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12049

Mexico

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Long-term Rating	A-
Outlook*	Stable
Short-term Rating	-

*Long-term Rating refers to Long-term Issuer Rating in principle.

1. Overview

In 2015, Mexico had a population of about 120 million and a nominal GDP of approximately USD1.2 trillion, the largest next to Brazil in Latin America. Its GDP per capita stood at around USD9,500. Mexico signed the North American Free Trade Agreement (NAFTA) with the US and Canada in 1994. The country has since established the status of an export-oriented industrial base for the North American market by capitalizing on massive foreign direct investment inflows. Its interdependence with the US has been deepening through the supply chain of manufacturing industries such as automobile and home electronics.

The US President Donald Trump who took office in January 2017 called for renegotiation of the NAFTA, construction of a wall along the US-Mexican border and deportation of undocumented immigrants. The environment surrounding the Mexican economy is still uncertain, although the financial market has recently recovering calmness comparing to the situation before his inauguration.

2. Political and social situation

Since taking office in December 2012, the administration of President Pena Nieto from PRI, the centrist party, has been pushing ahead with bold structural reforms involving wide-ranging sectors such as energy, finance, telecommunications, education and public finance by enacting a series of related bills. In the energy sector, among others, it has abolished the state monopoly and opened not only oil exploration and production but also refinery, marketing and power generation to private companies including foreign investors. Amid the stagnant oil prices, the bidding rounds have been progressing steadily albeit slowly. As part of its energy reforms, the administration raised energy prices such as gasoline and gas in January 2017, a year ahead of schedule. It also enacted the National Anticorruption System legal framework in July 2016 with the goals to create strong and autonomous institutions to prevent and sanction corruption as well as reformed the National Criminal Procedure Code which unifies the criminal justice procedure of the federation and the states to facilitate coordination among authorities. The administration continues its efforts to prevent corruption and to promote transparency of the public services.

The approval rate of President Pena Nieto declined to 17% in February 2017 from 55% at the time of his inauguration (according to Consulta Mitofsky) as his structural reforms had put burdens on the public. The next presidential election is scheduled for July 2018. Reelection of the president is prohibited by the constitution. According to the recent opinion poll, the approval rating for the ruling PRI is declining in contrast to the rising rates for the main opposition party PAN and the left-wing party MORENA.

3. Economic trend

The country’s annual exports accounted for 36% of GDP in 2016. Nearly 90% of the exports were manufacturing products and over 80% were bound for the US. The growth of the automobile industry has been particularly prominent in recent years. It produced 3.47 million cars and exported 2.77 million in 2016, ranking seventh and fourth respectively in the world. Those numbers have been renewing record highs since 2010.

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The economy grew 2.3% in real GDP terms in 2016, almost unchanged from a year earlier. The growth was led by the service sector such as transport, telecommunications, financial and real estate, which accounts for 62% of GDP, while the mining sector such as oil and gas which accounts for 6% of GDP remained lackluster. Given the growing uncertainty in its trade relations with the US, JCR projects that the real GDP growth may slow down to around 1% in 2017 on pulling back aggressive investments.

The year-on-year increase of the consumer price index has been staying just lower than 5% since January 2017, topping the 4% upper limit of the inflation targeting range set by Banco de Mexico, the central bank, due mainly to the Mexican peso's depreciation against the US dollar and the hikes of energy prices. JCR expects the central bank to keep its tight monetary policy stance amid the prospect of additional policy rate hikes by the US FRB.

4. Fiscal policy

Mexico's public finance, which was used to be characterized by the low level of non-oil-related tax revenues, had been susceptible to changes in domestic oil production and international oil prices. However, the efforts made by the Pena Nieto administration to broaden the tax base and build a framework to alleviate the impact of oil price fluctuations have proved successful in lowering the country's fiscal dependence on oil-related revenues.

Following the plunge of oil prices since the latter half of 2014, the public sector's oil-related revenues tumbled to 4.1% of GDP in 2016 from 7.1% in 2014. In contrast, the ratio of non-oil-related revenues rose to 21.0% in 2016 from 16.0% in 2014 due partly to a payout from oil hedging deals. In 2016, the government implemented additional spending cuts and allocated surplus of the central bank, to pay down debt, to repurchase government bonds, to accumulate assets (mainly in the Budgetary Revenues Stabilization Fund) and generated fiscal space to provide financial support to the state-run oil corporation PEMEX. The ratio of Public Sector Borrowing Requirement (PSBR) to GDP, the broadest measure of fiscal deficit, was trimmed from 4.1% a year earlier to 2.9% in 2016, or below the initial target of 3.5%. Adding up the central bank's 2016 surplus received by the government in March 2017, will bring down PSBR ratio to an estimated 1.4%.

The government is firmly committed to maintain the PSBR ratio at 2.9% in 2017 despite the revision of the growth assumption from 2.0-3.0% to 1.3-2.3%. The government holds fast to its target at 2.5% from 2018 onward. For the first time since 2008, a primary balance is prospected to be surplus in 2017, its GDP ratio will be 0.5% without the Bank's surplus and 1.6% including it. The PSBR's Historical Balance, the broadest measure of the country's public sector's debt, is expected to go down in 2017 from 50.2% of GDP in 2016 to 49.5% of GDP without the Bank's surplus and to 48.0% including it.

5. External position

The country's current account deficit stayed slightly smaller than 3% of GDP due to a large income deficit. In 2016, the current account deficit narrowed to 2.7% of GDP from 2.9% in 2015 due partly to the surge of remittances and revenues from travel services in the latter half of the year.

The financial account is susceptible to changes in the cross-border capital flows due to its highly open capital transactions regime. The Mexican peso has kept depreciating against the US dollar since a policy rate hike by the US FRB came into sight in 2015. Before the recent appreciation to the pre-US Presidential election level, Peso plunged to a historical low of 21.9 pesos per US dollar in January 2017. During that period, the Mexican authorities responded flexibly with policy rate increases, refraining from active intervention in the foreign exchange market. The central bank raised its policy rate on eight occasions by a cumulative 350 bps between December 2015 and March 2017. The official reserves stood at USD176.5 billion at the end of 2016, equivalent to about 5.2 times of the short-term external debt of that time. Apart from the reserves, the country has secured an IMF Flexible Credit Line totaling SDR62.4 billion (about USD88.0 billion).

6. Financial system

Mexico's banking system has stayed stable and sound despite the peso's sharp depreciation. Its nonperforming loan ratio and capital adequacy ratio stood at 2.2% and 15.2%, respectively, at the end of October 2016, as compared to 2.5% and 15.0% at the end of 2015. The authorities are making efforts to facilitate bank lending by promoting competition among banks and enhancing the legal framework for collateral execution.

Bank lending to the private sector centering on business corporations has been expanding at a robust pace. Credit to the private sector grew at 12.4% in real terms, with that to non-financial corporations swelling 17.4%. As to the share of the foreign currency loans in total bank lending, it remained low at 13.2% as of October 2016. This was mainly due to residents are, in principle, not even allowed to open foreign currency-denominated bank accounts. Foreign currency borrowings by firms are also restrained.

7. Overall assessment and rating outlook

The ratings are supported by the country's (i) solid export-oriented industrial base built under the NAFTA, (ii) adherence to fiscal discipline, (iii) resilience to exchange rate fluctuations and (iv) progress on structural reforms. Meanwhile, the ratings are constrained by (a) the Trump administration's protectionist policy stance and (b) remaining requirement for compressing the informal sector and growth-impeding factors such as the entrenched vested interests.

The environment surrounding the Mexican economy is still uncertain, although the financial market has recently recovering calmness. However, JCR expects that the country will keep responding appropriately to the difficult external conditions as it has been preserving fiscal discipline and soundness of the financial system while steadily advancing structural reforms in wider segments including the energy sector. JCR will closely monitor the possible impacts of the trade negotiations and the immigration policy of the Trump administration to have them reflected on its future ratings.

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Ratings

(millions of yen)

	Rating	Outlook*	Amount	Rate (%)	Issue Date	Maturity Date	Release
Japanese Yen Bonds 14th Series (2012)	A-	-	30,000	1.56	2012.06.08	2017.06.08	2017.04.11
Japanese Yen Bonds 16th Series (2013)	A-	-	15,000	1.39	2013.08.08	2018.08.08	2017.04.11
Japanese Yen Bonds 17th Series (2013)	A-	-	17,000	1.54	2013.08.08	2019.08.08	2017.04.11
Japanese Yen Bonds 18th Series (2014)	A-	-	33,800	0.80	2014.07.24	2019.07.24	2017.04.11
Japanese Yen Bonds 19th Series (2014)	A-	-	13,900	1.44	2014.07.24	2024.07.24	2017.04.11
Japanese Yen Bonds 20th Series (2014)	A-	-	12,300	2.57	2014.07.24	2034.07.24	2017.04.11
Japanese Yen Bonds 21st Series (2016)	A-	-	45,900	0.40	2016.06.16	2019.06.14	2017.04.11
Japanese Yen Bonds 22nd Series (2016)	A-	-	50,900	0.70	2016.06.16	2021.06.16	2017.04.11
Japanese Yen Bonds 23rd Series (2016)	A-	-	16,300	1.09	2016.06.16	2026.06.16	2017.04.11
Japanese Yen Bonds 24th Series (2016)	A-	-	21,900	2.40	2016.06.16	2036.06.16	2017.04.11
Foreign Currency Long-term Issuer Rating	A-	Stable	-	-	-	-	2017.04.11
Local Currency Long-term Issuer Rating	A+	Stable	-	-	-	-	2017.04.11

History of Long-term Issuer Rating

(Foreign Currency Long-term Issuer Rating or its equivalent)

Date	Rating	Outlook*	Issuer Name
1998.06.17	BB+	-	Mexico
2000.11.02	BBB	-	Mexico
2005.01.26	BBB	Stable	Mexico
2006.01.20	BBB+	Stable	Mexico
2008.01.28	A-	Stable	Mexico

*Outlook for Foreign Currency long-term issuer rating, or direction in case of Credit Monitor

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