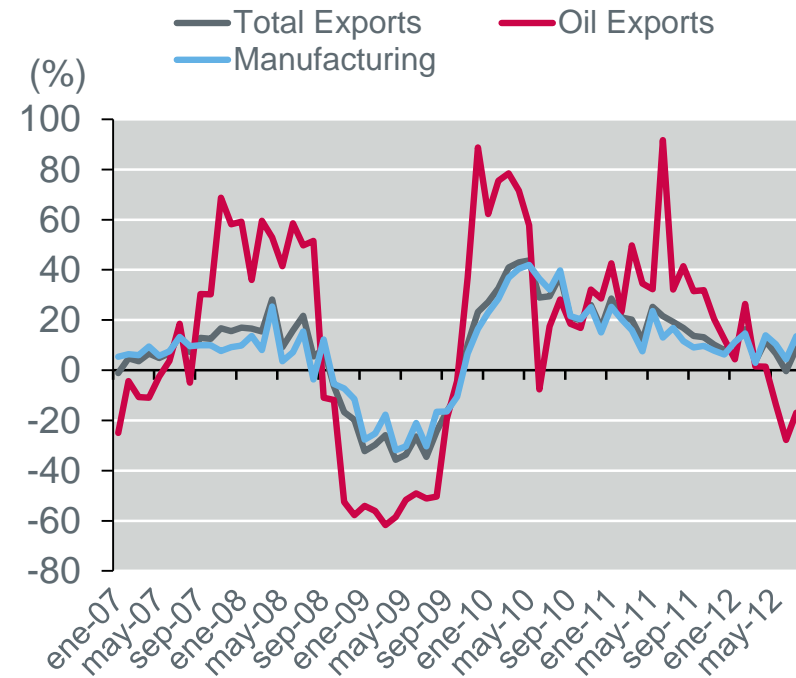
# Risk #1: External Demand Shock from the U.S.

## Percent of Total Exports



Source: International Monetary Fund

## Oil and Non-Oil Exports, YoY



Source: INEGI, Fitch Ratings

Risk #2: Higher External Volatility Related to Eurozone

Risk #3: Spillovers from Spanish Parent Banks

Risk #4: Negative Spillovers into Domestic Demand

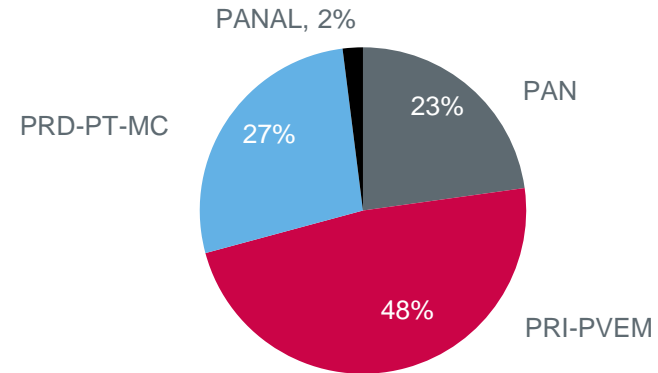
Risk #5 : Reform Inertia Under the PRI Administration

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## Reforms in the Pipeline

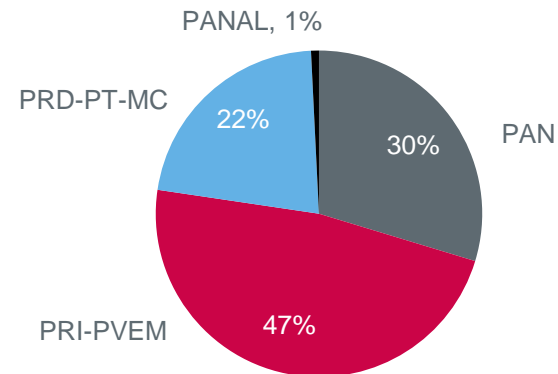
- Labor reform
- Tax reform
- Facilitate greater private partnership in the oil sector
- Fine-tuning of violence strategy

### House of Representatives



Source: Gobierno de México

### Senate



Source: Mexican Senate

# Overall Summary

- Mexico has exhibited a good level of resilience over the past two years aided by good macroeconomic management, elevated oil prices and improved penetration in the U.S. market
- Increased external buffers and access to the IMF Flexible Credit Line should allow it to absorb further external shocks should they occur
- The incoming PRI-led administration will inherit a resilient economy. Progress on reforms still needed to improve economic and fiscal prospects. A strong leadership and proactive negotiations critical for progress on reforms
- Main risks for Mexico in 2012/13 include: a) A slower than expected U.S. recovery and/or materialization of U.S. 'fiscal cliff', b) Lower than projected oil production and/or oil prices c) a renewed increase in global risk aversion
- **Positive Rating drivers:** sustained increase in non-oil income and fiscal buffers, further reforms to improve competitiveness and growth potential and further increases in international liquidity position
- **Negative Rating drivers:** significant fiscal deterioration and sustained economic weakness that undermine debt dynamics

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