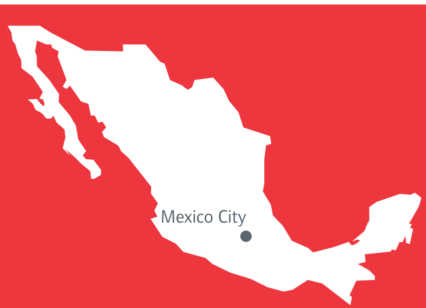
managing risk, enabling trade

Atradius Country Report

Mexico – November 2013



Mexico: Atradius STAR Political Risk Rating*:

4 (Good) - Negative

* The STAR rating runs on a scale from 1 to 10, where 1 represents the lowest risk and 10 the highest risk.

The 10 rating steps are aggregated into five broad categories to facilitate their interpretation in terms of credit quality. Starting from the most benign part of the quality spectrum, these categories range from 'High Quality', 'Good', 'Adequate', 'Impaired' to 'Prohibitive Conditions', with a separate grade reserved for 'Off Cover.'

In addition to the 10-point scale, there are rating modifiers associated with each scale step: 'Positive', 'Stable', and 'Negative'. These rating modifiers allow further granularity and differentiate more finely between countries in terms of risk.

For further information about the Atradius STAR rating, please click here

Overview

General information

Capital:	Mexico City
Government type:	Federal Republic
Currency:	Mexican Peso (MXN)
Population:	113.7 million
Status:	Upper middle income country (GDP/capita: US$ 10,500 in 2013)

Most important sectors (2012, % of GDP)

Services:	63 %
Industry:	33 %
Agriculture:	4 %

Main import sources (2012, % of total)

USA:	50.1 %
China:	15.4 %
Japan:	4.8 %
South Korea:	3.6 %
Germany:	3.6 %

Main export markets (2012, % of total)

USA:	77.7 %
Canada:	2.9 %
Spain:	1.9 %
China:	1.5 %
Brazil:	1.5 %

Main expenses of foreign exchange

Intermediate products (76 %), consumer goods (14 %)

Main sources of foreign exchange

Manufactured goods: 80 % - of which 45 % are maquiladora (i.e. Mexican factories that import material and equipment on a tariff-free basis for assembly and processing - mostly from the US - and then export the assembled and processed products, most often back to the US); oil (16 %); workers' remittances.

Key indicators

	2010	2011	2012	2013*	2014*
GDP (US$ million)	1,031,110	1,155,235	1,177,178	1,278,326	1,386,792
Real GDP growth (%)	5.3	4.0	3.8	1.2	3.9
GDP per capita (US$)	8,746	9,679	9,741	10,521	11,349
Inflation p.a. (%)	4.1	3.5	4.0	3.6	3.4
Fiscal balance (% of GDP)	-3.4	-3.1	-3.2	-3.1	-4.0
Total foreign debt (US$ million)	243,824	287,037	346,856	378,427	402,445
Foreign debt/GDP (%)	24	25	29	30	29
Foreign debt/XGS (%)	75	76	87	92	90
Short-term debt/inter. reserves (%)	33	35	45	47	50
Debt service ratio (%)	10	11	16	18	18
Current account balance (US$ million)	-3,859	-11,835	-14,183	-20,169	-22,010
Current account/GDP (%)	-0.4	-1.0	-1.2	-1.6	-1.6
Nom. exchange rate to US$ (average)	12.6	12.4	13.2	12.8	12.7
International reserves (US$ million)	119,159	148,253	160,553	174,959	179,856
In months of merchandise imports	4.7	5.1	5.2	5.6	5.4

*forecast Source: Economist Intelligence Unit (EIU), International Monetary Fund (IMF)

Political situation: Stable, but the domestic security situation is still poor

Head of state/government: President Enrique Peña Nieto (since December 1, 2012)

Government change in December 2012

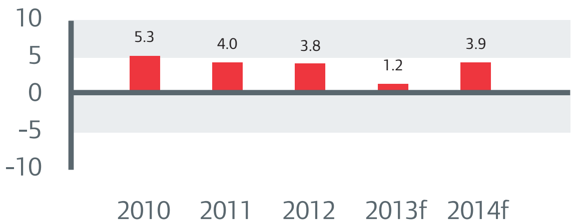
After 12 years in opposition, the Partido Revolucionario Institutional (PRI), which until 2000 had ruled the country for over 90 years, has returned to power after winning the presidential elections in July 2012. However, the PRI failed to gain a majority in Congress in the parliamentary elections. In order to pursue his reform agenda immediately after his inauguration, President Peña Nieto concluded an agreement to fast-track reforms with two main opposition parties (the conservative National Action Party, PAN, and the leftist Party of the Democratic Revolution, PRD), the so-called 'Pact for Mexico'.

Security has improved but violence is still harming the business environment

Violence has flared up considerably and security has deteriorated since the end of 2006, when former President Calderon's government stepped up its battle against the well-organised drug mafias. Since then, more than 70,000 people have fallen victim to this struggle. The worsening security situation has had an impact on the business environment, discouraging foreign investment that would otherwise flow into Mexico. Moreover, the profitability of many businesses has suffered from threats and violence against the business owners, including the kidnapping of their family members. However, security has recently improved somewhat, with the arrest of some major drug cartels bosses.

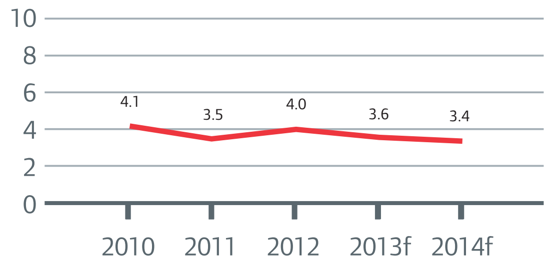
Internal economic situation: Growth will pick up again in 2014

Real GDP growth (%)



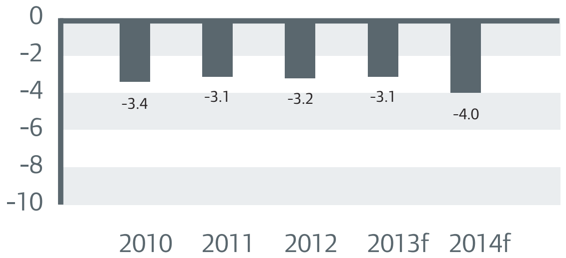
Source: EIU/IMF

Inflation p.a. (%)



Source: EIU/IMF

Fiscal balance (% of GDP)



Source: EIU/IMF

A rebound expected in 2014 after slowdown of growth in 2013

The unique relationship between the USA and Mexico means that Mexico's economy is closely synchronised with the business cycle of its northern neighbour. Because if this, Mexico's economy deteriorated dramatically during the credit crisis - due to those links to the US business cycle and consequently the impact of the deep US recession. However, since 2010 the economy has rebounded, thanks mainly to a resurgence of export demand from the US coupled with increasing domestic demand.

Despite that rebound, throughout 2013 Mexico's economic performance has been poor, with GDP contracting 0.7 % in the second quarter as domestic demand and exports were both disappointing. Moreover, the two severe hurricanes in September will have at least a short-term impact on the economy, which is now expected to grow just 1.2 % this year.

Nevertheless, we expect the economy to rebound in 2014, with growth of nearly 4 %, as exports pick up, driven by higher economic growth in the US. Reconstruction work following September's hurricanes will also benefit the economy next year.

Monetary policy will help spur growth

Monetary policy may also fuel GDP growth. Inflation figures have been encouraging at just 3.4 % in September: within the Bank of Mexico's target range of 2 %-4 %. Together with weaker growth, this has prompted the Bank of Mexico to lower its benchmark interest rate to 3.75 % in September and 3.5 % at the end of October. In general, Mexico's monetary policy faces the challenge of finding an interest rate that will curb inflation while maintaining the country's competitive position. And it is a real challenge: while higher interest rates will help to contain inflation and attract short-term portfolio capital inflows, leading to currency appreciation, an overly strong peso may damage Mexico's export competitiveness with other emerging markets.

Mexico's banks are, in general, well capitalised and liquid, with limited exposure to foreign currency risks. However, they are performing below potential (bank assets as a percentage of GDP stand at just 46 %), constraining the credit growth needed to stimulate more private consumption. A rather cautious lending policy is also restricting financing options for small and medium-sized enterprises.

Development of fiscal policies must be monitored

Overall, Mexico's current budgetary policy has been solid, with acceptable public sector finances, but the budget deficit exceeded 3 % of GDP in 2012 and is only slowly decreasing this year. Despite the small improvement, it is important to monitor the development of the budget deficit. Extra spending to spur the economy and for post-hurricane reconstruction, coupled with lower than anticipated tax revenues, might contribute to a deficit of 4 % of GDP in 2014. Although public sector debt is under control, at 35 % of GDP, an expansive budgetary policy is not sustainable in the longer term. Therefore additional fiscal consolidation is urgently required to compensate for low tax revenues (Mexico has a narrow tax base of only 10 %) and the structural decrease in oil revenues, which represent almost a third of public sector income.

Energy sector: oil production is decreasing

Mexico is the world's sixth largest crude oil producer, but proven reserves have shrunk from 34 to 14 billion barrels since 1998, and will last for only 10 more years. Current production has dropped from 3.4 million barrels per day (b/d) in 2004 to 2.5 million b/d and is expected to decrease further: to 2.1 million b/d in 2015.

Although offshore oil fields are said to be twice as large as land-based oil fields, Pemex, the state-owned oil and gas company, currently lacks the know-how and resources to invest in exploration and production, mainly because it pays 90 % of its revenues to the state. Pemex therefore urgently needs permission to cooperate with private (foreign) investors for joint exploration, refining and distribution. However, such a move is still met by fierce political opposition: the main hurdle being that Mexico's constitution stipulates that the oil industry must remain under state control.

Structural reforms needed to generate stronger growth

Despite a solid short-term economic policy, the Mexican economy still suffers from structural weaknesses, as poor reform results in past years have impeded economic efficiency and longer-term GDP growth. GDP increases are hardly exceeding population growth, leaving the GDP/capita ratio more or less on the same level as in 2008, at around US $10,000. Tax collection is very inefficient, the labour market is inflexible and the energy sector is monopolised by the state. The energy sector in particular - including the electricity network and Pemex monopoly - needs to be overhauled. While Pemex was granted more financial and managerial autonomy by the Mexican Senate in October 2008, a comprehensive reform of the oil industry is still the most pressing issue, because of dwindling production and since oil accounts for more than 30% of fiscal income.

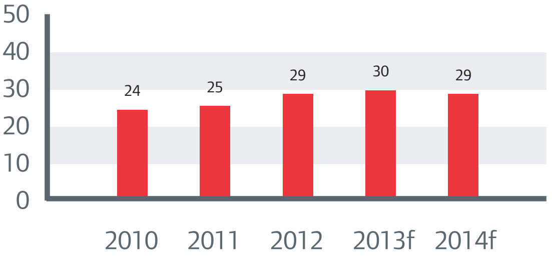
At last reform efforts are underway

Until recently, reform efforts have often failed because of a lack of political will at the top or support from opposition parties in Congress. The new government under President Peña Nieto has at last redoubled its efforts to speed up the reform progress. As a first step it concluded an agreement with two main opposition parties to ease the passage of reform laws through Congress. Despite some public protests, an education reform bill has been passed recently, together with a liberalisation of the telecommunications market and some minor reforms of the tax system.

The ongoing problems in the energy sector and the government's high dependence on oil revenues underline how important reforms in this field are to the economy. In August, President Peña Nieto presented his plan to change the constitution to allow private investment in the oil industry. However, as this issue is highly politically sensitive in Mexico, his proposals would limit private investment contracts to risk-sharing accords with cash payments, i.e. sharing in profits but not production with Pemex. The centre-right PAN party has presented a bill that goes further, by offering companies concessions to drill in Mexico. The final shape of the reform bill to be launched in Congress is currently under discussion between the parties.

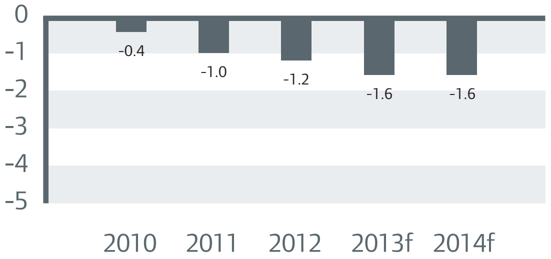
External economic situation: Good solvency and liquidity indicators

Foreign debt/GDP (%)



Source: EIU/IMF

Current account/GDP (%)



Source: EIU/IMF

Foreign debt

Level:	Relatively low: 30 % of GDP and 92 % of exports of goods and services in 2013
Structure:	Reasonable: less than 20 % due in short-term (2013)
Debt service ratio:	Moderate: 18 % in 2013, even including short-term debt (approx. 35 %).

International reserves

In months of imports (cif):	Reasonable with US$ 175 billion (5.6 months of import cover in 2013)

Remarks:
Mexico's international liquidity position is good, with enough foreign exchange reserves to cover imports for more than five months. Indeed, the true position is even better, as this figure excludes the huge liquidity potential from a precautionary IMF credit line of US $72 billion on which Mexico can draw in times of adverse global credit conditions, and which has been extended until November 2014. Solvency is also robust: foreign debt ratios are under control (30 % of GDP, 92 % of exports) and the debt service ratio has dropped to less than 20 %.

Balance of payments

Trade balance:	Structural deficits
Current account:	Increasing, but still reasonable deficits of below 2 % of GDP
Capital Account:	Positive due to FDI inflow
Total Account:	Mostly positive

Remarks:
Until this year, the moderate current account deficits have been easily financed by capital imports, occasionally driving up the peso exchange rate. However, recently this process was disturbed. When last summer the US Federal Reserve considered ending its programme of monetary easing, financial markets reacted by partly withdrawing or reversing short-term portfolio capital that has been invested in Mexican assets in the last few years, leading to higher currency volatility. Nevertheless, the Mexican peso has been only temporarily affected by this financial markets´ turmoil.

Outlook: Principally good, but more reforms are urgent

2014 growth increase highly dependent on US performance

The short-term outlook for Mexico is good, with growth expected to pick up again in 2014 by 3.9 %. However, this depends greatly on the performance of the US economy next year. With nearly 80 % of exports destined for the US, together with tourism and remittances, the US is Mexico's main source of foreign exchange. Currently, the US economy is expected to grow 2.5 %-2.6 % in 2014 after its growth of around 1.5 % this year.

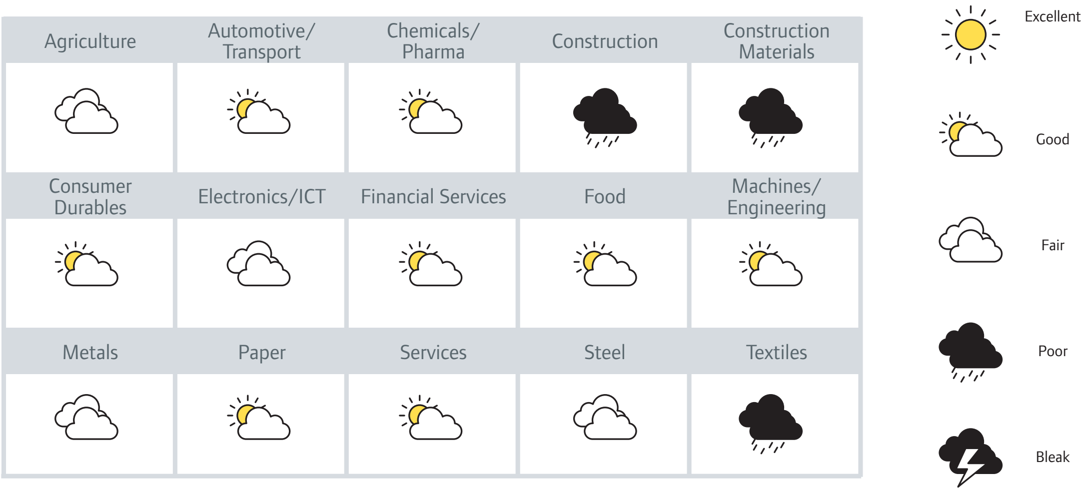
Solvency and liquidity indicators will remain stable. It is expected that the current account deficits will increase again in the coming years, but can easily financed by capital imports, especially FDI and incoming short-term portfolio capital. However, the behaviour of short-term portfolio capital that has been invested in Mexican assets, and which can be easily withdrawn or reversed, has to be monitored. While the currency regime is considered to be stable, there is always a potential devaluation risk which could cause problems. That said, the level of foreign exchange reserves is high enough to counter such threats. We currently see the fundamentals of the Mexican economy as strong enough to cope with setbacks without getting into major financial problems. The country will continue its solid investment ratings.

Reform of the energy sector will be crucial

While we believe that the measures taken so far by the new administration will have a positive impact one Mexico's economy in the mid and long term, the extent of future reforms in the energy sector will be crucial. While the more leftist PRD has already stated its opposition to reform of the Pemex monopoly, the ruling PRI, together with its smaller coalition partners and the PAN, have enough votes in both chambers of Congress to muster the two-thirds majority required to change the constitution. It still remains to be seen how deep the reform efforts in the energy sector will be in a final bill approved by Congress. However, there is the danger that such a bill would trigger the PRD to leave the bi-partisan reform consensus reached with the Pact for Mexico, especially given the fact that mid-term Chamber of Deputies elections are due in July 2015.

Mexico industries performance outlook

November 2013



General payment behaviour in Mexico

In Mexico, payments from public bodies are generally slow because of excessive bureaucracy. In addition, many private companies ask for extensions to the due dates of payment and in general the norm in Mexico is for companies to pay late: average delays are up to 60 days, while delays of 90 days or more are not uncommon.

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