INTERNATIONAL MONETARY FUND

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MEXICO

November 2024

2024 ARTICLE IV CONSULTATION AND REVIEW UNDER THE FLEXIBLE CREDIT LINE ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR MEXICO

In the context of the 2024 Article IV Consultation and Review Under the Flexible Credit Line 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 and summarizing the views of the Executive Board as expressed during its October 30, 2024, consideration of the staff report on issues related to the Article IV Consultation and the IMF arrangement.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on October 30, following discussions that ended on October 9, 2024, with the officials of Mexico on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on October 15, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for Mexico.

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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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2024 Article IV Consultation and Mid-Term Review under the Flexible Credit Line Arrangement with Mexico

FOR IMMEDIATE RELEASE

- *The IMF Executive Board concluded the 2024 Article IV consultation and approved the review of Mexico's qualification under the Flexible Credit Line with an access level of about US$35 billion.*
- *Economic activity is moderating due to binding capacity constraints and restrictive monetary policy. Inflation pressures are receding, with inflation expected to reach its 3-percent target by 2025.*
- *A frontloaded fiscal consolidation, underpinned by well-identified measures, is needed to preserve fiscal sustainability. Monetary restraint should be removed gradually. Securing sustainable and inclusive growth will require a broad set of reforms.*
- *Mexico continues to qualify for the FCL by virtue of its very strong fundamentals and institutional policy frameworks and track record of economic performance and policy implementation. The authorities intend to continue to treat the arrangement as precautionary.*

Washington, DC – November 1, 2024: On October 30, The Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] and the mid-term review under the Flexible Credit Line Arrangement with Mexico. The current two-year FCL arrangement for Mexico in an amount equivalent to 26.7381 SDR billion (300 percent of quota, about US$35 billion) was approved by the IMF's Executive Board on November 15, 2023 (see Press Release No. 23/398). The Mexican authorities stated their intention to continue to treat the arrangement as precautionary.

Economic activity is moderating, with private consumption and investment decelerating, and employment growth is slowing. Despite an expansionary fiscal stance, growth is expected to slow to around 1½ percent this year, due to binding capacity constraints and restrictive monetary policy. Growth is expected to moderate further in 2025, reflecting a withdrawal of fiscal stimulus and a slowdown in the U.S. Inflation pressures are receding and continued monetary restraint and slowing activity are expected to lower inflation to Banxico's 3-percent target by 2025.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

The fiscal deficit is expected to register a substantial increase in 2024, which is projected to increase gross public sector debt to about 58 percent of GDP at end-year. The authorities, however, plan to initiate a fiscal consolidation in 2025 to lower the deficit to below 3 percent of GDP over the medium term. After timely tightening, Banxico has started to remove monetary restraint gradually this year, signaling that future rate decisions would be conditioned on achieving an orderly and sustained convergence of inflation to the target.

Mexico maintains sizable buffers, a sustainable external position, and effective financial oversight. The financial system has high capital and liquidity buffers, low private sector leverage, and little sign of stretched asset prices. The current account deficit shrank in 2023 as terms of trade improved but is expected to widen slightly in 2024 as investment- and consumption-related imports outpace exports. International reserves remain at comfortable levels.

At the conclusion of the Executive Board’s discussion, Ms. Gopinath, First Deputy Managing Director and Chair stated:

The Mexican economy is decelerating and inflation pressures are receding. Notwithstanding the procyclical fiscal expansion in 2024, monetary policy has been successfully calibrated to reverse the upswing in inflation and the authorities are planning a sizeable front-loaded fiscal consolidation for 2025. Mexico’s macroeconomic policies and institutional policy frameworks remain very strong, with a flexible exchange rate regime, a credible inflation targeting framework, a fiscal responsibility law, and a well-regulated financial sector.

Nevertheless, Mexico continues to be exposed to sizable external risks amid lingering uncertainty. These remain broadly unchanged from last year and include risks stemming from the dynamics of the U.S. economy and changes in global financial market conditions associated with risk aversion towards emerging market economies. In this context, the arrangement under the Flexible Credit Line will continue to provide the authorities with valuable insurance against tail risks.

The authorities intend to treat the arrangement as precautionary and are firmly committed to maintaining their track record of very strong macroeconomic policies and institutional policy frameworks going forward. They consider the current access to remain appropriate to ensure a timely and adequate buffer to mitigate external risks should they materialize.

Executive Board Assessment[2]

Executive Directors noted Mexico's continued track record of very strong policies and policy frameworks that has contributed to an easing in inflation pressures, sizeable buffers and a strong external position. Noting a deceleration in economic activity and downside risks, Directors underscored the need to implement a sound macroeconomic policy mix and a broad set of reforms to secure high and sustained growth, while ensuring the sustainability of public finances and the return of inflation to its target.

Directors welcomed the authorities' commitment to fiscal sustainability and generally agreed that a sizeable, front-loaded fiscal consolidation is needed in 2025 to stabilize debt and safeguard fiscal sustainability. Directors stressed the importance of a comprehensive and ambitious tax reform that boosts non-oil revenues and encouraged the authorities to improve tax administration and cut tax expenditures to support near-term consolidation while protecting needed investments in infrastructure, health, and social assistance. Enacting a more comprehensive medium-term budget framework and ambitious pension reforms would also be important. Noting that the fiscal costs from Pemex's operations are sizeable, Directors emphasized that further support should be conditional on the development of a viable business strategy and improved corporate governance.

Directors commended Banxico's monetary policy response which enabled disinflation and anchoring of inflation expectations. They stressed that the pace of monetary easing should be gradual and data dependent. Enhancements in Banxico's communication could also be considered to further improve the effectiveness of monetary policy. Directors agreed that the flexible exchange rate should continue to be the key tool to facilitate adjustment to external and domestic shocks.

Directors welcomed the resilience of the financial system with high capital and liquidity buffers. They emphasized the need for continued supervisory attention on loan concentration and sovereign debt exposure and highlighted the importance of completing the recommendations from the 2022 FSAP and enhancing financial inclusion. Noting recent improvements in the AML/CFT framework, Directors emphasized the need for continued efforts in this area, particularly to tackle illicit flows related to organized crime.

Directors agreed that Mexico is well positioned to seize the opportunities arising from the reshaping of global supply chains. In that context, they underscored the importance of pursuing structural reforms to strengthen governance, tackle corruption and crime, and improve physical infrastructure. Directors urged continued commitment to open trade

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[2] At the conclusion of the discussion, the Managing Director, as Chair of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.IMF.org/external/np/sec/misc/qualifiers.htm.

policies and strong safeguards on judicial professionalism and independence in the implementation of recent constitutional amendments.

Directors agreed that Mexico continues to meet the qualification criteria for the FCL arrangement, given its very strong macroeconomic policies and institutional policy frameworks. They positively noted the authorities' plan to treat the arrangement as precautionary and concurred that maintaining the current access level is warranted given continued high external risks. Directors also acknowledged the authorities' state-contingent exit strategy.

Mexico: Selected Economic Indicators, 2023–25

Population (millions, 2023):	131.1	GDP per capita (U.S. dollars, 2023)	13,643.3
Quota (SDR, millions):	8,912.7	Poverty headcount ratio (% of population, 2023) 1/	37.0

Main export products: cars and car parts, electronics, crude oil
Main import products: cars and car parts, electronics, refined petroleum
Key export markets: United States, EU and Canada
Key import markets: United States, China, EU

	2023	2024	2025
Output			
Real GDP (% change)	3.2	1.5	1.3
Employment			
Unemployment rate, period average (%)	2.8	3.0	3.3
Prices			
Consumer prices, end of period (%)	4.7	4.5	3.2
Consumer prices, period average (%)	5.5	4.7	3.8
General government finances 2/			
Revenue and grants (% GDP)	24.4	24.2	23.8
Expenditure (% GDP)	28.7	30.1	27.3
Overall fiscal balance (% GDP)	-4.3	-5.9	-3.5
Gross public sector debt (% GDP)	53.0	57.6	57.9
Monetary and credit			
Broad money (% change)	11.0	7.8	7.3
Credit to non-financial private sector (% change) 3/	8.7	8.0	7.5
1-month Treasury bill yield (in percent)	11.1	…	…
Balance of payments			
Current account balance (% GDP)	-0.3	-0.7	-0.9
Foreign direct investment (% GDP)	1.7	1.3	1.5
Gross international reserves (US$ billions)	214.4	235.0	244.8
In months of next year's imports of goods and services	3.7	3.9	3.9
Total external debt (% GDP)	26.2	26.2	27.8
Exchange rate			
REER (% change)	16.4	…	…

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 Fund 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. CONEVAL estimates at 2023Q4.
2/ Data exclude state and local governments and include state-owned enterprises and public development banks.
3/ Includes domestic credit by banks, nonbank intermediaries, and social housing funds.

INTERNATIONAL MONETARY FUND

MEXICO

October 15, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION AND REVIEW UNDER THE FLEXIBLE CREDIT LINE ARRANGEMENT

KEY ISSUES

Context. Economic activity is decelerating, and inflation pressures are receding. The fiscal deficit is expected to register a substantial increase in 2024. Mexico maintains sizable buffers, a strong external position, and effective financial oversight. A range of supply-side reforms will be needed to catalyze lasting higher growth.

Outlook and risks. Growth is expected to moderate further in 2025, reflecting a withdrawal of this year's fiscal stimulus and continuing monetary restraint. Risks are tilted to the downside. The potential for a tightening of global financial conditions due to global risk aversion weigh against possible upsides from the ongoing reshaping of global supply chains. U.S. growth represents a two-sided risk.

Fiscal policy. A frontloaded fiscal consolidation, underpinned by credible and well-identified measures, is needed to reduce public debt over time and provide space for maneuver in the event of negative shocks. Tax reforms are needed to achieve a sustained improvement in the fiscal position and to fund needed investments in infrastructure, health, and social assistance.

Monetary policy. Monetary restraint should be removed gradually, conditional on continued progress in bringing inflation down to the central bank's target.

Financial sector policies. Upgrading the macroprudential toolkit, enhancing the autonomy and resources of regulatory agencies, strengthening bank resolution and recovery, and addressing gaps in implementation of the AML/CFT framework remain the main priorities.

Structural reforms. There is a critical need to strengthen governance, tackle corruption and crime, improve physical infrastructure, and mobilize private savings to fund private investments by expanding the coverage of financial intermediation.

Approved By
Nigel Chalk (WHD) and Martin Čihák (SPR)

Discussions were held in Mexico City during July 15–26, 2024, with concluding meetings with the new authorities held over October 8–9, 2024. The mission met with Finance Secretary Ramírez de la O, Governor Rodríguez Ceja, other officials, and representatives of the financial and private sectors. The team was led by Bikas Joshi and comprised Francisco Arizala and Matteo Ghilardi (all WHD), Samir Jahan (FAD), Tomohide Mineyama (SPR), Camilo Enciso and Ivana Rossi (both LEG), and Corrado Macchiarelli (MCM). Boele Bonthuis (FAD), Jean-Marc Fournier, and Johanna Schauer (both WHD) provided additional inputs. Rodrigo Valdés (WHD) joined the concluding meetings with the Finance Secretary, Governor, Economy Secretary Ebrard, and Energy Secretary González. Alfonso Guerra and Maria José Posadas Bolanos (OED) participated in the discussions. Anahit Aghababyan and Hugo Tuesta (both WHD) provided editorial support and research analysis.

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FIGURES

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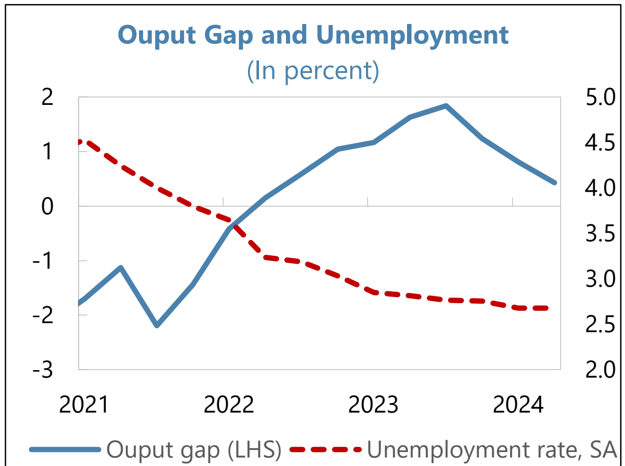
ANNEXES

RECENT DEVELOPMENTS

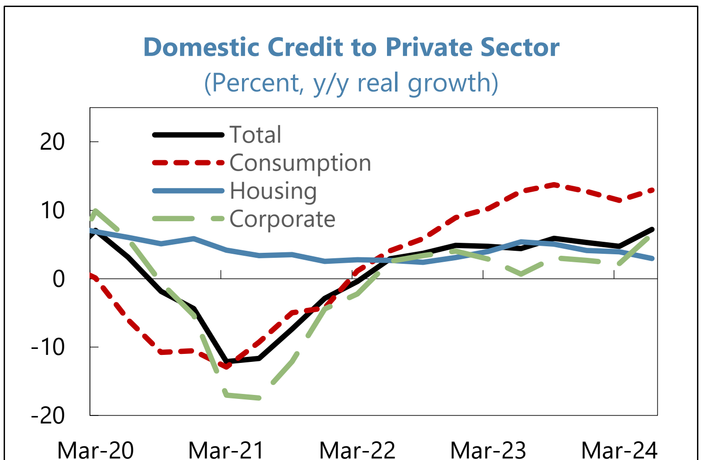
1. **A political transition is underway**. Claudia Sheinbaum Pardo assumed the Presidency on October 1, with her Morena party winning large majorities in Congress. On November 15, the new administration will present to Congress its budget. In September, the government adopted a constitutional amendment that transformed the judiciary. Additional constitutional amendments are currently being considered.

2. **Economic activity is moderating**. A sustained track record of very strong policies, economic fundamentals, and institutional policy frameworks have helped Mexico maintain a sound macroeconomic position. Public debt remains relatively low, proactive monetary policy is bringing inflation down, and benefits from a realignment of global supply chains may be materializing. The economy expanded by 3.2 percent in 2023, with rapid growth in non-residential construction and manufacturing, as firms expanded their capacity to supply the U.S. market. However, more recently a restrictive monetary policy and binding capacity constraints are restraining economic activity. Private consumption and investment are decelerating, employment growth is slowing, and the output gap is converging to potential from above.



Sources: Haver Analytics, and IMF staff calculations.

3. **Inflation remains above the central bank's target range** (at 4.6 percent y/y in September). Core inflation is falling as goods prices disinflate, but services inflation continues to run around 2 percentage points above its pre-pandemic level as higher operating costs and wages pass through to prices. Banco de México (Banxico) cut its policy rate by 25 basis points each in March, August, and September 2024, to 10.5 percent, and has signaled that future rate decisions would be conditioned on achieving an orderly and sustained convergence of inflation to the 3-percent target.



Sources: Haver Analytics, Banxico, and IMF staff calculations.

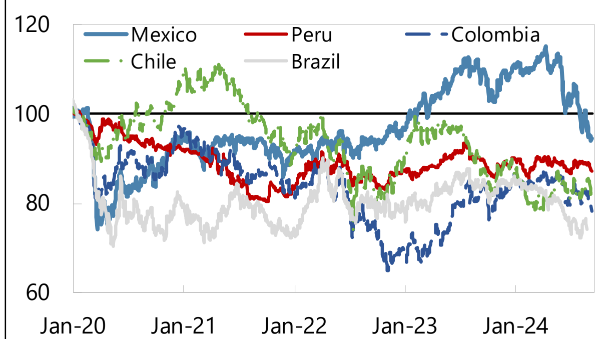
4. **Credit conditions are supportive of activity.** Consumer credit is moderating, reflecting a slowdown in domestic demand and tight monetary policy. However, mortgage lending

continues to grow, and household balance sheets have improved (Annex VI). In addition, there has been a robust expansion in corporate lending to fund ongoing expansions in capacity. However, despite the recovery, credit remains below its pre-pandemic trend.

5. **The Mexican financial system remains robust and resilient to a range of macrofinancial shocks**. Banks' regulatory Tier 1 capital to risk weighted assets, liquid assets to short-term liabilities, and provisioning for non-performing loans remain above regulatory minima. Recent stress tests that assume a default of each bank's five largest debtors predict that only one bank would end up with a capitalization ratio below the regulation requirement. Banks' exposure to the public sector is broadly unchanged at high levels, with much of the exposure on liquid government bonds.

Exchange Rates Against the US Dollar

(Index: Jan 2020 = 100, increase = appreciation)

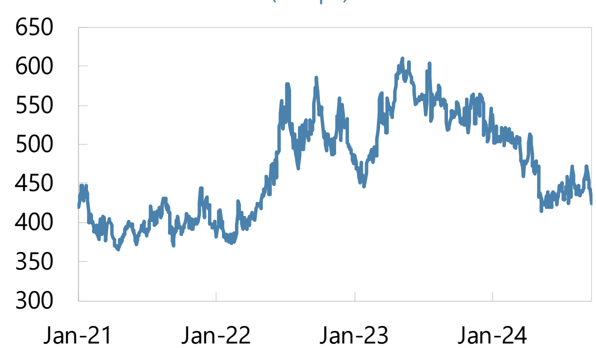


Sources: Bloomberg, and IMF staff calculations.

6. **The external position in 2023 was moderately stronger than the level implied by medium-term fundamentals and desirable policies** (Annex I). Exports were boosted by auto-related goods, medical and electrical products, while solid demand boosted imports of both consumption and investment goods. Remittance inflows have stabilized at relatively high levels, reflecting the softening of the U.S. labor market, while FDI and portfolio inflows remain strong (Box 1).

30-year Pemex-UMS Spread 1/

(In bps)



Sources: Bloomberg, and IMF staff calculations.

1/ Pemex-UMS spread is the difference between Pemex and Mexico sovereign bonds both expiring in 2050.

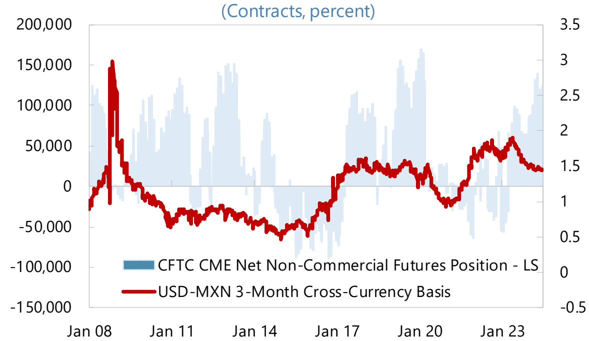
7. **Borrowing costs for Pemex have fallen as the government continues to support the state-owned enterprise.** Lower crude oil volumes (despite higher oil prices) and a stronger peso are lowering earnings, but Pemex's spread has fallen due to lower corporate indebtedness, increased cash contributions from the government, and a lower government share of Pemex profits. Pemex is reported to have had negative net income in the first half of 2024 (due to foreign exchange losses and a higher cost of sales).

8. **Economic policies have been broadly consistent with past Fund advice.** Monetary policy has responded appropriately to inflation dynamics. The authorities have continued to maintain a sustainable fiscal position, despite the expansion in 2024. Financial supervision and regulation remain robust. Measures are being undertaken to strengthen governance and improve physical infrastructure, though fiscal reform to finance productive public expenditure needs and supply-side reforms remain outstanding.

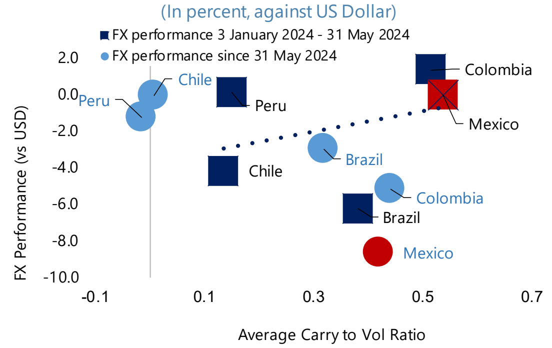
Box 1. Recent Trends in the Peso

Though the Mexican peso was one of the strongest performing EM currencies through the first half of 2024, adverse market reactions following the elections in June, coupled with uncertainty regarding monetary policy in advanced economies, led to heightened market volatility. In particular, the unwinding of global carry trade, including because of the policy shift by the Bank of Japan, exacerbated depreciation pressures on Latin American currencies with strong trade links to the U.S., while putting pressure on some Asian currencies. In addition, the recent approval of reforms to the judiciary as well as global factors led to an increase in the cost of hedging the currency risk—the 3-months ahead USD/MXN implied volatility rose to 17.7 percent in August, the highest in two years, moderating since to 15.7 percent. The peso continues to be supported, though, by a strong external position, spillover benefits from solid U.S. demand, and a still-favorable interest rate differentials versus funding currencies like the U.S. Dollar and the Japanese Yen, with option-implied probabilities suggesting marginal adjustments over the next 12-24 months.

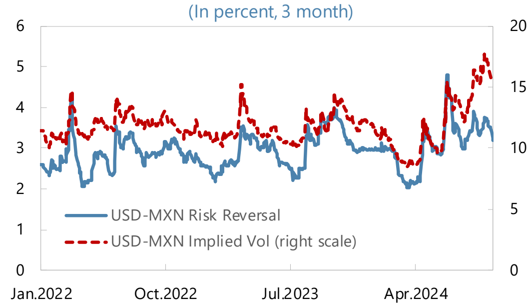
CFTC Net Non Commercial Futures Positioning
(Contracts, percent)



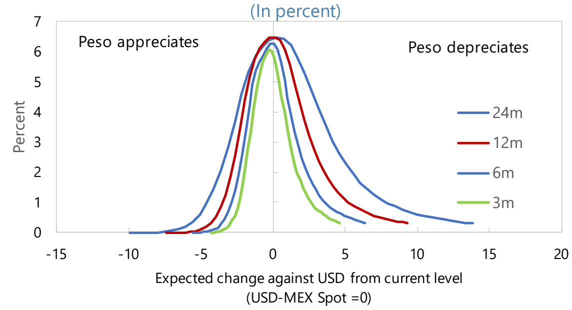
FX Performance
(In percent, against US Dollar)



US Dollar vs Mexican Peso Risk Reversal and Implied Volatility 1/
(In percent, 3 month)



Option-implied Probability of USD-MXN Echange Rate
(In percent)



Sources: Bloomberg, and IMF staff calculations.
1/ Risk reversal is interpreted as the market view of the most likely direction of the spot movement over the next maturity date (3 months), defined as the implied volatility for call options minus the implied volatility for put options on the USD. The implied volatility index is instead a measure of the market expected future volatility of a currency exchange rate from now until the maturity date (3 months).

OUTLOOK AND RISKS

9. **Growth is projected to moderate in 2024 as capacity constraints become more binding.** In 2025, the planned fiscal adjustment and slower growth in the U.S. would create a further headwind to growth. Over the medium term, growth is projected to converge towards potential of around 2 percent.

10. Inflation should return to the 3-percent target by end-2025. However, risks to inflation are to the upside, largely from more persistent-than-expected services inflation, higher commodity prices, or weather-related shocks.

11. The fiscal position has been highly procyclical in 2024. Under the authorities' current plans, the overall deficit will likely increase to 5.9 percent of GDP in 2024, a fiscal impulse of 2.2 percent of GDP. While revenues are running modestly above expectation—mostly due to higher oil prices—spending on pensions and flagship infrastructure projects is also higher. Additional support for Pemex or higher-than-expected expenditure on infrastructure projects in the latter part of the year could lead to a modestly higher deficit. With gross public sector debt expected to reach close to 58 percent of GDP at end-2024, Mexico continues to have some fiscal space to respond to temporary shocks.

12. Slowing U.S. import demand and sustained imports for consumption and investment should lead to a moderately higher current account deficit in 2024. Over the medium term, despite lower fiscal deficit, higher corporate investment is expected to keep the current account deficit at around 1 percent of GDP (Annex I).

13. Risks to the outlook are tilted to the downside (Annex II).

- Increased global risk aversion—perhaps arising from geopolitical risks or ongoing conflicts—or monetary policy miscalibration in advanced economies could trigger capital outflows, weaken the peso, boost inflation, increasing financing costs.
- An abrupt slowdown in the U.S. or changes in tariffs affecting global trade could have a significant negative impact on Mexico. On the other hand, a faster disinflation and stronger growth in the U.S. would create upsides for Mexico.
- While a slower-than-expected pace of fiscal consolidation could add to growth, this could, in part, be offset by a tighter monetary stance. A non-credible fiscal consolidation could result in rating downgrades, increased borrowing costs and—by contributing to policy uncertainty—lower investment and medium-term output.
- Presidential elections in the U.S. could imply policy changes in a range of areas—notably trade and immigration—that would have important spillovers to Mexico.
- Policy uncertainty due to recent changes to the judiciary—and possible additional constitutional amendments—could adversely affect investment and growth.
- The ongoing reshaping of global supply chains provide an upside risk.

14. Authorities' views. The Ministry of Finance expects higher growth for 2024 and 2025 than projected by other institutions. They noted that concerns about the 2024 budget being procyclical and inflationary have proven unfounded, underscoring that the 2024 budget has supported Mexico's capacity for long-term growth, above all, while providing support amid weaker external demand. They asserted that social programs, alongside public investment, will be crucial in sustaining demand in 2025, to protect the vulnerable and support employment, key elements in strengthening Mexico's resilience. Additionally, they pointed out that Mexico continues to benefit from the relocation of global supply chains, with its share of U.S. imports and FDI rising and expected to grow further. The authorities agreed that inflation is expected to continue declining—following the downward trajectory in core inflation, as price pressures in non-core items dissipate—and return to Banxico's target by end-2025. Despite volatility, they stated that the economy remains resilient to domestic and external shocks, supported by strong private- and public-sector buffers and a robust policy framework.

POLICY DISCUSSIONS

A. Recalibrating Fiscal Policy

15. The authorities are developing a budget with a sizable fiscal consolidation planned for 2025. Staff anticipates the budget will target a reduction in overall deficit from 5.9 to 3.5 percent of GDP in 2025, though measures to underpin this adjustment have not yet been specified. Achieving this will require identifying additional measures of around one percent of GDP, including enhancing tax administration and improving expenditure efficiency. Over the medium term, the deficit is expected to fall to below 3 percent of GDP, assuming a broadly neutral fiscal stance and stabilization in real terms in key expenditure items (such as compensation of employees and goods and services) as well as reduced interest expenditure due to lower interest rates. This would bring gross public sector debt to 58 percent of GDP by 2029, conditional on this projected adjustment. A front-loaded fiscal consolidation, underpinned by credible measures, would allow for a faster convergence to a stable debt level, and—by creating additional fiscal space—provide greater flexibility to react to shocks (Annex VII). Credibility of the new government's fiscal plans would be bolstered by putting in place a better medium-term budget framework that incorporates a medium-term debt anchor, clearer escape clauses (and corrective mechanisms to bring the economy back to the debt anchor after an escape clause has been used), and better fiscal forecasting and cash management. The Sovereign Risk and Debt Sustainability Analysis indicates a moderate overall risk of sovereign stress (Annex III).

16. Improving tax administration and cutting tax expenditures would help with near-term consolidation. Improvements in tax administration are planned through increased use of digital services and tax filing support, the use of AI to identify filing inconsistencies, and risk-based audits for specific sectors (notably construction). However, shortcoming that have not yet been addressed include: (i) the lack of a comprehensive Compliance Risk Management (CRM) strategy to address non-compliance; (ii) a "silo approach" to tax administration, which undermines efforts to reduce tax evasion; and (iii) declining customs collection following the recent separation of customs administration from the tax agency. Reducing a range of tax expenditures—which are often regressive and make the system more complicated—would raise revenues (see text table). Phasing out fuel subsidies would lessen the demand for fossil fuels and, when combined with progressive cash transfers, would be welfare-improving for poorer households.

Summary of Tax Expenditures Estimates, 2022-23
(Percent of GDP)

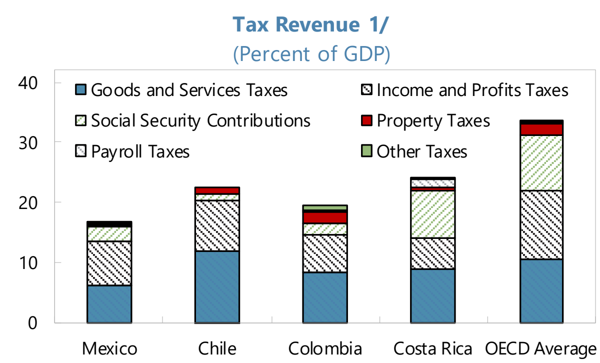
Tax Expenditures	2022	2023
CIT	0.45	0.45
PIT	0.85	0.88
Including:		
Deductions for medical, social assistance, savings and education expenses	0.12	0.12
Exempt income	0.71	0.75
of which: retirement, pensions, or retirement assets	0.25	0.25
Special or sectoral regimes	0.02	0.02
VAT	1.87	1.87
Including:		
Exemptions	0.23	0.23
of which:		
Teaching services	0.12	0.12
Zero rate	1.63	1.63
of which:		
Food	1.38	1.38
Medicine	0.12	0.12
Drinking Water	0.08	0.08
Books, Newspapers, and Magazines	0.02	0.02
Feminine Hygiene Products	0.02	0.02
Other	0.01	0.01
Special Taxes	0.03	0.03
Including:		
Excises exemption for telephony services	0.01	0.01
Fiscal Incentives	1.65	1.44
Including:		
Fuel subsidy	1.14	0.88
Tax Stimulus for Contribution of Real Estate to Trusts	0.10	0.10
Northern Border Tax Regime	0.33	0.33
Southern Border Tax Regime	0.01	0.01
Total	***4.85***	***4.66***

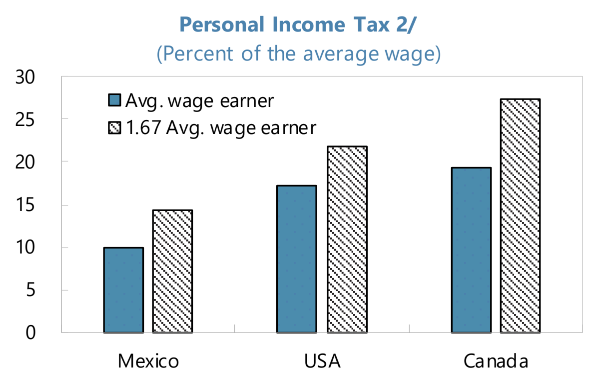
Sources: OECD, and IMF staff calculations.
Note: Only those exemptions deemed by SHCP to be 'waivers of collection' are labelled and estimated as tax expenditures. Exemptions due to technical difficulties in collection are not deemed tax expenditures and so are not estimated.

17. Non-oil revenue mobilization remains a priority. A comparatively low tax revenue-to-GDP ratio—lower than OECD peers—constrains Mexico's ability to spend on priorities such as infrastructure, health, and education. Possible reform areas include:

- *A comprehensive reassessment of the rates and thresholds of existing taxes*. In particular, personal income tax rates for individuals earning the average wage are below regional and OECD peers.

- *Revisiting Mexico's carbon-pricing architecture*. Mexico has both a carbon tax and emissions trading system, but the combined tax rate is relatively low (at USD 3.5 per excess ton of CO2) and natural gas is outside the system. Raising the cost of emissions would raise revenues and help reduce the reliance on fossil fuels.





Sources: OECD, and IMF staff calculations.
1/ To ensure comparability, OECD 2023 General Revenue Statistics 2023 data has been used for cross-country analysis, with the latest available year being 2021. This data utilizes different definitions for tax revenues and so does not match the IMF's GFS presentation. This is in part due to differences in the classification of 'non-tax revenues'.
2/ Estimates presented are the combined central and sub-national government rates and exclude employer and employee social security contributions.

18. Recently announced pension reforms are expected to have a limited fiscal impact but will not address the key structural inequities in the system. Public pension spending increased by almost 0.6 percent of GDP over the past three years and will continue to increase over the medium term. Recent reforms to raise the replacement rate to 100 percent for some pensioners would likely have a modest near-term impact due to the policy's narrow target. More ambitious steps are needed to address structural inequities in the system (Annex VIII).

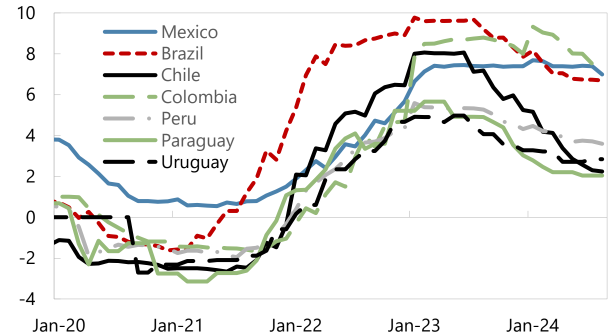
19. Support to Pemex should be made conditional on changes to its governance structure and business strategy. The direct and indirect fiscal costs from Pemex—through distortions to market incentives, emissions, and impact on sovereign risk premia—are sizable (Annex IX). Going forward, support to Pemex should be conditioned on changes to Pemex's business plans that focus production on profitable fields, selling non-core assets, scaling back unprofitable investments in refining activities, and attracting private partnerships.

20. Authorities' views. The authorities reaffirmed their commitment to a frontloaded fiscal consolidation, noting that specific targets and composition of measures are still under discussion. They agreed that advancing consolidation in 2025, followed by further efforts to reduce the deficit to below 3 percent of GDP over the medium term, would uphold their policy pledge to stabilize debt as a share of GDP. They noted that these efforts would focus primarily on expenditure reductions, supplemented by administrative actions to increase non-oil revenues. The authorities expressed confidence in achieving the 2024 targets. Regarding Pemex, they acknowledged its ongoing operational and financial challenges, and emphasized the need for enhanced internal collaboration to develop long-term solutions that would strengthen its business plan and financial health**.**

B. Sustainably Returning Inflation to Target

21. Banxico's timely tightening of monetary policy has anchored medium-term inflation expectations and reversed the 2021-2 upswing in inflation. The real ex ante monetary policy rate is now close to 7 percent, among the highest in the region and substantially above most neutral rate estimates, which should slow activity and further reduce inflation in the coming months.

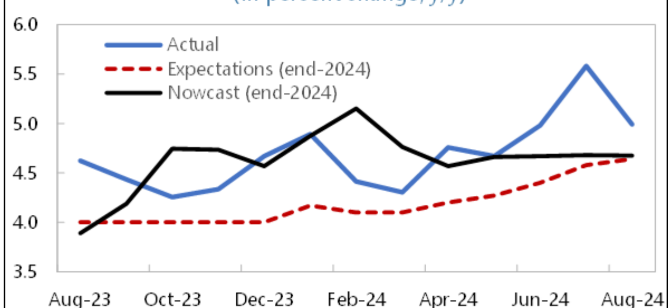
LA5: Ex-Ante Real Monetary Policy Rates
(In percent)



Sources: Consensus Economics, Haver Analytics, and IMF staff calculations.

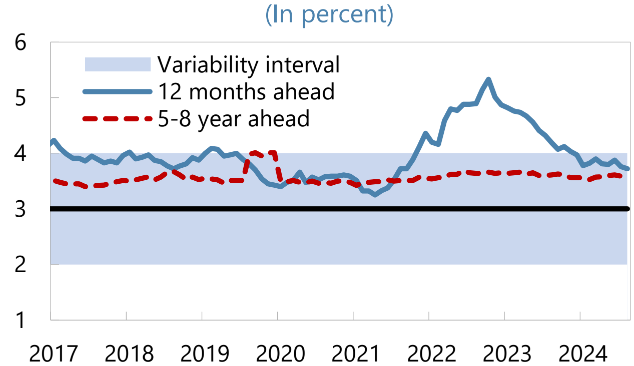
22. The pace of easing should be dependent on inflation being on a decisive path back to the central bank's target. Staff forecasts indicate that reducing the policy rate to 10 percent by end-2024 would be consistent with inflation converging to 3 percent by end-2025 as the output gap closes, labor market cools, and wage growth slows. In the event inflation proves to be more stubborn (e.g., from sustained price pressures in services or non-core items, continuing rapid increases in nominal wages, stronger-than-expected demand, and/or a weaker peso) then a slower path of interest rate reductions would be warranted. For example, in the event of higher services inflation and a positive growth surprise in the U.S., model-based results would argue for a more moderate pace of policy accommodation. Fiscal adjustment in the period ahead would also support the disinflation process through a moderation in demand.

Inflation and End-2024 Nowcast
(In percent change, y/y)



Sources: Banxico, and IMF staff calculations.

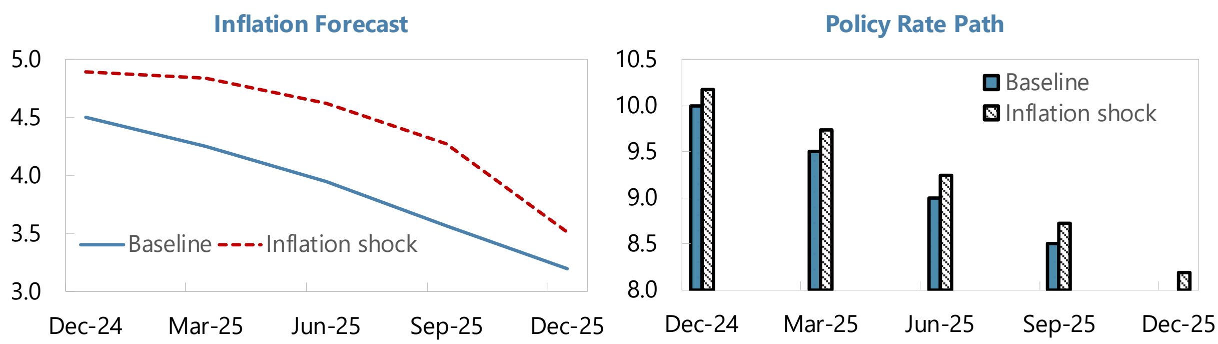
Inflation Expectations
(In percent)



Sources: Haver Analytics, and IMF staff calculations.

23. There is scope to boost the effectiveness of monetary policy by further enhancing Banxico's communication toolkit. Long-term inflation expectations (5–8-year horizon) remained anchored throughout the post-pandemic inflationary episode as a result of the central bank's decisive policy response to higher inflation. However, nearer-term inflation expectations remain close to the higher end of Banxico's variability range. Staff analysis (Annex X) suggests that short-term inflation expectations are an important determinant of inflation dynamics. As such, clear monetary policy communication will be critical to continue to foster such forward-looking price-setting behavior and bring inflation and inflation expectations back to target. Options to enhance communication could include a) publishing transcripts of the monetary policy meetings with a one-year lag (instead of three) to increase their relevance, b) providing greater information on the assumptions—including the policy path—that underpin the authorities' projections while making clear that these are forecasts and not policy commitments (Casiraghi and Perez 2022), and c) further tailoring central bank communication to a broader audience. A clear and credible fiscal consolidation would also help anchor inflation expectations (Box 2).

Scenario Analysis (DSGE): Baseline vs Higher-Inflation Scenario



Source: IMF staff calculatons.
Note: A combination of shocks to domestic price markup and foreign demand that brings the inflation rate to 5.0 percent and the output gap above the baseline by 0.5 percentage points at end-2024 are considered in the shock scenario. The model is as described in Chen and others (2023).

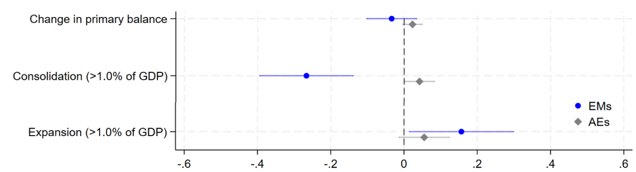
24. Mexico continues to maintain a fully flexible exchange rate. Mexico has a deep and liquid FX market, limited FX mismatches on balance sheets with natural and financial hedges, as well as sound macroprudential policies, and well-anchored inflation expectations. As such, guided by the Integrated Policy Framework (IPF) (see Annex VII of the 2023 Article IV Consultation), FX interventions should be used only when large shocks cause disruptions in liquidity conditions or a malfunctioning of the FX market. This has been the case over the past few years when FX interventions were limited to a few episodes of extreme volatility. Notably, FX intervention was not deployed in the face of the orderly depreciation of the peso that followed the election in June.

25. Authorities' views. The authorities agreed that core inflation was on a downward trajectory, although services inflation remains sticky, and noted that recent pressure on non-core inflation and its impact on headline would likely dissipate over a few quarters. The balance of risks on inflation was seen as tilted to the upside. They reiterated that future rate decisions would ensure that the policy path remains consistent with achieving the inflation target by end 2025, while assessing the residual impact of global shocks, weakening economic activity, and the impact of the restrictive monetary stance on inflation. They agreed with the importance of a communication strategy in enhancing the effectiveness of monetary policy but noted that the timing of any changes should be calibrated to avoid unintended consequences. A flexible exchange rate remains a key shock absorber, with efforts ongoing to develop markets to broaden the investor base and enhance the efficiency of market infrastructure.

Box 2. The Impact of Fiscal Policy on Inflation Expectations[1]

An empirical analysis is undertaken to explore the impact that fiscal policy can have on inflation expectations. Fiscal policy shocks are measured as (i) unexpectedly large fiscal consolidations and expansions (i.e., changes in the primary balance that are larger than 1 percent of GDP and are unexpected by the WEO forecast) or (ii) fiscal consolidations that are identified using a narrative approach (as defined in Carriere-Swallow and others (2021)). The analysis covers a sample of AEs and EMs, and differentiates between effects on short-term (1-2 years) and long-term (5-10 years) inflation expectations from Consensus Forecasts.

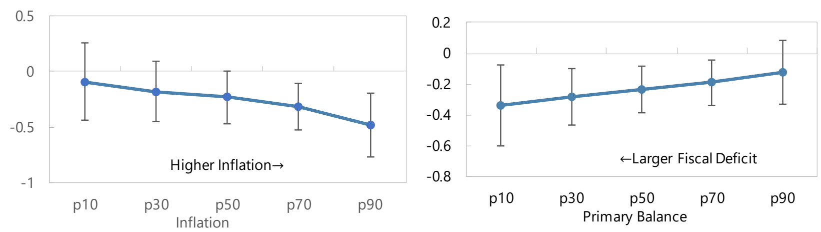
Responses of 2-year Ahead Inflation Expectations to Fiscal Shocks



Notes: Cumulative responses over 3 years to a 1 percent-of-GDP shock. Bars indicate 1 standard deviation.

Fiscal policy shocks are shown to have a significant impact on short-term inflation expectations in EMs only when the adjustments are large. In contrast, responses in AEs of similar sized fiscal shocks are not statistically significant. There is considerable heterogeneity among EMs. The impact of fiscal policy on inflation expectations is found to be larger in (a) high-inflation environments (where monetary policy frameworks are less credible) and (b) cases where the initial fiscal position is weak (i.e., with a larger fiscal deficit). As such, there is an important interaction between credible fiscal frameworks and monetary policy in anchoring inflation expectations.

EMs: State-dependence Impact on Inflation Expectations
(In percent)



Note: Responses of 2-year ahead inflation expectations over three years to a 1 percent-of-GDP fiscal consolidation shock in EMs. Horizontal axes indicate the responses in different percentiles of state variables (year-on-year inflation rate and primary balance-to-GDP ratio). Bars indicate the 90th percent confidence intervals.

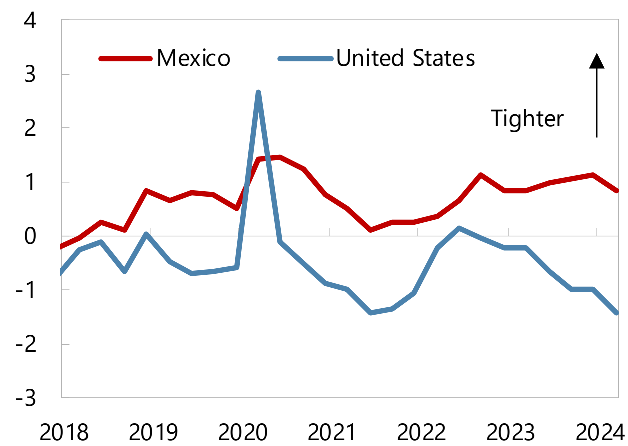
[1] Arizala, Francisco, Santiago Bazdresch, and Tomohide Mineyama (forthcoming), "Impact of Fiscal Policy on Inflation Expectations," *IMF Working Paper*.

C. Safeguarding Financial Stability

26. Systemic vulnerabilities in the banking system are moderate. The financial system has high capital and liquidity buffers, low private sector leverage, and little sign of stretched asset prices. Recent supervisory stress tests show bank capital remains above the regulatory minimum even in a significantly stressed environment, although some smaller banks could fall below the regulatory minima. Nonetheless, loan concentration, exposures to contingent credit lines, and the banks' comparatively large exposure to sovereign debt merit continued supervisory attention. Lower corporate local debt and sovereign USD spreads have translated into a modest easing of financial conditions index (FCI). The household sector has generally low levels of leverage and relatively strong balance sheets. Recently conducted cybersecurity exercises have helped enhance the capacity of regulators and banks to appropriately respond to cyber vulnerabilities. Credit unions, multiple-purpose financial companies, financial cooperatives, and microfinance intermediaries all carry out credit intermediation and are subject to lesser prudential requirements than the banks. Banxico stress tests indicate that some of these NBFIs would struggle with sustained high interest rates. However, these firms total only 4 percent of system assets, do not take deposits, and have little connection to the banking system. As such, they represent a limited systemic risk.

Financial Conditions Index

(Number of standard deviations over the long-term average)



Sources: Bloomberg Finance L.P.; Haver Analytics; National Data Sources, and IMF staff calculations.
Note: The IMF FCI is designed to capture the pricing of risk. It incorporates various pricing indicators, including real house prices. Balance sheet or credit growth metrics are not included. Higher values of FCIs indicate tighter conditions. For details, please see Online Annex 1.1 in the October 2018 *Global Financial Stability Report*.

27. There is scope to strengthen the macroprudential and oversight framework in several areas (Annex IV)**:**

- Publishing a macroprudential strategy, including guidelines for when the counter-cyclical capital buffer would be deployed.
- Continuing to closely monitor risks from loan concentration and contingent credit lines and apply Pillar 2 requirements to address relevant risks, if needed.
- Authorizing the banking regulator to supervise financial conglomerates on a consolidated basis.
- Removing barriers to using purchase and assumption and/or bridge bank instruments during bank resolution.
- Broadening the resolution regime to include financial holding companies.
- Continuing to strengthen cybersecurity preparedness especially regarding strategy, oversight, and information sharing.
- Improving the resourcing of regulatory agencies and the legal protection of supervisors.

28. Continued vigilance is warranted to prioritize the fight against organized crime and related illicit financial flows. Mexico recently updated its AML/CFT National Risk Assessment (NRA) to highlight the risks from organized crime groups operating in the country and the expansion of their activities beyond narcotrafficking. There has also been a considerable investment in identifying illicit flows. While the 2023 NRA includes preliminary proposals, Mexico would benefit from updating its policy priorities commensurate with the identified risks and the potential macroeconomic impact of financial crimes and organized crime. Weaknesses identified in the 2018 AML/CFT evaluation should be addressed, including the need for better coordination among relevant authorities and for improving the supervision of financial and non-financial institutions that can be misused by organized crime (including by improving the transparency of beneficial ownership information, in line with the updated FATF standards).

29. Authorities' views. The authorities assess the financial system to remain resilient to a range of stress test scenarios. Banks have ample lending capacity given higher-than-regulatory liquidity ratios and non-performing loans remain low. They noted that despite the challenges faced by a few NBFIs in recent years, the sector remains small, with limited exposure to banks. While some of the recommendations of the 2022 FSAP have been implemented, others—like providing centralized oversight of financial conglomerates and enhancing regulatory agencies' autonomy— are still in progress awaiting legal changes. Regarding market-wide cyber crisis simulation exercises, they noted that two exercises have taken place with the support of the IMF thus far, and further exercises are planned for the coming years involving financial market infrastructures and other financial sectors. The authorities also emphasized legal improvements to the AML/CFT framework and reaffirmed their commitment to strengthening its practical effectiveness. They highlighted that, in 2024, the CNBV developed two guidelines, to prevent illicit financial activities during elections and to address the financing of weapons proliferation. More recently, a reform to Article 115 of the Credit Institutions Law has also been published, aiming to increase legal certainty ahead of FATF's 5th Mutual Evaluation. This reform is expected to extend to other sectors, including fintech, promoting financial inclusion and mitigating money laundering and terrorist financing risks.

D. Securing High and Sustained Growth

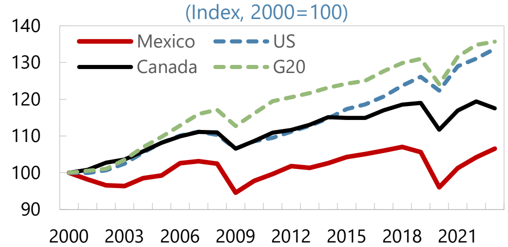
30. Mexico is benefitting from the ongoing reshaping of global supply chains. While geopolitical fragmentation, on average, adversely affects the global economy, Mexico has been a beneficiary given its proximity to the U.S. market and its membership of the USMCA. Mexico has already increased its share of U.S. imports and become more integrated into global supply chains (Annex XI). Improving the environment for private investment and business development would help capitalize on the benefits of this dynamic, while minimizing the potential vulnerabilities to adverse shocks. Priorities include streamlining regulations, addressing critical infrastructure gaps (especially in transport, water, and energy), strengthening worker skills, and raising female labor force participation. Greater regional market integration, including by improving infrastructure and connectivity between the north and south, would allow for growth spillovers to be more evenly distributed across the country (Box 3).

Box 3. Regional Integration and Growth in Mexico[1]

Per capita growth of the Mexican economy has lagged behind G20 peers in past decades, with notable disparities between the north and south. Forthcoming staff analysis revisits these issues. Drawing on the Law of One Price (LOOP) literature, it considers how regional market integration could affect regional growth. It finds that while market integration has increased in most states over time, the degree of integration differs across states and is consistent with regional growth inequalities, with faster-growing states more integrated into the national economy. The analysis also reaffirms the importance of human and physical capital—measured by years of schooling and road infrastructure—for growth, highlighting the important role that high-quality government investment can play in boosting growth and tackling inequality in Mexico.

GDP Per Capita

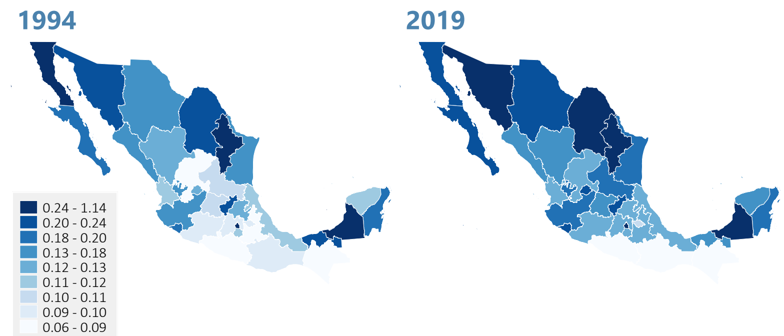
(Index, 2000=100)



Sources: WEO, and IMF staff calculations.
Note: GDP as GDP PPP 2017 International Dollars per capita.

Mexico: GDP per Capita

(In millions of 2018 Pesos)



Sources: INEGI, Banxico, and IMF staff calculations.
Note: Percentiles were calculated using 1994 GDP data.

An analysis of spillover effects finds that the level of integration of a state's neighbors into the national economy, as well as their income level, is positively correlated with a state's growth, indicating positive spillover effects to nearest neighbors. At the same time, a lack of nation-wide income convergence suggests that the spillovers are regionally clustered, in line with the observation that Mexican states experienced income divergence in the late 1990s after the introduction of NAFTA. While further work is needed to understand the drivers of market integration, these results are suggestive of deep path dependence in Mexico, with high-performing states more integrated with one another and increasingly diverging from the rest of the country. Given the existing sizable income disparities across regions, the redistributive role that government could play is further underscored.

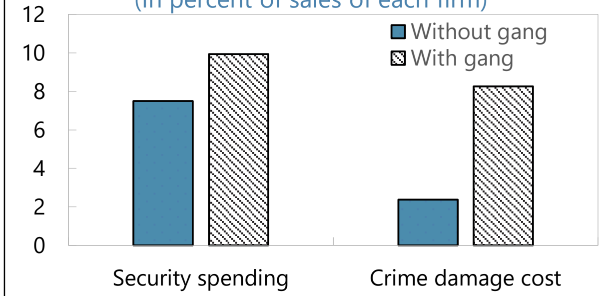
[1] Based on Fonseca et al. (forthcoming), *IMF Working Paper*.

31. Open trade policies have delivered significant benefits to the Mexican economy and should be maintained. As a temporary measure to counter unfair competition, tariffs on imports from non-FTA countries (around 3 percent of imports) were increased in April 2024, to between 5 and 50 percent. While the direct macroeconomic impact of these higher tariffs is limited, they could risk distorting trade and investment decisions and trigger retaliatory responses by trading partners. This policy runs counter to maintaining an open and rules-based system of international trade and should be reversed.

32. Crime, insecurity, and corruption are key constraints to new investment and job creation. Homicides have exceeded 20,000 per year since 2010, and extortion, theft, and corruption are widespread. Violent crime is seen to have a differentiated impact on male and female labor force participation, respectively (Annex XII). Crime, corruption, and a weak rule of law also impose sizable operating costs on firms and discourage firm growth (Annex XIII). Around 25 percent of firms and 29 percent of households indicated they were affected by crime and insecurity, with security costs averaging about 9 percent of firms' sales. Data from the Corruption Perception Index and the World Justice Project indicate little progress has been made in reducing the prevalence of corruption, and Mexico continues to lag its peers in both the rule of law and control of corruption. Finally, the judiciary is perceived to lack independence due to corruption, political interference, and pressures from organized crime, which significantly weakens property rights and contract enforcement.

Cost of Crime and Gangs

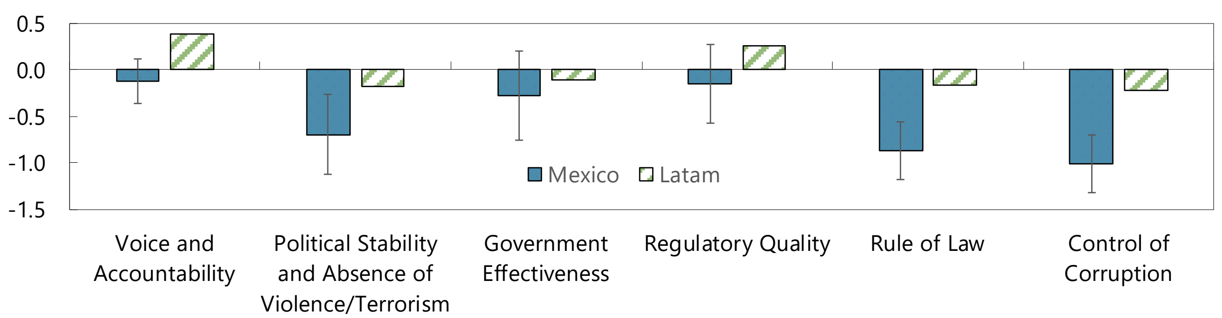
(In percent of sales of each firm)



Sources: ENVE, Economic Census, and IMF staff calculations.

Worldwide Governance Indicators, 2022

(Index)



Sources: Daniel Kaufmann (Natural Resource Governance Institute and Brookings Institution) and Aart Kraay (World Bank), and IMF staff calculations.

Note: Use of these indicators should be considered carefully, as they are derived from perceptions-based data. Whiskers report 95 percent confidence interval. These are not available for the Latam average.

33. Further legal reforms and robust enforcement are critical to address corruption risks. The 2015 National Anticorruption System, 2019 National Anticorruption Policy, and operationalization of the Executive Secretariat of the National Anti-Corruption System (SESNA) are key foundations of Mexico's anticorruption infrastructure, contributing to enhancing coordination of anticorruption efforts at the federal and state levels. Needed legal reforms include the adoption of a whistleblower protection law (which is currently awaiting parliamentary debate) and disclosure of beneficial ownership information in public procurement. Additionally, risk-based verification of asset declarations by the Secretariat of the Civil Service would boost the capacity to detect corruption. Training of specialized anticorruption prosecutors and investigators in financial investigations could also be improved. As a volunteer country for the assessment of transnational aspects of corruption, the authorities should continue mitigating risks of foreign bribery and laundering of proceeds of foreign corruption.

34. The recent constitutional amendment represents a significant change to the judiciary (Box 4)**.** To avoid policy uncertainty adversely affecting delivery of justice as well as private investment decisions, implementation—including via secondary legislation—should maintain strong safeguards on judicial professionalism and independence, which would help maintain fair adjudication of commercial disputes and contract enforcement, and protect property rights.

35. There is scope for further development of online payment systems. An underdeveloped digital payment ecosystem, regulatory hurdles, and a cultural preference for cash transactions has slowed Mexico's adoption of online payment systems in digital banking. There is scope to provide a more favorable regulatory environment for new entrants (Annex XIV).

Box 4. Recent Changes to the Judiciary

A constitutional amendment on the judiciary, which entered into force on September 16, requires all federal judges—including those in the Supreme Court, as well as circuit and district courts—to be elected by popular vote. Other main changes comprise:

- *Changes to the court*. The number of judges in the Supreme Court is reduced from eleven to nine. Judges will be elected for 12 years (reduced from the current 15-year appointment), with re-election not permitted. The President of the Supreme Court will have a two-year tenure, with the position rotating based on the number of votes obtained by the nine justices. Lower court judges will be elected to a nine-year term, with one consecutive re-election allowed.
- *Qualifications for a position*. The current system where promotions are contingent on experience and having passed qualification exams will be retired. Candidates now need to be residents of Mexico for at least two years, possess a law degree with certain minimum grades, and have at least five years of relevant professional experience.
- *Selection of candidates*. From a list of qualified applicants, up to six candidates will be chosen for each position—two by the President, two by Congress, and two by the Supreme Court. Candidates will then run for popular vote in the appropriate jurisdiction (either in the court's jurisdiction or country-wide for the Supreme Court). Applicants cannot be members of political parties and are not eligible to receive either public or private funding for their campaigns.
- *Establishment of a judiciary tribunal*. A Court of Judicial Discipline will be created, with all five members elected by popular vote for a six-year term in 2025. This body will be empowered with investigating and potentially sanctioning members of the judiciary for breaches of a judicial code of conduct.
- *Elections*. After a 60-day campaign period, the first elections will be held in June 2025 for all the judges for the Supreme Court, Superior Court, and the Electoral Judiciary Tribunal, as well as one-half of the approximately 1600 judges in the local circuit and district courts. The remaining half of lower court judges will be elected in September 2027.

36. Broadening access to financial services, including through new innovations, would help mobilize private savings. Credit-to-GDP is relatively low, and only a small portion of the population has access to bank accounts. Recent efforts to increase the number of bank branches and improve transparency of financial products are welcome. Strengthening the registry of movable assets to facilitate their use as collateral and eliminating obstacles to collateral recovery, including through strengthening of the functioning of the judicial system would be important. Since credit to women have lower NPL rates, the recent introduction of risk management regulations to reduce gender gaps in credit supply have the potential to increase the financial inclusion of women without adding to credit risks (Annex XV).

37. Authorities' views. Mexican firms have benefitted from the relocation of global supply chains, boosting exports to the U.S. under the USMCA. The authorities saw recent FDI announcements as encouraging, while stressing the need to monitor and support their materialization. They noted that FDI inflows are driven by Mexico's stable political and economic environment, trade agreements, skilled workforce, and geographic advantages, with the U.S. and other advanced economies remaining key sources of investment. To support growth in regions with weaker economic outcomes, especially those suitable for investment that could provide strategic resources (water and energy), the authorities emphasized policies that enhance financial inclusion, such as those to improve women's access to credit and to formal financial products, along with the development of digital payments systems and mechanisms for information exchange and delivery. While acknowledging challenges like crime and insecurity, they remain committed to strengthening institutional frameworks, enforcing laws effectively, and addressing corruption in the judiciary to improve the business climate. The authorities underscored that the recent legal reforms aim to make the justice system more transparent and accessible, with mechanisms to ensure high ethical standards for judges through independent oversight. The comprehensive reform packages aim to enhance governance by strengthening the rule of law, improving regulatory quality, and implementing anti-corruption measures, thereby fostering a more secure environment for investment and growth. The authorities also reaffirmed that the government would uphold rights to dissent and free expression while ensuring human rights, freedom, and democracy.

REVIEW OF FCL

A. Review of Qualification

38. Mexico continues to meet the qualification criteria for an FCL arrangement. Notwithstanding the fiscal expansion in 2024, Mexico has a sustained track record of implementing strong macroeconomic policies and continues to have very strong economic fundamentals and institutional policy frameworks. Staff does not see substantive changes in qualification since the approval of the 2023 FCL arrangement (see Text Table).

- *Sustainable external position*. The external position in 2023 was moderately stronger than the level implied by medium term fundamentals and desirable policies (Annex I). The external debt sustainability analysis projects external debt-to-GDP ratio to remain stable in 2024 thanks to continued robust remittance and FDI inflows, despite the recent depreciation (Annex III. C). The composition of external debt is favorable as around 30 percent of public sector external debt is peso-denominated, reducing the exposure to FX depreciation. FX risks of private sector external debt are also well covered by natural and financial hedges. Public sector external debt has a long duration with modest refinancing risks.

- *A capital account position dominated by private flows*. Private flows, underpinned by relatively stable FDI, remain dominant in the overall balance of payments flows. Public flows accounted for only 25 percent of total flows on average over the last three years, lower than the FCL's threshold of 50 percent.[1]

- *A track record of steady sovereign access to capital markets at favorable terms*. Mexico retains investment grade with all major rating agencies and did not lose market access at any point in the last year. Mexico's EMBI+ sovereign spread dropped to 149 basis points, in line with its pre-pandemic average. The cumulative public sector issued or guaranteed external bonds or disbursements of public and publicly guaranteed external commercial loans in international markets during the last five years is equivalent to about 360 percent of Mexico's IMF quota and over 570 percent including state-owned enterprises, well above the FCL threshold of 50 percent. The FCL's requirement of continued access to international markets during at least three of the last five years is also satisfied.

- *A comfortable international reserve position*. Over three (current and two previous) years, Mexico's gross international reserves are projected to stand on average at 121 percent of the ARA metric, exceeding the FCL threshold of 100 percent. The metric did not fall below 80 percent in any of these three years (hovering around 120 percent). Mexico also retains its swap line of US$3 billion with the Federal Reserve associated with the North American Framework Agreement, and one of US$9 billion with the U.S. Treasury.

- *Sound public finances, including a sustainable public debt position*. Fiscal policy is underpinned by a sound institutional budgetary framework, including the fiscal responsibility law, and capacity to implement effective policy responses to shocks. While the framework has helped enforce compliance with debt objectives, transparency and accountability of fiscal policymaking could be enhanced via a clearer link between the desired public debt level to annual budgetary decisions. The authorities met the balanced-budget rule requirement in 2023, with the PSBR outcome higher than the target approved in the budget in large part due to the increased cost of inflation-linked debt. The authorities are on track to meet the balanced-budget rule target in 2024.[2] Gross public sector debt is projected to stabilize around 58 percent over the medium

[1] Public flows are calculated as the sum of the absolute values of reserve assets flows, and portfolio and other asset and liability flows by general government and central bank. Total flows are calculated as the sum of the absolute values of direct, portfolio, and other asset and liability flows as well as the absolute value of net reserve asset flows. Private flows are the difference between total and public flows.

[2] Under the current fiscal framework, the authorities are required to maintain a balanced budget on their traditional balance (see Table 2), after discounting physical investment.

term, conditional on the needed adjustment being undertaken. Staff assesses Mexico's public debt to be sustainable with high probability (Annex III).

- *A sound monetary and exchange rate policy framework have supported low inflation*. Monetary policy has consistently remained focused on maintaining inflation and inflation expectations anchored around the central bank's inflation objective, delivering single-digit inflation since 2000. Banxico reduced its policy rate for the first time in a year in March 2024 and signaled that future rate decisions will be data dependent, with policy stance consistent with achieving the 3 percent inflation target over the projected horizon. The authorities have also reiterated their determination to maintain their flexible exchange rate framework.

- *A well-capitalized and liquid financial system remains robust to systemic risks*. Capital positions of Mexican banks remain strong, as Tier 1 capital ratio stood at 18.8 percent and non-performing loans (NPL) were 2.1 percent of total gross loans by end-2023. There continues to be little indication of stretched asset valuations and the financial system generally presents limited private sector leverage and strong buffers for bank capital and liquidity. The banking system proved resilient to a variety of macro-financial shocks in the solvency and liquidity stress tests carried out under the 2022 FSAP, although for some smaller banks with concentrated business lines would need extra reserves to withstand such pressures. While some non-bank financial intermediaries (NBFIs) continue to face difficult lending circumstances, due to their reliance on wholesale funding, banks' exposure to these intermediaries is relatively low.

- *Effective financial sector supervision*. The 2022 FSAP notes that the government's efforts to tighten banking regulation and oversight have shown significant results. Basel criteria were followed by the introduction of D-SIB buffers and capital and liquidity tools. The authorities have committed to implementing the 2022 FSAP recommendations and have made progress on some of the 2022 FSAP's proposals. The banking industry's Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) regulatory system does not highlight any significant issues. Mexico has also made progress with a number of technical compliance problems that were brought up in the Financial Action Task Force's (FATF) 2018 Mutual Evaluation Report. The banking regulator's (CNBV) inability to revoke or suspend a banking license for AML/CFT violations and the CNBV's requirement to strengthen its risk-based supervision to focus more on cross-border illicit flows through banks and money remitters are among the remaining areas for improvement.

- *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 2021 data ROSC update. Mexico has subscribed to the Special Data Dissemination Standards (SDDS) since August 1996 and has performed well in meeting SDDS requirements.

- *Track record*. Mexico continues to have a sustained track record of implementing very strong policies. Staff assesses that all relevant core indicators have been met in each of the five most recent years.

Summary of Qualification Assessments			
	2022 Mid-Year Review 1/	**2023 FCL Request 1/**	**2024 Mid-Year Review**
1. A sustainable external position (EBA assessment at least "moderately weaker").	Broadly in line	Moderately stronger	Moderately stronger
2. A capital account dominated by private flows (share of private flows in total capital flows>50 percent, on average over the last three years).	88 percent	79 percent	75 percent
3. A track record of steady sovereign access to sovereign markets at favorable terms (public sector bonds issued or loans disbursed in international markets in at least 3 of the last 5 years; cumulative amount during the last 5 years>50 percent of the country's quota at the Fund).	700 percent of quota	570 percent of quota	570 percent of quota
4. A comfortable reserve position (reserves>100 percent of ARA metric, on average over three (the current and the two previous years).	127 percent	125 percent	121 percent
5. Sound public finances (debt sustainable with high probability).	Debt is sustainable with high probability	Debt is sustainable with high probability	Debt is sustainable with high probability
6. Low and stable inflation (inflation in single digits in the last 5 years preceding qualification).	4.7 percent[2]	5.1 percent[2]	5.2 percent[2]
7. Sound financial system (the average capital adequacy ratio for the banking sector>regulatory thresholds;[3] no significant solvency risks or recapitalization needs).	Tier 1 capital ratio stood at 17.3 percent. No significant solvency risks or recapitalization needs.	Tier 1 capital ratio stood at 18.0 percent. No significant solvency risks or recapitalization needs.	Tier 1 capital ratio stood at 18.8 percent. No significant solvency risks or recapitalization needs.
8. Effective financial sector supervision (no substantial concerns regarding the supervisory framework.).	No substantial concern in supervisory framework	No substantial concern in supervisory framework	No substantial concern in supervisory framework
9. Data transparency and integrity (an SDDS subscriber or has made satisfactory progress toward meeting the SDDS requirements).	SDDS subscriber	SDDS subscriber	SDDS subscriber

1/ Reported indicators are those available at the time of the request and review, respectively.
2/ Headline and core inflation, as well as inflation expectations, are in single digits in each of the five years.
3/ The threshold for Tier 1 capital ratio is 6 percent.

39. The quality of institutions relevant to FCL qualification is very strong, despite the presence of some weaknesses in governance and corruption areas. Mexico has strong macroeconomic institutions and policy management, and a track record of policy implementation, including timely monetary policy tightening and countercyclical fiscal responses during the pandemic that underpins the assumed fiscal consolidation in 2025 (and expectations of countercyclical policies in the period ahead). The institutional quality of economic policy is underpinned by an inflation-targeting framework, a flexible exchange rate regime, a fiscal responsibility law, and an effective prudential and regulatory framework for financial supervision. However, weaknesses remain in other areas such as crime, corruption, and the rule of law, with measures undertaken as described in ¶33. Addressing outstanding gaps in the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) framework and enhancing collaboration between the various AML/CFT agencies and anti-corruption bodies would represent an important step forward. These vulnerabilities, however, do not hamper Mexico's ability to respond to shocks.

40. Staff completed the safeguards procedures for Mexico's 2023 FCL arrangement based on the FY2022 audited financial statements. KPMG Cárdenas Dosal, the external auditor, issued an unmodified (clean) audit opinion on these financial statements, which were published on the Banxico website in a timely manner. No significant issues emerged from the conduct of these procedures. In addition, staff recently reviewed the FY2023 audited financial statements and noted no substantial matters.

B. Access Consideration

41. In view of sizable external risks amid lingering uncertainty, the authorities are not requesting a change in access for this review. At the time of the approval of the FCL arrangement last year, the authorities had requested a reduction in access from 400 percent to 300 percent of quota based on an assessment that external risks remained sizable though lower than in earlier years. They had then intended to revisit appropriate access in the context of the mid-term review, assessing the evolution of external risks as part of their gradual, state-contingent exit strategy. While risks are broadly balanced, external downside risks remain sizable (¶13). The analysis of the external stress index indicates that external risks remain broadly unchanged from the last year, with the main risks stemming from the dynamics of the U.S. economy and changes in global financial market conditions associated with risk aversion towards emerging market economies (Box 5). In this context, the authorities consider the current access to remain appropriate to ensure a timely and adequate buffer to mitigate external risks should they materialize. They intend to continue to treat the FCL arrangement as precautionary. Mexico's capacity to repay the Fund remains strong.

Box 5. Calculation of the External Economic Stress Index

This box presents the external economic stress index (ESI) for Mexico.[1] The methodology for the index presented below is in line with that for the past FCL arrangements, while the current index excludes oil price from proxy variables given the fact that the oil trade balance now registers a small deficit (hence lower oil prices tend to improve the current account) as oil exports diminished recent years. As the weight for oil prices in the past indexes was small (0.03 at the time of the 2023 FCL request), the impact of the change is marginal.

Risks. There are two key risk factors relevant for the Mexican economy. First, Mexico's exports, remittances, and inward FDI are closely related to economic developments in the U.S. Second, the open capital account and the significant stock of debt and equity portfolio investment held by foreigners expose Mexico to changes in global financial conditions, including risk aversion towards emerging market economies.

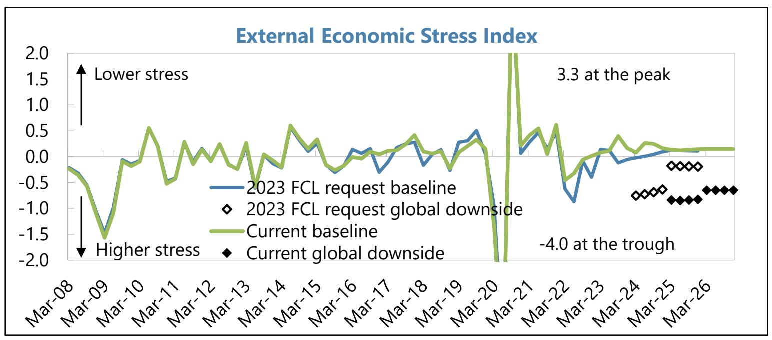
Box 5. Calculation of the External Economic Stress Index (concluded)

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 markets volatility index (VXEEM), respectively.

Weights. The weights are data-based using balance of payments and international investment position data in 2023. The weight on U.S. growth (0.58) corresponds to the sum of exports, FDI, and remittances; the weights on the change in the U.S. long-term yield (0.27) and the VXEEM (0.15) correspond to the stocks of foreign debt and equity, respectively. The weights are calculated as shares in the sum of these variables.

Baseline scenario. This scenario corresponds to the October 2024 WEO projections for U.S. growth and the U.S. 10-year bond yield. The VXEEM is assumed to remain constant over the projection period. The ESI under the baseline scenario indicates that the level of risks is somewhat lower (the ESI is higher) than that in the 2023 FCL request due to stronger U.S. growth.

Global downside scenario. This scenario is based on the downside scenario in the October 2024 WEO, which consists of five layers of global risks relevant for Mexico: (i) a global increase in tariffs; (ii) greater trade policy uncertainty; (iii) taxation of business income in the United States; (iv) reduction in migration flows to the United States and Europe; and (v) tightening in global financial conditions. Under the scenario, the VXEEM is assumed to rise by 3 standard deviations as assumed in previous FCL arrangements. This scenario leads to a sizable deterioration in the stress index in 2025. The impact is expected to persist in 2026, reflecting the lasting effects of policy changes considered in the scenario. The level of stress in the first year of the scenario is at the more or less similar level to the downside scenario of the 2023 FCL request.



Country-specific external downside scenario. Mexico could be affected by new disruptions in global value chains and an abrupt drop in FDI and capital flows, given its close relations with the U.S. Upcoming election in the U.S. could introduce additional uncertainty.

Note: The ESI reflects an assessment of the size of risks, with a lower value indicating a higher level of risks. Proxy variables are calculated by using the mean and standard deviation between 1995 and 2023. The sharp increase in the index (or a decline in stress) in the second half of 2020 reflects a technical rebound in U.S. growth after its sharp contraction in the first half.

[1] The methodology is explained in *Flexible Credit Line—Operational Guidance Note*, IMF Policy Paper, August 2018. The calculation of the index requires 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.

STAFF APPRAISAL

42. Economic activity is moderating, and inflation is decelerating. The macroeconomic position is sound due to Mexico's sustained track record of very strong policies and policy frameworks. External buffers remain strong, public debt is sustainable with a high probability, and the external position is moderately stronger than the level implied by medium-term fundamentals and desirable policies.

43. The authorities' stated commitment to fiscal restraint is welcome. Their plan to initiate an important fiscal consolidation in 2025 to lower the deficit to below 3 percent of GDP over the medium term should help safeguard fiscal sustainability. The 2025 budget should focus on reducing tax expenditures, reassessing tax rates and thresholds, improving tax administration, and rationalizing expenditure. A medium-term fiscal strategy is needed to reduce the deficit along these lines to contain debt, reduce inequities in the pension system, and create fiscal space for investments in human and physical capital. This will require identification and implementation of additional fiscal measures, preferably including a comprehensive tax reform early in the administration and phasing out fuel subsidies.

44. A review of policies regarding support for Pemex would enhance the credibility of the government's fiscal plans. Additional support should be conditioned on Pemex developing a viable business strategy and improving its corporate governance. This could include focusing Pemex activities on profitable fields, selling non-core assets, developing a new strategy for unprofitable refinery operations, and incentivizing public-private partnerships.

45. Banxico should continue to remove monetary restraint gradually. The central bank's timely response has managed to anchor medium-term inflation expectations and facilitated a smooth process of disinflation. Inflation dynamics have justified Banxico's decision to remove monetary restraint gradually, contingent on clearer evidence that inflation is heading decisively back to its target.

46. There is scope to boost the effectiveness of monetary policy by further enhancing Banxico's communication toolkit. Building on their recent reforms, Banxico could further strengthen its institutional framework by publishing transcripts of monetary policy meetings with a shorter lag, providing greater information on the assumptions—including the policy rate path—that underpin the authorities' inflation and activity projections, and further tailoring central bank communication to different audiences, emphasizing that the information being provided is not a policy commitment.

47. A flexible exchange rate should continue to be an integral part of Mexico's policy framework. Given Mexico's deep and liquid FX market, limited FX balance sheet mismatches, and a range of available natural and financial FX hedges, the peso remains an essential tool to facilitate a smooth adjustment of the economy in the face of external and domestic shocks.

48. Progress has been made in financial sector supervision. The financial system is resilient to a range of shocks. Efforts to implement the recommendations of the 2022 FSAP should continue, including via upgrading the macroprudential toolkit and enhancing the autonomy and resources of regulatory agencies. Addressing outstanding gaps in the Anti-Money Laundering/Combatting the Financing of Terrorism (AML/CFT) framework would be important.

49. Mexico is well placed to take advantage of opportunities arising from the ongoing reshaping of global value chains. Mexico has benefited from strong demand from the U.S. in the wake of the pandemic and is receiving robust FDI inflows, which are leveraging Mexico's developed manufacturing system, availability of human capital, and favorable access to the U.S. market under the USMCA. Mexican industry is, as a result, increasingly integrated into global value chains connected to the U.S. generating significant domestic value added. Maintaining open trade policies will continue to underpin business investment and bolster Mexico's international competitiveness.

50. Taking advantage of these prospects, however, requires a wide-ranging set of supply-side reforms. Regulatory reforms, better-targeted public investment that further relieves infrastructure bottlenecks—including a more predictable supply of energy and water—and broader access to financial services, would all support private sector-led growth.

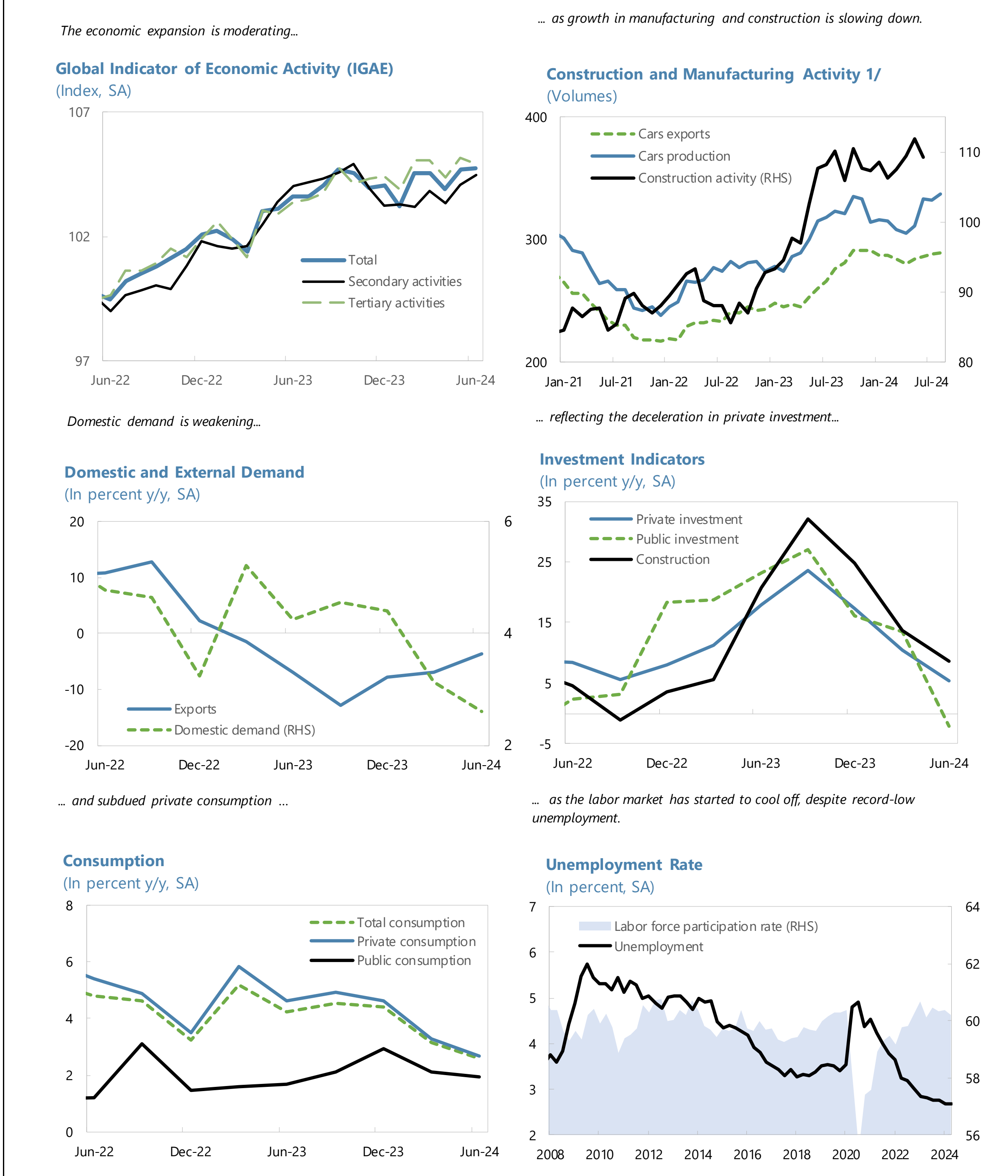
51. Addressing crime, insecurity, and corruption would spur investment and job creation. Governance reforms should prioritize establishing a robust asset declaration system, adequate legal protections for whistleblowers, and improve the effectiveness of anti-corruption institutions. Strong safeguards are needed to ensure that commercial disputes are fairly adjudicated, and contracts and property rights are enforceable. Recent judicial reforms should be implemented in a clear and predictable way that ensures the independence and professionalism of the judiciary and strengthens the rule of law.

52. Further deepening of financial intermediation would make growth more inclusive. The recent development of fintech products and digital payments have expanded access to financial products. In addition, financial regulations that lower loan-loss provisioning for female borrowers have increased women's access to credit. These efforts could be complemented by expanding the adoption of digital payment systems and eliminating institutional barriers to entry for new products and entities that are deemed to be financially sound.

53. Mexico continues to meet the qualification criteria for access to FCL resources. The incoming authorities remain firmly committed to maintaining their track record of very strong macroeconomic policies and institutional policy frameworks going forward. Along with sizable international reserves, the FCL has provided the authorities with valuable insurance. Consistent with their exit strategy, they are not requesting a reduction in access at this review given continued-high external risks. Staff recommend completion of the review under the FCL arrangement for Mexico.

54. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

Figure 1. Mexico: Real Sector Indicators

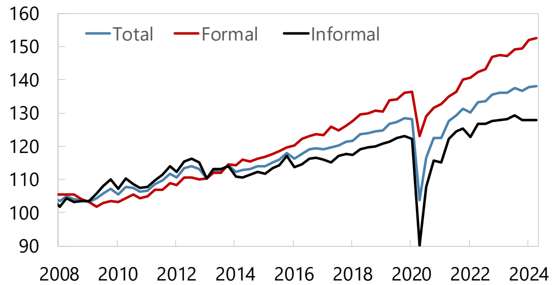


Sources: National authorities, INEGI, Haver Analytics and IMF staff calculations.
1/ Manufacturing activity corresponds to Manufactruring Economic Activity (IGAE). Car production and exports refer to the 6-month moving average.

Figure 2. Mexico: Labor Market Indicators

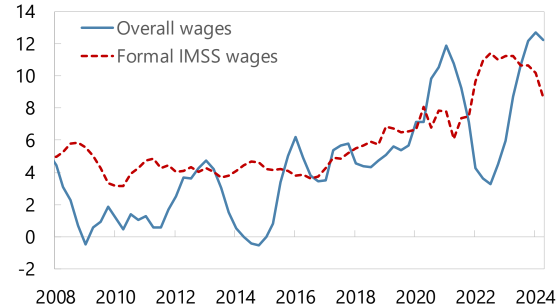
Formal jobs recovered more strongly than informal ones after the pandemic.

Total, Formal and Informal Employment
(Index, 2006=100)



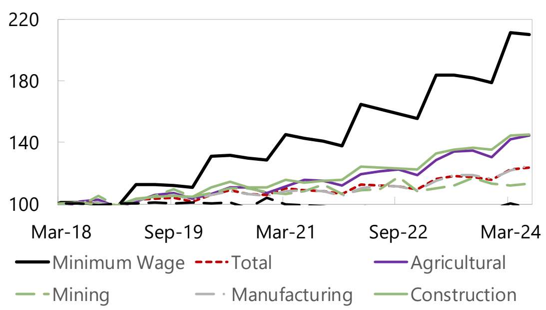
Nominal wages have experienced robust growth...

Average Nominal Wages
(Y/Y growth)



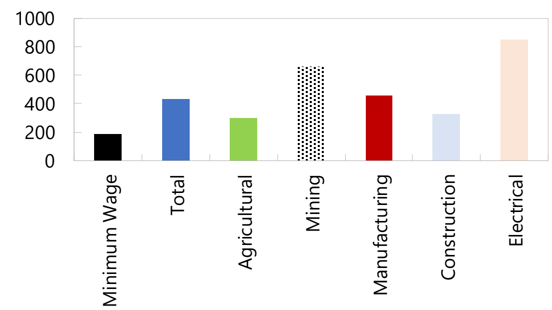
... including a significant increase in the minimum wage.

Minimum Wage and Formal Sector Salaries
(Index, 2018=100)



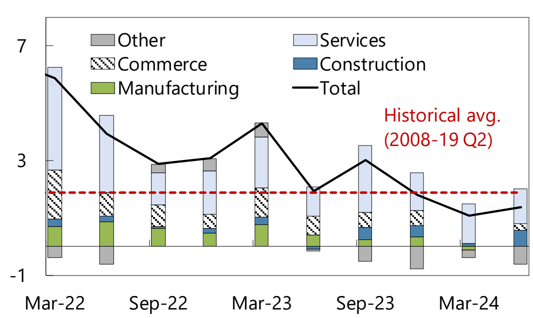
Wages in mining and electrical sectors are the highest.

Minimum Wage and Formal Sector Salaries
(In real pesos, 2024Q2)



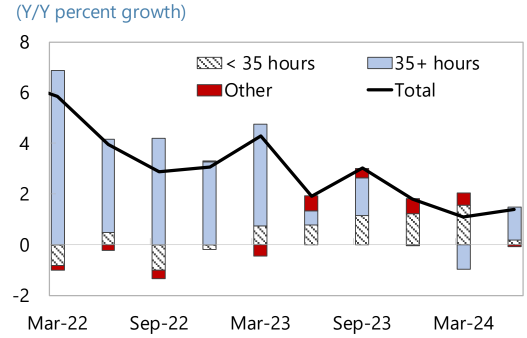
However, employment growth is slowing down...

Contributions to Employment Growth by Sector
(Y/Y percent growth)



... with less full-time jobs being created.

Contributions to Employment Growth by Hours
(Y/Y percent growth)



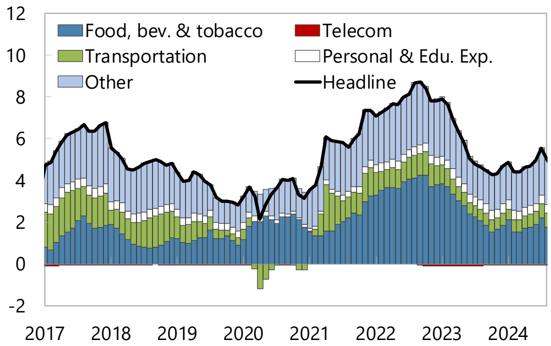
Sources: National Authorities, Haver Analytics, and IMF staff calculations.

1/ Unit Labor Cost as Unit Labor Cost Real Effective exchange rates, which was calculated taking the 4-quarter moving average.

Figure 3. Mexico: Prices and Inflation

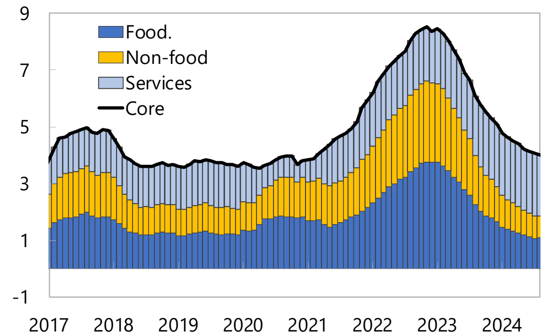
Headline inflation is receding.

Contributions to Headline Inflation
(Y/Y, in percent)



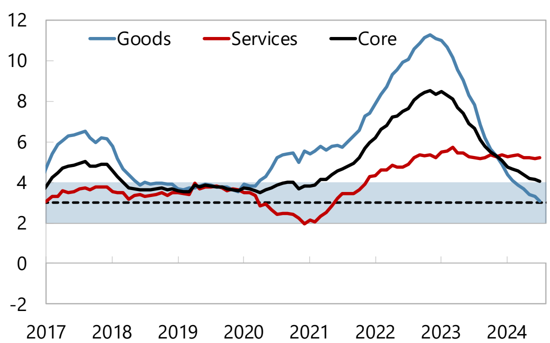
Mainly driven by core-goods inflation…

Contributions to Core Inflation
(Y/Y, in percent)



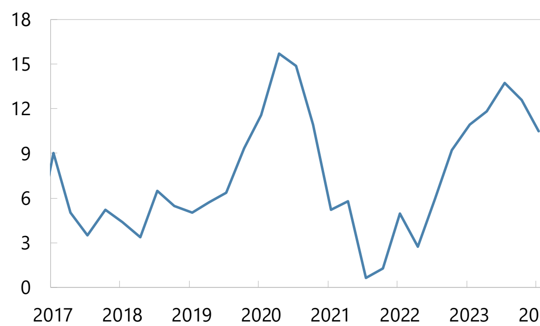
… while services inflation has remained broadly unchanged.

Inflation
(In percent)



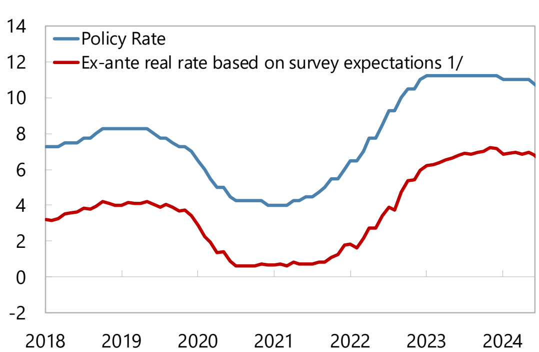
… supported by strong wage growth.

Wages
(In percent growth, Y/Y)



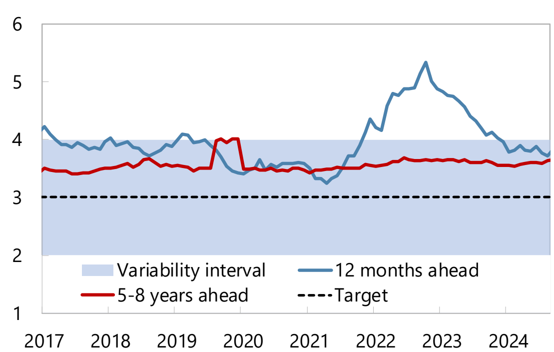
Banxico tightened monetary policy in a timely manner…

Policy Rates
(In percent)



… contributing to anchoring inflation expectations.

Inflation Expectations
(In percent)



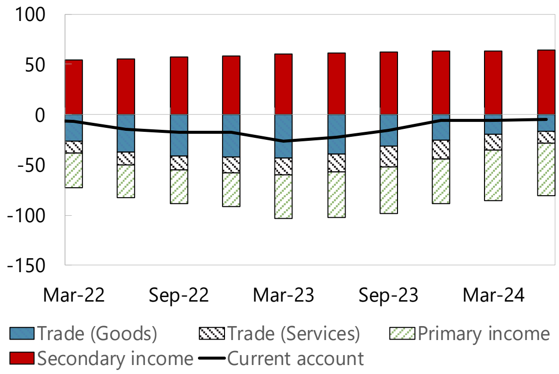
Sources: National Authorities, Haver Analytics, Banxico, and IMF staff calculations.

1/ Calculation using the average inflation expectation for the next 12 months (NSA, %). Source: Banco de México. Survey on the Expectations of Private Sector Economists.

Figure 4. Mexico: External Sector

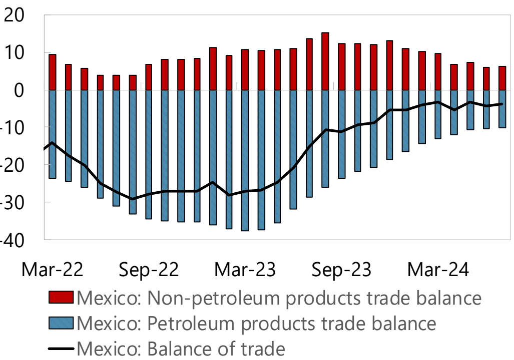
The current account is supported by remittances flows.

Current Account Balance
(In USD billions, 12 months cumulative sum)



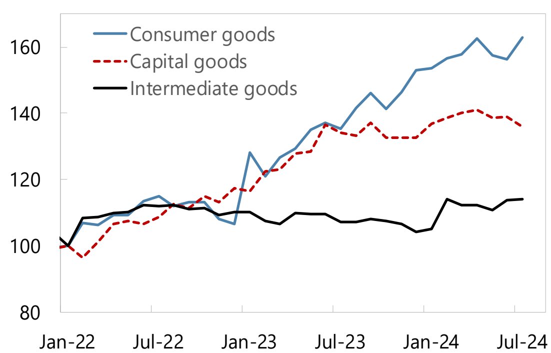
The trade deficit is driven by the oil balance.

Trade Balance
(In USD billions, NSA-12 months cumulative sum)



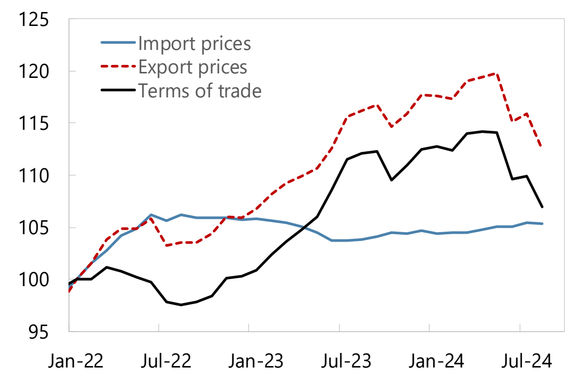
Consumption and capital goods imports have been strong.

Non-Oil Imports
(Index, Jan 2022=100, SA)



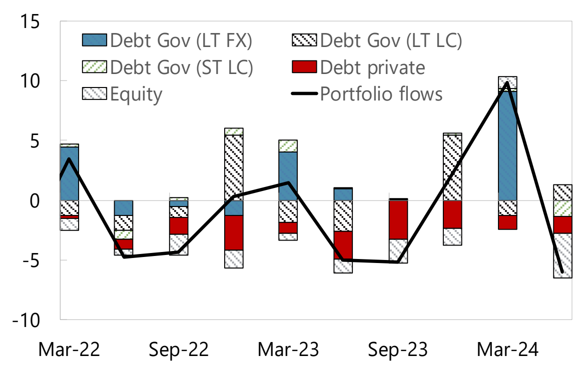
The terms of trade have remained broadly stable.

Terms of Trade
(Index, Jan 2022=100)



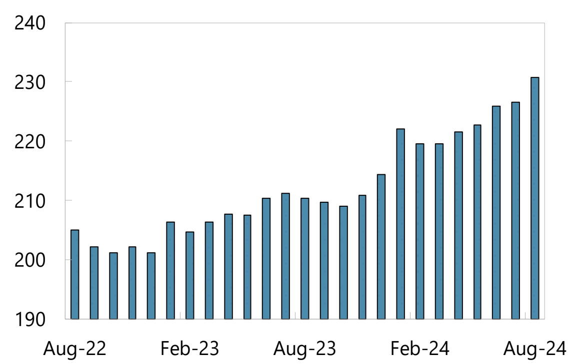
Government bonds issuance was robust in early 2024.

Portfolio Liability Flows
(In USD billions, +: inflows)



Gross international reserves continue to rise.

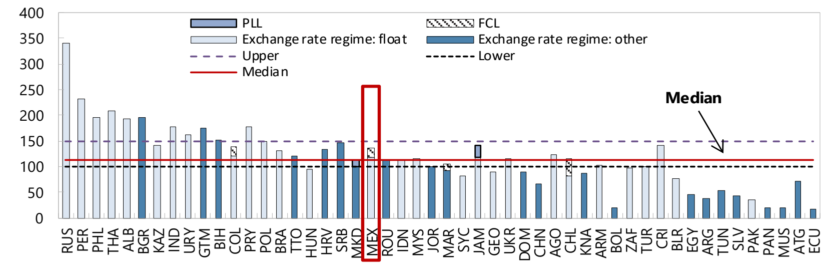
Gross International Reserves
(In USD billions)



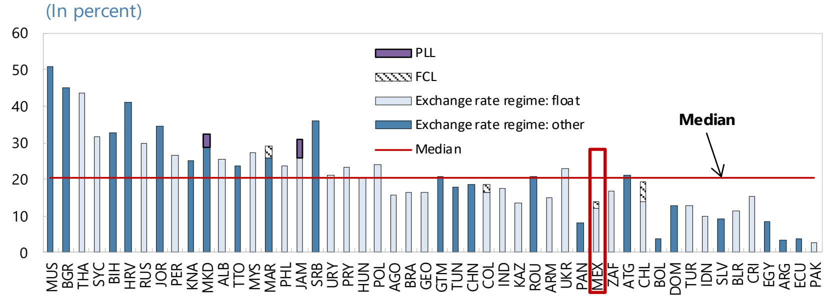
Sources: National Authorities, Haver Analytics, and IMF staff calculations.

Figure 5. Mexico: Reserve Coverage and FCLs in an International Perspective 1/

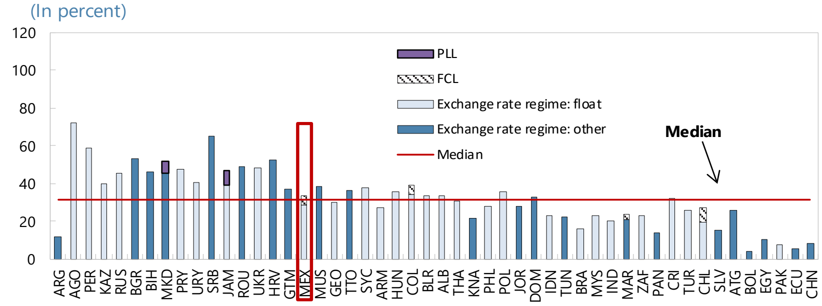
GIR to ARA Metric, end-2023 2/3/4/
(In percent)



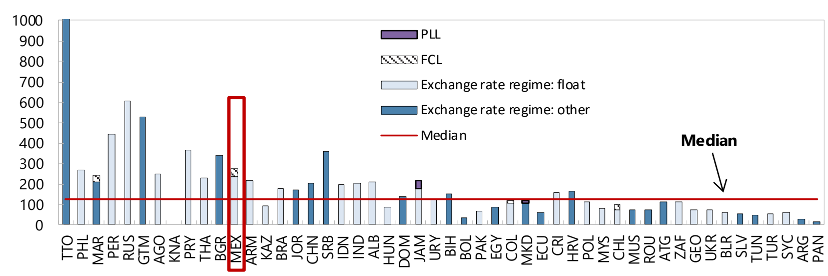
GIR to GDP, end-2023
(In percent)



GIR to Broad Money, end-2023
(In percent)



GIR to Short-term External Debt at Remaining Maturity plus Current Account Deficit (end-2023) 5/
(In percent)



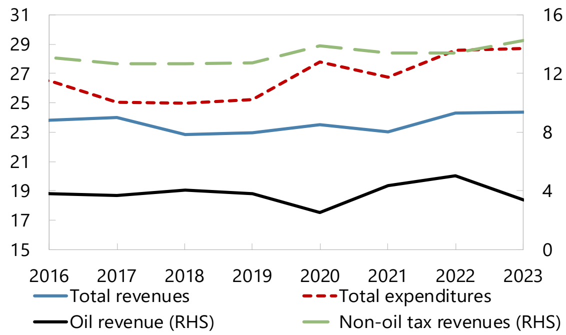
Sources: World Economic Outlook; IFS; and IMF staff estimates.
1/ The sample includes all EMEs for which data is available.
2/ The ARA metric helps inform reserve adequacy assessments, but individual circumstances (for example, access to swap lines, market maturity, etc.) require additional judgment and, for this reason, mechanistic comparisons of the ARA metric do not provide a complete view.
3/ The ARA Metric is a weighted sum of potential drains on the BoP, depending on the country's exchange rate regime. For fixed exchange rates, ARA Metric = 10% × Exports + 10% × Broad Money + 30% × Short-term Debt + 20% × Other Liabilities. For floating exchange rates, ARA Metric = 5% × Exports + 5% × Broad Money + 30% × Short-term Debt + 15% × Other Liabilities. See "Guidance Note on the Assessment of Reserve Adequacy and Related Considerations", IMF, 2016.
4/ The upper and lower lines denote the 100-150 percent range of ARA metric, which are considered broadly adequate for precautionary purposes.
5/ The current account balance is set to zero if it is in surplus.

Figure 6. Mexico: Fiscal Sector

Expenditures have recently increased.

Public Sector Revenues and expenditures

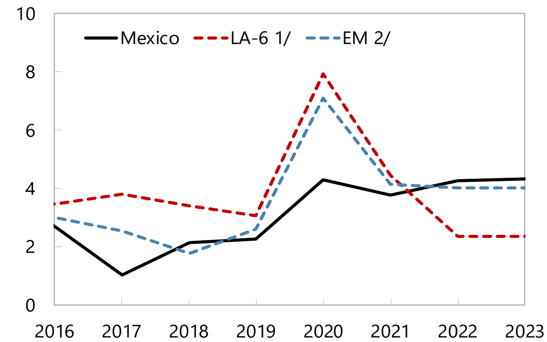
(In percent of GDP)



The deficit in Mexico has been in line with other EMs.

Overall Public Sector Deficit

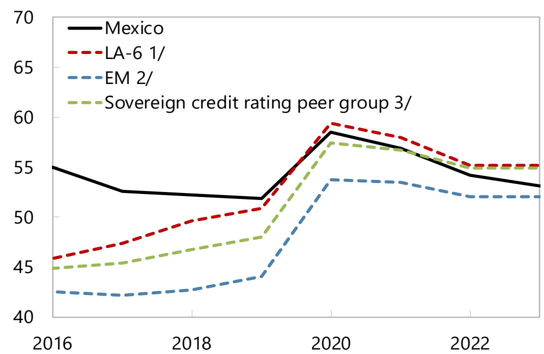
(In percent of GDP)



Public debt has declined more than among regional peers.

Gross Public Sector Debt

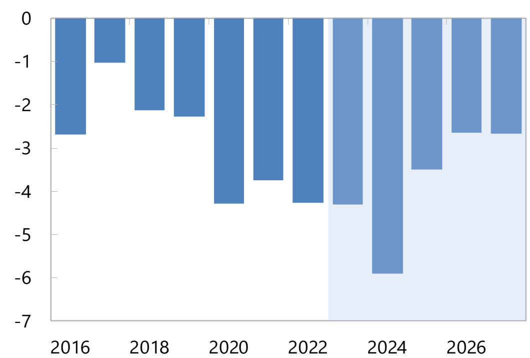
(In percent of GDP)



The deficit widened in 2024.

Fiscal Balance

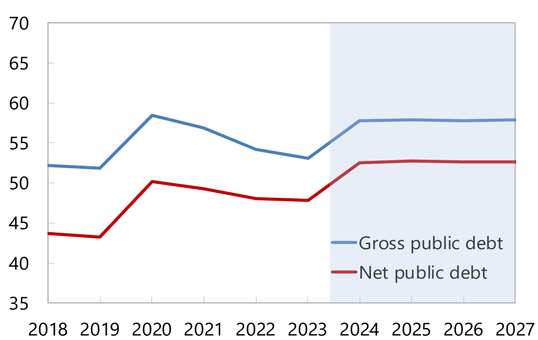
(In percent of GDP)



Public debt is projected to remain below 60 percent of GDP over the medium-term.

Public Sector Debt

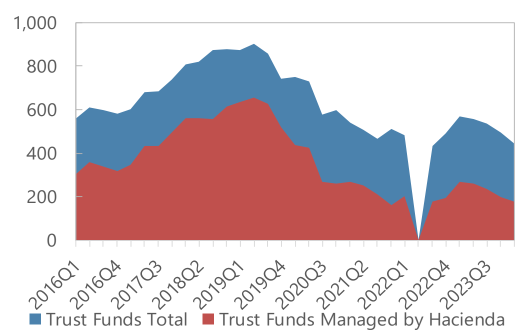
(In percent of GDP)



The trust funds were depleted during the pandemic, but have recovered since.

Trust Funds Managed by Secretaría de Hacienda

(As of June 2024, in billions of pesos)



Sources: National authorities, World Economic Outlook, Fitch Ratings, and IMF staff calculations.

1/ LA-6 excluding Mexico is comprised of Brazil, Chile, Colombia, Peru, and Uruguay.

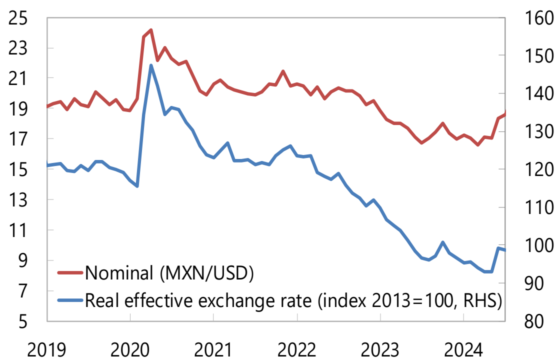
2/ EM comparator group is comprised of India, Indonesia, Poland, Russia, Thailand, and Turkey.

3/ Fitch sovereign credit rating peer group includes Brazil, Chile, Colombia, India, Poland, Russia, South Africa, Thailand, and Turkey.

Figure 7. Mexico: Financial Markets

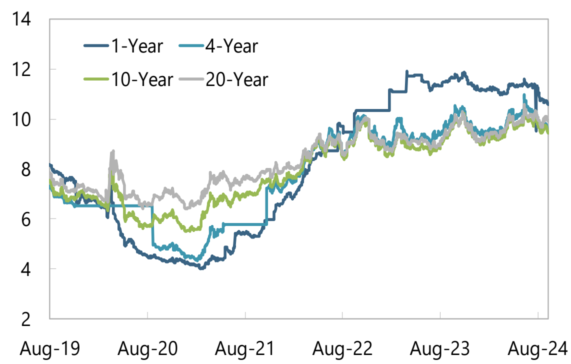
Following a sustained appreciation trend, the peso faced pressures in mid-2024

Exchange Rate
(As of August, 2024)



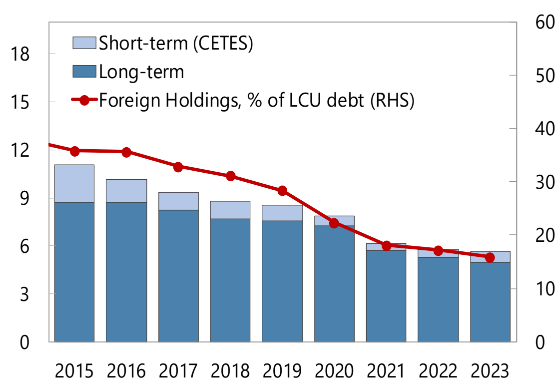
Shorter-dated yields have risen in response to policy hikes, leading to a reversal in the yield curve

Local Government Bonds Yields
(In percent; as of September, 2024)



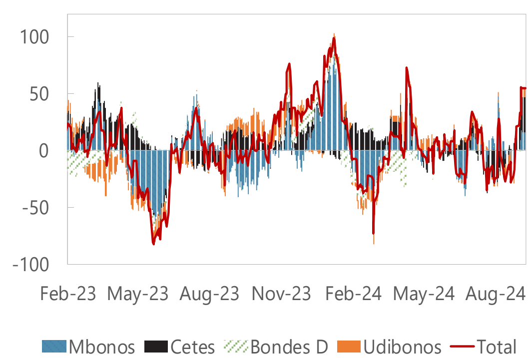
The share of peso-denominated bonds held by foreigners has continued to decline, but at a slower pace than prior years

Sovereign Debt Holdings in Local Currency
(In percent of GDP; December, 2023)



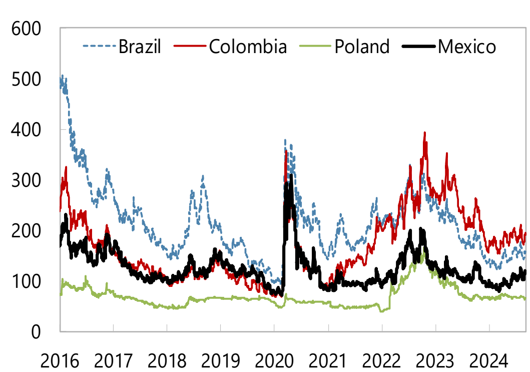
Flows have been stable, and fairly balanced across bond types

Foreign Inflows in Local Currency Debt 1/
(30 day Moving Sum, MXN bn)



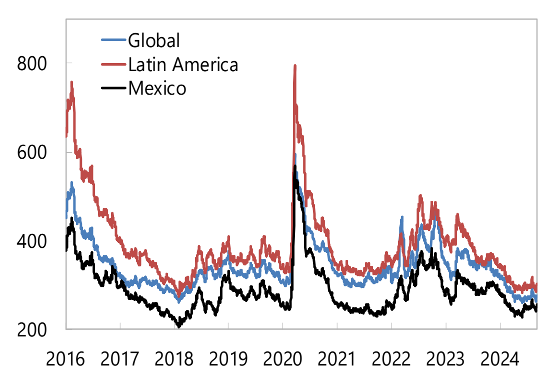
Mexico's sovereign spreads remain below regional peers

Sovereign Risk Spreads
(5Y CDS spread, in basis points; as of September 10, 2024)



Spreads on dollar-denominated corporate bonds have been mostly stable over the past year

Corporate Risk Spread
(CEMBI spread, in basis points; as of September 10, 2024)



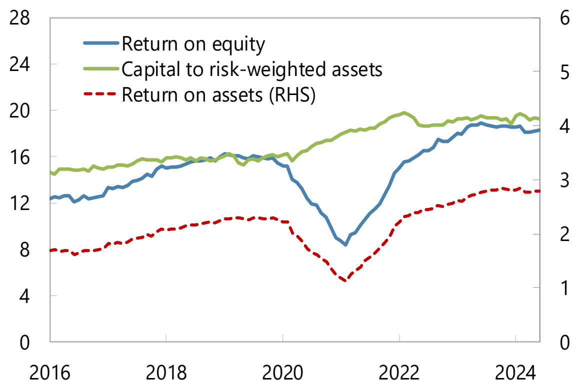
Sources: Bloomberg, Haver Analytics, National authorities, and IMF staff calculations.
1/ Flows associated with Pemex transaction on 11/20/2020 have been removed.

Figure 8. Mexico: Banking System

Bank capital has continued to improve and profitability has more than recovered from the pandemic downturn.

Commercial and Development Banking Sector

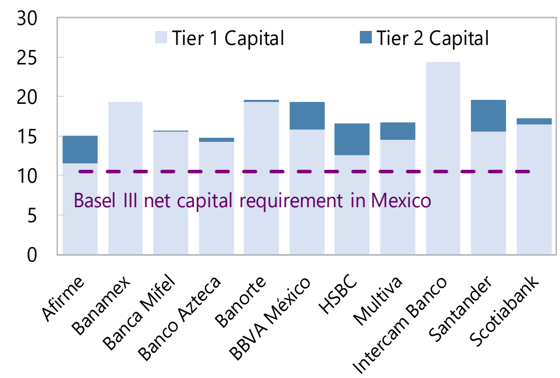
(In percent; as of July, 2024)



All major banks continue to exceed capital requirements.

Capital to Risk-Weighted Assets

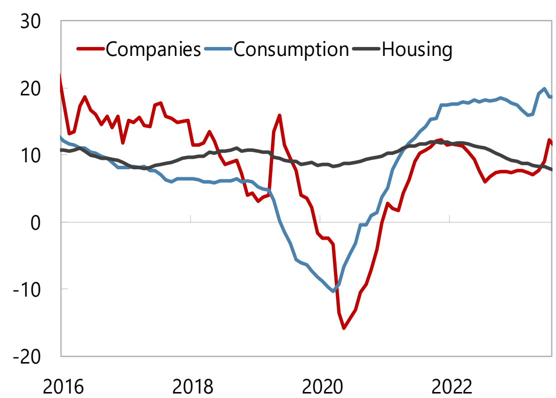
(In percent; as of July, 2024)



Consumption credit has rebounded.

Commercial Bank Credit Growth by Sector

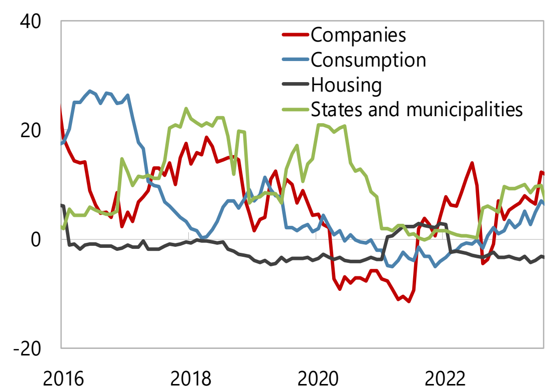
(Y/Y growth, nominal; as of August, 2024)



Development banks credit has recently accelerated.

Development Bank Credit Growth by Sector

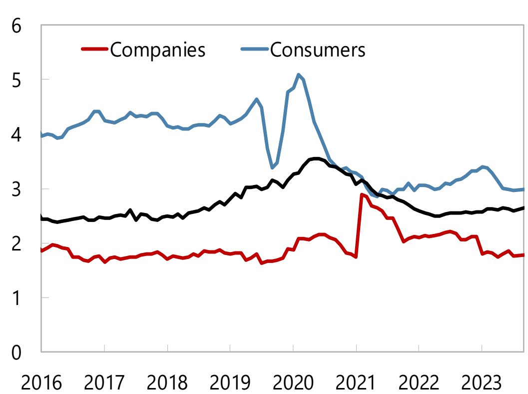
(Y/Y growth, nominal; as of August, 2024)



Non-performing loans have stabilized recently among commercial banks ...

Total Commercial Bank NPLs

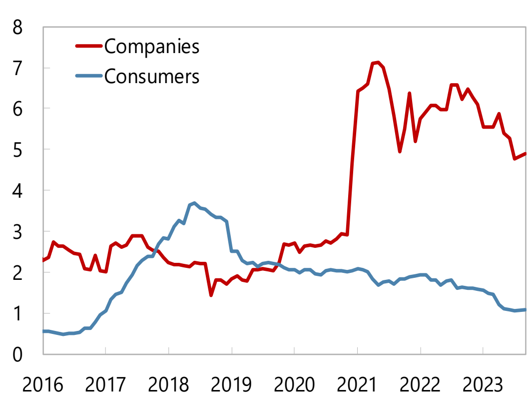
(In percent of outstanding loans; as of August, 2024)



...as well as among development banks.

Total Development Bank NPLs

(In percent of oustanding loans; as of August, 2024)



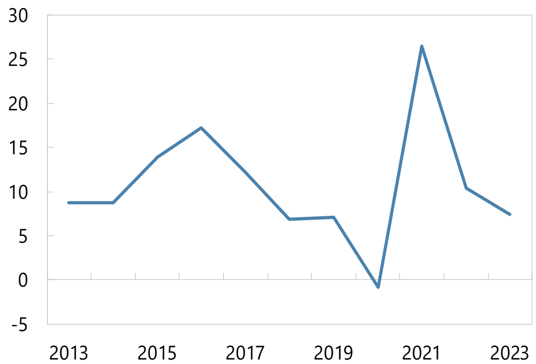
Sources: Bloomberg, Haver Analytics, National authorities, and IMF staff calculations.

Figure 9. Mexico: Nonfinancial Corporate Sector

Profitability is converging towards the pre-pandemic average.

EBITDA Growth

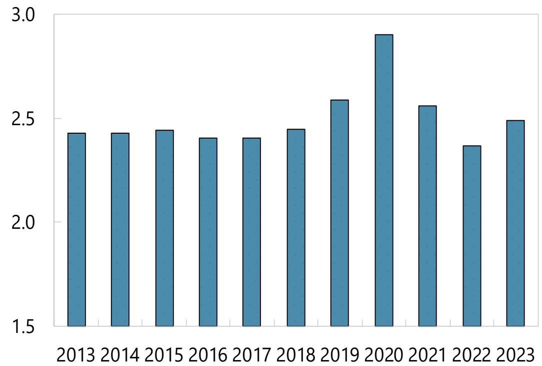
(In percent change, Y/Y median)



Leverage has remained broadly unchanged.

Total Debt to Total EBITDA

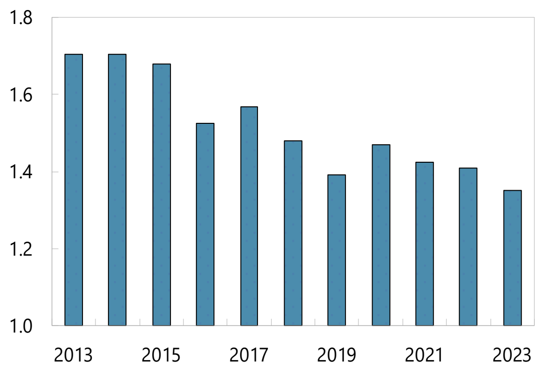
(In percent, median)



The current ratio has steadily declined.

Current ratio: Current Assets to Current Liabilities

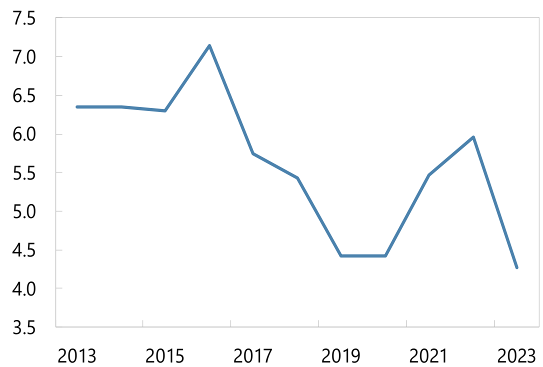
(Multiples, median)



Debt servicing capacity has weakened.

Interest Coverage Ratio

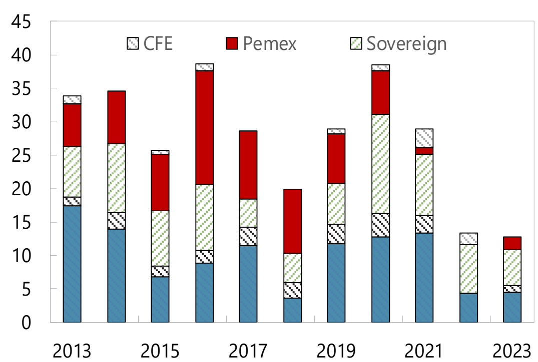
(Earnings in multiples of Interest Expense, median)



Issuance in hard currency has been subdued.

Hard Currency Issuance

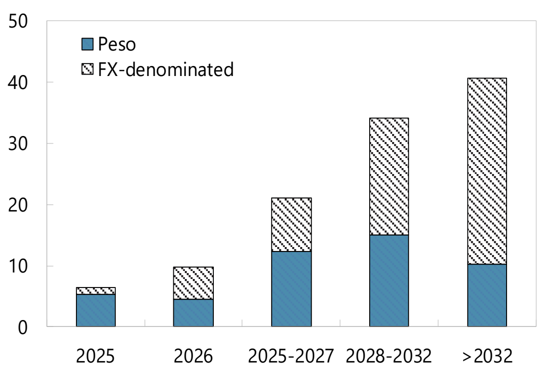
(In USD billions)



Near-term maturities are only a small portion of corporate debt.

Nonfinancial Corporate Bond Maturity Profile

(In USD billions)



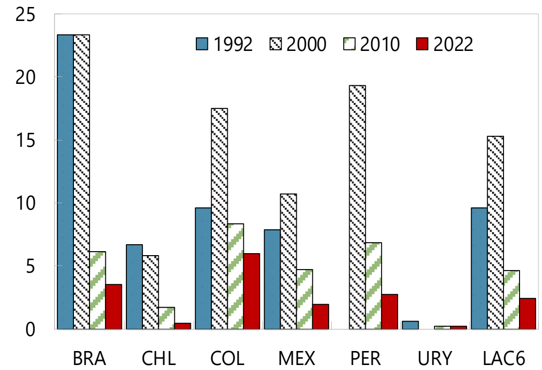
Sources: Bloomberg, Haver Analytics, National authorities, and IMF staff calculations.

Figure 10. Mexico: Social Indicators in a Regional Context

Extreme poverty has declined over the past 25 years...

Poverty Headcount Ratio at $2.15

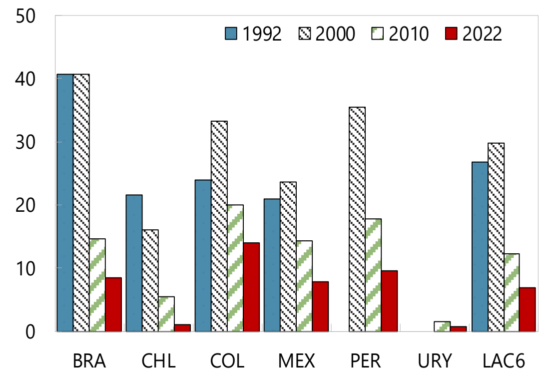
(2017 PPP, percent of population)



... poverty has also fallen.

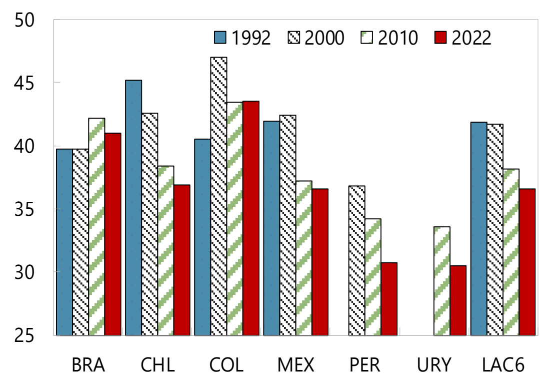
Poverty Headcount Ratio at $3.65

(2017 PPP, percent of population)



Income inequality has improved.

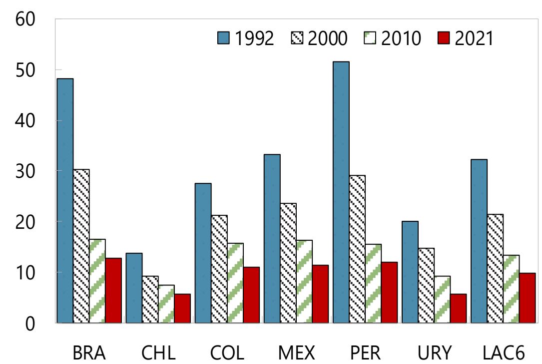
Income Share Held by Highest 10 Percent



Infant mortality rates have declined.

Infant Mortality Rate

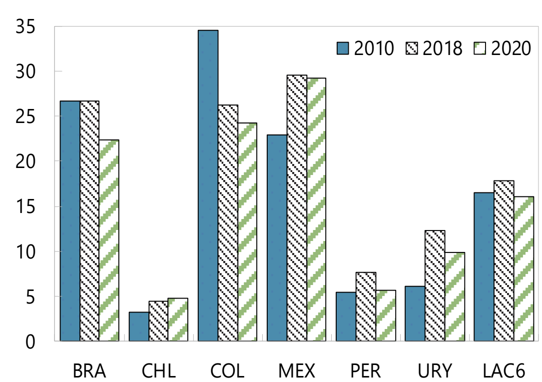
(Per 1,000 live births)



The homicide rate remains high.

Intentional Homicides

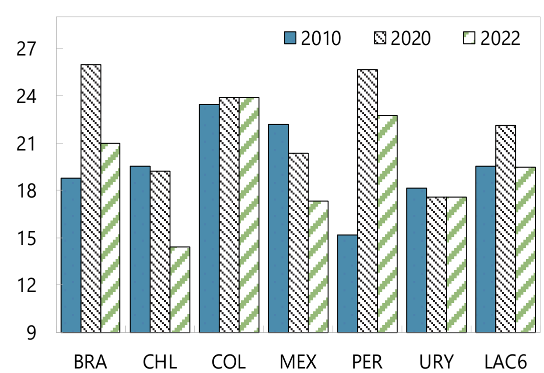
(Per 100,000 people)



The share of youth not employed or attending school has fallen.

Share of Youth not in Education, Employment or Training

(Total, percent of youth population)



Source: World Development Indicators.

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

I. Social and Demographic Indicators

GDP per capita (U.S. dollars, 2023)	13,643.3	Poverty headcount ratio (% of population, 2023) 1/	37.0
Population (millions, 2023)	131.1	Income share of highest 20 perc. / lowest 20 perc. (2022)	8.4
Life expectancy at birth (years, 2024)	75.5	Adult literacy rate (2020)	95.2
Infant mortality rate (per thousand, 2023)	13.6	Gross primary education enrollment rate (2022) 2/	102.0

II. Economic Indicators

					Proj.					
	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
(Annual percentage change, unless otherwise indicated)										
National accounts (in real terms)										
GDP	-8.4	6.0	3.7	3.2	1.5	1.3	2.0	2.3	2.1	2.1
Consumption	-8.6	7.1	4.5	4.6	1.0	0.9	2.2	2.3	2.1	2.0
Private	-9.8	8.4	4.9	5.0	1.0	0.9	2.2	2.3	2.0	2.0
Public	-0.7	-0.5	1.7	2.1	1.2	1.1	2.0	2.4	2.4	2.4
Investment	-18.3	11.4	7.4	17.8	4.0	3.8	3.0	2.3	2.0	2.0
Fixed	-17.2	10.5	7.5	18.0	5.0	3.0	3.0	2.3	2.0	2.1
Private	-18.6	12.6	7.7	17.6	5.3	3.2	3.1	2.3	2.0	2.0
Public	-5.7	-3.5	5.8	20.9	3.8	1.2	2.4	2.3	2.3	2.3
Inventories 3/	-0.3	0.2	0.0	0.0	-0.2	0.2	0.0	0.0	0.0	0.0
Exports of goods and services	-7.0	7.1	8.9	-7.4	-0.6	3.3	2.5	3.5	3.5	3.5
Imports of goods and services	-12.0	15.7	7.6	5.0	1.1	2.3	3.2	3.3	3.1	3.1
GDP per capita	-9.1	5.4	2.9	2.3	0.6	0.5	1.2	1.5	1.4	1.4
External sector										
External current account balance (in percent of GDP)	2.4	-0.3	-1.2	-0.3	-0.7	-0.9	-1.0	-1.0	-1.0	-1.0
Exports of goods, f.o.b. 4/	-9.4	18.6	16.7	2.6	1.4	3.6	4.6	4.9	4.9	4.9
Imports of goods, f.o.b. 4/	-15.9	32.0	19.6	-1.0	3.0	4.6	5.1	5.1	4.8	5.0
Net capital flows (in percent of GDP) 5/	0.8	-1.0	-0.9	-0.9	-1.9	-1.4	-1.4	-1.4	-1.4	-1.4
Terms of trade (goods, improvement +)	0.8	-1.0	-3.1	16.9	-1.7	-0.3	0.7	-0.4	-0.3	-0.4
Gross international reserves (in billions of U.S. dollars)	199.1	207.7	201.1	214.4	235.0	244.8	252.8	260.9	269.3	278.0
Exchange rates										
Real effective exchange rate (avg, appreciation +) 6/	-7.7	5.9	5.3	16.4	...	...	...	...	...	...
Nominal exchange rate (MXN/USD) (eop, appreciation +)	-5.9	-3.2	5.7	12.8	...	...	...	...	...	...
Inflation, Employment and Population										
Consumer prices (end-of-period)	3.2	7.4	7.8	4.7	4.5	3.2	3.0	3.0	3.0	3.0
Core consumer prices (end-of-period)	3.8	5.9	8.3	5.1	4.0	3.1	3.0	3.0	3.0	3.0
Formal sector employment, IMSS-insured workers (average)	-2.5	1.9	4.3	3.6	...	...	...	...	...	...
National unemployment rate (annual average)	4.4	4.1	3.3	2.8	3.0	3.3	3.4	3.5	3.6	3.6
Unit labor costs: manufacturing (real terms, average)	10.4	4.4	11.8	1.9	...	...	...	...	...	...
Total population 7/	0.8	0.6	0.8	0.9	0.9	0.8	0.8	0.7	0.7	0.6
Working-age population 7/	1.1	1.0	1.1	1.2	1.1	1.0	0.9	0.8	0.8	0.7
Money and credit										
Financial system credit to non-financial private sector 8/	0.9	4.2	10.9	8.7	8.0	7.5	6.2	6.0	5.9	5.7
Broad money	13.4	9.5	7.3	11.0	7.8	7.3	5.9	5.7	5.7	5.4
Monetary policy rate	4.25	5.50	10.50	11.25	10.00	8.00	6.50	6.50	6.50	6.50
Public sector finances (in percent of GDP) 9/										
General government revenue	23.5	22.9	24.3	24.4	24.2	23.8	23.4	23.2	23.0	22.9
General government expenditure	27.8	26.6	28.6	28.7	30.1	27.3	26.1	25.9	25.6	25.6
Overall fiscal balance	-4.3	-3.7	-4.3	-4.3	-5.9	-3.5	-2.7	-2.7	-2.7	-2.7
Structural primary balance 10/	0.6	1.2	0.9	1.1	-1.1	0.9	1.6	1.6	1.4	1.3
Fiscal impulse 11/	0.5	-0.5	0.2	-0.2	2.2	-2.0	-0.8	0.1	0.2	0.1
Gross public sector debt	58.5	56.7	54.1	53.0	57.6	57.9	57.8	57.9	58.0	58.2
Memorandum items										
Nominal GDP (billions of pesos)	24,087	26,690	29,473	31,772	34,313	36,766	38,917	41,081	43,341	45,608
Output gap (in percent of potential GDP)	-2.8	-2.0	0.0	1.2	0.6	-0.1	-0.2	0.0	0.0	0.0

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 Fund staff estimates.

1/ CONEVAL uses a multi-dimensional approach to measure 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. CONEVAL estimates at 2023Q4.
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/ Excludes goods procured in ports by carriers.
5/ Excludes reserve assets
6/ Based on IMF staff caluclations.
7/ Based on CONAPO population projections.
8/ Includes domestic credit by banks, nonbank intermediaries, and social housing funds.
9/ Data exclude state and local governments and include state-owned enterprises and public development banks.
10/ Adjusting revenues for the economic and oil-price cycles and excluding one-off items, in percent of potential GDP.
11/ Negative of the change in the structural primary fiscal balance.

Table 2. Mexico: Statement of Operations of the Public Sector, Authorities' Presentation 1/
(In percent of GDP)

	2021	2022	2023	Proj. 2024	2025	2026	2027	2028	2029
Budgetary Revenue, By Type	**22.3**	**22.4**	**22.2**	**21.6**	**21.3**	**21.0**	**20.8**	**20.7**	**20.7**
Oil revenue	4.3	5.0	3.4	3.3	3.1	3.0	2.8	2.6	2.5
Non-oil tax revenue	13.4	12.9	14.2	14.2	14.1	14.1	14.1	14.2	14.2
Non-oil non-tax revenue	4.6	4.4	4.5	4.0	4.0	3.9	3.9	3.9	3.9
Budgetary Revenue, By Entity	**22.3**	**22.4**	**22.2**	**21.6**	**21.3**	**21.0**	**20.8**	**20.7**	**20.7**
Federal government revenue	16.2	16.3	16.4	16.0	15.8	15.8	15.7	15.8	15.7
Tax revenue, *of which:*	13.4	12.9	14.2	14.2	14.1	14.1	14.1	14.2	14.2
Excises (including fuel)	1.5	0.4	1.4	1.7	1.7	1.8	1.8	1.9	1.9
Nontax revenue	2.8	3.3	2.2	1.8	1.6	1.6	1.6	1.6	1.5
Public enterprises	6.2	6.1	5.7	5.6	5.5	5.2	5.1	5.0	4.9
PEMEX	3.0	2.9	2.3	2.4	2.2	2.1	2.0	1.8	1.7
Other	3.2	3.3	3.4	3.2	3.3	3.1	3.1	3.1	3.2
Budgetary Expenditure	**25.2**	**25.6**	**25.6**	**26.6**	**24.0**	**22.9**	**22.8**	**22.7**	**22.6**
Primary	22.7	22.9	22.3	23.0	22.3	22.1	21.7	21.7	21.6
Programmable	19.2	19.2	18.6	19.3	18.5	18.3	18.0	17.9	17.8
Current	14.8	14.9	14.9	15.7	15.1	15.1	14.8	14.9	14.9
Wages	5.1	4.8	4.8	5.1	4.8	4.8	4.6	4.6	4.6
Pensions 2/	3.9	4.0	4.1	4.4	4.4	4.5	4.6	4.7	4.8
Subsidies and transfers	3.1	3.2	3.5	3.8	3.7	3.6	3.5	3.5	3.4
Other	2.7	2.8	2.5	2.4	2.3	2.2	2.2	2.1	2.1
Capital	4.4	4.3	3.6	3.6	3.4	3.2	3.1	3.0	2.9
Physical capital	2.6	3.2	2.8	3.0	2.9	2.8	2.6	2.6	2.5
Financial capital 3/	1.8	1.2	0.8	0.5	0.5	0.5	0.5	0.4	0.4
Nonprogrammable	3.5	3.6	3.7	3.7	3.8	3.8	3.8	3.8	3.8
Of which: revenue sharing	3.4	3.6	3.6	3.7	3.7	3.7	3.7	3.7	3.6
Interest Payments	**2.6**	**2.8**	**3.3**	**3.6**	**2.8**	**2.3**	**2.4**	**2.3**	**2.2**
Unspecified Measures	**0.0**	**0.0**	**0.0**	**0.0**	**-1.2**	**-1.6**	**-1.3**	**-1.2**	**-1.2**
Traditional Balance	**-2.9**	**-3.2**	**-3.4**	**-5.0**	**-2.7**	**-1.9**	**-2.0**	**-2.0**	**-1.9**
Adjustments To The Traditional Balance	**-0.9**	**-1.1**	**-1.0**	**-0.9**	**-0.8**	**-0.8**	**-0.7**	**-0.7**	**-0.7**
Public Sector Borrowing Requirements	**3.7**	**4.3**	**4.3**	**5.9**	**3.5**	**2.7**	**2.7**	**2.7**	**2.7**
Memorandum Items									
Structural current spending	9.8	9.9	10.1						
Structural current spending real growth (y/y, in percent)	-0.3	4.3	5.6						

Sources: Ministry of Finance and Public Credit; and IMF staff estimates.
1/ Data exclude state and local governments, and include state-owned enterprises and public development banks.
2/ Includes social assistance benefits.
3/ Due to lack of disaggregated data this item includes both financing and capital transfers.

Table 3. Mexico: Statement of Operations of the Public Sector, GFSM 2014 Presentation 1/
(In percent of GDP)

	2021	2022	2023	Proj. 2024	2025	2026	2027	2028	2029
Revenue	**22.9**	**24.3**	**24.4**	**24.2**	**23.8**	**23.4**	**23.2**	**23.0**	**22.9**
Taxes	**13.4**	**13.4**	**14.2**	**14.2**	**14.1**	**14.1**	**14.1**	**14.0**	**14.0**
Taxes on income, profits and capital gains	7.1	7.7	7.9	7.9	7.9	7.9	7.9	7.9	7.9
Taxes on goods and services	5.7	5.0	5.7	5.7	5.6	5.6	5.6	5.5	5.5
Value added tax	4.2	4.1	4.3	3.9	3.9	3.8	3.8	3.8	3.8
Excises	1.5	0.8	1.4	1.7	1.7	1.8	1.8	1.7	1.7
Taxes on international trade and transactions	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other taxes	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Social Contributions	**2.3**	**2.3**	**2.4**	**2.3**	**2.3**	**2.2**	**2.3**	**2.3**	**2.3**
Other Revenue	**7.3**	**8.7**	**7.8**	**7.7**	**7.4**	**7.0**	**6.9**	**6.8**	**6.7**
Property income	2.7	3.3	1.8	1.7	1.7	1.7	1.6	1.6	1.5
Other	4.6	5.4	5.9	6.1	5.8	5.4	5.3	5.2	5.1
Total Expenditure	**26.6**	**28.6**	**28.7**	**30.1**	**27.3**	**26.1**	**25.9**	**25.6**	**25.6**
Expense	**24.9**	**26.4**	**26.8**	**27.7**	**26.5**	**25.7**	**25.2**	**25.0**	**25.0**
Compensation of employees	3.3	3.3	3.2	3.4	3.2	3.2	3.0	3.1	3.1
Purchases of goods and services	2.9	3.0	2.7	3.2	3.0	2.9	2.9	2.8	2.7
Interest 2/	4.6	5.4	6.2	5.4	4.7	4.5	4.5	4.3	4.1
Subsidies and transfers	2.4	2.9	2.9	3.4	3.3	3.0	2.8	2.6	2.3
Grants 3/	7.7	7.6	7.6	7.7	7.8	7.8	7.7	7.7	7.7
Social benefits	3.9	4.0	4.1	4.4	4.4	4.5	4.6	4.7	4.8
Other expense	0.2	0.2	0.0	0.2	0.1	-0.2	-0.3	-0.2	0.2
Net Acquisition of Nonfinancial Assets 4/	**1.7**	**2.2**	**1.8**	**2.4**	**2.0**	**2.0**	**2.0**	**1.9**	**1.8**
Unspecified Measures	**0.0**	**0.0**	**0.0**	**0.0**	**-1.2**	**-1.6**	**-1.3**	**-1.2**	**-1.2**
Gross Operating Balance	**-2.0**	**-2.1**	**-2.5**	**-3.5**	**-2.7**	**-2.3**	**-2.0**	**-2.0**	**-2.1**
Overall Fiscal Balance (Net lending/borrowing)	**-3.7**	**-4.3**	**-4.3**	**-5.9**	**-3.5**	**-2.7**	**-2.7**	**-2.7**	**-2.7**
Primary Net Lending/Borrowing	**0.7**	**0.7**	**1.5**	**-0.8**	**1.0**	**1.7**	**1.6**	**1.4**	**1.3**
Memorandum Items									
Primary expenditure	22.0	23.2	22.4	24.7	22.6	21.5	21.4	21.4	21.5
Current expenditure	24.9	26.4	26.8	27.7	25.4	24.1	23.9	23.7	23.8
Structural fiscal balance	-3.1	-4.1	-4.7	-6.2	-3.6	-2.7	-2.7	-2.7	-2.7
Structural primary balance 5/	1.2	0.9	1.1	-1.1	0.9	1.6	1.6	1.4	1.3
Fiscal impulse 6/	-0.5	0.2	-0.2	2.2	-2.0	-0.8	0.1	0.2	0.1
Gross public sector debt 7/	56.7	54.1	53.0	57.6	57.9	57.8	57.9	58.0	58.2
In domestic currency (percentage of total debt)	69.3	73.0	78.0	73.4	71.3	70.1	69.6	69.3	69.0
In foreign currency (percentage of total debt)	30.7	27.0	22.0	26.6	28.7	29.9	30.4	30.7	31.0
Net public sector debt 8/	49.1	48.0	46.9	51.5	51.7	51.7	51.8	51.9	52.1

Sources: Ministry of Finance and Public Credit; and Fund staff estimates and projections.
1/ Data exclude state and local governments, and include state-owned enterprises and public development banks.
2/ Interest payments differ from official data due to adjustments to account for changes in valuation and interest rates.
3/ Includes transfers to state and local governments under revenue-sharing agreements with the federal government.
4/ This category differs from official data on physical capital spending due to adjustments to account for Pidiregas amortizations included in budget figures and the reclassification of earmarked transfers to sub-national governments.
5/ Adjusting revenues for the economic and oil-price cycles and excluding one-off items (e.g. oil hedge income and Bank of Mexico transfers), in percent of potential.
6/ Negative of the change in the structural primary fiscal balance.
7/ Corresponds to the gross stock of public sector borrowing requirements, calculated as the net stock of public sector borrowing requirements as published by the authorities plus public sector financial assets.
8/ Corresponds to the net stock of public sector borrowing requirements (i.e., net of public sector financial assets) as published by the authorities.

Table 4a. Mexico: Summary Balance of Payments
(In billions of U.S. dollars)

				Proj.					
	2021	2022	2023	2024	2025	2026	2027	2028	2029
Current account	**-4.5**	**-17.6**	**-5.5**	**-13.7**	**-15.7**	**-19.3**	**-20.2**	**-20.4**	**-20.9**
Merchandise goods trade balance	-10.8	-26.9	-5.5	-15.2	-21.7	-26.0	-28.6	-29.3	-31.0
Exports, f.o.b. 2/	494.9	577.7	593.0	601.3	622.9	651.5	683.6	717.4	752.7
o/w Manufactures	436.1	508.4	528.8	540.3	562.4	592.2	622.9	656.5	691.1
o/w Petroleum and derivatives 1/	29.4	38.9	33.2	30.4	30.2	28.3	27.0	26.1	25.7
Imports, f.o.b. 2/	505.7	604.6	598.5	616.5	644.6	677.5	712.2	746.7	783.7
o/w Petroleum and derivatives 1/	53.9	74.1	51.8	45.4	47.1	47.4	47.1	47.7	49.2
Services, net	-12.4	-15.5	-19.4	-12.7	-11.8	-14.9	-15.5	-16.5	-18.1
Primary income, net	-33.9	-33.8	-43.7	-49.7	-46.2	-43.9	-42.9	-43.4	-42.8
Secondary income (mostly remittances), net	52.6	58.8	63.2	64.0	64.2	65.5	66.9	69.0	71.1
Capital Account, net	**0.0**	**-0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Financial Account (Net lending (+)/Net borrowing (-))	**-3.4**	**-14.7**	**-7.9**	**-13.8**	**-15.7**	**-19.4**	**-20.2**	**-20.4**	**-20.9**
Foreign direct investment, net	-35.6	-21.8	-29.8	-24.3	-27.0	-29.1	-31.5	-34.0	-36.9
Net acquisition of financial assets	-0.2	17.3	0.4	9.2	10.1	10.9	11.8	12.7	13.7
Net incurrence of liabilities	35.4	39.1	30.2	33.5	37.1	40.1	43.3	46.8	50.6
Portfolio investment, net	41.6	5.1	11.3	-4.2	-3.4	-0.8	1.0	1.6	2.3
Net acquisition of financial assets	22.7	-0.3	4.9	8.2	11.0	13.8	16.6	19.6	22.7
Net incurrence of liabilities	-18.9	-5.4	-6.4	12.5	14.4	14.6	15.6	18.0	20.4
Public Sector 3/	-15.7	1.6	2.9	9.3	10.3	9.3	9.2	10.5	11.7
o/w Local currency domestic-issued bonds	-13.6	2.3	2.3	2.2	2.9	3.5	4.4	5.1	5.9
Private sector 4/	-3.2	-7.0	-9.3	3.1	4.1	5.3	6.4	7.5	8.7
Securities	0.0	-2.4	-4.1	2.1	2.1	2.3	2.4	2.5	2.7
Equity	-3.2	-4.7	-5.2	1.0	2.0	3.0	4.0	5.0	6.0
Financial derivatives, net	2.1	2.9	5.6	0.0	0.0	0.0	0.0	0.0	0.0
Other investments, net	-21.7	0.7	-2.5	-5.8	5.0	2.6	2.1	3.7	5.0
Net acquisition of financial assets	-9.5	4.9	-8.0	-2.0	9.0	7.0	6.9	8.9	10.6
Net incurrence of liabilities	12.3	4.2	-5.6	3.8	4.1	4.4	4.8	5.2	5.6
Change in Reserves Assets	10.3	-1.7	7.6	20.6	9.8	8.0	8.1	8.4	8.7
Total change in gross reserves assets	8.7	-6.6	13.3	20.6	9.8	8.0	8.1	8.4	8.7
Valuation change	-1.6	-4.9	5.7	0.0	0.0	0.0	0.0	0.0	0.0
Errors and Omissions	**1.2**	**3.0**	**-2.4**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
International Investment Position, net	**-552.2**	**-613.5**	**-756.0**	**-747.7**	**-758.9**	**-773.4**	**-788.2**	**-802.7**	**-817.1**
Memorandum items									
Hydrocarbons exports volume growth (in percent)	-6.2	-3.6	2.0	-2.3	6.0	-1.1	-1.3	-1.1	-1.5
Non-hydrocarbons exports volume growth (in percent)	5.8	8.6	-7.4	1.4	1.7	2.1	3.6	3.6	3.6
Hydrocarbons imports volume growth (in percent)	-4.5	27.6	3.9	-12.4	2.3	2.0	2.3	1.8	2.4
Non-hydrocarbons imports volume growth (in percent)	16.7	7.2	4.6	1.3	2.4	3.2	3.3	3.2	3.1
Crude oil export volume (in millions of bbl/day) 5/	1.0	1.0	1.0	0.9	1.0	1.0	1.0	1.0	0.9
Gross international reserves (in billions of U.S. dollars)	207.7	201.1	214.4	235.0	244.8	252.8	260.9	269.3	278.0
Gross domestic product (in billions of U.S. dollars)	1,316.6	1,464.3	1,789.1	1,853.8	1,823.0	1,911.4	1,999.9	2,091.4	2,182.1

Sources: Bank of Mexico, National Institute of Statistics and Geography, PEMEX, and Fund staff estimates.
1/ Crude oil, derivatives, petrochemicals, and natural gas.
2/ Excludes goods procured in ports by carriers.
3/ Public sector is the sum of central bank, general government, and development banks, and SOEs.
4/ Private sector is the sum of commercial banks, other financial corporations, households, NPISHs, and pidiregas.
5/ Crude oil export volumes reported by PEMEX.

Table 4b. Mexico: Summary Balance of Payments
(In percent of GDP)

	2021	2022	2023	Proj. 2024	2025	2026	2027	2028	2029
Current account	**-0.3**	**-1.2**	**-0.3**	**-0.7**	**-0.9**	**-1.0**	**-1.0**	**-1.0**	**-1.0**
Merchandise goods trade balance	-0.8	-1.8	-0.3	-0.8	-1.2	-1.4	-1.4	-1.4	-1.4
Exports, f.o.b. 2/	37.6	39.5	33.1	32.4	34.2	34.1	34.2	34.3	34.5
o/w Manufactures	33.1	34.7	29.6	29.1	30.9	31.0	31.1	31.4	31.7
o/w Petroleum and derivatives 1/	2.2	2.7	1.9	1.6	1.7	1.5	1.3	1.2	1.2
Imports, f.o.b. 2/	38.4	41.3	33.5	33.3	35.4	35.4	35.6	35.7	35.9
o/w Petroleum and derivatives 1/	4.1	5.1	2.9	2.4	2.6	2.5	2.4	2.3	2.3
Services, net	-0.9	-1.1	-1.1	-0.7	-0.6	-0.8	-0.8	-0.8	-0.8
Primary income, net	-2.6	-2.3	-2.4	-2.7	-2.5	-2.3	-2.1	-2.1	-2.0
Secondary income (mostly remittances), net	4.0	4.0	3.5	3.5	3.5	3.4	3.3	3.3	3.3
Capital Account, net	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Financial Account (Net lending (+)/Net borrowing (-))	**-0.3**	**-1.0**	**-0.4**	**-0.7**	**-0.9**	**-1.0**	**-1.0**	**-1.0**	**-1.0**
Foreign direct investment, net	-2.7	-1.5	-1.7	-1.3	-1.5	-1.5	-1.6	-1.6	-1.7
Net acquisition of financial assets	0.0	1.2	0.0	0.5	0.6	0.6	0.6	0.6	0.6
Net incurrence of liabilities	2.7	2.7	1.7	1.8	2.0	2.1	2.2	2.2	2.3
Portfolio investment, net	3.2	0.3	0.6	-0.2	-0.2	0.0	0.1	0.1	0.1
Net acquisition of financial assets	1.7	0.0	0.3	0.4	0.6	0.7	0.8	0.9	1.0
Net incurrence of liabilities	-1.4	-0.4	-0.4	0.7	0.8	0.8	0.8	0.9	0.9
Public Sector 3/	-1.2	0.1	0.2	0.5	0.6	0.5	0.5	0.5	0.5
o/w Local currency domestic-issued bonds	-1.0	0.2	0.1	0.1	0.2	0.2	0.2	0.2	0.3
Private sector 4/	-0.2	-0.5	-0.5	0.2	0.2	0.3	0.3	0.4	0.4
Securities	0.0	-0.2	-0.2	0.1	0.1	0.1	0.1	0.1	0.1
Equity	-0.2	-0.3	-0.3	0.1	0.1	0.2	0.2	0.2	0.3
Financial derivatives, net	0.2	0.2	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Other investments, net	-1.7	0.0	-0.1	-0.3	0.3	0.1	0.1	0.2	0.2
Net acquisition of financial assets	-0.7	0.3	-0.4	-0.1	0.5	0.4	0.3	0.4	0.5
Net incurrence of liabilities	0.9	0.3	-0.3	0.2	0.2	0.2	0.2	0.2	0.3
Change in Reserves Assets	0.8	-0.1	0.4	1.1	0.5	0.4	0.4	0.4	0.4
Total change in gross reserves assets	0.7	-0.5	0.7	1.1	0.5	0.4	0.4	0.4	0.4
Valuation change	-0.1	-0.3	0.3	0.0	0.0	0.0	0.0	0.0	0.0
Errors and Omissions	**0.1**	**0.2**	**-0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
International Investment Position, net	**-41.9**	**-41.9**	**-42.3**	**-40.3**	**-41.6**	**-40.5**	**-39.4**	**-38.4**	**-37.4**

Sources: Bank of Mexico, National Institute of Statistics and Geography, and Fund staff estimates.
1/ Crude oil, derivatives, petrochemicals, and natural gas.
2/ Excludes goods procured in ports by carriers.
3/ Public sector is the sum of central bank, general government, and development banks, and SOEs.
4/ Private sector is the sum of commercial banks, other financial corporations, households, NPISHs, and pidiregas.

Table 5. Mexico: Financial Soundness Indicators
(In percent)

	2018	2019	2020	2021	2022	2023	2024	Latest data available 1/
Capital Adequacy								
Regulatory capital to risk-weighted assets	15.9	16.0	17.7	19.5	19.0	18.8	19.3	July
Regulatory Tier 1 capital to risk-weighted assets	14.2	14.4	16.1	18.1	17.6	17.5	17.5	July
Capital to assets	9.1	9.8	9.7	10.9	9.8	10.2	10.0	July
Gross asset position in financial derivatives to capital	66.2	52.1	82.7	49.4	62.8	44.5	36.7	July
Gross liability position in financial derivatives to capital	66.9	53.3	84.8	50.0	63.0	41.4	37.0	July
Asset Quality								
Nonperforming loans to total gross loans	2.1	2.2	2.6	2.0	2.1	2.1	2.0	July
Provisions to Nonperforming loans	157.1	157.1	154.8	152.4	147.0	160.1	157.0	July
Earnings And Profitability								
Return on assets	2.2	2.3	1.2	2.1	2.6	2.8	2.8	July
Return on equity	16.0	15.5	9.0	14.6	17.6	18.5	18.7	July
Liquidity								
Liquid assets to short-term liabilities	120.9	119.2	136.8	152.9	124.3	121.8	107.9	July
Liquid assets to total assets	30.0	29.6	33.1	34.5	30.1	29.7	30.4	July
Customer deposits to total (noninterbank) loans	92.2	93.2	105.8	109.3	106.3	105.6	101.9	July
Trading income to total income	4.5	5.8	5.5	6.7	9.5	9.7	7.2	July

Source: Financial Soundness Indicators.
1/ End of period.

Table 6. Mexico: Financial Indicators and Measures of External Vulnerabilities

	2021	2022	2023	2024	Latest data available
Financial Market Indicators					
Exchange rate (per U.S. dollar, period average)	20.3	20.1	17.8	17.1	Jun-24
(year-to-date percent change, + appreciation)	5.6	0.7	11.8	6.0	Jun-24
28-day treasury auction rate (percent; period average)	4.4	7.6	11.1	11.0	Jun-24
EMBIG Mexico spread (basis points; period average)	354.2	404.3	377.5	322.1	Jun-24
Sovereign 10-year local currency bond yield (period average)	6.9	8.8	9.1	9.5	Jun-24
Stock exchange index (period average, year on year percent change)	26.4	1.4	6.2	4.1	Jun-24
Financial System					
Bank of Mexico net international reserves (US$ billion)	202.4	199.1	212.8	233.3	Proj.
Financial system credit on non-financial private sector (year on year percent change) 1/	4.2	10.9	8.7	8.0	Proj.
Nonperforming loans to total gross loans (deposit takers)	2.0	2.1	2.1	2.0	Jul-24
External Vulnerability Indicators					
Gross financing needs (billions of US$) 2/	79.0	66.0	78.3	95.7	Proj.
Gross international reserves (end-year, billions of US$) 3/	207.7	201.1	214.4	225.9	Jun-24
Change (billions of US$)	8.7	-6.6	13.3	1.7	Jun-24
Months of imports of goods and services	4.4	3.6	3.8	4.1	Proj.
Months of imports plus interest payments	4.3	3.5	3.6	3.9	Proj.
Percent of broad money	37.3	31.7	26.5	32.0	Proj.
Percent of portfolio liabilities	40.5	41.9	39.8	42.6	Proj.
Percent of short-term debt (by residual maturity)	342.3	292.5	303.5	302.8	Proj.
Percent of ARA Metric 4/	131.0	122.8	117.9	131.3	Proj.
Percent of GDP	15.8	13.7	12.0	11.7	Jun-24
Gross total external debt (in percent of GDP)	36.0	31.1	26.2	26.2	Proj.
Of which: In local currency	6.3	5.8	5.7	0.0	Proj.
Of which: Public debt	24.4	21.7	18.6	17.6	Proj.
Of which: Private debt	11.6	9.4	7.6	8.5	Proj.
Financial sector	1.8	1.8	1.5		
Nonfinancial sector	9.8	7.6	6.1		
Gross total external debt (billions of US$)	473.9	454.7	468.0	485.2	Proj.
Of which: In local currency	83.6	84.6	101.5	0.0	Proj.
Of which: Public debt	321.2	317.5	331.9	326.8	Proj.
Of which: Private debt	152.7	137.2	136.0	158.4	Proj.
Financial sector	23.3	25.7	27.1		
Nonfinancial sector	129.4	111.6	109.0		
External debt service (in percent of GDP)	7.3	5.8	5.6	5.2	Proj.

Sources: Bank of Mexico, National Banking and Securities Commission, National Institute of Statistics and Geography, Ministry of Finance and Public Credit, and Fund staff estimates.

1/ Includes domestic credit by banks, nonbank intermediaries, and social housing funds.

2/ Corresponds to the sum of the current account deficit, amortization payments, and the change in gross international reserves.

3/ Excludes balances under bilateral payments accounts. Includes SDR2.337 billion of the general SDR allocation and SDR 0.224 billion of the special SDR allocation in 2009, and SDR 8.542 billion in the general SDR allocation in 2021.

4/ 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 7. Mexico: Monetary Indicators 1/
(In billions of Pesos)

	2020	2021	2022	2023	Proj. 2024
Banco De México					
Net foreign assets	3,876	3,945	3,640	3,383	4,384
Net international reserves	3,966	4,257	3,923	3,632	4,705
Gross international reserves 2/	3,966	4,254	3,917	3,628	4,706
Reserve liabilities	0	0	0	0	0
Other net foreign assets	-90	-312	-282	-248	-322
Net domestic assets	-1,709	-1,496	-932	-417	-1,193
Net domestic credit	-1,640	-1,376	-1,143	-1,054	-1,102
Net credit to non-financial public sector	-1,778	-1,400	-1,045	-1,034	-1,113
Credit to non-financial private sector	0	0	0	0	0
Net credit to financial corporations	138	24	-98	-20	11
Net claims on other depository corporations	138	24	-98	-20	11
Net claims on other financial corporations	0	0	0	0	0
Capital account	103	61	-280	-722	28
Other items net	-15	-68	-77	-91	-63
Monetary base	2,118	2,441	2,700	2,960	3,191
Other Depository Corporations					
Net foreign assets	142	340	287	331	357
Foreign assets	940	1,013	1,104	1,133	1,221
Foreign liabilities	798	672	817	802	864
Net domestic assets	9,230	9,863	10,592	11,671	13,261
Net credit to the public sector	4,239	4,437	4,588	5,123	6,147
Claims on non-financial public sector	4,644	4,880	5,096	5,621	6,683
in pesos	4,442	4,701	4,893	5,435	6,465
in FX	202	178	204	186	217
Liabilities to the nonfinancial public sector	405	442	508	498	536
Credit to the private sector	6,665	6,971	7,675	8,073	8,718
Local Currency	5,941	6,198	6,823	7,188	7,802
Foreign Currency	724	773	852	884	917
Net credit to the financial system	690	806	1,094	1,044	908
Other	-2,364	-2,351	-2,765	-2,569	-2,512
Liabilities to the private sector	9,372	10,204	10,879	12,002	13,618
Liquid liabilities	8,572	9,248	9,840	10,963	12,493
Local currency	7,905	8,481	9,068	10,245	11,749
Foreign currency	667	766	772	718	744
Non liquid liabilities	800	956	1,039	1,039	1,125
Local currency	762	915	981	980	1,063
Foreign currency	38	41	57	59	62
Total Banking System					
Net foreign assets	4,017	4,281	3,921	3,711	4,740
Net domestic assets	7,522	8,367	9,659	11,254	12,068
Liquid liabilities	10,691	11,688	12,540	13,923	15,683
Non-liquid liabilities	800	956	1,039	1,039	1,125
Memorandum Items					
Monetary base (percent change)	21.6	15.2	10.6	9.6	7.8
Currency in circulation (percent change)	23.3	16.8	11.1	9.5	7.8
Broad money (percent change)	13.4	9.5	7.3	11.0	7.8
Bank credit to the non-financial private sector (growth rate)	-4.5	4.6	10.1	5.2	8.0
Bank credit to the non-financial private sector (as percent of GDP)	27.7	26.2	26.1	25.4	25.5

Sources: Bank of Mexico, National Institute of Statistics and Geography and Fund staff estimates.
1/ Data of the monetary sector are prepared based on the IMF's methodological criteria and do not necessarily coincide with the definitions published by Bank of Mexico.
2/ Excludes balances under bilateral payments accounts. Includes SDR 8.542 billion in the general SDR allocation in 2021.

Table 8. Mexico: Capacity to Repay Indicators Under FCL Drawing Scenario 1/

	2023	2024	2025	2026	2027	2028	2029
Exposure and Repayments in SDR millions							
GRA credit to Mexico	0.0	26,738	26,738	26,738	26,738	13,369	0.0
(In percent of quota)	0.0	300.0	300.0	300.0	300.0	150.0	0.0
Charges due on GRA credit 2/	0.2	142	1,424	1,424	1,425	1,136	379
Debt service due on GRA credit 2/	0.2	142	1,424	1,424	1,425	14,505	13,748
Debt and Debt Service Ratios 3/							
In percent of GDP							
Total external debt	26.2	29.7	36.1	34.0	33.3	32.0	31.0
Public external debt	17.7	20.5	24.7	22.9	22.1	20.6	19.4
GRA credit to Mexico	0.0	2.0	2.5	2.3	2.0	1.0	0.0
Total external debt service	5.6	5.5	8.3	7.9	6.8	7.4	6.6
Public external debt service	2.6	2.5	3.7	3.4	3.1	3.6	3.4
Debt service due on GRA credit	0.0	0.0	0.1	0.1	0.1	1.1	1.0
In percent of Gross International Reserves							
Total external debt	218.3	221.7	247.4	242.0	249.0	238.0	228.7
Public external debt	147.7	153.4	169.4	163.4	165.4	153.3	142.8
GRA credit to Mexico	0.0	15.2	17.2	16.2	15.3	7.3	0.0
In percent of Exports of Goods and Services							
Total external debt service	15.4	14.6	17.8	18.4	17.0	18.5	16.4
Public external debt service	7.2	6.7	7.9	8.0	7.8	9.0	8.5
Debt service due on GRA credit	0.0	0.0	0.3	0.3	0.3	2.6	2.4
In percent of Government Fiscal Revenue							
Total external debt service	22.9	22.7	33.7	32.5	28.7	31.5	28.2
Public external debt service	10.7	10.4	14.9	14.1	13.1	15.4	14.7
Debt service due on GRA credit	0.0	0.0	0.5	0.5	0.5	4.5	4.1
In percent of Total External Debt							
GRA credit to Mexico	0.0	6.9	6.9	6.7	6.2	3.0	0.0
In percent of Public External Debt							
GRA credit to Mexico	0.0	9.9	10.1	9.9	9.3	4.7	0.0

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

1/ Assumes full drawings under the FCL upon the mid-term review. The Mexican authorities have expressed their intention to treat the arrangement as precautionary.
2/ Includes surcharges under the system currently in force, service charges and interest on SDRs.
3/ Based on the downside scenario. External debt ratios (to GDP, gross international reserves, and exports of goods and services) are adjusted for the impact of the assumed FCL drawing.

Table 9. Mexico: Selected Macro-Critical Gender-Related Indicators, 2017–22

	2017	2018	2019	2020	2021	2022
Composite Gender Indices						
Female Human Capital Index (HCI) 1/	0.62	0.63	...	0.63	...	...
Gender Development Index (GDI)	0.97	0.97	0.97	0.98	0.99	0.98
Gender Inequality Index (GII) 2/	0.37	0.36	0.36	0.36	0.36	0.35
Global Gender Gap Index 1/	0.69	0.72	...	0.75	0.76	0.76
Women Business and the Law Index (WBL) 3/	88.75	88.75	88.75	88.75	88.75	88.75
Labor and Income						
Female Employment-to-Population Ratio, Modeled ILO Estimate (15-64 yrs) (as share of the female population)	41.86	42.42	43.75	39.80	42.51	44.25
Gender Wage Gap 4/	-3.71	-2.76	-1.88	-6.56	-4.66	-1.77
Female Informal Employment Rate	57.50	57.35	57.78	54.16	56.07	56.25
Female Labor Force Participation Rate, Modeled ILO Estimate (15-64 yrs)	43.42	43.91	45.34	41.49	44.35	45.77
Female Unemployment Rate, Modeled ILO Estimate (15-64 yrs)	3.60	3.41	3.52	4.09	4.14	3.32
Female Gross Pension Replacement Rate (as share of average worker earnings)	...	...	...	...	...	10.80
Leadership and Social						
Proportion of Seats Held By Women in National Parliaments	42.60	48.20	48.20	48.20	50.00	50.00
Proportion of Women in Managerial Positions	...	...	...	...	...	...
Prevalence of Intimate Partner Violence among Ever-partnered Women (in percent) 2/	...	24.00	...	...	...	...
Access to Finance						
Number of Household Loan Accounts with Commercial Banks, Females' Accounts per 1,000 Female Adults	...	...	...	...	...	592.61
Number of Household Deposit Accounts with Commercial Banks, Females' Accounts per 1,000 Female Adults	...	887.81	1009.34	1043.74	1078.15	1110.98
Share of Female Adults (in Total Female Adults) Who Borrowed From a Financial Institution (in percent)	10.31	...	...	...	...	...
Share of Female Adults (in Total Female Adults) Who Own a Financial Institution Account (in percent)	32.69	...	...	...	...	...
Share of Female Adults (in Total Female Adults) with Mobile Money Account (in percent)	4.21	...	...	...	...	...
Share of Female Adults (in Total Female Adults) Who Made or Received Digital Payments in the Past Year (in percent)	28.15	...	...	...	...	...
Education						
Female Adult Literacy Rate	94.17	94.61	...	94.50	...	...
Female Mean Years of Schooling	8.58	8.78	8.94	9.10	9.10	9.10
Female Primary Gross Enrollment Rate 5/	105.64	105.05	105.08	104.51	103.38	...
Female Secondary Gross Enrollment Rate 5/	109.08	110.51	110.39	107.48	103.97	...
Female Tertiary Gross Enrollment Rate 5/	40.87	42.58	44.35	47.06	48.47	...
Health						
Female Adult Mortality Rate per 1,000 Adults 6/	100.86	101.43	99.11	141.36	130.81	...
Female Life Expectancy at Birth	77.30	77.29	77.57	74.31	74.86	...
Maternal Mortality Ratio per 100,000 Live Births, Modeled Estimate (15-49 yrs) 2/	52.00	56.00	58.00	59.00	...	...
Total Fertility Rate (Births Per Woman)	2.04	2.00	1.92	1.91	1.82	...

Source: GenderDataHub.

1/ This index is scored on a scale of 0-1, with a higher score corresponding to better outcomes for women.

2/ A higher value on this indicator corresponds to worse outcomes for women. For example, the Gender Inequality Index is scored on a scale of 0-1, where a higher score indicates higher inequality.

3/ The Women, Business, and the Law Index is reported on a scale of 0-100, with a higher score corresponding to better outcomes for women.

4/ The Gender Wage Gap is the difference between average earnings of men and average earnings of women expressed as a percentage of average earnings of men (as calculated by the International Labor Organization). The gap listed here is for Occupation = "Total" under the ICSO 08 Classification.

5/ Gross enrollment rates can exceed 100% due to the inclusion of over-aged and under-aged pupils/students because of early or late entrants, and grade repetition.

6/ The adult mortality rate refers to the probability that those who have reached age 15 will die before reaching age 60 (shown per 1,000 persons). In other words, a value of 150 means that out of 1,000 persons who have reached age 15, 150 are expected to die before reaching age 60, and 850 are expected to survive to age 60. This is based on a "synthetic cohort": current life-table mortality

Annex I. External Sector Assessment

<table>
<tr><td colspan="7">Overall Assessment: The external position in 2023 was moderately stronger than the level implied by medium-term fundamentals and desirable policies. As Mexico's current account (CA) deficit shrank to 0.3 percent of GDP in 2023, its adjusted external position strengthened owing to the improvement of terms of trade and the impact of the more accommodative fiscal stance in other economies. The CA deficit is expected to widen moderately in 2024 and hover around 1 percent of GDP in the medium term.

Potential Policy Responses: Further structural reforms to address investment obstacles are critical to boost investment, including through FDI inflows, and thereby enhance growth in the medium and long term, and to maintain external sustainability. These reforms could include tackling economic informality and governance gaps, encouraging female labor force participation, promoting financial deepening, initiating private sector participation in energy, and reforming Pemex's business strategy and governance. Maintaining a prudent fiscal stance is also vital to buttress external stability. Mexico should continue to promote open trade policies and avoid increasing barriers to trade and investment. The floating exchange rate should continue to serve as a shock absorber, with FX interventions employed only in exceptional circumstances. The IMF's Flexible Credit Line with Mexico continues to provide an added buffer against global tail risks.</td></tr>
<tr><td>Foreign Asset and Liability Position and Trajectory</td><td colspan="6">Background. The NIIP is projected to improve from –41 percent of GDP in 2023 to about –28 percent of GDP over the medium term, driven mainly by a decline in foreign liabilities relative to nominal GDP. Foreign assets in 2023 (44 percent of GDP) were mostly direct investment (15 percent of GDP) and international reserves (12 percent of GDP). Foreign liabilities (84 percent of GDP) were mostly direct investment (46 percent of GDP) and portfolio investment (30 percent of GDP).

Assessment. While the NIIP is sustainable and the relatively high share of local currency denomination in its foreign public liabilities reduces FX risks, the large gross foreign portfolio liabilities could be a source of vulnerability in case of global financial volatility. Vulnerabilities from exchange rate volatility are moderate, as most Mexican firms with FX debt have natural hedges and actively manage their FX exposures.</td></tr>
<tr><td>2023 (% GDP)</td><td colspan="2">NIIP: –41</td><td>Gross Assets: 44</td><td>Debt Assets: 17</td><td>Gross Liab.: 84</td><td>Debt Liab.: 33</td></tr>
<tr><td>Current Account</td><td colspan="6">Background. The CA deficit was 0.3 percent of GDP in 2023, down from 1.2 percent in 2022, mainly reflecting a higher (by 1.5 percent of GDP) trade balance partly offset by a lower (by 0.1 percent of GDP) primary income balance and lower (by 0.5 percent of GDP) secondary income balance relative to GDP. The trade deficit shrunk as terms of trade improved. The improvement of the CA reflected higher private savings, while these were partly offset by higher investment. The CA deficit is expected to widen moderately in 2024 with strong demand boosting imports. Over the medium term, the CA balance is projected to hover around a deficit of 1 percent of GDP.

Assessment. The EBA model estimates a cyclically adjusted CA balance of 0.1 percent of GDP and a cyclically adjusted CA norm of –1.3 percent of GDP. This implies an EBA model CA gap of 1.4 percent of GDP, reflecting policy gaps (0.6 percent of GDP, mostly driven by the fiscal gap of 0.7 percent of GDP) and an unidentified residual (0.8 percent of GDP). The estimated fiscal gap of 0.7 percent of GDP reflects a relatively tighter fiscal stance than in the rest of the world. The cyclically adjusted CA norm has an error band (with one standard deviation) of –0.9 to –1.7 percent of GDP.</td></tr>
<tr><td>2023 (% GDP)</td><td>CA: –0.3</td><td>Cycl. Adj. CA: 0.1</td><td>EBA Norm: –1.3</td><td>EBA Gap: 1.4</td><td>Staff Adj.: 0.0</td><td>Staff Gap: 1.4</td></tr>
<tr><td>Real Exchange Rate</td><td colspan="6">Background. In 2023, the peso appreciated by more than 10 percent against the US dollar. Average REER in 2023 appreciated by about 21 percent compared with the 2022 average, mostly driven by a nominal appreciation, reflected in an average NEER appreciation of 18 percent in 2023 compared with the average 2022 NEER. As of April 2024, the REER was 9 percent above the 2023 average.

Assessment. The IMF staff CA gap implies a REER undervaluation of 4.5 percent (with a semi-elasticity of 0.31 applied). The EBA REER index and level models estimate overvaluations of 8.1 percent and 27.6 percent, respectively, in 2023. The staff's overall assessment, based on the CA gap approach, is a REER undervaluation in the range of 3.2 to 5.9 percent, with a midpoint of 4.5 percent. This assessment is subject to high uncertainty, including due to large unidentified CA model residuals.</td></tr>
<tr><td>Capital and Financial Accounts: Flows and Policy Measures</td><td colspan="6">Background. In 2023, Mexico recorded net financial account inflows to the tune of 0.3 percent of GDP, compared with 1.0 percent of GDP in 2022. Net inflows of FDI rose to 1.7 percent of GDP, partially offset by net portfolio outflows of 0.6 percent of GDP, widening somewhat from the previous year (0.3 percent of GDP), and reserve accumulation.

Assessment. The long maturity of external sovereign debt and the relatively high share of local-currency-denominated debt, supported by prudent fiscal and debt management by the government, reduce the exposure of government finances to FX depreciation and refinancing risks. The banking sector is resilient, with FX risks contained under macroprudential policy measures. FX risks of nonfinancial corporate debt are generally covered by natural and financial hedges. However, the strong presence of foreign investors leaves Mexico exposed to capital flow reversals and risk premium increases.</td></tr>
<tr><td>FX Intervention and Reserves Level</td><td colspan="6">Background. The authorities remain committed to a free-floating exchange rate and have used FX intervention in limited occasions of extreme volatility, in line with their policy framework. This is consistent with staff determination in the context of the IPF (CR No. 23/356) that use of FX interventions should remain limited to exceptional circumstances, as staff analysis did not identify material frictions that would warrant regular FXI in Mexico, given Mexican peso's deep and liquid FX market, limited FX mismatches on balance sheet, and well-anchored inflation expectations under the inflation targeting framework. At the end of 2023, gross international reserves were $214 billion (12 percent of GDP), up from $201 billion at the end of 2022. In 2023, the FX hedging mechanism using nondeliverable forwards, created in 2017 to address heightened market volatility, was started to be unwound. No other FX intervention was conducted.

Assessment. At 126 percent of the ARA metric and 296 percent of short-term debt (at remaining maturity), the level of Mexico's foreign reserves at the end of 2023 remains adequate. The IMF staff recommends that the authorities continue to maintain reserves at an adequate level over the medium term. The Flexible Credit Line arrangement continues to provide an additional buffer.</td></tr>
</table>

Annex II. Risk Assessment Matrix[1]

Risks	Likelihood	Impact	Policy Response
Global Risks			
Commodity price volatility. Supply and demand fluctuations (e.g., due to conflicts, export restrictions, OPEC+ decisions, and green transition) cause recurrent commodity price volatility, external and fiscal pressures and food insecurity in EMDEs, cross-border spillovers, and social and economic instability.	**High**	**Medium.** Energy and food price shocks feed through to headline and core inflation.	Monetary policy should respond if shocks feed into core inflation and ensure that inflation expectations remain anchored.
Monetary policy calibration. Amid high uncertainty and data surprises, major central banks turn out to be too loose, hindering disinflation, or too tight for longer than warranted, which stifles growth and triggers increased capital-flow and exchange-rate volatility in EMDEs.	**Medium**	**High.** Spillovers to financial markets would affect Mexico through tighter financial conditions and capital outflows.	Let the exchange rate act as a shock absorber. Tighten monetary policy, consistent with Banxico's price-stability mandate, if inflation in Mexico is affected by additional price pressures. Frontload fiscal expenditure plans and delay revenue measures to provide support during the downturn without adding to domestic price pressures.
Global growth surprises: Growth slowdown in major economies, including due to supply disruptions, tight monetary policy, rising corporate bankruptcies, or a deeper-than-envisaged real estate sector contraction, with adverse spillovers through trade and financial channels, triggering sudden stops in some EMDEs.	**Medium**	**High.** The Fed could tighten more and faster in response to persistently high inflation. The resulting U.S. "hard landing" would transmit to Mexico through reduced external demand and remittances as well as tighter financial conditions and capital outflows.	Tighten monetary policy, consistent with Banxico's price-stability mandate, if inflation in Mexico is affected by additional price pressures, decoupling from the Fed when appropriate. Frontload fiscal expenditure plans and delay revenue measures to provide support during the downturn without adding to domestic price pressures.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Risks	Likelihood	Impact	Policy Response
Global Risks			
Deepening geo-economic fragmentation. Broader conflicts, inward-oriented policies, and weakened international cooperation result in a less efficient configuration of trade and FDI, supply disruptions, protectionism, policy uncertainty, technological and payments systems fragmentation, rising shipping and input costs, financial instability, a fracturing of international monetary system, and lower growth.	**High**	**Low.** While geopolitical fragmentation, on average, adversely affects the global economy, a reshaping of global supply chains could have a net positive impact for Mexico.	Fully taking advantage of these dynamics requires strengthening governance, tackling corruption and crime, improving physical infrastructure, and mobilizing private saving to fund private investments by expanding coverage of financial intermediations.
Climate change. Extreme climate events driven by rising temperatures cause loss of life, damage to infrastructure, food insecurity, supply disruptions, lower growth, and financial instability. A disorderly transition to net-zero emissions and regulatory uncertainty lead to stranded assets and low investment.	**Medium**	**Low.** Given the relatively slower energy transition, dependency on critical metals is moderate.	If lower oil prices create stranded assets, restrict Pemex projects to the most efficient fields and accelerate the transition to green energy, including the production of electrical vehicles.
Cyberthreats. Cyberattacks on physical or digital infrastructure and service providers (including digital currency and crypto assets), technical failures, or misuse of AI technologies trigger financial and economic instability.	**Medium**	**Medium.** High financial integration exposes Mexico to global threats. Cyberattacks can also be of domestic origin.	Cyber response and recovery capabilities have been enhanced. In the face of cyberattacks, authorities would deploy the established protocols.
Domestic Risks			
Slower-than-anticipated fiscal consolidation, leading to steady increase in public debt and an increase in country risk premiums.	**Medium**	**Medium.** A moderate risk of debt distress and the strength of the fiscal framework would dampen the market stress.	Tighten monetary policy if price pressures are observed. Resume the consolidation effort, especially if country risk premiums rise.

Risks	Likelihood	Impact	Policy Response
Domestic Risks			
Social discontent. High inflation, real income loss, and spillovers from crises in other countries (including migration) worsen inequality, trigger social unrest, and give rise to financing pressures and detrimental populist policies. This exacerbates imbalances, slows growth, and triggers market repricing.	**Medium**	**Medium.** A global wave of social discontent is likely to fall more lightly on Mexico in the current political context.	Increase and better target social transfers to alleviate stress vulnerable households while adjusting monetary policy to anchor inflation expectations. Accelerate investment plans in low-income regions.

Annex III. Debt Sustainability Analysis

A. Sovereign Risk and Debt Sustainability Analysis

Annex III. Figure 1. Mexico: Risk of Sovereign Stress

Horizon	Mechanical signal	Final assessment	Comments
Overall	...	Moderate	The overall risk of sovereign stress is judged to be moderate. A procyclical policy stance in 2024 will exert some pressure over the medium-term but planned fiscal consolidation from 2025 onwards should serve to guide debt-to-GDP down and support fiscal sustainability. The unwinding of debt servicing costs, a return to trend growth and a tight fiscal stance will help contain the debt path and drive a reduction in debt over the extended 10-year period.
Near term 1/			
Medium term	Moderate	Moderate	Medium-term risks are assessed as moderate. Fanchart analysis suggests that baseline projections are reasonable but risks remain around the non-stabilization of debt by the end of the projection period. GFN analysis indicates that financing needs will be broadly stable. The standardized stress tests suggest that financing needs could reach close to 16 percent of GDP at most in a stress scenario but the domestic banking and non-depository sectors could pick up slack. Undertaking the contingent liability stress test to account for subnational government borrowing, deteriorations relative to the baseline in the fanchart and GFN analysis in a stress event are assessed as small.
Fanchart	Moderate	...	
GFN	Moderate	...	
Stress test	Cont. Liabty.	...	
Long term	...	Moderate	The large amortization module indicates that GFN and public debt-to-GDP ratios could be large in some scenarios, absent proactive government policy. Nonetheless, staff's central scenario indicates declining ratios over time and staff judge the likelihood of preemptory policy action to be high enough to avert most worst case scenarios. Given the importance of oil revenues to Mexico's revenue base, the natural resources module indicates that oil depletion in the long-term could have large impacts on GFN and debt ratios. This analysis underscores staff's advice to widen the revenue base and better mobilize domestic revenues.
Sustainability assessment 2/		Sustainable with high probability	The projected debt path is expected to increase over the main projection period and to decline over the extended 10-year period. GFN is expected to rise with looser fiscal policy in 2024 before declining and broadly stablizing. Debt is therefore judged to be sustainable with high probability but notable risks from further shocks remain, particularly given the global macroeconomic context and the tight fiscal stance underpinning debt dynamics.
Debt stabilization in the baseline			No

DSA Summary Assessment

Commentary: Under current policies, which include a front-loaded fiscal consolidation, the risk of Mexico experiencing sovereign stress is moderate overall and its public debt is assessed to be sustainable with high probability over the extended time horizon. Underpinning this is a track record of fiscal prudence and potential growth exceeding the 10-year historical average real GDP growth rate. Nonetheless, additional fiscal effort would be required to stabilize debt ratios in the medium-term. The public debt ratio is not expected to decline in the medium-term. While still manageable under most downside scenarios, fan chart analysis suggests that public debt ratios could increase materially in the medium-term, possibly constraining policy options and leading to a moderate risk of sovereign stress. Over the long-term, a run down in oil reserves is the most palpable risk to debt levels, as highlighted by the long-term analysis. This underscores staff advice to widen the revenue base and better mobilize domestic revenues.

Source: Fund staff.

Note: The risk of sovereign stress is a broader concept than debt sustainability. Unsustainable debt can only be resolved through exceptional measures (such as debt restructuring). In contrast, a sovereign can face stress without its debt necessarily being unsustainable, and there can be various measures—that do not involve a debt restructuring—to remedy such a situation, such as fiscal adjustment and new financing.

1/ The near-term assessment is not applicable in cases where there is a disbursing IMF arrangement. In surveillance-only cases or in cases with precautionary IMF arrangements, the near-term assessment is performed but not published.

2/ A debt sustainability assessment is optional for surveillance-only cases and mandatory in cases where there is a Fund arrangement. The mechanical signal of the debt sustainability assessment is deleted before publication. In surveillance-only cases or cases with IMF arrangements with normal access, the qualifier indicating probability of sustainable debt ("with high probability" or "but not with high probability") is deleted before publication.

Annex III. Figure 2. Mexico: Debt Coverage and Disclosures

						Comments
1. Debt coverage in the DSA: 1/	CG	GG	NFPS	CPS (chosen)	Other	
1a. If central government, are non-central government entities insignificant?					n.a.	

2. Subsectors included in the chosen coverage in (1) above:

Sector (CPS / NFPS / GG: expected / CG)		Subsectors captured in the baseline	Inclusion	Comments
CPS, NFPS, GG, CG	1	Budgetary central government	Yes	
CPS, NFPS, GG, CG	2	Extra budgetary funds (EBFs)	Yes	
CPS, NFPS, GG, CG	3	Social security funds (SSFs)	Yes	
CPS, NFPS, GG	4	State governments	No	See commentary below.
CPS, NFPS, GG	5	Local governments	No	See commentary below.
CPS, NFPS	6	Public nonfinancial corporations	Yes	
CPS	7	Central bank	No (not applicable)	
CPS	8	Other public financial corporations	Yes	

3. Instrument coverage:	Currency & deposits	Loans	Debt securities	Oth acct. payable 2/	IPSGSs 3/	Comments
	chosen coverage	chosen coverage	chosen coverage	Missing from recommended coverage	chosen coverage	See commentary below.

4. Accounting principles:	Basis of recording		Valuation of debt stock		
	Non-cash basis 4/	Cash basis (chosen)	Nominal value 5/ (chosen)	Face value 6/	Market value 7/

5. Debt consolidation across sectors:	Consolidated	Non-consolidated (chosen)

Color code: chosen coverage | Missing from recommended coverage | Not applicable

Reporting on Intra-Government Debt Holdings

	Issuer \ Holder	Budget. central govt	Extra-budget. funds (EBFs)	Social security funds (SSFs)	State govt.	Local govt.	Nonfin. pub. corp.	Central bank	Oth. pub. fin corp	Total
1	Budget. central govt						397	707.2	536.1	1640.3
2	Extra-budget. funds									0
3	Social security funds									0
4	State govt.						1.8		1.4	3.2
5	Local govt.									0
6	Nonfin pub. corp.							0.5	15	15.5
7	Central bank									0
8	Oth. pub. fin. corp						160.9	1.2		162.1
	Total	0	0	0	0	0	559.7	708.9	552.5	1821.1

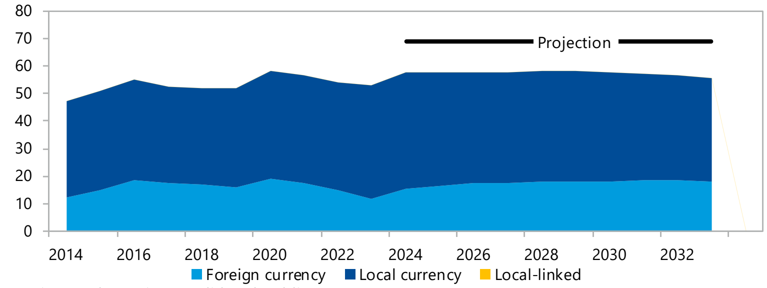
1/ CG=Central government; GG=General government; NFPS=Nonfinancial public sector; PS=Public sector.
2/ Stock of arrears could be used as a proxy in the absence of accrual data on other accounts payable.
3/ Insurance, Pension, and Standardized Guarantee Schemes, typically including government employee pension liabilities.
4/ Includes accrual recording, commitment basis, due for payment, etc.
5/ Nominal value at any moment in time is the amount the debtor owes to the creditor. It reflects the value of the instrument at creation and subsequent economic flows (such as transactions, exchange rate, and other valuation changes other than market price changes, and other volume changes).
6/ The face value of a debt instrument is the undiscounted amount of principal to be paid at (or before) maturity.
7/ Market value of debt instruments is the value as if they were acquired in market transactions on the balance sheet reporting date (reference date). Only traded debt securities have observed market values.

Commentary: Data on debt of sub-national governments are not readily available. Regulatory limits on state and local government's debt burden limits risks. Debt is not consolidated across the Federal government and Non-Financial Public Sector and the aggregate debt data represents the gross amount of all individual debt liabilities.

Annex III. Figure 3. Mexico: Public Debt Structure Indicators

Debt by Currency

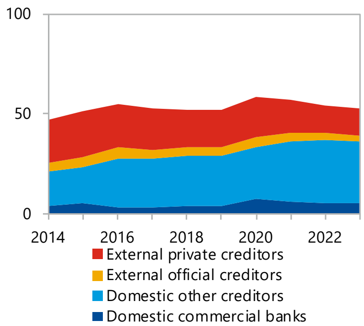
(Percent of GDP)



Note: The perimeter shown is consolidated public sector.

Public Debt by Holder

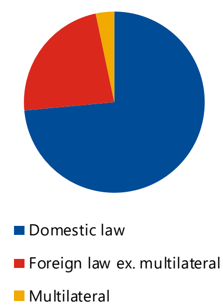
(Percent of GDP)



Note: The perimeter shown is consolidated public sector.

Public Debt by Governing Law, 2023

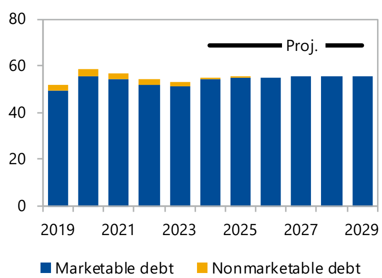
(In percent)



Note: The perimeter shown is consolidated public sector.

Debt by Instruments

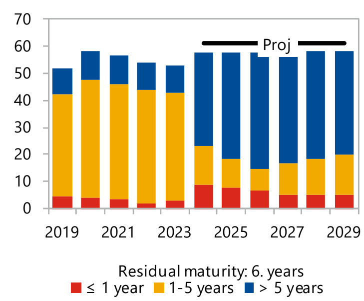
(Percent of GDP)



Note: The perimeter shown is consolidated public sector.

Public Debt by Maturity

(Percent of GDP)



Note: The perimeter shown is consolidated public sector.

Commentary: The shares of foreign and domestic currency-denominated liabilities in total public debt are expected to be broadly stable in the projection period. The increased share of domestic other creditors reflects the increased holdings of public debt liabilities by domestic pension funds following pension reforms. Small amounts of non-marketable debt principally relate to external official lending. Overall debt as a ratio to GDP will be broadly stable over the projection period. However, the share of liabilities with longer maturities is expected to increase relative to the pre-projection period, in-line with the government's debt management strategy. The historical debt composition - in terms of maturity and marketability - has been revised in light of more granular data on the past debt stock vis-a-vis the 2023 AIV.

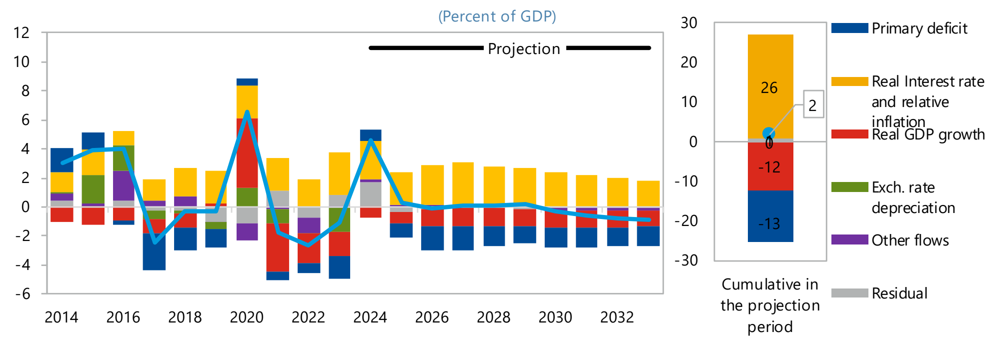
Annex III. Figure 4. Mexico: Baseline Scenario

(Percent of GDP unless indicated otherwise)

	Actual	Medium-term projection						Extended projection			
	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033
Public debt	53.0	57.6	57.9	57.8	57.9	58.0	58.2	57.9	57.3	56.6	55.7
Change in public debt	-1.1	4.6	0.3	-0.1	0.1	0.1	0.2	-0.3	-0.6	-0.8	-0.9
Contribution of identified flows	-1.9	2.8	0.6	0.1	0.2	0.2	0.3	-0.3	-0.6	-0.7	-0.8
Primary deficit	-1.5	0.8	-1.0	-1.7	-1.6	-1.4	-1.3	-1.4	-1.4	-1.4	-1.4
Noninterest revenues	23.9	23.9	23.6	23.2	23.0	22.8	22.7	22.7	22.7	22.7	22.7
Noninterest expenditures	22.4	24.7	22.6	21.5	21.4	21.4	21.5	21.4	21.4	21.4	21.4
Automatic debt dynamics	-0.4	1.9	1.4	1.6	1.6	1.5	1.4	1.2	1.0	0.8	0.7
Real interest rate and relative inflation	3.0	2.6	2.2	2.8	2.9	2.7	2.6	2.4	2.2	2.0	1.9
Real interest rate	2.9	2.2	1.6	2.5	2.7	2.5	2.4	2.2	2.0	1.8	1.6
Relative inflation	0.1	0.4	0.6	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Real growth rate	-1.7	-0.8	-0.8	-1.1	-1.3	-1.2	-1.2	-1.2	-1.2	-1.2	-1.2
Real exchange rate	-1.7	…	…	…	…	…	…	…	…	…	…
Other identified flows	0.0	0.2	0.2	0.1	0.1	0.1	0.1	-0.2	-0.2	-0.2	-0.2
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
(minus) Interest Revenues	-0.4	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2
Other transactions	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.0	0.0	0.0	0.0
Contribution of residual	0.8	1.8	-0.4	-0.1	-0.1	-0.1	-0.1	0.0	0.0	0.0	0.0
Gross financing needs	11.8	14.6	11.8	11.3	11.1	10.4	11.0	11.4	11.5	11.8	11.6
of which: debt service	13.8	14.1	13.0	13.2	12.9	12.0	12.5	12.9	13.1	13.4	13.1
Local currency	12.6	12.5	11.4	11.0	10.4	9.6	9.9	10.2	10.1	10.3	9.9
Foreign currency	1.1	1.5	1.5	2.2	2.6	2.4	2.5	2.7	2.9	3.1	3.3
Memo:											
Real GDP growth (percent)	3.2	1.5	1.3	2.0	2.3	2.1	2.1	2.1	2.1	2.1	2.1
Inflation (GDP deflator; percent)	4.5	6.5	5.7	3.8	3.2	3.3	3.1	3.1	3.1	3.1	3.1
Nominal GDP growth (percent)	7.8	8.0	7.1	5.9	5.6	5.5	5.2	5.2	5.2	5.2	5.2
Effective interest rate (percent)	10.2	10.9	8.8	8.3	8.2	7.8	7.5	7.1	6.7	6.3	6.1

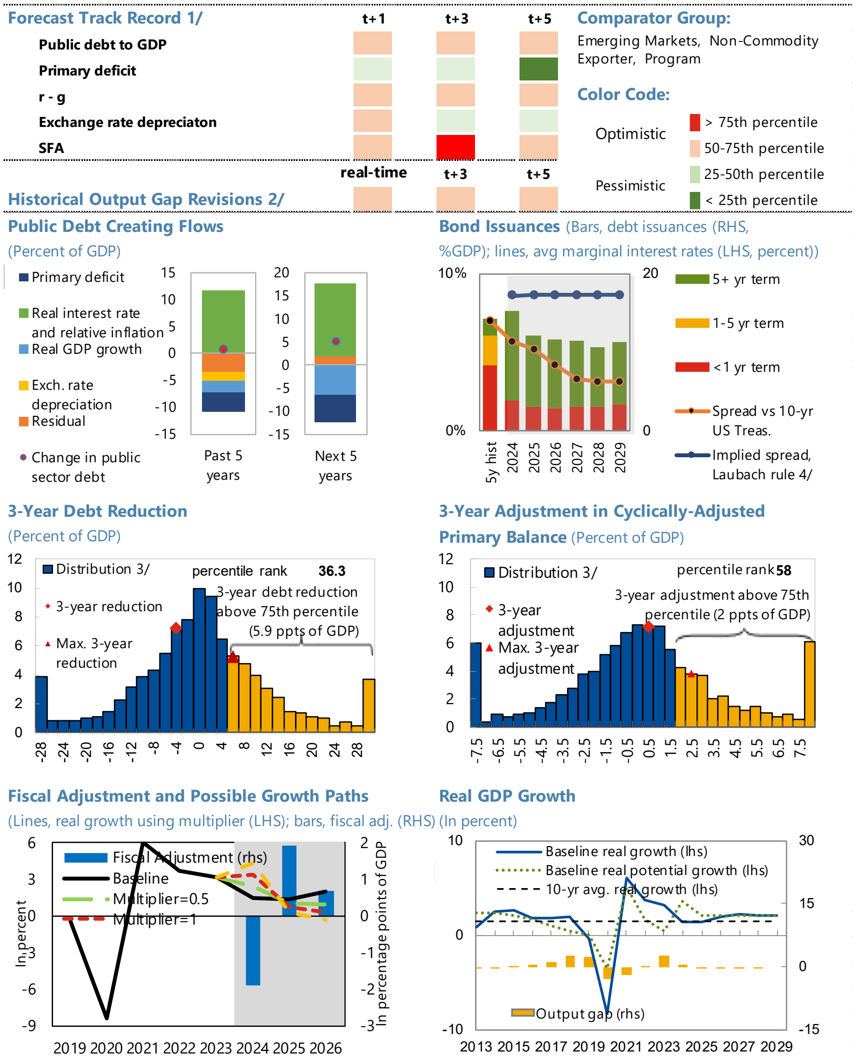
Contribution to Change in Public Debt

(Percent of GDP)



Commentary: A large residual contribution to the debt stock in 2023 is explained by subpar issuance and an increase in inflation-related Udibonos costs (here not accounted for in the real interest rate and relative inflation lines). A large fiscal expansion and the recent weakening of the exchange rate in 2024 exert upwards pressure on debt ratios despite a rapid consolidation over the extended projection horizon. This persistence is due to high real interest rates (reflecting structural and conjunctural factors) and the need to finance the looser stance with greater debt issuance. Mexico's tight fiscal stance and trend growth is expected to dominate other debt drivers and serve to lower debt ratios in the extended projection period. The pace of fiscal tightening and sustained tight fiscal stance, though notable amongst emerging market peers, is consistent with Mexico's track record of fiscal prudence and the new administration's emphasis on maintaining this record. The contribution of growth to the reduction in debt levels is expected to be slightly larger compared to the pre-pandemic period due to higher potential growth following increased investment in recent years.

Annex III. Figure 5. Mexico: Realism of Baseline Assumptions



Commentary: The forecast track record is generally within bounds for optimism, excepting the SFA projections. With the exception of the contribution of GDP growth, debt creating flows are broadly compositionally similar between the last and next 5 years. The higher contribution of GDP growth over the next 5 years is substantiated by a strong recent performance and potential output growth above the 10-year average real growth rate. Spreads are expected to contract relative to the Laubach rule given sensitivity to the loosening of monetary policy and tighter fiscal policy geared towards preserving fiscal sustainability. The three-year debt and CAPB adjustment are well below Mexico's past maximum adjustment, with the latter close to the median of the distribution of comparator countries. The effect of fiscal adjustments on growth reflects the pace and size of fiscal consolidation efforts, highlighting the need for appropriate calibration of fiscal adjustment. Real projected potential growth is expected to outstrip the average of the preceding ten years given durable increases in investment in recent years, including government infrastructure spending.

Source: IMF staff calculations.

1/ Projections made in the October and April WEO vintage. Program status not used in creating comparator group due to lack of data.

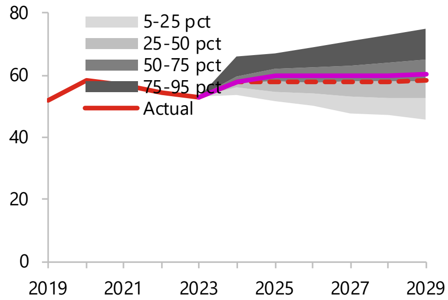
2/ Calculated as the percentile rank of the country's output gap revisions (defined as the difference between real time/period ahead estimates)

3/ Data cover annual obervations from 1990 to 2019 for MAC advanced and emerging economies. Percent of sample on vertical axis.

4/ The Laubach (2009) rule is a linear rule assuming bond spreads increase by about 4 bps in response to a 1 ppt increase in the projected debt-to-GDP ratio.

Annex III. Figure 6. Mexico: Medium-Term Risk Assessment

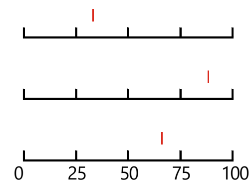
Final Fanchart
(Percent of GDP)



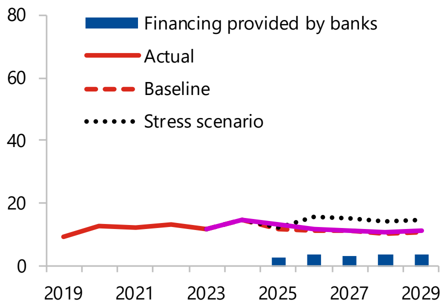
Debt fanchart module

	Value	Contrib 1/
Fanchart width *(percent of GDP)*	29.2	0.4
Probability of debt non-stabilization *(percent)*	48.9	0.4
Terminal debt-to-GDP x institutions index	37.9	0.8
Debt fanchart index (DFI)		1.7
Risk signal: 3/		Moderate

Percentile in peer group 2/



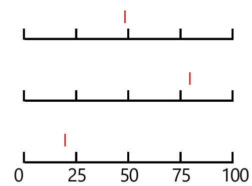
Gross Financing Needs
(Percent of GDP)



Gross financing needs (GFN) module

	Value	Contrib 1/
Average baseline GFN *(percent of GDP)*	11.7	4.0
Initial Banks' claims on the gen. govt *(pct bank assets)*	25.7	8.3
Chg. In banks' claims in stress *(pct banks' assets)*	8.5	2.8
GFN financeability index (GFI)		15.2
Risk signal: 4/		Moderate

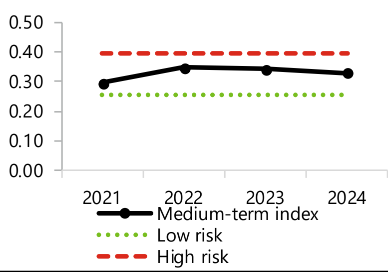
Percentile in peer group 2/



Triggered stress tests (stress tests not activated in gray)

Banking crisis | Commodity prices | Exchange rate | Contingent liab. | Natural disaster

Medium-Term Index
(Index number)



Medium-term risk analysis

	Value	Value (normalized)	Weight	Contribution
Debt fanchart index	1.7	0.4	0.5	0.2
GFN finaceability index	15.2	0.3	0.5	0.1
Medium-term index		0.3		
Risk signal: 5/		Moderate		
Final assessment:		Moderate		

Prob. of missed crisis, 2024-2029, if stress not predicted: 18.2 pct.
Prob. of false alarms, 2024-2029, if stress predicted: 21.6 pct.

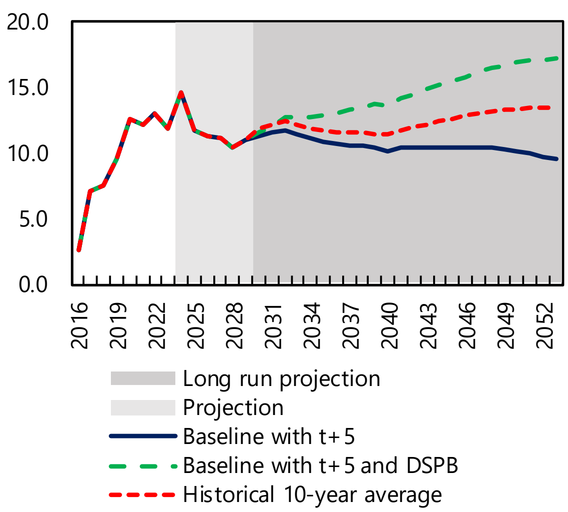
Commentary: The medium-term analysis suggests a moderate risk of sovereign stress over that time horizon. The main issue suggested by the analysis is a substantial increase in the public debt ratio under low-probability downside scenarios. The increase in gross financing needs under a stress scenario is moderate. The change in bank claims under stress scenarios is relatively small, but the initial share of claims on the Federal government in banks' assets is in the upper quartile relative to comparator countries. The banking system should be able to absorb higher government financing needs in a stress scenario. Institutional investors other than banks, particularly pension funds, could also absorb additional financing needs. Undertaking the contingent liability stress test to account for subnational borrowing, both the debt fanchart and GFN analysis show only modest deteriorations relative to the baseline.

Source: IMF staff estimates and projections.
1/ See Annex IV of IMF, 2022, Staff Guidance Note on the Sovereign Risk and Debt Sustainability Framework for details on index calculation.
2/ The comparison group is emerging markets, non-commodity exporter, program.
3/ The signal is low risk if the DFI is below 1.13; high risk if the DFI is above 2.08; and otherwise, it is moderate risk.
4/ The signal is low risk if the GFI is below 7.6; high risk if the DFI is above 17.9; and otherwise, it is moderate risk.
5/ The signal is low risk if the GFI is below 0.26; high risk if the DFI is above 0.40; and otherwise, it is moderate risk.

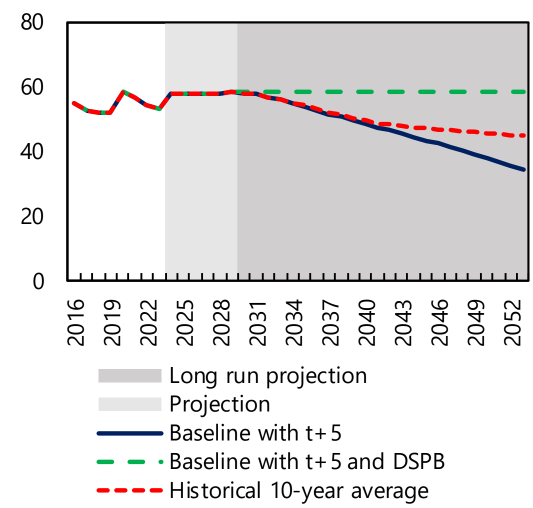
Annex III. Figure 7. Mexico: Long-Term Analysis: Large Amortization Module

Projection	Variable	Risk Indication
Medium-term extrapolation	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Medium-term extrapolation with debt stabilizing primary balance	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Historical average assumptions	GFN-to-GDP ratio	
	Amortization-to-GDP ratio	
	Amortization	
Overall Risk Indication		

GFN-to-GDP Ratio

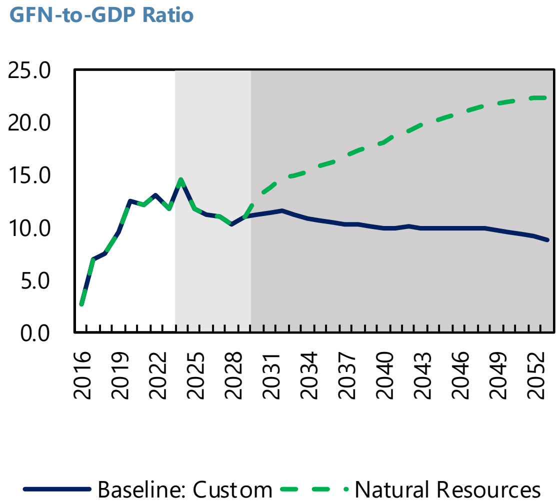


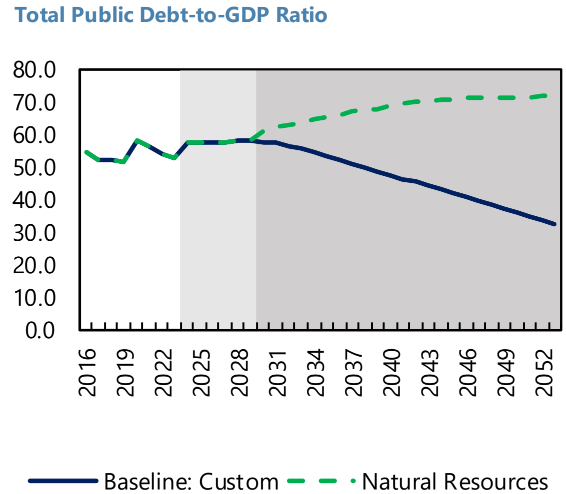
Total Public Debt-to-GDP Ratio



Commentary: Staff's baseline scenario, Baseline with t+5, shows both GFN- and public debt-to-GDP ratios declining over the long-term as Mexico converges to steady-state growth and a concomitant fiscal stance. While the Baseline with t+5 and DSPB scenario shows stabilization of the long-term GFN and public debt ratios at higher levels than staff's baseline, this is due to the fact that a smaller primary surplus is required to stabilize debt than is consistent with the projected steady-state. Extrapolating historical relationships between key debt drivers, both the GFN- and GDP-to-debt ratios are broadly stable over the long-run in the Historical 10-year average scenario. In all scenarios, goverment policy is assumed to be passive and while this analysis provides some illustration of risks, staff judge the likelihood of preemptory action averting worst case scenarios to be high given Mexico's track record of fiscal prudence and proactive debt management policies.

Annex III. Figure 8. Mexico: Long-Term Analysis: Natural Resource Module





Commentary: Given the importance of oil revenues to the government's revenue base and its contribution to the Mexican economy, depletion of oil reserves would result in rapid and large increases in GFN- and public debt-to-GDP ratios. The illustration provided by the long-term module underscores staff advice to increase domestic revenue mobilization and widen the revenue base.

B. External Debt Sustainability

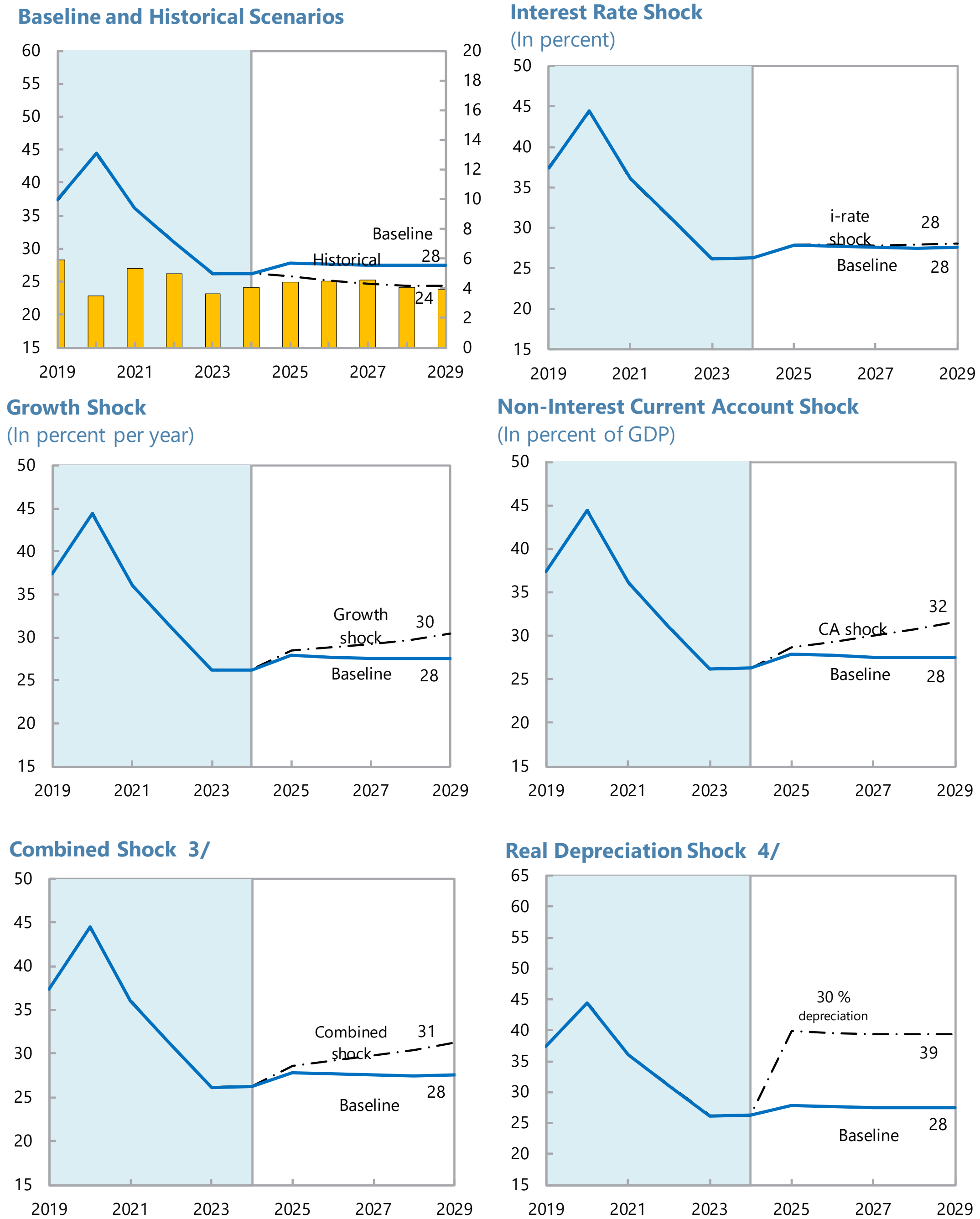
Mexico's external debt as a ratio to GDP is comparatively low and is projected to remain stable in 2024. Despite the recent depreciation, continued robust remittance and FDI inflows, as well as sustained growth, will keep external debt contained. The main risks to the external debt trajectory relate to growth underperformance, deterioration of the current account, and large currency depreciation. However, their potential impact is mitigated by several factors, especially favorable maturity and currency structures of public and private external debt.

1. The baseline projections: Gross external debt is expected to remain at 26 percent of GDP by end-2024. Debt creating flows continue to contribute to a decline in the external debt to GDP ratio, mainly driven by robust remittances and FDI inflows, as well as sustained GDP growth, whereas the recent depreciation mechanically raised the ratio. In the medium-term, the external debt ratio is expected to remain broadly stable at around 28 percent of GDP.

2. Risks and mitigating factors: The major downside risks to the external debt trajectory are weaker-than-expected growth, including declines in exports, possibly owing to a global slowdown, domestic policy missteps and/or climate-change related risks, and a sharp tightening of global financial conditions, leading to a spike in risk premia on Mexico's external debt liabilities, a weaker peso, and more capital flow volatility. Currency depreciation is a significant risk; for example, a 30 percent depreciation of the peso in real effective terms could raise the external debt to about 39 percent of GDP. However, several factors mitigate the impact of potential shocks on Mexico's external debt position. Rollover risks for the public sector external debt, which constitute around two-thirds of Mexico's external debt, are mitigated by a favorable maturity structure (more than 90 percent of debt has a residual maturity of more than one year), currency composition (around 30 percent of external public debt is denominated in peso), and prudent debt management by the government. Private sector external debt, which is concentrated in the non-financial corporate sector, consists of mostly medium- and long-term maturities, while foreign exchange risks are well-covered by natural and financial hedges. The banking sector is well capitalized and liquid and assessed to be resilient to large shocks under prudent macroprudential policies.

Annex III. Figure 9. 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.

Annex III. Table 1. Mexico: External Debt Sustainability Framework

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2019	2020	2021	2022	2023			2024	2025	2026	2027	2028	2029	**Debt-stabilizing non-interest current account 6/**
Baseline: External debt	37.4	44.4	36.1	31.1	26.2			**26.3**	**27.9**	**27.7**	**27.6**	**27.5**	**27.6**	**-2.2**
Change in external debt	1.4	7.0	-8.4	-5.0	-4.9			0.1	1.6	-0.2	-0.1	-0.1	0.1	
Identified external debt-creating flows (4+8+9)	-3.4	1.6	-8.2	-4.4	-6.8			-1.4	-1.4	-1.5	-1.7	-1.8	-1.9	
Current account deficit, excluding interest payments	-1.7	-4.6	-1.4	-0.5	-1.4			-0.7	-0.7	-0.5	-0.4	-0.3	-0.3	
Deficit in balance of goods and services	-0.3	1.9	-1.8	-2.9	-1.4			-1.5	-1.8	-2.2	-2.2	-2.2	-2.3	
Exports	38.7	39.8	41.0	43.1	36.3			35.8	37.9	37.8	38.0	38.1	38.4	
Imports	-39.0	-37.8	-42.7	-46.0	-37.7			-37.3	-39.8	-40.0	-40.2	-40.3	-40.6	
Net non-debt creating capital inflows (negative)	-2.4	-2.1	-1.9	-2.0	-1.5			-1.8	-1.9	-2.0	-2.1	-2.2	-2.3	
Automatic debt dynamics 1/	0.7	8.2	-4.9	-2.0	-3.9			1.0	1.1	1.0	0.8	0.8	0.7	
Contribution from nominal interest rate	2.0	2.2	1.7	1.7	1.7			1.4	1.5	1.5	1.4	1.3	1.3	
Contribution from real GDP growth	0.1	3.6	-2.3	-1.2	-0.8			-0.4	-0.4	-0.5	-0.6	-0.6	-0.6	
Contribution from price and exchange rate changes 2/	-1.4	2.4	-4.3	-2.4	-4.8			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	4.8	5.5	-0.2	-0.6	1.9			1.5	3.0	1.3	1.5	1.7	2.0	
External debt-to-exports ratio (in percent)	96.7	111.7	88.1	72.1	72.0			73.3	73.5	73.2	72.6	72.1	71.8	
Gross external financing needs (in billions of US dollars) 4/	76.7	39.2	70.3	72.6	65.1			75.1	80.8	85.7	90.3	84.9	85.4	
in percent of GDP	5.9	3.5	5.4	5.0	3.6	10-Year	10-Year	4.1	4.4	4.5	4.5	4.1	3.9	
Scenario with key variables at their historical averages 5/								**26.3**	**25.8**	**25.2**	**24.7**	**24.4**	**24.4**	**-1.8**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	-0.4	-8.4	6.0	3.7	3.2	1.5	3.8	1.5	1.3	2.0	2.3	2.1	2.1	
GDP deflator in US dollars (change in percent)	4.2	-6.0	10.8	7.2	18.2	2.0	9.6	1.8	-2.9	2.8	2.3	2.4	2.2	
Nominal external interest rate (in percent)	5.8	5.0	4.5	5.1	6.8	5.1	0.7	5.6	5.6	5.6	5.4	5.1	4.8	
Growth of exports (US dollar terms, in percent)	2.8	-11.7	20.6	17.2	3.1	5.2	9.6	1.9	4.1	4.6	5.0	5.0	5.0	
Growth of imports (US dollar terms, in percent)	-1.8	-16.7	32.2	20.0	0.3	5.5	13.5	2.3	4.8	5.4	5.2	5.0	5.0	
Current account balance, excluding interest payments	1.7	4.6	1.4	0.5	1.4	0.8	1.6	0.7	0.7	0.5	0.4	0.3	0.3	
Net non-debt creating capital inflows	2.4	2.1	1.9	2.0	1.5	2.2	0.4	1.8	1.9	2.0	2.1	2.2	2.3	

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; 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.

Annex IV. Key FSAP Recommendations[1]

FSAP Recommendations	Development
Cross-Cutting Themes	
Enhance the autonomy of regulatory government agencies and legal protection of supervisors.	No measures taken.
Assess and enhance the organizational structure and resource needs of individual agencies.	No measures taken.
Enhance the oversight of the Interbank Electronic Payment System (SPEI) relative to the PFMI and cybersecurity.	Authorities reviewed the recommendation to enhance the oversight of SPEI, in accordance with its mandate and organizational arrangements. Banco de México created an independent oversight unit within the Directorate General of Payment Systems and Market Infrastructures.
Systemic Risk Analysis	
Monitor the dynamics of contingent credit lines and portfolio concentration closely and use Pillar 2 requirements to address relevant risks, as needed.	Authorities are monitoring the dynamics of contingent credit lines and are working to improve their regulatory reporting. Authorities note that the existing regulatory framework in projects such as LEX, the Total Loss-Absorbing Capacity (TLAC) and the capital supplement for institutions with a local systemic nature, contemplates a differentiation in the treatment for Systemically Important (SI) Institutions in which greater capital and better diversification in the operations are required. For such large institutions, the determination of the Annual Supervision Plan is set based on a comprehensive evaluation of each entity's risks exposure, considering the complexity of their operations, and the results of the Capital Adequacy Assessment. There are still a few smaller banks with concentrated business lines with vulnerabilities in a stress-test scenarios of higher interest rates, as Basel's Pillar 2 is not in place for those banks.
Expand the liquidity stress test framework; incorporate in the Supervisory Review Process to inform Pillar 2 requirements for banks.	Banxico is working to improve the liquidity stress test framework. In 4Q2022 Banco de México implemented a liquidity stress test based on cashflows and maturity ladder, and the distance to liquidity stress indicator. In 2023, the stress test is being expanded to include concentration risks (HNWI). Also, Banxico is working on a system-wide liquidity stress test to assess the resilience of different intermediaries, expected

[1] This annex is based on information provided by the authorities.

FSAP Recommendations	Development
	to be completed by 2024. The implementation of FSAP 2022 recommendation on Supervisory Review Process (SRP) – Liquidity Analysis is in progress. Banxico has invited banks to continue their stress test exercises and resume drills to access central bank's liquidity facilities.
Financial Sector Oversight	
Develop and publish a macroprudential policy strategy.	Authorities are continuing to work on a review of macroprudential strategies. The proposal was initially intended to be discussed among various Mexican financial authorities by 4Q2023, but it has been delayed.
Consider expanding the macroprudential toolkit with limits on loan-to-value and debt-service-to-income ratios.	Authorities have a project to review the international experience on LTV and DSTI, to assess possible implementation of these tools in México. The evaluation is expected to be completed by end-2024.
Ensure effective consolidated supervision of financial holding companies.	The CNBV currently monitors indirect risks derived from the activities of non-regulated financial entities through the surveillance of patrimonial ties under the remit of the existing regulatory framework. Furthermore, the implementation of the Large Exposures Framework (LEX), facilitates the exposures' diversification in common risk groups, including those that correspond to non-regulated financial entities belonging to the same control group.
Refine the risk-based supervisory methodology (CEFER) to effectively assess banks' adherence to adequate risk management practices.	The implementation of the FSAP 2022 recommendation on CEFER is in progress. The CNBV is analyzing the suitability of the recommendation for using the CEFER as a tool to request capital under the supervisory framework. Currently, the CNBV has the annual Capital Adequacy Assessment (ICAAP, SRP) as a supervisory tool that is part of the additional capital requirements. This tool includes adverse scenarios, both internal scenarios set by the bank and those determined by CNBV, in which certain aspects of risks that are not captured in the capital requirements under Pillar 1 are considered, comprising projections measurements in which the bank's characteristic risks and its strategy are evaluated for the subsequent two years. In the event of capital shortage, the CNBV can request preventive solvency action plans.

FSAP Recommendations	Development
Continue developing the cybersecurity strategy for the financial system; improve cybersecurity regulatory and supervisory practices.	Authorities have enhanced the structures and procedures to exchange information in the Data Security Incidents Response Group (Grupo de Respuesta a Incidentes de Seguridad de la Información, GRI). The implementation of the FSAP 2022 recommendation on cyber risk roles and responsibilities is in progress. There are several projects to improve cybersecurity regulation and supervisory practices, such as: - Updating the cybersecurity strategies of the financial system; - Clarifying roles and responsibilities related to cyber risks. Banco de México has developed a modification project of Internal Regulations that clarifies roles and responsibilities about cybersecurity, between different units. - Setting clear regulatory requirements for FMI; DALI, CCV and Asigna. Banco de México has reviewed and updated a regulation project for CCV based on international cybersecurity frameworks. This project, is in drafting process.
Improve cyber response and recovery capabilities; conduct market-wide cyber crisis simulation exercises.	Authorities are working on several projects to improve cyber response and recovery capabilities. The implementation of the FSAP 2022 recommendation on cyber resilience capacity is in progress. Measures currently implemented include: - Strengthening the Data Security Incidents Response Group by including all Mexican financial authorities, improving their response capacity though crisis simulation exercises and the development of predefined formats for public communication; - Conducting two cyber crisis exercises with further scope to conduct additional exercises involving FMIs and the broader financial sector, in addition to banks; - Conducting a red team exercise on Banxico's IT environment; - Developing a cyber-map to assess transmission channels. Banxico has defined the scope of the cyber mapping for the systemically important FMIs it regulates; - Including cyber security risks as part of regulation, including rating financial entities by considering their cyber risks and prioritizing cyber risk supervision based on each entity systemic importance. - Using independent third-party reports to assess financial institutions' compliance levels regarding cyber regulation. - Adopting incident response protocols and playbooks for off-site supervision;

FSAP Recommendations	Development
	-Developing and monitoring of the Information Security Sensitive Incident Response Group (GRI) Collaboration Site and the GRI Cyber Intelligence Exchange Platform (MISP), aimed at collecting information relating to sensitive documents and cyber security for the use of financial authorities that are part of the GRI; -Playing an effective role in enhancing cyber deterrence. Banxico published in May 2022 a guide for collecting forensic evidence for the financial system. - Requiring all new Memoranda of Understanding signed by CNBV with foreign financial authorities to cover a clause on cybersecurity information sharing.
Issue supervisory guidance on climate-related risk management, governance, and business strategies; introduce disclosure requirements of climate and ESG information.	The issuance of supervision expectations and guidelines will be part of an institutional project of Mexican Financial Authorities for 2024/2025. In August of 2023, Banxico submitted to public consultation amendments to Provisions 4/2012 (in relation to derivatives) to incorporate the identification, measurement, assessment, and track- keeping of climate and environmental risks stemming from derivative products under the functions of the Risk Management Unit. The implementation of the FSAP 2022 recommendation on cyber risk guidance for all supervised entities is in progress.
Financial Integrity	
Implement the remaining 2018 Mutual Evaluation Report recommendations.	Authorities have adopted several high-level actions for the mitigation of the risks identified in the Mutual Evaluation Report of 2018, implementing reforms in 2019, 2020, 2021, 2022 and 2024 to its General Provisions with the aim of: - Adding criteria to differentiate the risks of Terrorist Financing from Money Laundering. - Adopting new technologies and alert systems for the mitigation of ML/TF risks. - Requiring banks to submit to the CNBV an annual report regarding their individual exposure to ML/TF risks. - Developing best practices for banks operating in high-risk jurisdictions or with low ML/TF risks mitigation regimes, including an alert system for operations involving people on the List of Blocked People, Politically Exposed People or sanctioned jurisdictions.
Systemic Liquidity and Crisis Management	
Review the liquidity risk mitigation framework for development banks.	The implementation of the FSAP 2022 recommendation on bank idiosyncratic risk profiles is in progress. The 2022 FSAP identified a group of banks whose liquidity remained low, given regulatory standards.

FSAP Recommendations	Development
Explore options to enhance the ELA framework.	Banco de México has updated its standing liquidity facility and is preparing an assessment of its liquidity facilities to determine if changes are warranted.
Further strengthen mechanisms to ensure the credibility and feasibility of banks' financial contingency arrangements while preserving resolvability and cost-effective resolutions.	No measures taken.
Introduce statutory bail-in powers and eliminate barriers to the effective use of the purchase and assumption and bridge bank tools.	Authorities are currently working on a legislative proposal to introduce bail-in as a complementary resolution tool. Authorities are also working on regulatory changes to allow for an effective operational use of the purchase and assumption and bridge bank tools.
Shorten the resolution planning cycle for D-SIBs and midsize banks, and eliminate impediments to banks' resolvability.	In the 2Q23, IPAB reformed its rules to shorten the resolution planning cycle for DSIBs and midsize banks. This adjustment reduces the time intervals for updating their resolution plans. Authorities are currently working on a legislative proposal aimed at establishing mechanisms to mitigate or eliminate impediments to bank resolvability identified in resolution planning.
Financial Development Issues	
Broaden the scope of regulated fintech activities; finalize the implementation of open finance (¶61-62).	As part of the activities of the National Council for Financial Inclusion (CONAIF, for its Spanish acronym), in 2Q2023 CNBV and Banco de México launched several working groups aimed at discussing, consumers' consent and personal data protections, authentication methods, the architecture for data exchange through APIs and cybersecurity considerations. In 4Q2023, CNBV presented to the CONAIF a roadmap to implement open banking in the context of art. 76 of the Financial Technological Institutions Law. The implementation of the FSAP 2022 recommendation on Fintech activities, including their competition regulation, the implementation of article 76 the Financial Technological Institutions Law, as well as open finance digital lending platforms, its governance structure, APIs implementation and consent-based architecture, is in progress.
Establish a national climate finance strategy; set ambitious climate finance targets for development financial institutions (¶64).	In March 2023, the Ministry of Finance published the "Mexico's Sustainable Taxonomy," a classification system that allows the identification and definition of activities, assets or investment projects with positive environmental and social impacts, based on established goals and criteria. The goal is to provide certainty and transparency to financial markets,

FSAP Recommendations	Development
	encourage investment in sustainable activities, and better monitor financial flows for sustainability, with precise and consistent definitions. Additionally, in September 2023, the Ministry published the Sustainable Finance Mobilization Strategy, which seeks to redirect capital flows toward sustainable projects, with the Taxonomy being a key component of this Strategy.

Annex V. Data Issues

Annex V. Table 1. Mexico: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/							
A							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	A	A	A	A	A	A	A
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	A	A	B	A	A		
Granularity 3/	A		A	A	A		
			A		A		
Consistency			A	A		A	
Frequency and Timeliness	A	A	A	A	A		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance*, January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. Data is generally timely, comprehensive, and accurate for surveillance. Fiscal statistics are comprehensive and timely, except for the subnational sector, which is not included in the coverage. In addition, The 2021 Data ROSC mission pointed out that, while source data used for the national and international (GFSM2014) presentations are the same, differences in the classification of transactions and coverage of institutional units make it difficult for users to reconcile the different presentations. The recent updating by INEGI of the CPI basket and weights is welcome.

Changes since the last Article IV consultation. No changes since the last Article IV consultation.

Corrective actions and capacity development priorities. The 2021 Data ROSC mission recommended publishing a table of all institutional units in the public sector and its subsectors, clearly grouping them according to: (i) the coverage of units used in the national presentation; (ii) the coverage used in the international presentation; and (iii) the subsectors of the public sector as described in the GFSM2014. A full adoption of uniform accounting standards at the sub-national level would help obtain an improved measure of public fixed investment in the national accounts.

Use of data and/or estimates in Article IV consultations in lieu of official statistics available to staff. Staff do not use data and/or estimates different from official statistics.

Other data gaps. No data gaps are envisaged.

Annex V. Table 2. Mexico: Data Standard Initiatives

Mexico subscribes to the Special Data Dissemination Standard (SDDS) since August 1996 and publishes the data on its National Summary Data Page. The latest SDDS Annual Observance Report is available on the Dissemination Standards Bulletin Board (https://dsbb.imf.org/).

Annex V. Table 3. Mexico: Table of Common Indicators Required for Surveillance

(As of October 15, 2024)

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Mexico[8]	Expected Timeliness[6,7]	Mexico[8]
Exchange Rates	Oct, 2024	Oct, 2024	D	D	D	D	...	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Oct, 2024	Oct, 2024	W	W	M	30	1W	30
Reserve/Base Money	Oct, 2024	Oct, 2024	W	W	M	7	2W	2
Broad Money	Sep, 2024	Sep, 2024	M	M	M	30	1M	30
Central Bank Balance Sheet	Oct, 2024	Oct, 2024	W	W	M	7	2W	2
Consolidated Balance Sheet of the Banking System	Sep, 2024	Sep, 2024	M	M	M	30	1M	30
Interest Rates[2]	Oct, 2024	Oct, 2024	D	D	D	D	...	D
Consumer Price Index	Sep, 2024	Oct, 2024	Bi-W	Bi-W	M	M	1M	10
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	Aug, 2024	Sep, 2024	M	M	A	30	2Q	30
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Aug, 2024	Sep, 2024	M	M	M	30	1M	30
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Aug, 2024	Sep, 2024	M	M	Q	30	1Q	30
External Current Account Balance	June, 2024	Aug, 2024	Q	Q	Q	90	1Q	70
Exports and Imports of Goods and Services	Sep, 2024	Oct, 2024	Q	Q	Q	90	1Q	90
GDP/GNP	June, 2024	Aug, 2024	Q	Q	Q	90	1Q	75
Gross External Debt	June, 2024	Aug, 2024	Q	Q	Q	90	1Q	90
International Investment Position	June, 2024	Aug, 2024	Q	Q	Q	90	1Q	90

[1] Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than.

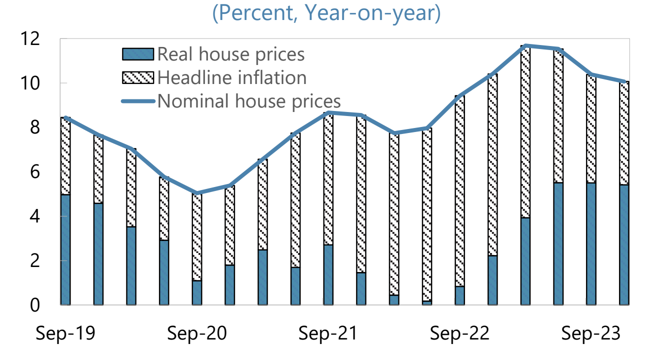
[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.

[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

Annex VI. Housing Market Developments in Mexico[1]

1. Housing prices remain resilient, notwithstanding some recent deceleration. After increasing sharply in 2022, house price inflation moderated in 2023, owing to some increases in borrowing costs as monetary policy contracted. However, demand for real estate continues to be supported by dynamic real wages and employment growth, as well as expansion of production in the north. As such, property prices have grown faster in Mexico than in peer countries, with the price-to-income ratio increasing by over 10 percent since 2019.

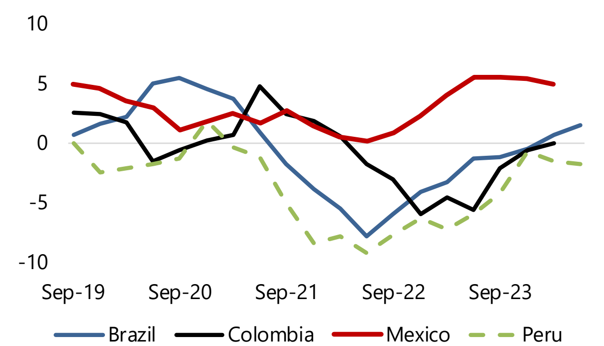
Nominal House Price Decomposition in Mexico
(Percent, Year-on-year)



Sources: Bank of International Settlements,and IMF staff calculations.

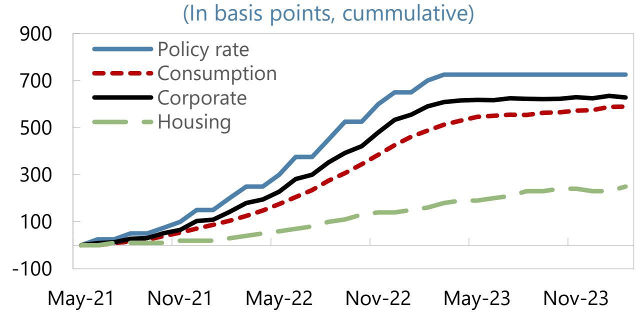
2. Passthrough of the policy rate to mortgage rates has been limited. Mortgage rates are relatively insensitive to changes in the policy rate as 65 percent of loans are provided at a non-market-based interest rate determined by Infonavit (a public institution supporting affordable housing). While rates on new market-based loans have increased by up to 900 bps (basis points) to 28 percent since 2021, the average mortgage rate provided by Infonavit has increased more moderately and has remained close to 11 percent. Considering the existing loan stock, with an estimated 20-year average duration, average mortgage rates increased by only 135 bps over the same period, despite an increase in the policy rate of 750 bps. As Infonavit loans represent a large share of the mortgage market, average borrowing costs for new mortgages remained broadly contained, supporting housing market activity through monetary policy tightening.

Real Houses Prices
(Percent change, y/y)



Sources: BIS, and IMF staff calculations.

Interest Rates
(In basis points, cummulative)



Sources: Banxico, Quarterly Report Apr-June 2024.
Note: Cummulative basis points between May 2021 and February 2024.

[1] Prepared by Francisco Arizala, Corrado Macchiarelli, and Hugo Tuesta.

More recently, activity in the housing market has accelerated, with the start of a loosening monetary policy cycle translated into lower borrowing costs (see also Bank of México, 2024).

3. Demographic trends and urbanization are significant factors influencing the housing market. Mexico's population growth and urbanization are driving persistent demand for housing, especially in metropolitan areas, with the most dynamic regions in terms of price increases located in the northern and eastern parts of the country (namely, Baja California Norte and Sur, Nayarit, Sinaloa, Sonora, and Queretaro). Housing prices have also benefitted from an increase in foreign buyers, including because of capital gains tax exemptions and a reduced rate for foreign property tax for U.S.-based buyers.

4. Growing construction costs and land-use constraints continue to limit the supply of new housing. These limitations hinder real estate developments and worsen affordability problems, especially for lower-income population groups (World Bank, 2022). Resolving these issues calls for continued cooperation between public projects, developers, and legislators (Banxico, 2024). Recent initiatives, including housing subsidies and simplification of property registration, have been instrumental in supporting the construction of affordable housing and improving accessibility (Maravalle and others, 2024).

5. The provision of subsidized loans by Infonavit has been crucial in enhancing housing affordability. Supported by social security contributions (of five percent of employees' salaries), Infonavit offers housing loans at favorable rates, with a loan-to-value ratio of up to 99 percent (compared to a median LTV of 70 percent in the rest of the system). Although delinquencies of Infonavit's mortgage portfolio are higher than for mortgages obtained through traditional banks, the fund does not pose large risks to financial stability as its solvency is guaranteed by automatic payroll contributions. However, the fund may contribute to the buildup of contingent liabilities at risk in the event of mortgage market stress. Importantly, the fund's loans have been instrumental in reducing housing inequality and supporting economic stability (see also World Bank, 2022). More recently, reforms at Infonavit have focused on increasing its operational effectiveness and expanding its impact, including through improved loan conditions and broadener eligibility criteria for clients.

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Maravalle, Alessandro, Aida Caldera Sánchez, and Alberto González Pandiella, 2024, "Improving Housing and Urban Development Policies in Mexico," in OECD Economic Surveys: Mexico 2024 (Paris: OECD Publishing).

World Bank, 2022, "Mexico—Access to Affordable Housing Project," (Washington: World Bank Group).

Annex VII. A Buffer-Stock Model for Fiscal Policy[1]

1. **The authorities' ambitious fiscal consolidation agenda is consistent with a model-based assessment balancing debt sustainability with economic stabilization**. Considering this trade-off, a stochastic "buffer-stock" model, drawing on Fournier (2019) and elaborated in Fournier and Roemer (forthcoming), suggests that the plan to reduce fiscal deficits substantially in 2025 may be close to an optimal fiscal stance. This annex describes this model, applying it to Mexico.

2. **The model comprises the following elements**:

- A benevolent government that decides its fiscal stance—defined as a change in the structural primary balance—using its discretionary policy.
- Debt financing is available, with a share of debt issued in foreign currency.
- In addition to growth, exchange rate and potentially stock-flow adjustment shocks, the government also faces a risk of losing market access.

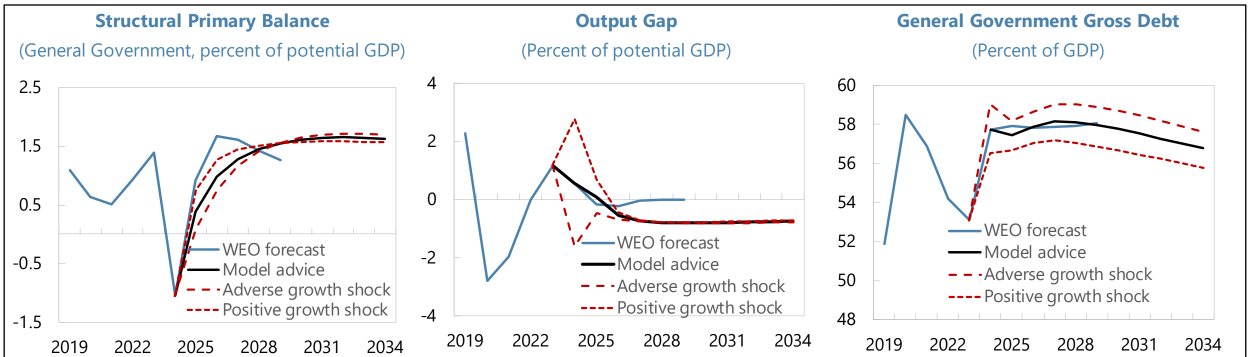
The government can help counter adverse growth shocks with fiscal policy, boosting output and reducing permanent scarring effects. However, this comes at the cost of increasing debt. Fiscal policy is also constrained by implementation lags and adjustment costs.

3. **In the model, outcomes depend on lagged output gap, debt, and the exchange rate:**

- Governments try to smooth the cycle. A counter-cyclical fiscal policy dampens recessions and avoids distortions from overheating, improving short-term utility and reducing scarring. However, shocks are not fully offset due to adjustment costs and implementation delays.
- Governments react to rising debt to preserve buffers. A lower debt level is a "buffer" that allows governments to increase debt in case of a shock without incurring excessive interest rates or risking market access. When public debt is high, it has to generate surpluses to restore buffers, and the need to react to debt becomes sharper as debt gets larger.
- Highly indebted governments react less to shocks. When the buffer is small, the probability of market stress is high and the marginal value of an extra unit of buffer is large. This provides an incentive to preserve buffers to guard against future shocks.
- Governments look through short-term currency fluctuations to focus on medium-term debt prospects. With the real exchange rate expected to reverse to its long-run mean, a relatively tighter stance is advisable when the currency is stronger and hence expected to depreciate (which would increase future valuation of debt).

[1] Prepared by Jean-Marc Fournier, based on Fournier and Roemer (forthcoming).

4. This model is calibrated to Mexico. Interest-growth rate differentials have been calibrated with a 25-year average over 1998 to 2022. Given Mexico's modest potential growth rate, this differential is around two percentage points, accounting for different borrowing costs for local- and foreign-currency debt. Growth and exchange rate shocks and the steady-state share of FX debt are also inferred from historical data. The fiscal multiplier, set at 0.5, is in the middle of the 0.3-0.7 range estimated for Mexico in Restrepo (2020), consistent with important dampening factors, such as high trade openness and independent monetary policy. The primary balance deteriorates mechanically by 0.15 percent of GDP for each percentage point fall in GDP, reflecting the modest size of tax revenues in the economy. Interest rates increase by 2 basis points for each 1 percentage point increase in the debt-to-GDP ratio, broadly in line with estimates from Henao-Arbeleaez and Sobrinho (2017).



Source: IMF staff calculations.

5. The calibration supports a front-loaded consolidation plan. Given positive output gap and structural primary balance well below the desired medium-term level in 2024, the model recommends an immediate consolidation. This mostly reflects debt considerations, as the current primary balance is well below one that is consistent with debt stabilization. The output is broadly consistent with the current baseline. The model recommends a consolidation effort of around 1½ percentage points of GDP in 2025, slightly smaller than the currently programmed 2 percentage points but complements that with a higher medium-term structural surplus (1.6 percentage points of GDP by 2029 versus 1.3 percentage points in the baseline), to anchor public debt dynamics. This advice is nuanced—a slower growth in 2024 would merit a smaller adjustment to the structural primary balance in 2025 to contain short-term growth costs. Symmetrically, positive surprises to growth would call for a faster consolidation. Growth shocks play a relatively moderate role because of the modest persistence of shocks historically; roughly two-third of shocks dissipate after one year. In contrast, the advice is more sensitive to long-term growth-interest rate differentials: Should interest rates be 50 basis point lower, holding growth constant, the model would tolerate more debt and recommend a lower medium-term structural primary balance (by 0.5 percentage point of GDP).

6. The recommended fiscal stance strategy is consistent with keeping the risk of high debt moderate. In the long run, a consistent implementation of the model's advice would lead, on average, to a lower debt, of around 40 percent (and would remain below 60 percent in 90 percent of scenarios). As debt gradually declines, the necessary surplus would decline as well, and the primary balance would fluctuate to offset shocks, including primary deficits above one percent in about 5 percent of scenarios, typically to counter adverse growth shocks.

Annex VIII. An Assessment of Fiscal Implications of the 2024 Pension Reform[1]

1. The previous administration enacted an extensive reform in the Mexican pension system. The social pension, which was previously means-tested and with relatively low benefit levels, was expanded to become universal in 2019 with benefit levels increased in subsequent years. Further major reforms were implemented in 2020 in the private sector's main pension scheme. These reforms included an increase in contribution rates, loosening of the criteria for eligibility to receive earnings-related and minimum pensions, alongside an increase in the benefits of the latter.

2. In February 2024, a further reform was announced. The reform aims to reinstitute a 100-percent replacement rate for workers who just missed out on the pre-1997 regime (Secretaría de Gobernación, 2024).[2] The Presidential decree outlining the policy indicated that workers who reached 65 years of age and whose pension was equal to or less than the average monthly salary in 2023 (indexed to inflation) should receive a top up to their pension to bring it in line with the average salary of the last year of contributions (Decreto del Fondo de Pensiones para el Bienestar, 2024). However, many parameters (most notably the minimum contribution requirement) have not yet been outlined. A more restrictive interpretation of the decree would be that the minimum years of contribution requirement currently in place for pensions under the 1997 regime would apply equally to the 100 percent replacement rate. However, officials have also noted publicly that at least 1000 weeks of contributions will be required, despite the current 825-week minimum to receive a permanent old-age pension.[3]

3. While the intent of the reform is to equalize pension treatment across workers, the 100 percent replacement rate was not guaranteed under the pre-1997 regime. Following the methodology in Bonthuis (2024), for an individual earning a monthly wage of 10,000 pesos in 2024 with a 25-year career, the replacement rate in 2024 from the pay-as-you-go system would be only 76 percent (or 7,600 pesos).[4] Even this relatively high replacement rate is mostly due to a significant rise in the minimum wage, which sets the benchmark for the minimum pension under the pre-1997 regime. Discounting the 75-percent real increase in the minimum wage since 2020, the replacement rate would have been 57 percent. With the 2020 reform, the replacement rate for the defined

[1] Prepared by Boele Bonthuis.

[2] While the policy rationale assumes that all workers under the pre-1997 regime receive a 100 percent replacement rate, this only holds when the requirement of a 45-year career under the old IMSS rules is met and also depends on the reference wage used. As such, shorter careers will lead to lower replacement rates, again also dependent on reference earnings.

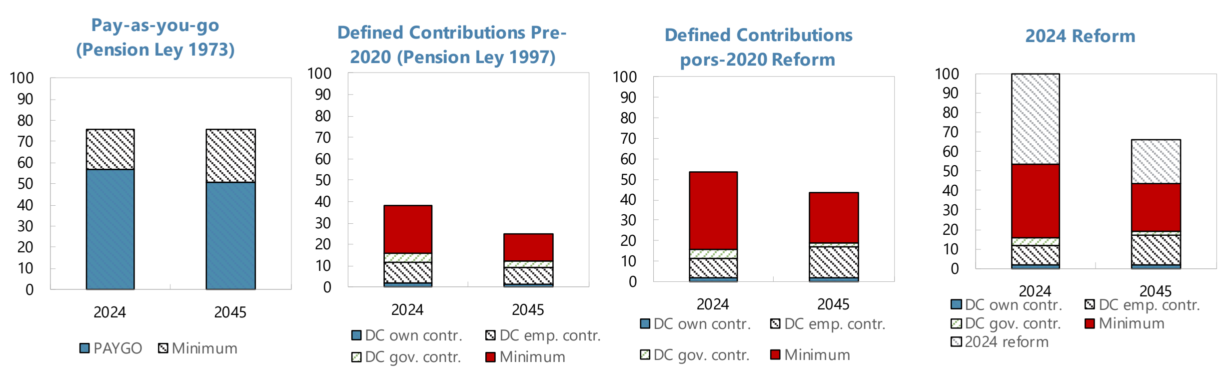
[3] See, for example, Secretaría de Gobernación, 2024, *Reforma en materia de pensiones 2024*.

[4] This constitutes of 27.8 percent accrual for the first 500 weeks of contributions and 2.1 percent in addition for every year, amounting to 59.9 percent total accrual, the calculation of the reference wage brings the actual replacement rate down a little. Although it is unclear which career length is represented in the official presentation, it needs to be at least 1250 weeks, given that the receipt of a permanent pension is presented under the 1997 reform. The post-97 pension would indeed result in much lower replacement rates, although higher (at 38 percent) than the 27 percent replacement rate in the presentation, because of the existence of a minimum pension.

contribution system would be around 54 percent (third chart), due to a substantial hike in minimum pensions in 2020, compared to the 1997 reform (second chart). Consequently, for those meeting the eligibility criteria, the new pension law will be considerably more generous than both the former pay-as-you-go scheme and the 2020 reforms (fourth chart), especially since older people have received a basic pension since 2019 in addition to their contributory pension.

4. The 2019 and 2020 pension reforms increased pension spending in Mexico.[5] While spending on the old pay-as-you-go pension scheme will gradually fall, making the social pension universal, the increases in its benefit level and the large increase in minimum pensions will permanently increase overall pension spending. While the basic pension effectively addresses pressing issues of pension adequacy and poverty among retirees, it also entails a significant increase in pension-related expenditures compared to the pre-2019 baseline. However, spending on minimum pensions is a small contributor to overall pension spending and largely accrue to richer contributors, given the strict eligibility criteria.

Replacement Rates under various Regimes and Iterations of Reforms



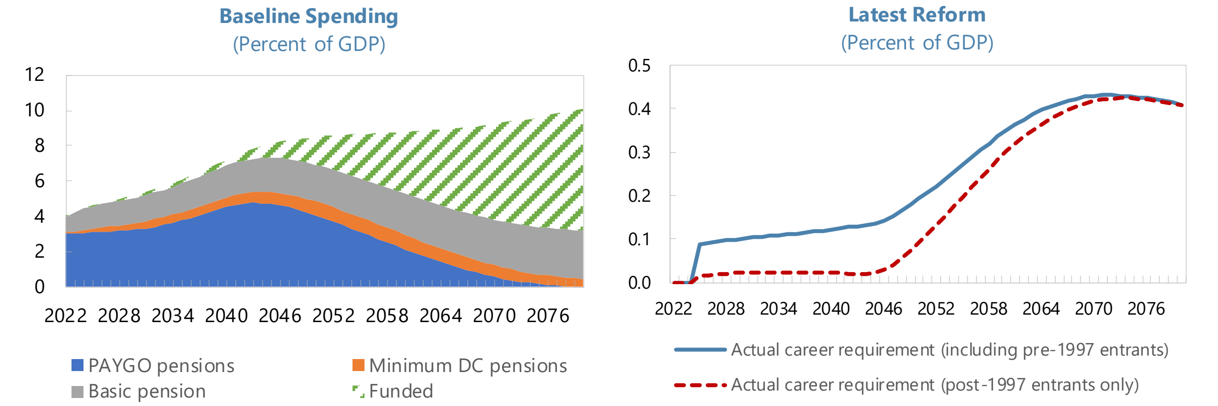
Source: IMF staff calculations.

Note: 25-year carreer at a 10 thousand montly wage in 2024, revalorized with wage growth for earlier and later years.

5. The fiscal impact of the 2024 reform would vary significantly based on its interpretation. Assuming a 100 percent replacement rate for individuals with at least 825 weeks of contributions (rising to 1000 weeks by 2031) who began contributing after 1997, the yearly additional cost would start at 0.02 percent of GDP and increasing to 0.42 percent by 2070. However, excluding contributors before 1997, who do not appear to be the intended target of the reform, may also raise questions. Since contributors before 1997 have the option to retire under the 1997 regime, this could result in legal challenges. Including these individuals would significantly raise the cost in the short run to 0.4 percent of GDP before converging with the other scenarios by 2070 as pension spending is determined by later cohorts.

[5] The IMF's *Pension Expenditure Simulation Tool* was used to simulate pension spending.

Spending Projections



Source: IMF staff calculations.

6. **The 2024 law could be regressive.** The 2024 law seems to exclude higher replacement rates for shorter careers, which is correlated with lower earners, with the low anticipated costs of the reform stemming in large part from criteria which disadvantages individuals with shorter career spans. As a result, the program's social impact may be limited. Ranking prospective pension recipients according to lifetime labor earnings makes this clearer: For cohorts born between 1960-1980, there may be few benefits since a majority entered the labor market before 1997. For subsequent generations, the bulk of the benefits of the pension reform go to men in the sixth to ninth decile. [6] This continues for later generations even if slowly the highest deciles are excluded, both because of rising contributions and because of the cap on benefits of the indexed 2024 average wage.

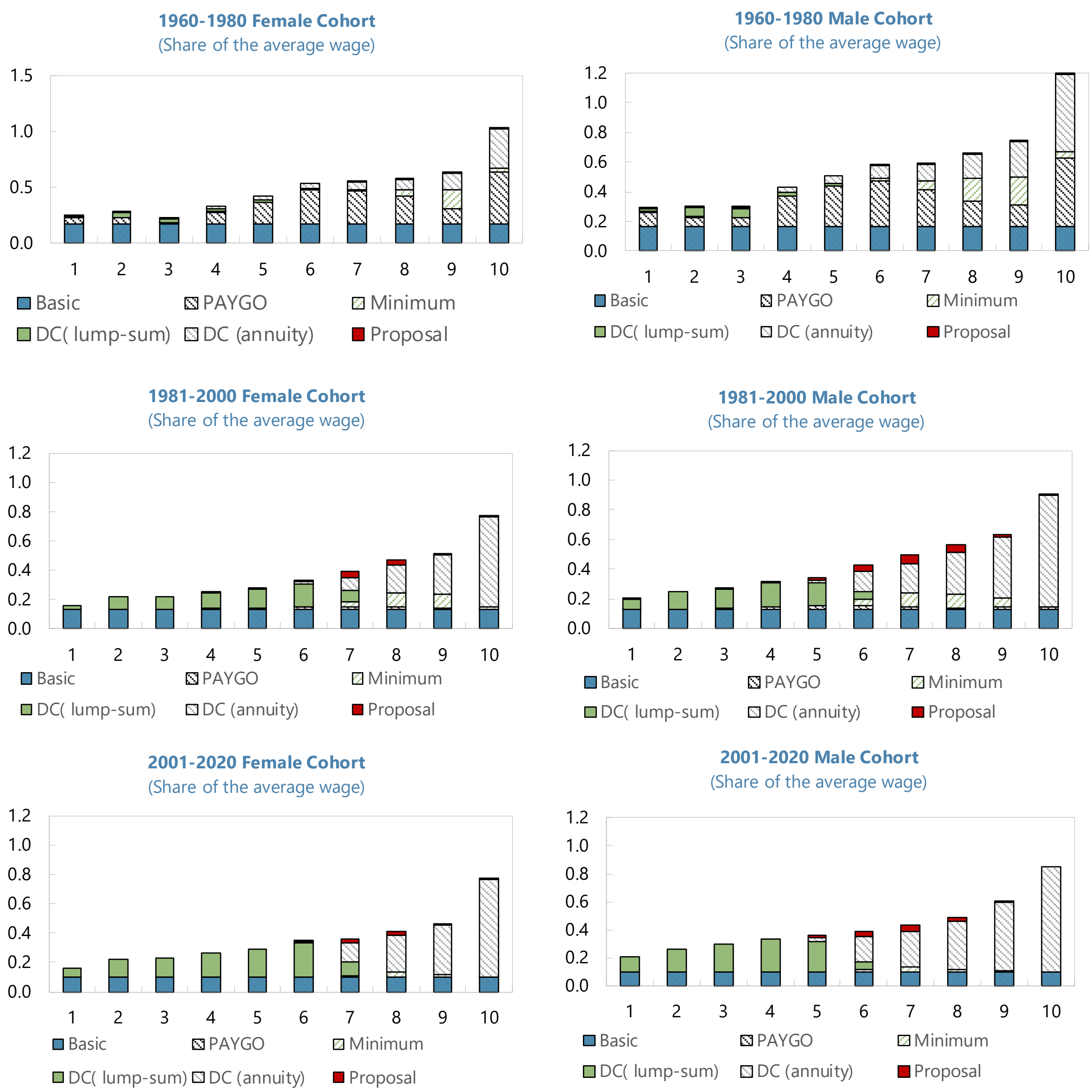
7. **A more effective option to enhance equity and adequacy of the pension system may be to lower the minimum years of contribution requirements for a permanent pension.** The 2020 reform had some regressive features, due to the increased minimum pensions going largely to high earners. However, this could be exacerbated in the 2024 reform by excluding those with shorter careers, who tend to be more financially vulnerable. As such, reducing the years of contribution needed to receive a permanent pension might be a more effective way to support these workers. Pro-rated minimum pension could also be an effective step toward a more equitable pension coverage, but this would need to be combined with measures to contain pension spending. The changing minimum requirements, both compared to the pay-as-you-go system and the changing requirement under the 2020 reform, also raises questions about equitable treatment of pension cohorts. Comparing the 1960-80 cohorts with subsequent ones, it can be seen that their pensions, though relatively low as a share of the average wage for individuals with lower lifetime earnings, still exceed those of later cohorts. Importantly, these pensions are also provided on a permanent basis,

[6] The graphs exclude anyone who has never contributed at all. As such, if accounting for the entire elderly population, the concentration among the higher deciles would be even starker.

contrasting with lump-sum payments received by subsequent cohorts. This is largely due to the increase in minimum years of contribution from 500 weeks to the current 825 (and eventually 1000).

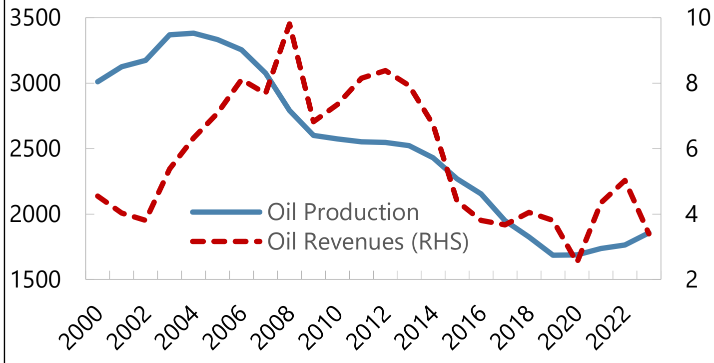
Annex VIII. Figure 1. Mexico: Distribution of Benefits Under the 2024 Reform

(By decile, benefits shown as share of the average wage)



Source: IMF staff calculations.

Annex IX. Pemex: Costs of Support and Reform Options[1]



Sources: PEMEX, WEO, and IMF staff calculations.

1. **Petróleos Mexicanos (Pemex), Mexico's state-owned oil company, continues to face financing challenges.** Its main vulnerability arises from declining output of its extensive mature fields, which constitute the bulk of its proven reserves, combined with a limited level of remaining reserves. While recent contributions from newer fields have temporarily stabilized oil production, output remains well below historical levels. As a result, oil revenues have declined substantially since 2008. Despite repeated government support, Pemex's net cash flow has remained largely flat in recent years, consistently fluctuating around breakeven levels, with several periods with a negative balance, (Table 1), while debt levels (currently at US$99n billion or 5.3 percent of GDP) remain high, with insufficient liquidity to meet its debt obligations and maintain ongoing projects.

Annex IX. Table 1. Mexico: Net Cash Flow, 2019-23

In million of Pesos	2019	2020	2021	2022	2023
Net cash flow from operating activities	85,221	56,120	189,235	356,638	311,946
Net cash flow from investing activities	-111,299	-131,611	-262,236	-372,935	-266,972
Net cash flow from financing activities	4,974	46,810	99,380	11,189	-28,762
Net Increase (decrease) in cash and cash equivalents	**-21,104**	**-28,680**	**26,379**	**-5,108**	**16,211**
In Percent of GDP	-0.08	-0.12	0.10	-0.02	0.05
Debt (in Percent of GDP)	7.89	9.38	8.45	7.10	5.65

Sources: PEMEX, and IMF staff calculations.

2. **Financing challenges remain as the energy-sector framework has been updated.** Reforms in 2008 primarily focused on improving Pemex's governance and operational efficiency, while the 2013 reform was more comprehensive, allowing private investment in the energy sector. While it has not been fully implemented (see Vietor and Thomas, 2016), the 2013 reform enabled Pemex to form partnerships with private companies and introduced new profit-sharing frameworks, aiming to revitalize Mexico's hydrocarbon and electricity sectors and boost long-term viability of Pemex by expanding its financial and operational capabilities.

3. **Pemex has received substantial support in recent years.** Fiscal support measures to ease the company's financial strain have been bolstered by strategic initiatives, such as legislative reforms

[1] Prepared by Matteo Ghilardi and Corrado Macchiarelli

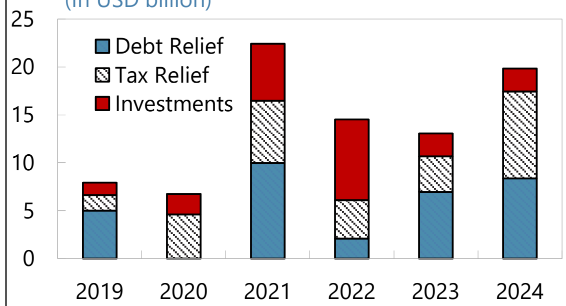
to attract private investment, promote competition, and modernize key infrastructure through targeted programs. These measures, which are estimated to have resulted in a significant fiscal cost of about US$85 billion (or over 5.6 percent of GDP) between 2019-2024, comprise:

- *Tax Support*. Support through tax relief measures amounted to about US$29 billion between 2019 and 2024. The main element was a gradual reduction of the Shared Utility Tax (Derecho de Utilidad Compartida, DUC) from 65 percent in 2019 to 30 percent in 2024, intended to help strengthen Pemex's liquidity.

- *Debt Relief and Capital Injections*. These measures, used to stabilize the company amidst challenges such as low oil prices and high debt, and to support exploration, production, and infrastructure investments amounted to US$32 billion over the same period.

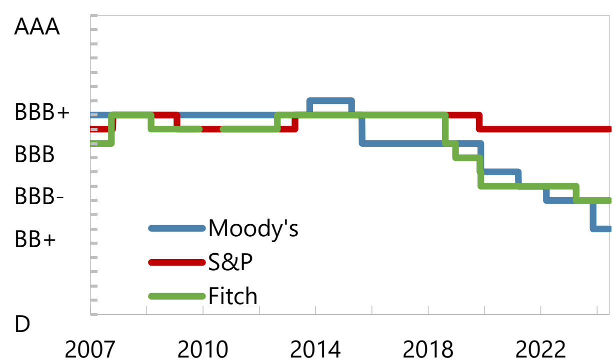
- *Investment Programs*. Totaling around US$23 billion over 2019-2024, these included significant investments in deepwater exploration in the Gulf of Mexico, particularly following the 2013 energy reform, and, from 2016 onwards, modernization of refineries to improve efficiency and meet environmental regulations.

Support to Pemex
(In USD billion)



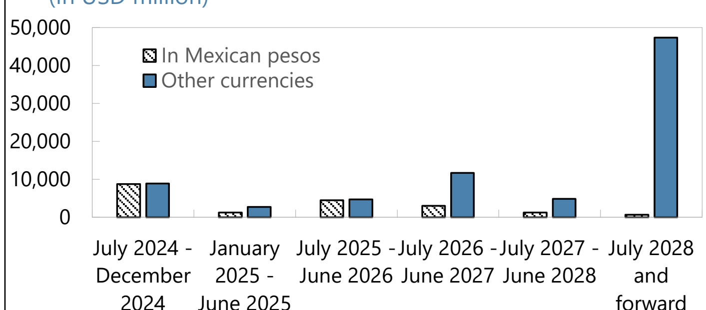
Sources: Pemex and IMF staff calculations.

PEMEX Credit Rating



Source: Bloomberg.

Financial Debt Maturity Profile
(In USD million)



Source: PEMEX Financial Statement, 2024Q2.

4. **The ongoing support for Pemex may entail an indirect cost on the sovereign.** Pemex's liabilities represent a substantial portion of Mexico's sovereign debt. It has received multiple downgrades from credit agencies, with weak liquidity position cited as one of the driving factors, which has necessitated additional government intervention. With around 50 percent of its debt in foreign currency (about US$48 billion, or 2.9 percent of GDP) coming due on or after 2028, market participants may be expecting additional government support in the period ahead. The spread on Pemex's notes due in 2032 over similar Mexican sovereign debt is currently close to 450 basis points

and has trended lower, indicating investors' increasing internalization of government support. Since September 2023, when the government's draft budget for 2024 included a capital allocation to Pemex to cover maturing debts, spreads have declined further. Previous staff analysis (IMF, 2022) has highlighted the need for changes to the governance structure and business strategy to ensure that Pemex remains a viable standalone entity. Since 2015, Pemex's five-year CDS have been decoupling from Mexico's CDS over the same maturity, in line with its lower corporate credit rating. However, this divergence has decreased recently in line with the public support included in the national budget.

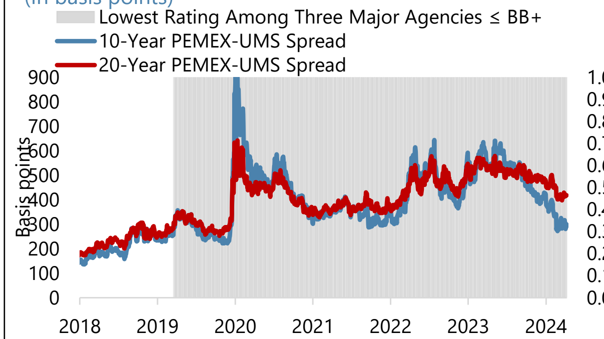
5. These challenges underscore the need for reforms to ensure sustainability and competitiveness, and limit further fiscal costs. Considerations include:

- *Conditional support*. Implementing conditionality in government support—where assistance is linked to performance metrics and operational improvements—could encourage more responsible management practices.

- *Opening the sector to private investments*. Allowing private investment, particularly in deep-water production, could bring in much-needed capital and cutting-edge technological knowhow, given Pemex's current limitations in terms of the equipment, technology, and financial resources required for the exploration and development of new oil and gas reserves. Further private participation would not only increase operational efficiency but would also position Pemex to better exploit existing reserves and undertake new exploration initiatives, thereby enhancing its competitiveness in the global energy market.

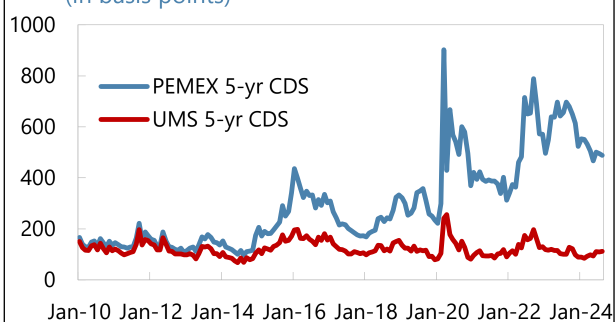
- *Applying the 2013 energy reform and use of energy and infrastructure investment trusts (FIBRA-Es)*. Although there have been prior proposals to sell part of the company's assets, Pemex still has several moderate options for its assets that can be addressed within the Energy Reform legal framework. One example is the option to issue securities that can be traded on the stock markets, specifically as certificates from a FIBRA-E (see Vietor and Sheldahl-Thomason, 2016).

PEMEX 10 and 20-Year Spread vs Mexico
(In basis points)



Sources: Bloomberg and IMF staff calculations.
Note: Shaded area corresponds to ther lowest rating among three major rating agencies in the high-yield ("non-investment-grade") category equal to bonds rated Ba1/BB+ and lower.

Divergence in PEMEX and Mexico's CDS Prices
(In basis points)



Source: Bloomberg.

- *Re-thinking Pemex taxation regime*. To address long-standing structural issues, the government could apply the 2014 Hydrocarbon Revenue Law to Pemex, which would allow them to reduce some of the company's support-related costs through an effective royalty tax (Shah, 2021).

- *Strengthening transparency and accountability mechanisms*. Establishing and reinforcing mechanisms for transparent financial management, including a clear reporting of government subsidies and other forms of support, remain crucial. Moreover, adopting international standards of governance and accountability would help to build trust and confidence among investors, stakeholders, and the broader public.

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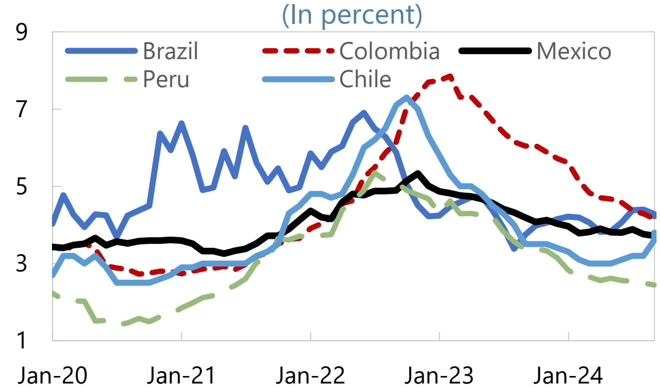
Annex X. Monetary Policy: The Role of Inflation Expectations[1]

1. The recent inflation episode has highlighted the criticality of inflation expectations in restraining inflation. Together with the rise in inflation in the aftermath of the pandemic, inflation expectations also increased substantially across the globe. While in most countries inflation and expectations are now in a downward trajectory, expectations are yet to converge to central banks' target in others. In this context, the literature has discussed the role of the formation of inflation expectations for monetary policy (Cole and others, 2023). In particular, various studies have highlighted how the transmission of monetary policy, including forward guidance, and the output-inflation trade-off, depend on how forward-looking agents are (Gabaix, 2020; Angeletos and Huo, 2020; Hakamada and Walsh, 2024). In essence, the modeling framework shows that in the face of inflationary shocks, the presence of relatively less forward-looking agents impairs the transmission of monetary policy and calls for a tighter monetary policy stance to lower inflation expectations and actual inflation, resulting in a larger output contraction.

LA5: Inflation Expectations

(In percent)



Sources: Haver Analytics, and IMF staff calculations.

2. A New-Keynesian model provides a useful framework to describe how the formation of inflation expectations can affect monetary policy. The basic structure of a small open economy DSGE model consists of an Euler equation and a Phillips curve, both with behavioral discounting capturing less forward-looking agents (Cole and others, 2023), and a standard Taylor rule, a simplified version of which is presented below. The rest of the model features are as described in Chen and others (2023).

Euler equation: $$y_t = \delta \mathbb{E}_t[y_{t+1}] - \frac{1}{\sigma}(i_t - \mathbb{E}_t[\pi_{t+1}]),$$

Phillips curve: $$\pi_t = \beta\delta \mathbb{E}_t[\pi_{t+1}] + \kappa y_t + \alpha \pi_{t-1},$$

Taylor rule: $$i_t = \phi \pi_t + e_t, \quad \text{where} \quad e_t = \rho e_{t-1} + \varepsilon_t \text{ and } \varepsilon_t \sim \text{i.i.d.}$$

where $y_t, \pi_t,$ and i_t are the output gap, inflation, and interest rate, respectively. δ represents the behavioral discounting (lower δ indicates less forward-looking expectations).

3. A weaker inflation expectations channel requires a larger output gap contraction to lower inflation. Given that inflation is determined by inflation expectations, lagged inflation, and

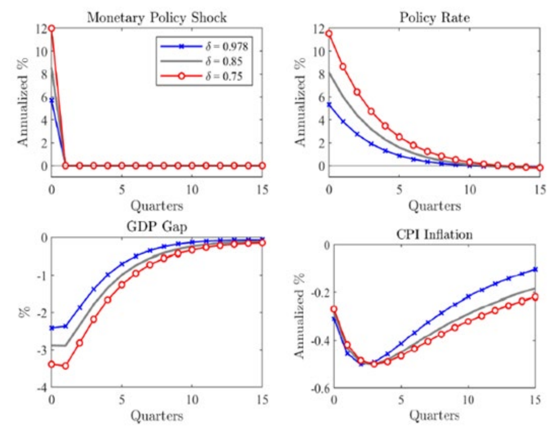
[1] Prepared by Francisco Arizala and Tomohide Mineyama.

the output gap, a weakened expectations channel, i.e., a lower delta, calls for a larger contraction in output to reduce inflation pressures, resulting in a more costly outcome. In the simplified model above, we can analytically show that the sacrifice ratio—the inverse of the coefficient of the output gap on inflation—becomes higher with a lower delta.

$$\pi_t = \underbrace{\frac{\kappa}{1-\beta\rho\delta}}_{\text{The inverse of the sacrifice ratio}} y_t, \quad \text{where} \quad y_t = -\underbrace{\frac{1-\sigma\rho\delta}{\sigma+(1-\beta\rho\delta)^{-1}\kappa(\phi-\rho)}}_{c_y} e_t$$

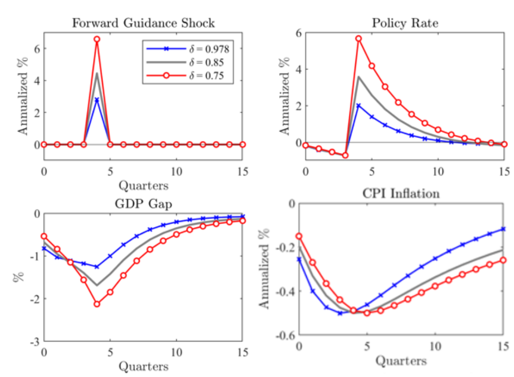
4. A quantitative analysis highlights key implications of the model in a DSGE environment. Simulations with the model parametrized to Mexican data indicate that with lower delta parameters (i.e., less forward-looking agents) transmission of monetary policy is weakened, and the policy stance needs to be more contractionary, to lower inflation by the same amount, resulting in a larger output gap loss. In addition, inflation takes longer to return to target. Similarly, simulations indicate that the effectiveness of forward guidance is weakened with less forward-looking agents, and as a result, in such context, monetary policy is less efficient and more costly in terms of output loss.

Effects of Unexpected Interest Rate Tightening in a DSGE Model



Notes: Deviations from the steady state. The size of shock is calibrated so that the peak inflation response is -0.5 percent. Higher value of δ implies more forward-looking agents.

Effects of Unexpected Interest Rate Tightening including Forward Guidance in a DSGE model

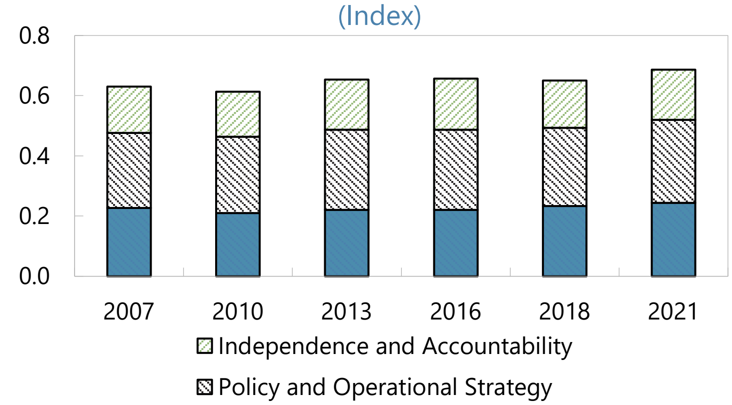


Notes: Deviations from the steady state. The size of shock is calibrated so that the peak inflation response is -0.5 percent. Higher value of δ implies more forward-looking agents.

5. Inflation expectations play an important factor for inflation dynamics in AEs and LA5 countries. Estimates from a hybrid Phillips curve (instrumental variables), where inflation is explained by inflation expectations, past inflation, and the output gap, show that the role of inflation expectations relative to past inflation has been more important among advanced economies (AEs) and the LA5 (Brazil, Chile, Colombia, Mexico, and Peru) than among other EMs (Table 1). A stronger role for inflation expectations in determining inflation likely points to the formation of expectations being more forward looking (IMF, 2023). In addition, a test of rationality of expectations fails to reject the hypothesis that expectations are rational among AEs and LA5, suggesting a more forward-looking formation of inflation expectations in these countries (Table 2). As suggested by the literature, these results can potentially be linked to enhancements to monetary policy frameworks, including increased independence and improved communication (Coibion and others, 2020; IMF, 2023).

6. Strengthened communication strategies have contributed to improving monetary policy frameworks in AEs and Mexico. Having made substantial improvements in independence and accountability, as well as on the policy and operational strategy pillars in previous decades, most recent central bank reforms in AEs—and in Mexico—have focused on communications frameworks (Unsal and others, 2022). Improvements to monetary policy frameworks and communication strategies are welcome as they can help boost the forward- looking nature of price setters through efforts to explain policy decisions and educate the public (WEO, 2023; Haldane and others, 2020). These initiatives can also include targeting segments of the audience that are identified as having more backward-looking expectations and providing enhanced guidance on the assumptions behind the economic outlook (WEO, 2023), remaining mindful of the risk that additional disclosure could be interpreted as a policy commitment (Casiraghi and Perez, 2022).

Monetary Policy Pillars
(Index)



Sources: Unsal, D.F., Papageorgiou, C., and Garbers, H. 2022, and IMF staff calculations.

Regression Tables

Annex X. Table 1. Mexico: Hybrid Phillips Curve Analysis AEs, LA5, and Other EMs

	(1) AEs	(2) EMs	(3) LA5	(4) EMs ex LA5
Next year inflation expectations	0.948***	0.477***	0.613***	0.482***
	(0.216)	(0.072)	(0.187)	(0.070)
Output gap	0.148***	0.505***	0.444***	0.502**
	(0.052)	(0.149)	(0.054)	(0.204)
Inflation (t-1)	0.114	0.290***	0.321***	0.275***
	(0.074)	(0.064)	(0.069)	(0.070)
Exchange rate (percent change)	0.047***	0.122***	0.081***	0.141***
	(0.007)	(0.018)	(0.014)	(0.024)
Observations	1,351	1,494	448	1,046
Country Fixed-effects	Yes	Yes	Yes	Yes
Time Fixed-effects	Yes	Yes	Yes	Yes
R-squared	0.573	0.632	0.735	0.642
Number of ifs	19	17	5	12

Note: The dependent variable is the quarter-on-quarter percent change in the CPI. For explanatory variables, inflation expectations are from Consensus Forecast, and the output gap corresponds to IMF staff estimates. Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1.

Annex X. Table 2. Mexico: Test of Rationality, AEs, LA5, and other EMs

Variables	(1) AEs	(2) EMs	(3) LA5	(4) EMs ex LA5
Next year inflation expectations (t-4)	0.718***	0.719***	0.648***	0.750***
	(0.056)	(0.052)	(0.148)	(0.061)
Inflation (t-5)	-0.051	-0.138***	-0.089	-0.166***
	(0.037)	(0.042)	(0.085)	(0.051)
Constant	0.454*	2.286***	1.259	2.664***
	(0.243)	(0.651)	(0.876)	(0.857)
Observations	2,220	1,268	373	895
Country Fixed-effects	Yes	Yes	Yes	Yes
Time Fixed-effects	Yes	Yes	Yes	Yes
R-squared	0.535	0.466	0.432	0.514
Number of ifs	30	17	5	12

Note: The dependent variable is the year-on-year percent change in the CPI. For explanatory variables, inflation expectations are from Consensus Forecast and lagged inflation is the year-on-year percent change in the CPI. Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1.

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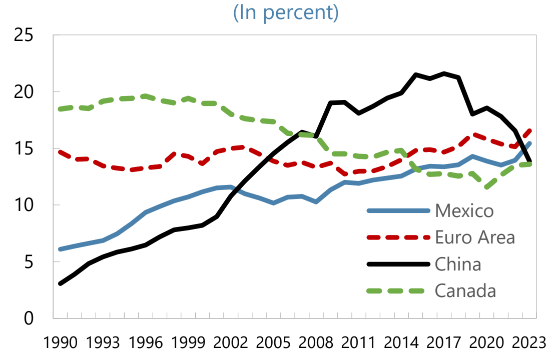
Annex XI. Relocation of Global Value Chains: The Role of Mexico[1]

1. Mexico is increasingly integrated into the U.S. market. Since the introduction of NAFTA in 1992, Mexico has benefited from its favorable access to the U.S. market, with Mexico steadily increasing its share of U.S. imports. Given Mexico's relative cost competitiveness, productivity, and established logistics networks, this integration with the U.S. has continued even in the face of intensified geoeconomic fragmentation, with Mexico becoming the most important U.S. trading partner in 2023, representing 15.4 percent of total U.S. imports, and displacing China whose share has declined from its peak in 2017, prior to the introduction of U.S. tariffs on imports from China.

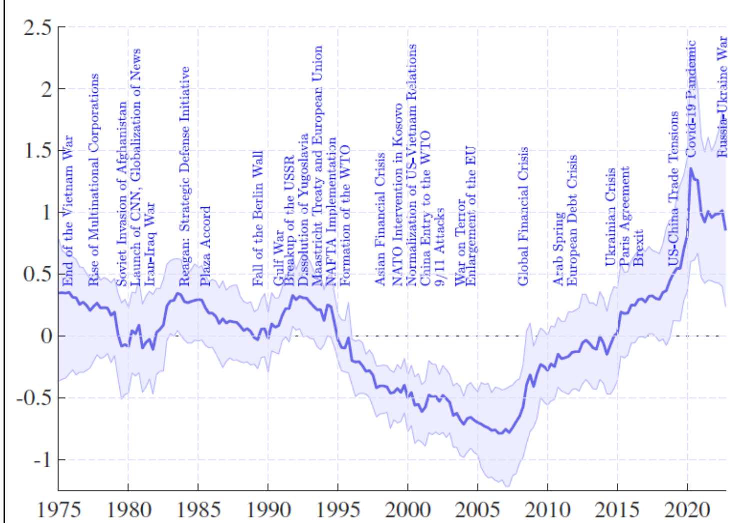
Share of US Imports
(In percent)



Sources: Haver Analytics, and IMF staff calculations.

2. This integration is taking place amidst increased geopolitical fragmentation. The post-war growth in trade was interrupted by the GFC and subsequently negatively affected by other events with global implications such as the Arab Spring and Brexit. Global trade has further slowed down as geopolitical fragmentation accelerated with the rise in U.S.-China trade tensions, the pandemic, and Russia's invasion of Ukraine (Fernández-Villaverde and others, 2024; Gopinath and others, 2024).

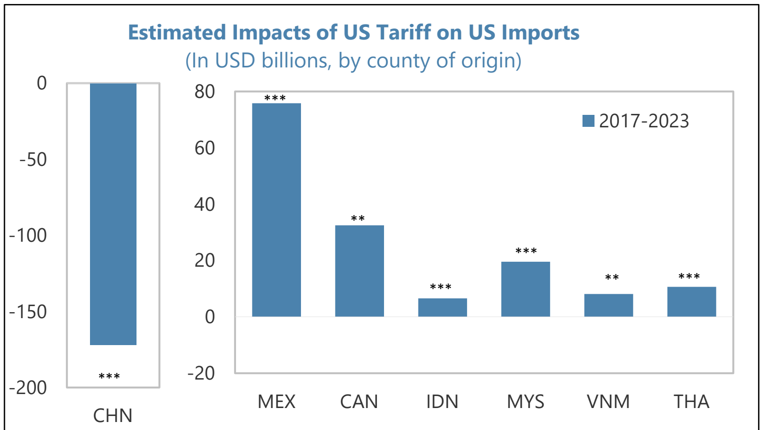
Geopolitical Fragmentation Index
(Index)



Source: Fernández-Villaverde and others (2024).
Notes: The index is derived from various empirical indicators using a dynamic factor model. The solid line displays the posterior median-smoothed estimates whereas the bands show the 90th percentile credible intervals.

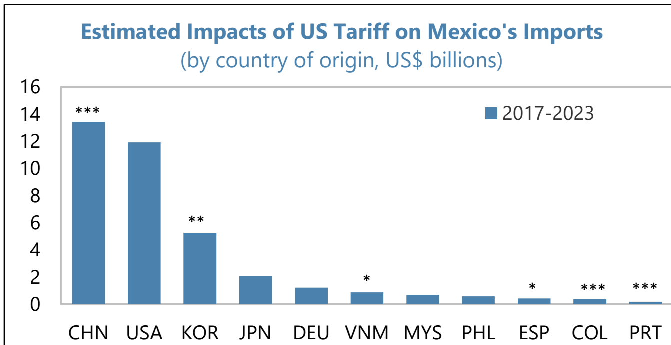
3. Increased fragmentation has led to relocation of global supply chains. The introduction of U.S. tariffs on Chinese products in 2018-19, the aftermath of the pandemic, and Russia's invasion of Ukraine, as well as rising costs of Chinese labor and higher trans-Pacific shipping costs have contributed to important relocation of supply chains across the globe. While U.S. imports from China have declined substantially since 2018, the share in U.S. imports of Mexico and other trading partners, including countries in Southeast Asia, have increased over the same period. Indeed, a

[1] Prepared by Francisco Arizala, Tomohide Mineyama, and Hugo Tuesta.



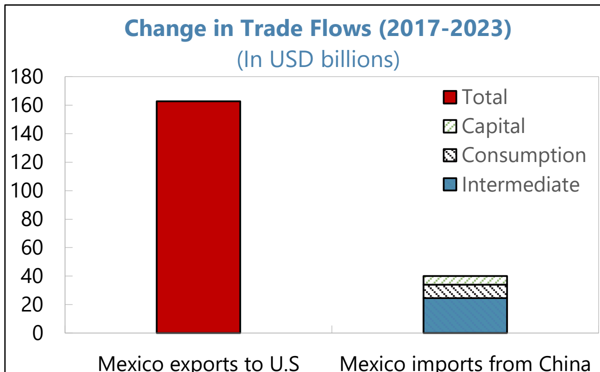
Source: IMF staff calculations.
Note: Stars mean significance as *** p<0.01, ** p<0.05, * p<0.1.

difference-in-difference analysis (Arizala and others, forthcoming) using six-digit product level trade data (building on Wang and Hannan, 2023) shows that Mexico and other U.S. partners have increased their exports to the U.S. by more in those industries that were affected by the 2018-19 tariffs on Chinese products. In the case of Mexico, the estimated impact (of around US$75 billion) accounts for around 45 percent of the total increase in Mexico's exports to the U.S. during 2017-2023. Mexico's imports of intermediate goods that are inputs to those products affected by the 2018-19 tariffs have also increased, although by smaller amounts, originating from various other EMs, including in Asia. This suggests that Mexican firms are increasingly part of global value chains connected to the U.S., consistent with the literature that finds that net exports of Mexican firms integrated to global value chains increased after the introduction of the U.S. tariffs on imports from China in 2018 (Utar and others, 2023), and that U.S. import growth from other countries than China after 2018 was higher on products with higher trade integration with China in 2017 (Freund and others, 2024).



Source: IMF staff calculations.
Note: Stars mean significance as *** p<0.01, ** p<0.05, * p<0.1.

4. **Exports of manufactures represent most of the increase in Mexico's exports to the U.S.** Between 2017-23 Mexico's exports to the U.S. increased by US$163 billion, with vehicles and cars representing about 30 percent of the total increase, followed by exports of computing and electronic products, accounting for about 15 percent. Over the same period, Mexico's imports of intermediate goods from China increased by only a fraction of the increase of Mexico's exports to the U.S. (US$40 billion), suggesting that final products exported from Mexico to the U.S. contain significant valued added from Mexico and other trading partners.

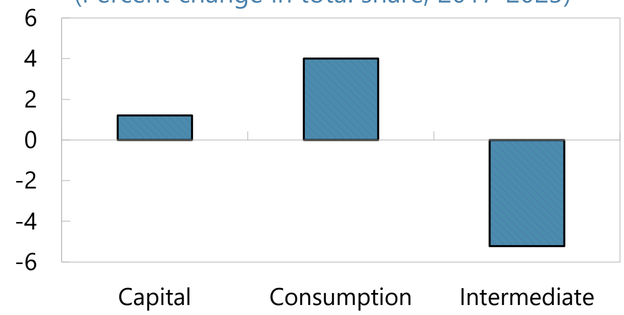


Sources: INEGI, UNComtrade, and IMF staff calculations.

5. Mexico's imports from China are now less concentrated on intermediate goods, with increased consumption goods imported for the domestic market. Mexico's imports of final goods (consumption and capital) from China have increased as a share of total imports (by about close to 6 percentage points), reflecting changes in Mexican households' consumption patterns and increased imports of machinery to increase productive capacity. In fact, at the six-digit product level, large increases in Mexico's imports from China over 2017-23 are observed in consumption goods, especially smartphones and flat panel screens. In addition, imports of vehicles from China are increasingly supplying the domestic market in Mexico, with sales of Chinese vehicles gaining an important share in the Mexican market.

Mexico's Imports from China

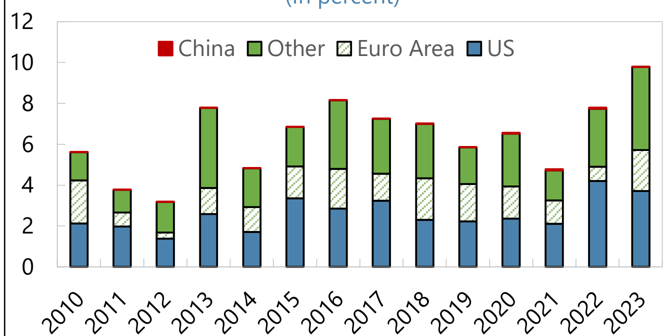
(Percent change in total share, 2017-2023)



Sources: Haver Analytics, INEGI, and IMF staff calculations.

Mexico's FDI Share within EMs

(In percent)



Sources: WEO, and IMF staff calculations.

Note: EM includes BRA, CHL, COL, CHN, IND, IDN, MEX, PER, PHL, POL, ROU, RUS, ZAF, THA, TUR, VNM.

6. FDI to EMs has been increasingly directed towards Mexico. Increased export penetration by Mexico in the U.S. market has been accompanied by a rise in Mexico's share in global FDI to EMs, rising from 6 percent on average in the 2010s to close to 10 percent in 2023, suggesting augmented interest from firms to invest in Mexico to supply to the U.S. market. In fact, most of the growth in the concentration of global FDI to Mexico among EMs has been led by investment flows from the U.S. and the Euro Area. While Mexico is increasingly attracting interest from investors across the globe, as shown by elevated amounts of FDI announcements, FDI has continued to come predominantly from the U.S. (around 40 percent of total), the Euro Area (20 percent of total) and other advanced economies, including Japan, Canada, the UK, and Korea.

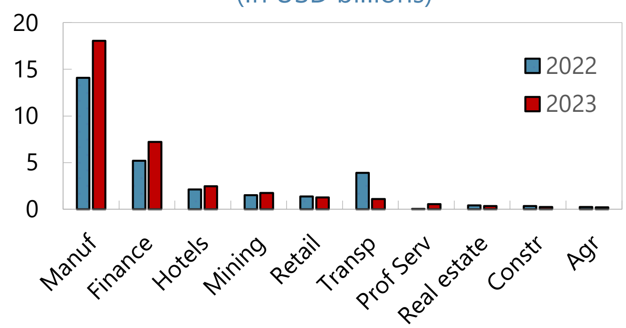
FDI

(In USD billions, 2023)

Sources: National Authorities, and IMF staff calculations.

7. FDI to Mexico remains highly concentrated in terms of its regional and sectoral destination. FDI inflows to Mexico are mostly clustered in the northern states, where proximity to the U.S. facilitates the transportation of inputs and final products between the two countries. Indeed, most FDI over the past decade, and the acceleration in foreign investment in recent years, has been mainly directed to Sonora, Nuevo Leon, Jalisco, and Chihuahua, in addition to Mexico City. Furthermore, the sectors benefitting the most from FDI are those involved in the production of exports to the U.S, such as manufacturing (particularly vehicles and electronics industries), finance, and real estate. Similarly to the analysis on trade flows mentioned above, a difference-in-difference analysis (Arizala, Mineyama, and Tuesta, forthcoming) using four-digit industry level FDI data shows that FDI directed to Mexico increased more in industries that were affected by the 2018-19 U.S. tariffs on Chinese products. The analysis also finds that, since 2017, FDI directed to the northern states increased more than those in located in the south.

Mexico's FDI by Sector
(In USD billions)



Sources: National Authorities, and IMF staff calculations.

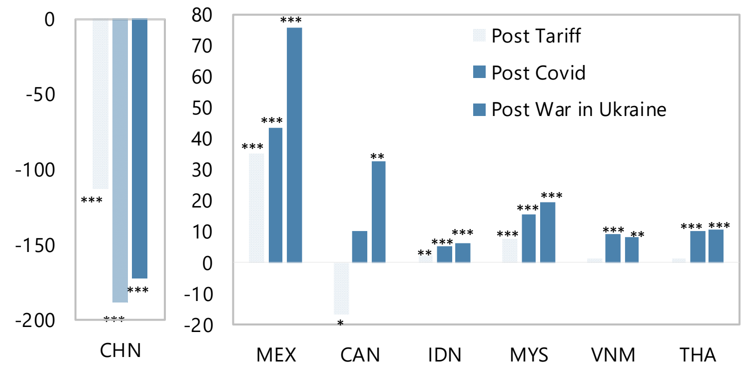
8. **Deeper integration to the North American market and global value chains provides opportunities for Mexico.** Overall, findings presented in this annex suggest that a range of factors—including cost competitiveness, proximity, deeper trade integration owing to USMCA membership, and various trade measures—have allowed Mexico to expand its participation in global value chains, particularly for goods destined to the U.S., even as the dynamics of global value chains may present some inherent uncertainty. As part of this extended role in supply chains, Mexico has also increased its imports of a range of inputs from a broad range of countries. FDI into Mexico has been instrumental in supporting this increasing share of Mexico in U.S. imports, with much of that FDI coming from the U.S. itself. Fully taking advantage of these favorable dynamics will require improving the environment for private investment and business development, including opening markets to private sector participation, streamlining regulations, and addressing critical infrastructure gaps—in energy, transport, and water.

Regression Tables

Annex XI. Table 1. Mexico: Estimated Impact of 2018-19 U.S. Tariffs on Exports to the U.S.
(In percent)

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Variables/Country	CHN	MEX	CAN	GTM	HND	IDN	MYS	VNM	THA	AUT	POL
Tariff increase × Post Jul 2018	-1.285***	0.364***	0.084	1.108***	1.025***	0.749***	1.050***	0.415**	0.642***	0.440**	0.796***
	(0.076)	(0.107)	(0.090)	(0.326)	(0.373)	(0.195)	(0.253)	(0.166)	(0.154)	(0.183)	(0.215)
lagged ln(US imports)	0.414***	0.539***	0.419***	0.402***	0.498***	0.442***	0.442***	0.528***	0.440***	0.284***	0.360***
	(0.007)	(0.009)	(0.008)	(0.019)	(0.022)	(0.012)	(0.012)	(0.010)	(0.010)	(0.010)	(0.010)
N. of observations	328,669	234,849	289,195	26,249	19,389	88,706	80,701	116,075	122,143	96,719	98,681
R-squared	0.903	0.923	0.914	0.843	0.892	0.844	0.846	0.868	0.848	0.801	0.799
ID FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Time FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Note: Standard errors (SEs) in parentheses. SEs are clustered by HS6-digit code. Sample period: 2016M1-2023M12.
*** p<0.01, ** p<0.05, * p<0.1



Source: IMF staff calculations.
Note: Stars mean significance as *** p<0.01, ** p<0.05, * p<0.1.

Annex XI. Table 2. Mexico: Estimated Impact of 2018 U.S. Tariffs on Mexico's Imports by Country of Origin
(In percent)

	Dependant variable: **ln(MEX imports)**																	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	(17)	(18)
Variables/Country	CHN	USA	BRA	CHL	COL	PER	IDN	MYS	PHL	VNM	THA	JPN	KOR	DEU	ESP	POL	PRT	All
Tariff increase × Post Jul 2018	0.361***	0.104	-0.728*	2.023**	2.587***	-0.157	0.317	0.226	0.435	1.156***	0.242	0.183	0.438	0.315*	0.498**	-0.716	2.136***	-0.129*
	(0.097)	(0.090)	(0.376)	(0.913)	(0.731)	(1.587)	(0.443)	(0.400)	(0.568)	(0.349)	(0.354)	(0.196)	(0.308)	(0.179)	(0.219)	(0.876)	(0.683)	(0.066)
lagged ln(MEX imports)	0.363***	0.374***	0.292***	0.343***	0.228***	0.282***	0.341***	0.380***	0.445***	0.418***	0.413***	0.328***	0.379***	0.267***	0.230***	0.420***	0.403***	0.333***
	(0.009)	(0.009)	(0.016)	(0.061)	(0.030)	(0.038)	(0.021)	(0.020)	(0.027)	(0.016)	(0.021)	(0.014)	(0.016)	(0.012)	(0.012)	(0.031)	(0.024)	(0.008)
N. of observations	187,982	239,398	31,836	2,312	8,928	2,251	23,541	23,947	13,056	31,568	30,812	79,315	58,793	101,391	67,090	20,608	11,971	280,247
R-squared	0.883	0.929	0.822	0.901	0.814	0.857	0.812	0.867	0.886	0.855	0.839	0.893	0.870	0.851	0.772	0.790	0.770	0.918
ID FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Time FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Note: Standard errors (SEs) in parentheses. SEs are clustered by HS6-digit code. Sample period: 2016M1-2023M12.
*** p<0.01, ** p<0.05, * p<0.1

Annex XI. Table 3. Mexico: Estimated Impact of 2018 U.S. Tariffs on FDI to Mexico by Industry of Destination

(In percent)

	Dependant variable: **ln(FDI)**			
	Baseline			
	(1)	(2)	(3)	(4)
Variables				
Post Jul 2018 × Output Tariff	0.876***			0.831***
	(0.130)			(0.133)
Post Jul 2018 × Upstream Tariff		1.160***		-0.349
		(0.393)		(0.419)
Post Jul 2018 × Downstream Tariff			0.998***	0.664***
			(0.182)	(0.170)
Lagged ln(FDI)	0.822***	0.824***	0.823***	0.822***
	(0.015)	(0.015)	(0.015)	(0.015)
N. of observations	50,126	50,126	50,126	50,126
R-squared	0.953	0.953	0.953	0.953
State FE	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes
Time FE	Yes	Yes	Yes	Yes

Notes: The construction of tariff rates follows Wang and Hannan (2023). "Output tariff" is the change in the U.S. tariff on Chinese products in own industries. "Upstream tariff" is that imposed on upstream industries that provide inputs to own industries through input linkages, whereas "downstream tariff" captures the tariffs on downstream industries that use outputs of own sectors. Input and output linkages are calculated using the input-output table of the Mexican economy from INEGI. Unit of observations is state by INEGI 4-digit industry at a quarterly frequency. Sample period: 2016Q1-2023Q4. Clustered standard errors (SEs) by state in parenthesis. *** $p<0.01$, ** $p<0.05$, * $p<0.1$.

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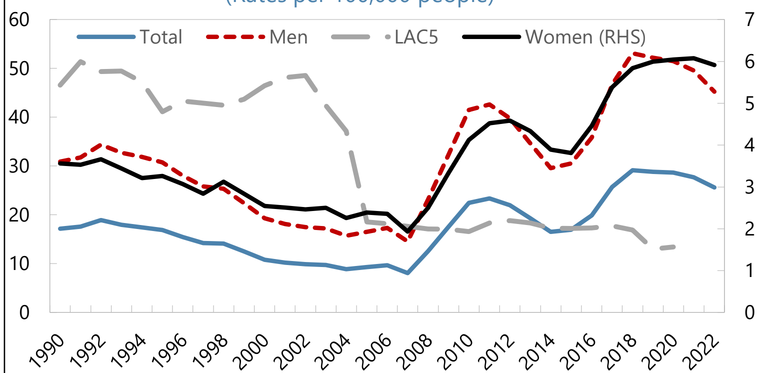
Annex XII. Violent Crime and Labor Market Dynamics in Mexico[1]

A. Introduction

1. This annex analyzes the effects of homicides on the labor market in Mexico, disentangling demand and supply effects. Violent crime in Mexico has surged in recent years, particularly since 2007, peaking at 29.1 per 100,000 people in 2018, diverging from the trend in other Latin American countries. Using a national quarterly labor survey, the analysis employs panel regression with individual fixed effects to assess the consequences of homicides on labor market dynamics. Building on previous studies showing negative impacts of homicides on labor market outcomes (Mishra and others, 2021; Velásquez, 2020) and on the relationship between crime and economic outcomes (Aldeco and others, 2024; BenYishay and Pearlman, 2014; Dell, 2005; Dell and others, 2019; Rozo, 2018; Verdugo-Yepes and others, 2015), this work investigates whether homicides act primarily as a labor demand or supply shock and explores gender-specific variations. Understanding these impacts is crucial for tailoring policy responses: demand shocks reduce household incomes, while supply shocks increase labor costs for firms.

Mexico's Homicide Rates
(Rates per 100,000 people)



Sources: INEGI, World Bank, and IMF staff calculations.
Note: Using INEGI homicides mortality data. Men and Women rates were calculated over their respective population.

2. The analysis reveals distinct gender dynamics regarding the impact of homicide on labor force participation. Men tend to withdraw from the labor market due to decreased demand for their labor, while women increasingly enter or remain in the workforce to compensate for this decline, helping mitigate economic disruptions caused by violent crime. However, the rise in violence also leads to a significant increase in job separations, particularly among women, who are more likely to leave their jobs due to worsening work conditions and increased risks.

B. Empirical Setup

3. The analysis uses data from broad-based Mexican labor force surveys.

- *Labor force participation* data comes from ENOE (National Survey of Occupation and Employment), conducted by INEGI (National Institute of Statistics and Geography). This survey tracks individuals over five quarters, collecting detailed labor market information.

[1] Prepared by Matteo Ghilardi and Hugo Tuesta, based on Aldeco et al. (forthcoming).

- *Motives for workers to leave the labor force*, stated in the ENOE survey, are used to identify labor supply and demand effects. Workers not participating for demand reasons cite factors like job unavailability or market conditions, while those not participating for supply reasons mention education, appearance, public insecurity, family duties, or personal reasons.

- *Municipality-level homicide data* is from INEGI, with rates calculated per 100,000 inhabitants.

- *Control variables*, included to account for non-homicide factors that can affect labor supply and demand, use ENOE data. These include variables like marriage status and the number of children as well as whether an individual receives government transfers.

- *Labor shares by sector at the municipality level* are used to control for labor demand variation stemming from sector-level shocks. These are interacted with quarter dummies and included as additional controls. Our sample, covering 2005-2019, includes 16,530,279 individual-quarters, spanning a wide period, including those marked by significant violence.

4. The main estimation equation includes individual and time fixed effects, along with controls for supply and demand. The following equation is estimated:

$$y_{im,t} = \gamma_i + \delta_t + \beta_1 HomicideRate_{m,t} + \beta_2 HomicideRate_{m,t-1} + \Gamma' X_{m,t} + \mathrm{I}' Z_{i,t} + \epsilon_{im,t},$$

where $y_{im,t}$ is the outcome variable, which is either: (i) a labor force participation dummy; or (ii) a dummy equal to 1 if the respondent does *not* participate due to supply/demand reasons. Individual i and quarter t fixed effects, γ_i and δ_t are included, taking advantage of the survey's rotating panel structure. $HomicideRate_{mt}$ is the homicide rate at quarter t, in municipality m, while $HomicideRate_{mt-1}$ represents lagged homicide rates. Z_{it} is a vector of individual characteristics, including marital status, number of children, and whether the individual receives government transfers; and X_{mt} is a vector of control variables in municipality *m*, in particular the 2000 shares of sectoral employment in agriculture, manufactures, construction, and services interacted with quarter dummies. The equation is estimated for the full sample and separately for males and females, with standard errors clustered at the individual level. For job separations, state-level fixed effects replace individual fixed effects, and clustering is done at the municipal level.[2]

C. Results

5. The impact of homicides on labor force participation reveals distinct gendered dynamics. While the contemporaneous effects of homicide on labor force participation are minor and statistically insignificant, lagged impact reveals significant and gender-specific differences. For men, these effects are negative and significant: a 10-percent increase in homicides is associated with a roughly 0.4 percent decrease in male participation. Conversely, the effects for women are positive,

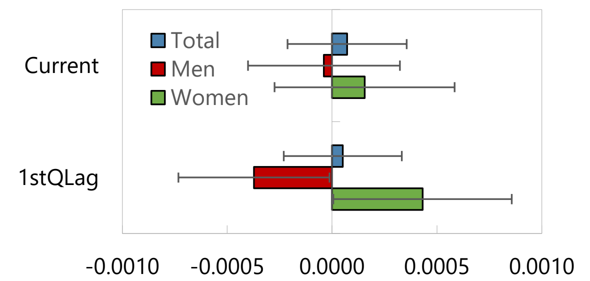
[2] Examples include studies of the labor supply effects of family composition (Talamas, 2023) and air pollution (Hoffman & Rud, 2024), and the effects of violence on international migration (Orozco-Aleman & Gonzalez-Lozano, 2018). Another paper that studies the labor market effects of violence in Mexico with a different dataset also implements individual fixed effects regressions (Velázquez, 2020).

suggesting that women may be stepping in to compensate for the decline in male participation. Specifically, a 10-percent rise in homicides results in approximately a 0.4 percent increase in female participation. This dynamic points to a possible compensatory mechanism, where women enter in the workforce in response to a diminished male participation, resulting in a mildly positive but statistically insignificant outcome for the population as a whole.

6. The impact of crime in shaping both labor supply and demand varies by gender. While a decrease in demand for labor directly undermines household incomes, a decrease in supply could lead to increased labor costs for firms. Homicides lead to a significant rise in the proportion of men withdrawing from the labor market, due to decreased demand for their labor, highlighting how violence can erode economic opportunities for men, pushing them out of the workforce (Prieto-Curiel and others, 2023). The lack of effect of homicides on female labor demand suggests a broader decline in aggregate worker demand.

Effects of Homicides on Labor Force Participation

(Semi-elasticities)

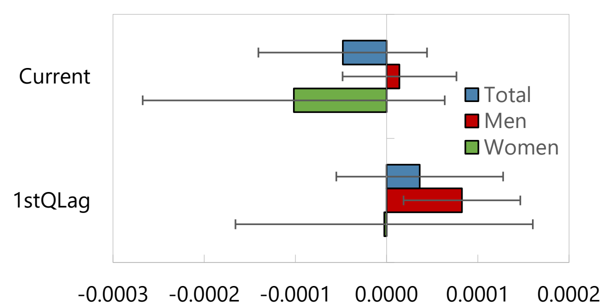


Sources: IMF staff calculations.

Note: The figures present results with a statistical significance at the 5 percent level, i.e. p<0.05.

Effects of Homicides on the Share People who do not Participate (Demand Reasons)

(Semi-elasticities)

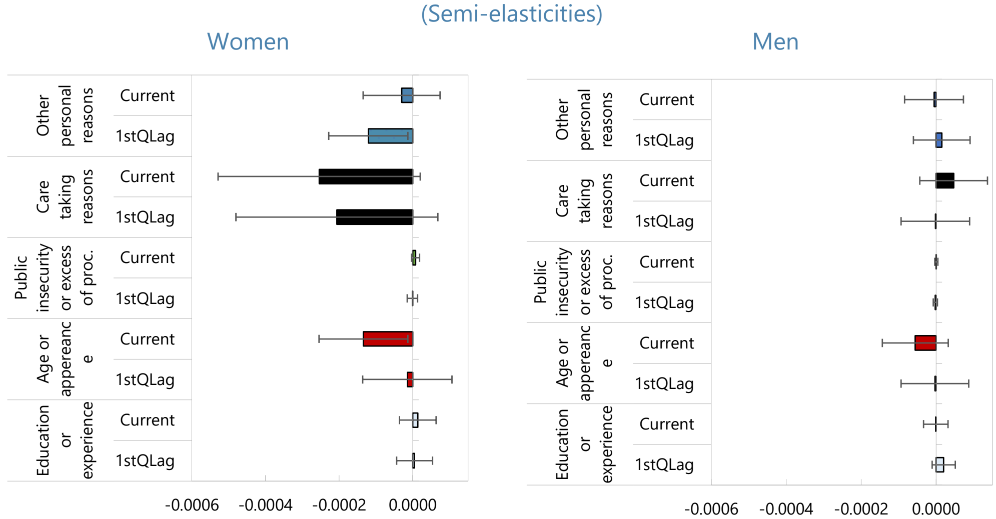


Sources: IMF staff calculations.

Note: The figures present results with a statistical significance at the 5 percent level, i.e. p<0.05.

Effects of Homicides on the Share People who do not Participate (Supply Reasons)

(Semi-elasticities)



Sources: IMF staff calculations.

Note: The figures present results with a statistical significance at the 5 percent level, i.e. p<0.05.

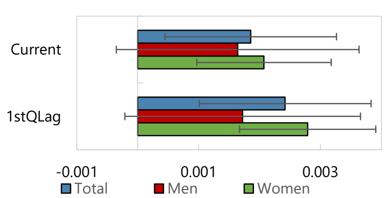
On the supply side, while homicide rate does not seem to affect men's willingness to participate in the labor market, the negative impact on male labor demand is matched by a corresponding shift in the labor supply of women. As homicides increase, the share of women invoking personal reasons to not participate in the labor market falls, suggesting that women may be stepping in to fill the gap, effectively counterbalancing the reduction in male participation. Interestingly, neither women nor men report public insecurity or caretaking reasons and any other motives among the reasons to withdraw from the labor market.

7. Job separations rise following a surge in violence, more so for women. This overall rise in job separations is both significant and substantial: a 10-percent rise in homicides is linked to an approximate 3 percent increase in male job separation.[3] The effect seems to be primarily driven by a high rate of job separations among women, attributable to factors influencing labor supply rather than demand as women are more likely to leave their jobs due to factors such as changes in work conditions, increased risk or unhealthiness of their work environment, or the desire for higher earnings. This suggests that the rise in job separations is closely linked to the adjustments women make in response to the altered work conditions resulting from increased violence.

8. These findings underscore the need to further examine gender-specific impacts of crime on labor markets. Policies to curb crime should not only focus on enhancing public safety but also on ways to mitigate economic disruptions that affect men and women in different ways. By understanding these gendered responses, more targeted and effective policies could be developed to stabilize labor markets and support household incomes in the face of rising crime.

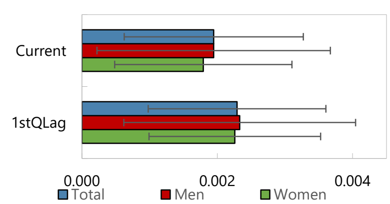
Effects of Homicides on Job Separation

(Semi-elasticities)



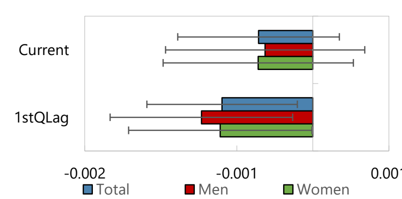
Effects of Homicides on Job Separation for Supply Reasons

(Semi-elasticities)



Effects of Homicides on Job Separation for Demand Reasons

(Semi-elasticities)



Sources: IMF staff calculations.

Note: The figures present results with a statistical significance at the 5 percent level, i.e. $p<0.05$.

[3] The effects of homicides on job separation for men are significant at the 10-percent level.

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Annex XIII. Some Patterns on Economic Costs of Crime[1]

1. This annex illustrates economic costs of crime, such as spending for safety or losses, due to crime with victimization surveys. These surveys provide a wide set of information on crime costs and on perception of insecurity with one covering about 100,000 households every year and another one covering 30,000 firms (both formal and informal) every other year. This goes beyond administrative records, as about 80 percent of cases reported there are not filed with the police.

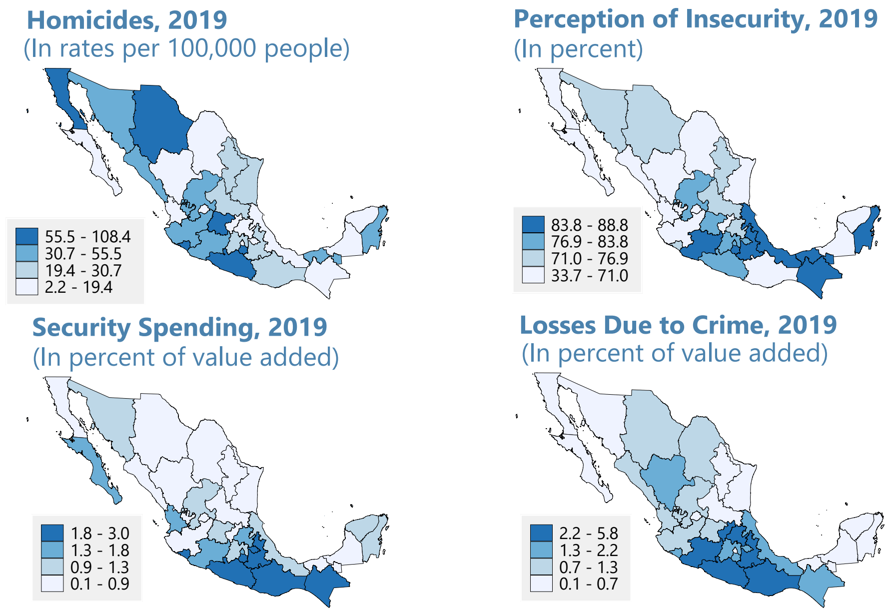
Annex XIII. Table 1. Mexico: Dimensions of Crime: Correlations at the State Level
(In percent)

		2017			2019			
		Homicides	*Losses due to crime*	*Security spending*	*Homicides*	*Losses due to crime*	*Security spending*	*Percep. of insecurity*
2017	*Homicides*	1.00						
	Losses due to crime	-0.04	1.00					
	Security spending	0.19	0.76	1.00				
2019	*Homicides*	0.69	0.03	0.11	1.00			
	Losses due to crime	-0.09	0.37	0.22	-0.07	1.00		
	Security spending	0.35	0.56	0.76	0.18	0.16	1.00	
	Percep. of insecurity	0.04	0.33	0.26	0.34	0.18	0.22	1.00

Sources: INEGI, and IMF staff caculations.
Note: Homicides as share of state population, losses and security spending as share of state-level value added.

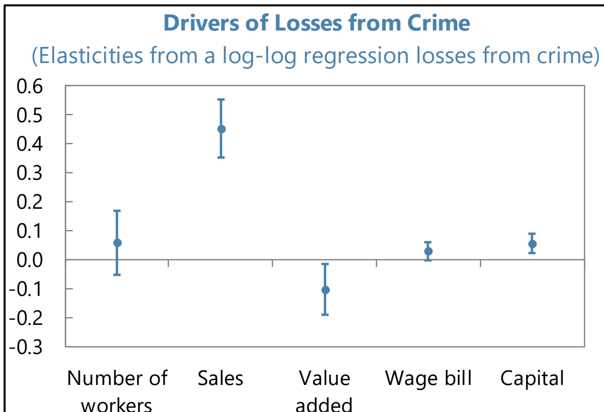
2. Economic cost and perception of crime are more concentrated in the south and vary substantially across states and indicators. Crimes can entail direct economic costs, with direct losses due to crime (e.g. costs of robberies and extorsions), spending by firms on security, and also indirect costs as decisions can factor in expected costs of crime, which may reflect not only actual crime, but also the perception of crime prevalence. Firm-level security spending is quite strongly linked with history of crime losses and somewhat linked with past homicides at the state level, but do not appear to be related to subsequently lower losses or homicides. Also, crime takes divergent forms across state—some with higher homicide rates versus other with more economic losses. While criminal organizations could be expected to generate both homicides and economic costs like extorsions, slightly negative correlations between homicides and economic losses suggest other mechanism are at play. For instance, where a criminal organization faces less contestation, it may extract more revenues while homicides can be lower.

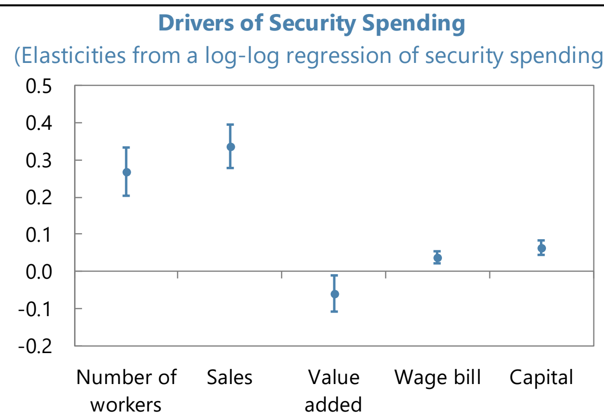
[1] Prepared by Jean-Marc Fournier.



Sources: INEGI (ENVIPE, ENVE, Economic Census), and IMF staff calculations.

3. Costs of crime are associated with firm sales. To understand the economic implication of crime, one can consider an analogy with a tax, and test what is the base that drives losses. In an analysis that considers various metrics of firm size (sales, number of employees, value added), finds a stronger relation between firm sales and losses due to crime, suggesting the cost of crime resembles somewhat a sales tax.[2] This likely reflects the fact that sales are a visible indicator triggering the attention. By contrast, a firm's value added is not associated with crime losses suggesting that crime may affect more value chains with more intermediaries and in turn relatively more gross sales for a given level of final output. This could be because each intermediate





Source: INEGI (ENVE and Economic Census), and IMF staff calculations.

Note: Coefficients and 95 percent confidence interval, estimated using a cross-section firm-level regression of the reported amount of losses due to crime from a victimization survey (in log), controlling for municipal and industry level fixed effects. Sales, value added, wage bill and capital are expressed in nominal terms.

[2] The elasticity is positive but below one, which means that losses from crime typically increase with the level of sales, but slower than sales so that the loss to sales ratio declines with sales.

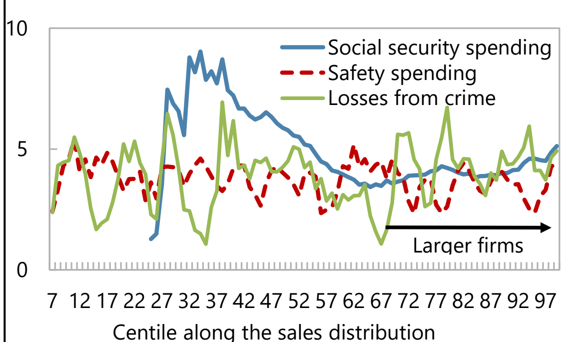
transaction likely increasing vulnerabilities. In response, firms' security spending is also predominantly driven by sales, but these are also relatively more associated with the number of workers, likely because of the need to protect employees against violence.

4. Economic costs of crime hit disproportionately the smallest firms and are larger where the presence of gangs is reported. The smallest firms lack economies of scale and spend disproportionate amounts on safety. However, this spending is also likely less effective than that of larger firms, so that the losses from crime are also substantially larger for smaller firms. If one compares to social security spending as a benchmark for a conventional compulsory spending, the pattern is the opposite with relatively larger costs for larger firms. Also, there is a wide heterogeneity of costs across firms with the most hit ones loosing typically four to six times more than average firms of a similar size, suggesting other factors may be at play (i.e., differences in security spending, political connections, etc.).20F In particular, one cause of this heterogeneity is the uneven presence of gangs – when their presence is reported, crime damage costs are considerably larger.

5. Impunity is likely facilitating the operations of criminal groups, as only about one in five cases are filed with the police in Mexico. In about two thirds of the non-filed cases, the reason for not filing reflects lack of trust, with filing rate being even lower among respondents who believe the police is corrupt.

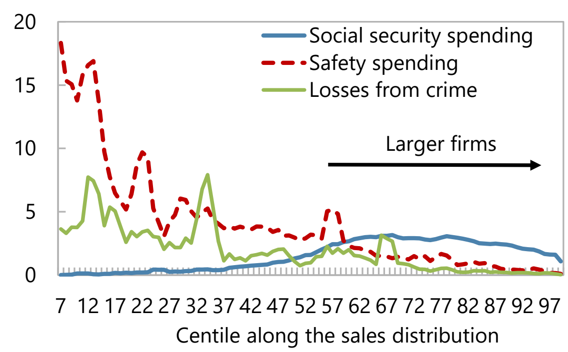
Cost of Crime

(P95 to mean ratio for each centile of sales)



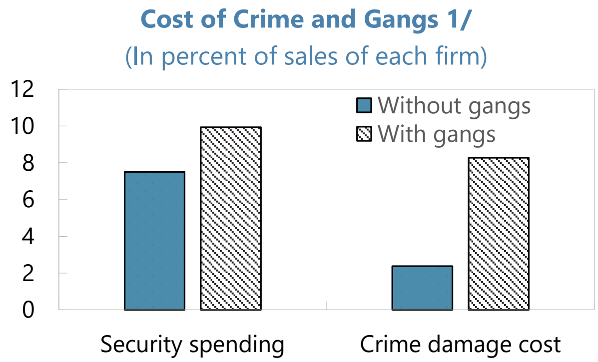
Cost of Crime

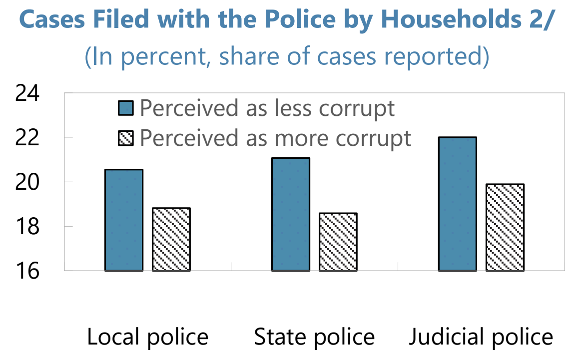
(Share of sales)



Sources: INEGI (ENVE and Economic Census, 2014), IMF staff calculations.

Note: Firms are gathered in buckets along the distribution of their sale, which each dot reporting an average over 3 centiles. For instance, at the 10th centile in the right-hand chart, the red line reports the total amount of safety spending for firms in the 9th a 11th centile divided by the total sales of these firms; and at the 10th centile in the left-hand chart, the red line reports the average of the 95th centile of safety spending for firms for each of the 9th , 10th and 11th centiles divided by the average of safety spending for firms in the 9th a 11th centile. Social security spending is provided as an indicative benchmark.





Sources: INEGI (ENVE, 2014, ENVIPE), and IMF staff

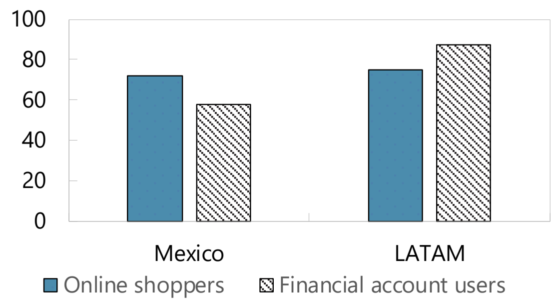
1/ Unweighted average of costs to sale ratios (in percent) computed as the firm level. The firm sample is split along a binary question to each firm about whether they are aware or have heard of the presence of criminal or violent gangs in their neighborhood.

2/ Share of cases reported to the prosecution agency (Ministerio Publico) or any other authorities, as per responses of the respondant. Corruption perception is measured with a binary (yes/no) question.

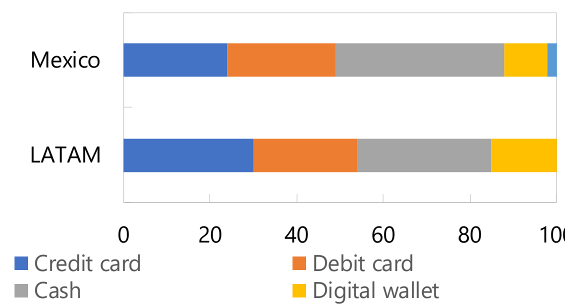
Annex XIV. Online Payment Systems in Mexico[1]

1. Mexico has seen a notable rise in digital payments. With technical improvements and a supportive regulatory framework, Mexico's financial inclusion strategy has progressively bridged the regional gap in the adoption of digital payments, including digital wallets (Banxico, 2023). Notably, Banxico launched CoDi (Cobro Digital)—which allows both B2B (business-to-business) and P2P (peer-to-peer) transactions but restricts participation to financial institutions that are members of the interbank electronic payments system—in 2019 to provide an affordable cross-device payments system. However, the rate of adoption of online payment systems and digital banking remains lower in Mexico than among peers.

Digital Penetration in LATAM 1/
(In percent of adult population)



Top Payment Methods for In-person Purchases
(Percent, 2022)



Sources: Worldpay from FSI, PCMI, and IMF staff calculations.
1/ The 2023 Latin America E-commerce Blueprint

2. Digital payments have also risen in other Latin American countries. Innovative systems, like PIX in Brazil, a real-time payment system launched in 2020, has seen rapid adoption, with significant improvements in transaction speed and accessibility. In Mexico, by January 2024, there were over 16 million CoDi accounts registered, although they generated only 2 million transactions, and only 10 percent of the population reported usage of digital payments (compared, for instance, to 96 percent in Brazil).

3. While regulatory framework and financial inclusion policies have supported the development of digital payments, structural factors remain a major obstacle. Usage of new payment technologies in Mexico has benefitted from the interoperability of different payment systems, increased internet coverage (particularly in rural areas), and integration of domestic and cross-border payment systems (especially those that process remittance inflows). However, firms and households often have a strong preference for cash, with only 50 percent of adults owning a bank account, and technological infrastructure remains limited. Limited enforcement of broader acceptability of payment systems and scarce sharing of client financial information may also affect further adoption, as some conventional banks may have a profit pool to safeguard and little incentives to adopt digital alternatives. Furthermore, inadequate digital infrastructure and weak

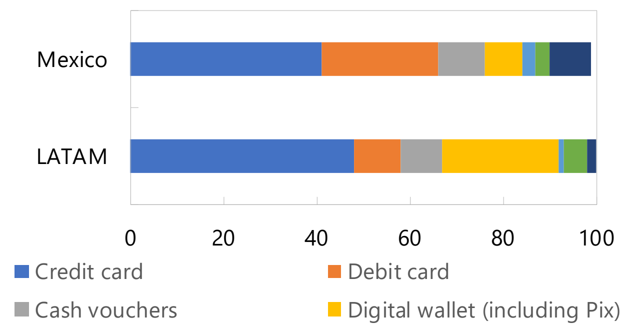
[1] Prepared by Francisco Arizala, Corrado Macchiarelli and Hugo Tuesta.

financial literacy hamper access to digital financial services. In rural areas and low-income communities, unreliable connectivity and the lack of affordable smartphones may prevent consumers from engaging with digital payment systems, mobile banking, and online financial tools. Indeed, a review of financial inclusion in Mexico concluded that limited infrastructure has led to low connectivity and a highly fragmented usage of financial services (CNBV, 2023). These challenges to financial inclusion are often worsened by weak financial literacy, especially in rural and underserved areas, where financial education is sparse (World Bank, 2020).

4. There is room to leverage digital payment systems to enhance the efficiency and reach of social protection programs. While peer-to-Government payments have been developed in several key areas, Government-to-peer payments remain limited, with a few exceptions (e.g., Infonavit). Paying social benefits and subsidies through digital payments can be a secure and cost-effective mechanism to deliver of government support to the population (World Bank, 2020).

Top Payment Methods for E-commerce Purchases

(Percent, 2023)



Sources: Worldpay from FSI, PCMI, and IMF staff calculations.

Note: For Brazil e-commerce digital wallet includes Pix transactions.

5. There is potential for expanding digital products offering through SOFIPOs (NBFIs) obtaining bank licenses. The SOFIPO industry has grown significantly over the past year, driven by a rapid increase in customers, as the largest industry players have expanded, notably led by Nu Bank (which converted from SOFIPO to bank through a license in late 2022) and the expansion of three traditional banking groups—namely, Banorte, Santander, and Banregio—into to digital banking.

6. Developing a regulatory framework that supports digital payment innovations, while ensuring consumer protection remains important. The regulatory framework should facilitate the growth of digital payment platforms, by ensuring interoperability between all financial operators, and protecting users from fraud and abuse. It also needs to be sufficiently flexible to cope with technological advancements, while providing guidance on security procedures and risk mitigation.

7. Strengthened collaboration between the government, financial institutions, and fintech companies would help expand digital payment services. Public-private partnerships can support the development of inclusive digital payment solutions, such as low-cost mobile wallets and digital identity systems. These partnerships can also help address infrastructure challenges and expand the reach of digital payments to underserved populations (GSMA, 2023).

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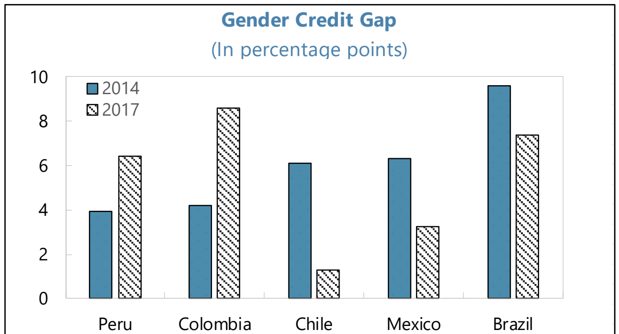
Annex XV. Financial Inclusion from a Gender Perspective[1]

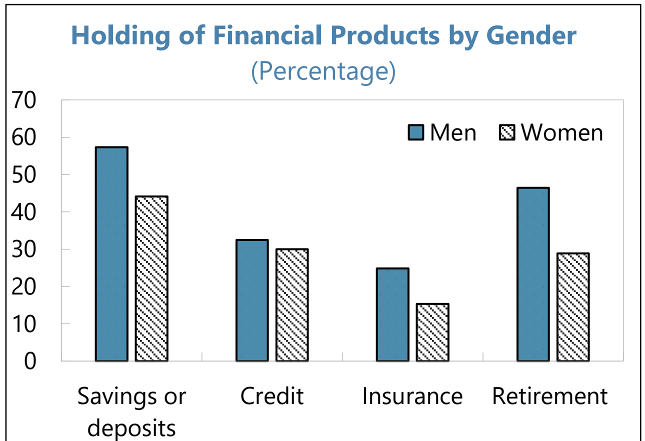
A. An Overview of Female Financial Inclusion in Mexico

1. Financial inclusion is a key component of long-term economic growth in Mexico. Over recent years, the drive towards ensuring equitable access to financial services and increasing financial literacy has gained significant momentum, yet there remain noticeable disparities, especially when it comes to women, who historically face greater barriers to traditional financial services.

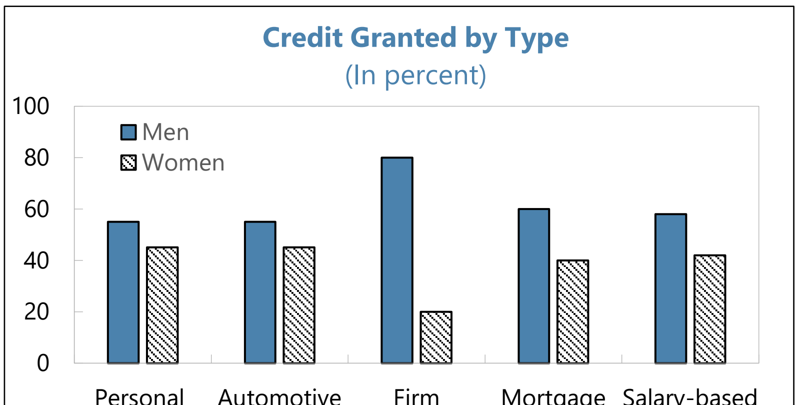


Sources: World Bank-Global Financial Inclusion, and IMF staff calculations.
Note: Share of age 15+ that borrowed from a financial institution using credit card. Gap defined as the difference in the share of men and women that borrowed from a financial institution, in percentage points.

2. Several barriers contribute to gender gaps in financial inclusion in Mexico. Socioeconomic factors, including women having lower income than men and being disproportionately represented in informal employment sectors, limit women's access to formal financial services, as they often lack the collateral and/or credit history required by traditional financial institutions to offer access to their products (Demirgüç-Kunt and others, 2018). Although equal access to financial services is guaranteed by law, other structural disparities, such as low labor force participation (about 30 percent lower than men), constitute additional barriers to women's access to financial services (IMF Gender SIP, 2023). In addition, traditional gender roles may limit women's financial autonomy, with cultural norms discouraging women from participation in financial decision-making, property ownership, and independent use of financial services (Perryn and Hyland, 2023).



Source: Banxico.



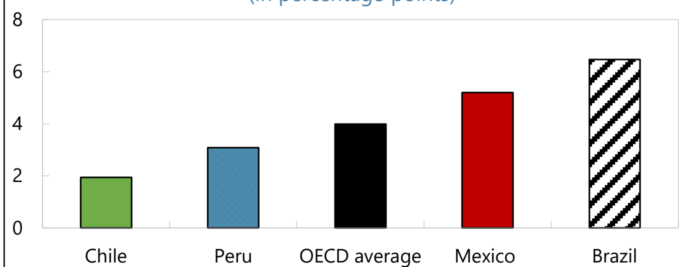
Source: Banxico Financial Stability Report 2023 S1. Data for Dec 2022.

[1] Francisco Arizala, Corrado Macchiarelli, and Hugo Tuesta.

3. Gender gaps are present across all financial products. While close to 60 percent of Mexican men hold a bank account, only about 45 percent of women have one. There is also a gender gap in terms of access to insurance products, and it is more pronounced for retirement accounts. There are also disparities in access to lending, with the gender credit gap being wider for mortgage loans and for firms owned by women, which obtain less than 20 percent of total credit extended to businesses.

4. Asymmetry of information continues to impact female participation in financial transactions. Without adequate information, agents struggle to navigate financial services, leading to lower engagement and utilization. Financial literacy disparities between men and women can further exacerbate the gender gap, affecting women's ability to effectively use financial products, especially in rural and underserved areas, where targeted financial education is sparse (Hesse, Klapper and Beegle, 2021).

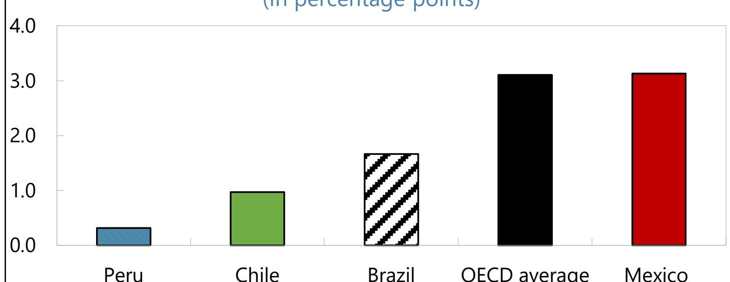
Average Financial Literacy Scores Gap
(In percentage points)



Sources: OECD, and IMF staff calculations.
Note: OECD/INFE 2023 International Survey of Adult Financial Literacy. Gap defined as the difference betweeen men and women over total men.

5. Limited digital infrastructure contributes to financial inclusion disparities. In rural areas and low-income communities, unreliable connectivity and the lack of affordable smartphones can prevent communities, and especially women given lower incomes relative to men, from engaging with digital payment systems, mobile banking, and online financial tools. In Mexico, the share of men with a digital account is 3.7 percent, about 2 percentage points larger than for women (1.8 percent).

Average Digital Financial Literacy Scores Gap
(In percentage points)



Sources: OECD, and IMF staff calculations.
Note: OECD/INFE 2023 International Survey of Adult Financial Literacy. Gap defined as the difference betweeen men and women over total men.

B. Policies Are Addressing Gender Gaps in Financial Inclusion

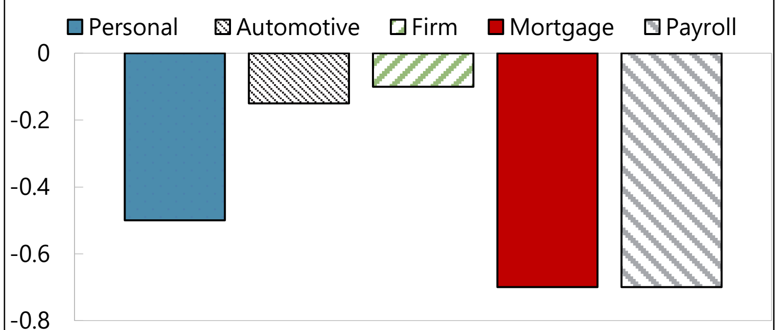
6. Several initiatives encourage female financial inclusion. The National Financial Inclusion Survey (Encuesta Nacional de Inclusión Financiera, ENIF), launched in 2020, serves as a comprehensive framework to advance access to financial services for all citizens, with particular emphasis on underserved populations, in line with the goals established by the G-20 Global Partnership for Financial Inclusion (Banxico, 2023). In addition, the Inter-institutional Committee for Gender Equality in Financial Institutions (CIIGEF) was formed in 2022 to promote workplace nondiscrimination and gender equality, as well as equitable access to financial services. Also, the National Commission for the Protection and Defense of Users of Financial Services (CONDUSEF) has launched initiatives targeting women's financial literacy. For instance, CONDUSEF's "Minerva Project" delivers workshops and educational materials designed to empower women in their financial decision-making.

7. **Microfinance institutions and development banks have tailored financial products to address the specific needs common among women**. Specifically, they have provided microloans and offered savings accounts designed to support women entrepreneurs and low-income households, e.g., Fundación Microfinanzas BBVA. Also, Nafin and Bancomext have tailored supply-oriented policies to improve gender inclusion, and Banobras has targeted increasing the provision of credit in highly marginalized municipalities.

8. **Regulatory reforms promote gender equity in financial services**. Recent regulatory changes require financial institutions to report on gender disparities in financial access and outcomes (Comisión Nacional Bancaria y de Valores, 2023). In addition, the reforms encourage financial institutions to increase lending to women and develop gender-sensitive services. For instance, recognizing women's lower credit risk, a regulation introduced in 2021 requires financial institutions to reduce loan loss provisions for female borrowers (Becerra-Ornelas and others, 2024). By supporting female participation in the credit market, this measure has contributed to lower delinquencies across different types of credit (Banxico Financial Stability Report, 2023). Expanding a risk-based approach to provisioning among financial institutions, including by properly accounting borrower's observed risk, could deepen financial inclusion. In addition to improving gender gaps in access to financial services, these policies have the potential to benefit the financial system by increasing lenders' credit risk diversification and improving efficiency in capital allocation (Morazzoni and Sy, 2022).

Difference in Men and Women Deliquencies by Credit Type

(Percentage points)



Source: Banxico Financial Stability Report 2023 S1. Data for Dec 2022.

C. Other Avenues for Furthering Female Financial Inclusion

9. **Investment in digital infrastructure can contribute to bridging the gender gap**. Provided that access to technology and digital networks is expanded, fintech innovations have the potential to reach remote areas and provide greater access to financial services to underserved individuals, including women (Wang Tok and Heng, 2022). For instance, mobile money platforms and digital wallets can reach individuals without requiring physical bank branches, which is

particularly beneficial in rural areas where banking infrastructure is limited (GSMA, 2021). Also, digital literacy programs have proven effective in empowering women to effectively utilize digital financial services and improve their financial management skills (IFC, 2021).

10. New technologies can support female financial inclusion. Digital banking can render financial services more affordable and convenient, allowing women to increase their overall financial autonomy (Demirguc-Kunt and others, 2017). At the same time, digital payment systems offer greater security with respect to street crime compared to carrying cash. In addition, through partnerships with fintech companies and traditional financial institutions, digital payment systems can offer financial products that can be of interest to women, including microloans and flexible savings plans (Lusardi and Mitchell, 2014).

11. Support systems for women entrepreneurs should continue to be strengthened. Female participation as business owners can be fostered by providing mentorship programs, offering business development services, and facilitating access to capital. Also, public-private partnerships and targeted funding initiatives can enhance the growth and sustainability of women-owned businesses (IFC, 2021). Furthermore, the availability of funding to female-owned SMEs requires particular attention, as gender gaps in this segment often widen in periods of increased risk aversion among lenders (Barrios and others, 2024).

12. Transforming socio-cultural norms that limit women's economic participation and helping build credit history remains essential. Advocacy, policy reforms, and community engagement should focus on promoting gender equality and ensuring that women have equal opportunities in the financial sector. At the same time, increasing the use of financial accounts for public transfers would aid in the build-up of credit history, as well as encourage the use of non-traditional data sources in the assessment of candidates with a shorter financial history.

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INTERNATIONAL MONETARY FUND

MEXICO

October 15, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION AND REVIEW UNDER THE FLEXIBLE CREDIT LINE ARRANGEMENT—INFORMATIONAL ANNEX

Prepared By

The Western Hemisphere Department
(in consultation with other departments)

CONTENTS

FUND RELATIONS

(As of September 30, 2024)

The 2024 Article IV discussions were held in Mexico City during July 15–26, 2024, with concluding meetings with the new authorities held over October 8–9, 2024. The mission met with Finance Secretary Ramírez de la O, Governor Rodríguez Ceja, other officials, and representatives of the financial and private sectors. The team was led by Bikas Joshi and comprised Francisco Arizala and Matteo Ghilardi (all WHD), Samir Jahan (FAD), Tomohide Mineyama (SPR), Camilo Enciso and Ivana Rossi (both LEG), and Corrado Macchiarelli (MCM). Boele Bonthuis (FAD), Jean-Marc Fournier, and Johanna Schauer (both WHD) provided additional inputs. Rodrigo Valdés (WHD) joined the concluding meetings with the Finance Secretary, Governor, Economy Secretary Ebrard, and Energy Secretary González. Alfonso Guerra and Maria José Posadas Bolanos (OED) participated in the discussions.

Mexico has accepted the obligations of Article VIII, sections 2, 3, and 4. Comprehensive economic data are available for Mexico on a timely basis and economic data are adequate for surveillance. It subscribes to the SDDS.

Membership Status: Joined December 31, 1945

General Resources Account:	**SDR Million**	**Percent of Quota**
Quota	8,912.70	100.00
Fund holdings of currency	6,603.94	74.10
Reserve position in Fund	2,308.79	25.90

SDR Department:	**SDR Million**	**Percent of Allocation**
Net cumulative allocation	11,393.62	100.00
Holdings	12,144.16	106.59

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	**Arrangement Date**	**Expiration Date**	**Amount Approved (SDR Million)**	**Amount Drawn (SDR Million)**
FCL	Nov. 15, 2023	Nov. 14, 2025	26,738.10	0.00
FCL	Nov. 19, 2021	Nov. 18, 2023	35,650.80	0.00
FCL	Nov. 22, 2019	Nov. 18, 2021	44,563.50	0.00
FCL	Nov. 29, 2017	Nov. 21, 2019	53,476.20[1]	0.00
FCL	May 27, 2016	Nov. 28, 2017	62,388.90	0.00
FCL	Nov 26, 2014	May 26, 2016	47,292.00	0.00
FCL	Nov. 30, 2012	Nov. 25, 2014	47,292.00	0.00
FCL	Jan. 10, 2011	Nov. 29, 2012	47,292.00	0.00
FCL	Mar. 25,2010	Jan. 09, 2011	31,528.00	0.00
FCL	Apr 17, 2009	Mar. 24, 2010	31,528.00	0.00

[1] Access was reduced from 62,388.90 to 53,476.20 SDR million on November 26, 2018.

Projected Payments to the Fund (SDR million):

	Forthcoming				
	2024	2025	2026	2027	2028
Principal					
Charges / Interest		0.09	0.09	0.09	0.09
Total		0.09	0.09	0.09	0.09

Exchange Arrangements: The currency of Mexico is the Mexican peso. Mexico's de-jure and de-facto exchange rate arrangements are free-floating. Mexico has accepted the obligations under Article VIII, Section 2(a), 3, and 4, and maintains an exchange system that is free of multiple currency practices and restrictions on the making of payments and transfers for current international transactions.

Article IV Consultation: The last Article IV consultation was concluded by the Executive Board on October 30, 2023. The staff report was published as IMF Country Report No. 23/356.

Technical Assistance

Year	Dept.	Purpose
2024	MCM	Cyber Crisis Exercise II
2023	MCM	Cyber Crisis Exercise I
2022	STA	Government Finance Statistics
2022	STA	National Accounts
2021	FAD	Public Assets and Liabilities Management
2020	FAD	Fiscal Framework and Council
2018	FAD	Public Investment Management Assessment
2018	FAD	Tax policy and Compliance
2018	FAD	Fiscal Transparency Evaluation
2017	STA	Government Finance Statistics
2017	FAD	Tax policy
2017	MCM	Central Securities Depositories
2017	FAD	Revenue Administration
2016	FAD	Revenue Administration
2016	FAD	Workshop on Supervision of Subnational Finances
2015	STA	Balance of Payments
2015	FAD	Supervision of Subnational Finances
2014	FAD	Tax Policy and Compliance
2014	FAD	Treasury
2014	STA	Sectoral Balance Sheets
2014	STA	National Accounts
2014	STA	Balance of Payments

Resident Representative: None

RELATIONS WITH OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

World Bank: https://www.worldbank.org/en/country/mexico

Inter-American Development Bank: https://www.iadb.org/en/who-we-are/country-offices/mexico

STATISTICAL ISSUES

I. Assessment of Data Adequacy for Surveillance
General: Data provision is adequate for surveillance.
National accounts: The national accounts follow the recommendations of the *System of National Accounts, 2008 (2008 SNA)*. Economic activities, products, household final consumption expenditure, and government final consumption expenditure are classified according to updated international classifications. Data sources and statistical techniques are robust. A wide range of source data is available, including economic censuses conducted every five years and a vast program of monthly and annual surveys, administrative data, as well as a business register of economic units that is regularly updated. INEGI (the National Statistical Office) disseminates annual and quarterly GDP statistics, sectoral accounts, and balance sheets. The 2021 data ROSC update found that the national accounts are of a high quality. Since 2015, Mexico has made significant improvements on the methodological and dissemination aspects of data quality. There are still some areas for further improvements, such as implementing chained GDP volume indices with previous period annual weights, the treatment of goods for processing abroad, and the coverage of illegal activities. In addition, some government transactions on a quarterly basis are recorded on a cash basis rather than on an accrual basis. The ROSC mission identified the need for greater consistency in data recording between the Bank of Mexico (Banxico), and the Ministry of Finance (SHCP) and for regular reconciliation exercises among compilers to resolve some discrepancies involving data on the public sector.
Prices: The concepts and definitions for both the CPI and PPI meet international standards. The CPI reference period is the second half of July 2018, and the basket is based on information from the National Survey of Household Expenditure 2022 Household Income and Expenditure Survey, and the 2018 COICOP classification. The PPI reference period is July 2019, and the basket of goods and weighting structure is based on the Economic Censuses and the System of National Accounts. The PPI covers agricultural, manufacturing, construction, and services sectors, which account for 79.2 percent of Mexican production. It excludes trade and some services.
Government finance statistics: Fiscal statistics are comprehensive and timely, except for the subnational sector. The authorities compile fiscal statistics following national concepts, definitions, and classifications to support domestic policy needs. The authorities also compile fiscal statistics in alignment with the *Government Finance Statistics Manual (GFSM2014)*. The 2021 Data ROSC mission pointed out that, while source data used for the national and international (*GFSM2014*) presentations are the same, differences in the classification of transactions and coverage of institutional units make it difficult for users to reconcile the different presentations. It recommended publishing a table of all institutional units in the public sector and its subsectors, clearly grouping them according to: 1) the coverage of units used in the national presentation; 2) the coverage used in the international presentation; and 3) the subsectors of the public sector as described in the *GFSM2014.* A full adoption of uniform

I. Assessment of Data Adequacy for Surveillance
accounting standards at the sub-national level would help obtain an improved measure of public fixed investment in the national accounts. Pension liabilities are partially reported, while government securities are reported at face value. The official debt statistics do not include the stock of T-bonds issued to the Bank of Mexico (Banxico) for liquidity management purposes, and the accounting practices adopted by the federal government and Banxico differ.
Monetary and financial statistics: The methodological foundations of monetary statistics are generally sound. Availability of data on other financial intermediaries such as insurance companies and pension funds allow for the construction of a financial corporation's survey with full coverage of the Mexican financial system. Mexico reports data on some indicators of the Financial Access Survey (FAS), including gender disaggregated data on the use of basic financial services and the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals. **Financial sector surveillance:** Mexico regularly reports monthly Financial Soundness Indicators (FSIs) to the IMF for publication. Currently, Mexico reports 14 core and 9 encouraged indicators for deposit takers, 2 additional FSI for OFCs,1 additional FSI for households and 1 additional FSI for real estate markets. FSIs on the non-financial corporate sector are not reported.
External sector statistics (ESS): The 2021 data ROSC update found that ESS are of a high quality. In 2017, Banxico migrated the BOP and IIP statistics to the *Balance of Payments and International Investment Position Manual (BPM6*), sixth edition, with the publication of quarterly *BPM6*-based BOP data and IIP data. The *External Debt Statistics, Guide for Compilers and Users, 2013* (*EDS Guide*) is yet to be fully implemented. Remaining issues relate to: (i) including the intercompany external debt and SDR allocations in external debt statistics disseminated by Banxico; (ii) extending the market valuation of liabilities to all financial institutions (some external debt are presented at face value); and (iii) recording the interest of the public sector external debt on an accrual basis. Consistency could be improved between the IIP and external debt. There are also differences between the balance of payments and national accounts, notably in the financial account transactions and positions. The authorities participate in the coordinated direct investment survey and coordinated portfolio investment survey and disseminate the data template on international reserves and foreign currency liquidity (reserve template) and quarterly external debt statistics.

II. Data Standards and Quality	
Mexico subscribed to the IMF's Special Data Dissemination Standard (SDDS) on August 13, 1996. Mexico's latest SDDS Annual Observance Report and metadata are available on the Dissemination Standards Bulletin Board. Mexico uses periodicity and timeliness flexibility options on central government debt and takes a timeliness flexibility option on general government operations. Mexico exceeds SDDS periodicity and timeliness requirements in many other data categories.	An updated data module Report on the Observance of Standards and Codes (ROSC update) for Mexico was published in December 2021.

Table 1. Mexico: Table of Common Indicators Required for Surveillance

As of October 17, 2023	Date of latest observation	Date received	Frequency of Data[7]	Frequency of Reporting[7]	Frequency of Publication[7]	Data Quality-Methodological Soundness[8]	Data Quality Accuracy and Reliability[9]
Exchange Rates	Oct. 2024	Oct. 2024	D	D	D		
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Oct. 2024	Oct. 2024	W	W	W		
Reserve/Base Money	Oct. 2024	Oct. 2024	W	W	W	LO, O, O, LO	LO, O, O, O, O
Broad Money	Sep. 2024	Sep. 2024	M	M	M		
Central Bank Balance Sheet	Oct. 2024	Oct. 2024	W	W	W		
Consolidated Balance Sheet of the Banking System	Sep. 2024	Sep. 2024	M	M	M		
Interest Rates[2]	Oct. 2024	Oct. 2024	D	D	D		
Consumer Price Index	Sep. 2024	Oct. 2024	Bi-W	Bi-W	Bi-W	O, O, LNO, O	LO, LNO, O, O, LNO
Revenue, Expenditure, Balance and Composition of Financing[3]–Gen. Government[4]	Aug. 2024	Sep. 2024	M	M	M	LO, LO, LNO, LO	O, O, O, O, O
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Aug. 2024	Sep. 2024	M	M	M		
Stocks of Central Government and Central Government-Guaranteed Debt[5]	Aug. 2024	Sep. 2024	M	M	M		

Table 1. Mexico: Table of Common Indicators Required for Surveillance (concluded)

External Current Account Balance	Q2 2024	Aug. 2024	Q	Q	Q	LO, O, LO, LO	LO, O, O, O, LO
Exports and Imports of Goods and Services	Sep. 2024	Oct. 2024	Q	Q	Q		
GDP/GNP	Q2 2024	Aug. 2024	Q	Q	Q	O, O, O, LO	O, O, LO, O, O
Gross External Debt	Q2 2024	Aug. 2024	Q	Q	Q	LO, O, LO, LO	LO, O, O, O, LO
International Investment Position[6]	Q2 2024	Aug. 2024	Q	Q	Q	LO, O, LO, LO	LO, O, O, O, LO

[1] Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

[2] Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes, and bonds.

[3] Foreign, domestic bank, and domestic nonbank financing.

[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

[5] Including currency and maturity composition.

[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

[7] Daily (D); Weekly (W); Monthly (M); Quarterly (Q); Annually (A); Irregular (I); Not Available (NA).

[8] Reflects the assessment provided in the data ROSC conducted in July 2021, except for consumer prices, which is based on the ROSC conducted in 2012 and monetary statistics, which is based on the ROSC conducted in 2010. For the dataset corresponding to the variable in each row, the assessment indicates whether international standards concerning (respectively) concepts and definitions, scope, classification/sectorization, and basis for recording are fully observed (O), largely observed (LO), largely not observed (LNO), or not observed (NO).

[9] Same as footnote 8, except referring to international standards concerning source data, assessment and validation of source data, statistical techniques, assessment and validation of intermediate data and statistical outputs, and revision studies.

Statement by Mr. Guerra, Executive Director for Mexico
and Ms. Posadas Bolanos, Advisor to Executive Director
October 30, 2024

We want to thank Mr. Joshi and his team for their insightful analysis and policy dialogue with the Mexican authorities. The new administration in Mexico is fully committed to continuing to pursue strong macroeconomic policies and an institutional framework that ensures economic and social stability.

While growth is expected to moderate in 2024, Mexico still benefits from a resilient domestic market, with private consumption reflecting the strong labor market and higher wages. In 2025, social programs and strong public investment will be crucial in sustaining demand to protect the vulnerable population, support employment, and reduce regional disparities, which are critical elements in the new administration policy agenda. Additionally, Mexico continues to benefit from the relocation of global supply chains, supported by a dynamic and more diversified export sector, with FDI rising and expected to grow further. Inflation is expected to continue declining—following the downward trajectory in core inflation as price pressures in non-core items dissipate—and to return to the Central Bank's target by 2025. The flexible exchange rate regime continues to serve as the first line of defense while the financial system remains robust to systemic risks. In this context, business and consumer confidence are anticipated to remain high.

The Mexican authorities have reaffirmed their unwavering commitment to a frontloaded fiscal consolidation in 2025. The 2024 budget temporary increase supported Mexico's capacity for long-term growth by ensuring the completion of key regional public investment projects while averting undue procyclicality. The authorities have full confidence in achieving the 2024 fiscal targets. The new administration is committed to a front-loaded fiscal consolidation that advances consolidation in 2025, followed by further efforts to reduce the deficit to below 3 percent of GDP over the medium term. The Mexican authorities reiterate their fiscal policy pledge to stabilize debt as a share of GDP. While a detailed 2025 budget is still being developed, policy efforts will focus primarily on expenditure reductions, supplemented by administrative actions to increase non-oil revenues. The authorities fully acknowledged Pemex's ongoing operational and financial challenges and emphasized the commitment to developing long-term solutions to strengthen its business plan and financial health.

Banco de México remains committed to achieving an orderly and sustained convergence of headline inflation to its 3-percent target. While core inflation is on a downward trajectory, service inflation remains sticky, and the recent pressure on non-core inflation and its impact on headline inflation would likely take a few quarters to dissipate. The monetary authorities believe that the balance of risks on inflation is tilted to the upside. The Central Bank's future rate decisions would ensure that the policy path remains consistent with achieving the inflation target by the end of 2025 while assessing the residual impact of global shocks, weakening economic activity, and the effect of the restrictive monetary stance on inflation. The Central Bank is committed to a robust communication strategy to enhance the effectiveness of monetary policy. In fact, the improvements of its communication strategy during the post-pandemic inflationary episode were conducive to keeping inflation expectations anchored and reverting the trend to put it on a downward trajectory. Thus, this is a continuous process, and any adjustments must be carefully considered to avoid unintended consequences. The flexible exchange rate will remain a vital element of the policy framework and a first line of defense against external shocks, with efforts ongoing on different fronts to develop markets to broaden the investor base and enhance the efficiency of market infrastructures.

The financial system remains sound, and the authorities continue to upgrade their supervisory capacity. Recent stress test scenarios assess the financial system´s ability to remain resilient to a range of shocks, including climate events. Banks have ample lending capacity, given higher-than-regulatory liquidity ratios, while non-performing loans remain low. Although some small non-bank financial intermediaries have faced some challenges in recent years, the sector remains small, with limited exposure to banks. The authorities continue to implement the 2022 FSAP recommendations, although some are still in progress. They are awaiting legal changes, including providing centralized oversight of financial conglomerates and enhancing regulatory agencies' autonomy. Mexico continues to make the financial system more resilient to cyber risks. Recently, market-wide cyber crisis simulation exercises have taken place with the support of the IMF. Further cyber resilience exercises involving financial market infrastructure and other financial sectors are planned for the coming years.

The authorities are continuing with their efforts to make legal improvements to the AML/CFT framework and are committed to strengthening its practical effectiveness. Recently, the National Banking and Securities Commission (CNBV), the financial supervisory agency, has developed two guidelines to address the financing of weapons proliferation and prevent illicit financial activities during electoral processes. More recently, a reform to Article 115 of the Credit Institutions Law has also been published, aiming to increase legal certainty ahead of the FATF's 5th Mutual Evaluation. This reform is expected to extend to other sectors, including fintech, promoting financial inclusion and mitigating money laundering and terrorist financing risks. While acknowledging challenges like crime and insecurity, the authorities remain committed to strengthening institutional frameworks, enforcing laws effectively, and addressing corruption in the judiciary to improve the business climate. The recent legal reforms aim to make the justice system more transparent and accessible, with mechanisms to ensure high ethical standards for judges through independent oversight. The comprehensive reform packages aim to enhance governance by strengthening the rule of law, improving regulatory quality, and implementing anti-corruption measures, thereby fostering a more secure environment for investment and growth. The new administration continues to be committed to upholding rights to dissent and free expression while ensuring human rights, freedom, and democracy.

Mexico has benefited from the relocation of global supply chains and the recent record FDI inflows reflect Mexico’s stable political and economic environment, trade agreements, skilled workforce, and geographic advantages. The authorities are implementing policies to enhance financial inclusion, such as those intended to improve women’s access to credit and formal financial products and developing digital payment systems and information exchange and delivery mechanisms. The new government policy agenda is focused on promoting conditions to attract investment and build value chains through developing a national investment strategy that will simplify federal, state, and municipal procedures to create businesses, develop strategic infrastructure, strengthen the national security system through a comprehensive strategy, and expand and improve the education system. In addition, the authorities will invest in energy generation to ensure the expansion and development of nearshoring. The private sector will also be sought to promote the transition to renewable energies.

The Flexible Credit Line Review

Mexico's arrangement under the Flexible Credit Line (FCL) supports the country's commitment to maintaining very strong macroeconomic policies and institutional frameworks. We concur with staff’s assessment that the analysis of external risks remains broadly unchanged from last year, and while risks are broadly balanced, external downside risks are considerable. In this context, the FCL will continue to act as a valuable backstop to shield the Mexican economy from financial market volatility and unanticipated capital movements. The authorities welcome staff’s assessment, which confirms that Mexico continues to meet the qualification criteria for the FCL arrangement.

The Mexican authorities remain firmly committed to maintaining the track record of very strong macroeconomic policies implemented for many years. Nevertheless, the Mexican economy remains exposed to significant tail risks from external developments, a decline in global growth, lower oil prices, and renewed international financial market volatility, all in the context of additional geopolitical risks.

In this context, the Mexican authorities have decided to maintain the current access level of 300 percent of quota. The authorities agreed that this access level, combined with an adequate level of international reserves, would provide an additional layer of insurance to the Mexican economy against severe global tail-risk events. The authorities intend to continue to treat the arrangement as a precautionary support and will continue with its state-contingent exit strategy.

Finally, the Mexican authorities consider that in a more challenging and volatile international environment, the role of the IMF as a trusted advisor has become more prominent. In particular, an active policy dialogue with the IMF, including cooperation in analytical research projects and technical assistance, provides constructive value to the economic policy formulation process.