Mexico

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First Citizens
Research & Analytics

COUNTRY

Real GDP growth(%) Q4 2015	2.50%
Next General Election	1-Jul-18
Exchange Rate MXN/USD	0.056

CREDIT RATING

S&P Foreign Currency	BBB+ (Stable)
Fitch Foreign Currency	A3 (Neg)
Moody's Foreign Currency	BBB+ (Stable)

Major Trade Partners	US 80.2%, EU 5.1%, Canada 2.7%, China 1.5%, Brazil 1.2%
Major Exports	Crude petroleum, Cars, Vehicle Parts, Delivery trucks, Computers
GDP Composition	Agriculture: 3.6%, industry: 36.6% and services: 59.8%

RECENT ECONOMIC DEVELOPMENTS

ECONOMIC OUTLOOK **STABLE**

Mexico will benefit from stronger U.S. labor markets, bolstering manufacturing sector exports and remittance inflows. However, sharper monetary and fiscal tightening will weigh on Mexico's economy in the years ahead, tempering private consumption and real export growth. According to BMI forecast, real GDP growth will remain relatively flat between 2015 (2.5%) and 2016 (2.8%), accelerating only gradually in 2017(3.1%). Lay-offs by the federal government and more significant rate hiking cycle will weigh on private consumption. Pemex has recently announced plans to cut back capital spending, softening crude production and exports.

FISCAL PROFILE **POSITIVE**

Mexico's fiscal deficit is expected to narrow in 2016, based on government cut back on expenditure, efforts to widen the tax base and strengthen the fiscal responsibility law. The fiscal deficit is forecasted at 3.5% of GDP in 2016, and BMI forecasts average deficit between 2017 and 2020 of 2.5%, as stronger economic growth and structural reforms will gradually improve fiscal deficits. Continued government efforts to temper the pace of spending will allow for fiscal consolidation in 2017. The approved spending budget of MXN4.76 billion was marginally above the draft proposal of MXN4.75 billion put forward by the Mexican Ministry of Finance, but still represented less than 2.0% growth in comparison to 2015. Overall, efforts to rein in spending suggest that Mexico is likely to see the lowest level of overall spending growth in more than a decade.

EXTERNAL ACCOUNTS **NEGATIVE**

Mexican exports are expected to be depressed throughout 2016 due to weak oil prices. Global demand looks increasingly sluggish, with the Chinese economy stuttering, while there is only limited pull back in production. While oil forms a relatively small proportion of total exports at around 10.8% in 2014, the sharp drop in prices and falling production contributed to a 3.5% y-o-y contraction in goods exported for the first 11 months of 2015. The current account deficit forecast of 3.2% of GDP in 2016 was revised up from 2.9% and well above the 2.6% of GDP estimate for 2015. The average predicted export price of Mexican crude of USD35 per barrel in 2017, up from USD25 in 2016. However, Mexico's government has hedges that give it the right to sell its 2016 crude exports at USD49 per barrel and moreover the Finance Minister Luis Videgaray aims to seek price protection for 2017. Oil output is estimated to be 2.12 million barrels per day this year but production is expected to decline to 2.03 million barrels a day in 2017.

CREDIT RATING **STABLE**

On 27th January 2016, Mexico's S&P credit rating was kept at 'BBB+/A-2' Foreign Currency and 'A/A-1' Local currency sovereign credit ratings; Outlook remains Stable. The ratings on Mexico reflects its track record of fiscal and monetary policies, which has contributed to limited government deficits and low inflation, as well as moderate fiscal and external debt levels. According to S&P, Mexico possess a flexible economy which is able to adjust to changing global conditions, including a sharp drop in oil prices and local currency depreciation. The creation of more dynamic energy sector will lead to strengthening of the non-energy sector, such as manufacturing, over time, leading to an improved rating.

On 31st March 2016, Moody's Investors Service affirmed Mexico's A3 issuer and government bonds rating but change the outlook from stable to negative. The key reasons for the outlook change were:

1) Subdued economic performance and continued external headwinds, which challenge government fiscal consolidation efforts and increase the risk of debt ratios not stabilizing during the period of rating.

2) Contingent liabilities in the form of government support to PEMEX, given liquidity pressures that can undermine the fiscal consolidation process.

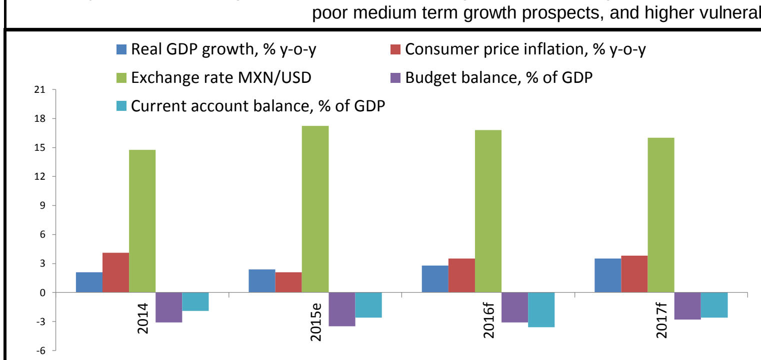
Upward pressure on Mexico's rating could result from higher than expected growth driven by continuing structural reform efforts, conversely downward pressure on Mexico's rating could result from stalled fiscal consolidation.

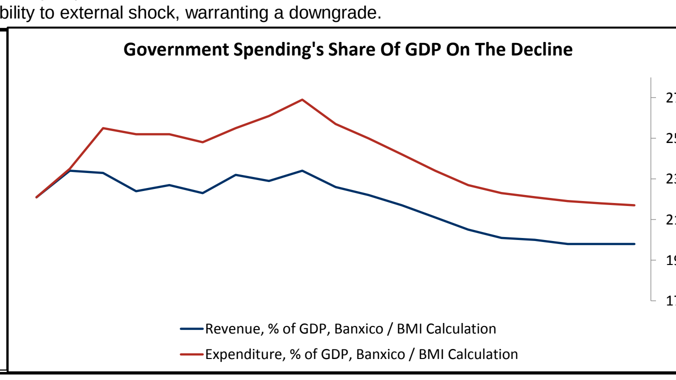
PEMEX IMPACT

A bailout of Mexico's state-owned oil company Pemex would likely prompt a modest deterioration in Mexico's fiscal or growth dynamics in the year ahead, though it will should not threaten the sovereign's ability to meet its obligation. It is assumed that the Mexican government will likely be forced to offer financial assistance to Pemex in 2016 as the state-owned oil company struggles in the face of elevated debt burden, sizeable arrears to oilfields service providers and limited liquidity. While a bailout would weigh on Mexico's sovereign credentials in the short term, damage to investor sentiment would be mitigated by government's history of prudent macroeconomic policies and Pemex's ongoing cost cutting measures.

OUTLOOK

First Citizens Research & Analytics maintains a *stable* outlook on Mexico because of its expected continuity in economic policies, along with ongoing fiscal adjustment that compensates for lower oil revenues and contains the government debt burden. However, a further prolonged decline in oil prices, or slower than expected growth in the U.S. economy, could lead to larger deficits and slower GDP growth. That, along with failure to effectively implement the recent reforms could contribute to weaker investor confidence, poor medium term growth prospects, and higher vulnerability to external shock, warranting a downgrade.





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