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Economic Overview: April 2014

Summary

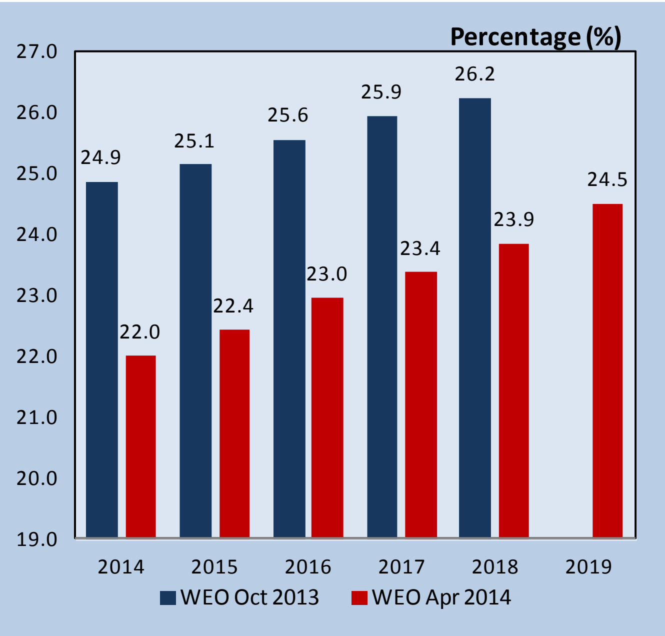
- The International Monetary Fund (IMF) published its World Economic Outlook (WEO) for the next five years. Despite poor performance in 1Q2014, the IMF remains optimistic about the Mexican economy, due to its proven resistance to volatility, and ongoing energy reform. However, IMF lowers expected Government revenues over next five years. Higher debt levels foreseen, yet these remain comparatively low against other economies in the region.
- President Pena Nieto launched National Infrastructure Plan 2014-2018, which will guide government spending in this key sector. Total amount of resources allocated is UK£385b for 745 projects, with both public and potential private investment planned.
- UNICEF and CONEVAL present a joint report on domestic child poverty. In 2012 53.8% of the population under 17 lived in poverty, 12.1% in extreme poverty. Report recommends a comprehensive strategy to foster human capital and provide employment opportunities.

IMF updates forecasts for Mexican economy

1. On April 2014, the International Monetary Fund (IMF) updated its World Economic Outlook (WEO), which includes forecasts for Mexico over the next five years. The report forecasts growth in 2014 at around 3%, similar to ECLAC and Banxico expectations (and the same as the previous IMF outlook last October). Despite the poor domestic performance at the beginning of the year, optimism remains in the international markets, due to the minor impact of the QE tapering, paired with an energy reform that aims to increase oil exports.

2. The IMF´s overall perspective for Latin America for the next couple of years is modest, as the expected growth of the region is 2.5% for 2014 and 3% for 2015. This due to the tightening of the international credit market caused by the FED tapering. Compared to other emerging economies of the region, the growth rate for the Mexican economy shows a better performance than Brazil (1.8%) and Argentina (0.5%).

Chart 1: Total investment as a share of GDP, 2014-2019



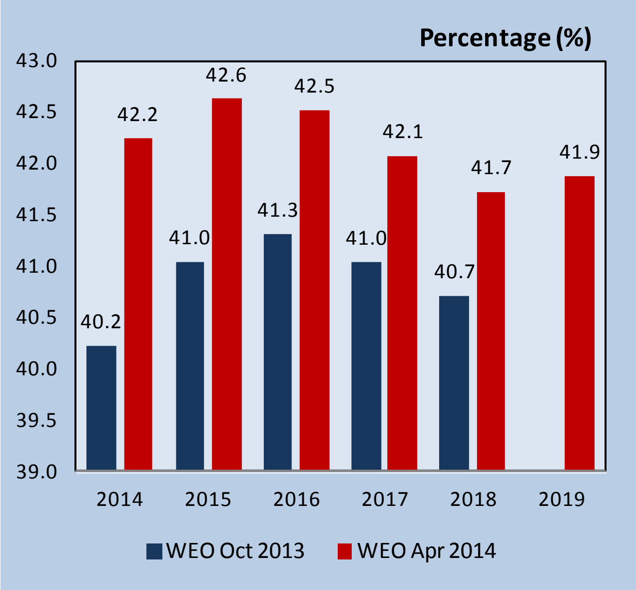
Source: World Economic Outlook April 2014 and October 2013, International Monetary Fund

Political and Economic Team
For further information please contact: Samantha Dunger or Diego Vazquez
Samantha.Dunger@fco.gov.uk
Diego.Vazquez@fco.gov.uk

3. While expected total investment as a share of GDP will be less than expected in 2014, it seems that the IMF considers this negative effect on growth will be compensated by a more dynamic export sector and more government spending. In 2014, total investment as a GDP share dropped from 24.9% to 22%. Meanwhile, the exports growth rate for the same period increased from 4.1% to 5.1%. Finally, general government expenditure as GDP share increased from 27.2% to 27.5%.

4. This drop in the forecast for total investment and savings spans the next five years, which means that the growth rates in the medium term will be the result of a more aggressive fiscal policy, and probably not the result of sustainable capital accumulation. This has serious implications for long term growth, as one of the biggest risks to achieving sustainable growth is the lack of financing for firms.

Chart 2: Government net debt as a share of GDP, 2014-2019



Source: World Economic Outlook April 2014 and October 2013, International Monetary Fund

5. Finally, the expected medium-term impact of the fiscal reform in Government revenues has being watered down. Expected revenues for the last half of Pena's term are now lower than previously expected, which will affect Government's net debt and the current account deficit. This downgrade may have resulted from the fiscal pact proposed by the Federal Government to preserve the new tax regime until 2018 (see our Feb 2014 Economic Report). Even so, the expected current account deficit as GDP percentage for 2014 (1.86%) is the third lowest deficit in the region, following Argentina (0.5%) and Paraguay (0.88), and lower in comparison to Chile (3.2%), Brazil (3.6%), Peru (4.79%) and Colombia (3.3%).

Policy in Focus 1: Government launches the National Infrastructure Plan

6. On 28 April 2014 President Pena Nieto launched the National Infrastructure Plan 2014-2018, which will guide government resource allocation. This is key, due to the role of investment in public infrastructure as an engine for growth. It is also notable due to the inclusion in the plan of projects which will be financed by public and private investment, providing an opportunity to capitalise high profile projects for foreign investment. The total amount of investment anticipated is UK£385 bn; 87% higher than the amount invested by previous administration´s last six-year term. The funds will be allocated to 743 projects in different sectors. Potential significant opportunities for the UK will be around energy and PPP infrastructure projects.

7. The Plan is divided into six sections: communications and transport, energy, hydraulic infrastructure, health, urban development and housing, and tourism. Almost half of the expected revenues will be allocated to energy projects (UK£195b), with the aim to provide sufficient and high quality energy, with competitive prices. The extent of the projects in the sector will depend on the secondary legislation of the energy reform, but the main activities to be developed are the maintaining of the most important oil wells (Cantarell, Ku-Maloob-Zaap, Burgos, etc.), the upgrade of several refineries, the expansion of the pipelines system, and some projects to obtain and use natural gas.

8. The Federal Government envisages investing up to UK£65 bn in 223 transport and communications projects, creating a holistic transport and communications platform to enhance competitiveness and productivity. Around UK£20bn will be spent on 223 water projects. These projects will have significant economic as well as social

impact, due to positive spillovers in agriculture and in the living standards of many households living in marginalised areas. In terms of health, the plan contemplates an investment of UK£3.6b divided into 87 projects. This sector is essential for the social development agenda of the government, in which health and universal access was the most important promise of Pena Nieto's campaign.

9. The construction sector is one of the most important sources of employment in the country, with last year´s dismal performance being a key factor in 2013´s low growth figures. The new plan therefore provides for an injection of Government revenues to the sector, to help to overcome the housing crisis, as well as to provide incentives to improve urban growth. Almost UK£90 bn will be spent on projects and subsidies to regenerate used housing as well as construct new properties, with a focus on increasing the density of new urban developments and reducing the current chaotic and dispersed expansion of housing developments nationwide. Finally, UK£9 bn will be invested in 83 tourism projects. Over UK$400m will be invested in the tourism to develop sustainable centres around national heritage sites.

Policy in focus 2: Children poverty in Mexico

10. On April 29 2014 UNICEF, in collaboration with the Mexican National Council for the Evaluation of Social Policy (CONEVAL) presented a report on child poverty. The report contains a general overview of national and regional indicators of poverty, inequality and development for Mexican children, as well as policy recommendations to eradicate extreme poverty amongst this group. Some of the recommendations of the report are focused on work on a more comprehensive strategy coordinating education, nutrition and health services for children below five years old, with special attention paid to indigenous communities. The report recognised that programmes to foster employment and economic activity in households with child poverty are essential to prevent the intergenerational transmission of poverty. The Mexican Government is already working in the redesign of several social programmes of the National Crusade against Huger in order to increase the amount of resources for reducing child poverty in marginalised zones.

11. According to the report, in 2012 53.8% of the population younger than 17 years old lived in poverty and 12.1% of them were in extreme poverty. This is an alarming figure even for Mexican standards, considering that, for the overall population in 2012, the percentage of people living in poverty and extreme poverty was 45.5% and 9.8%, respectively. In terms of social deprivation, in 2012 8.5% of Mexican children were lacking the legal minimum education, 21.5% did not have access to any health services, 61.2% did not have access to social security, 13.6% were in sub-standard housing, 21.2% lived in houses without access to basic services, and 23.3% lived in alimentary insecurity.

Monthly Economic Monitor

12. In terms of growth, the survey for April registered again a downgrade in expectations, with the expected growth rate for 2014 falling 0.08 percentage points to 3.01%. The reasons behind this lower rate were poor performance in 1Q2014, which will render a yearly quarterly growth rate near 0.5%. Whilst the survey for March had a 3.09% and 3.92% forecast for 2014 and 2015, in April the forecast for 2014 and 2015 fell to 3.01% and 3.91%, respectively. If the negative trend continues through the next couple of months, forecasts will go below 3%.

13. The inflation forecast for 2014 decreased to 3.85%, and expected inflation for 2015 marginally increased to 3.58%, within Banxico's benchmark. A good sign that the negative effect of tax reform in prices is disappearing is that inflation is decreasing over time. With lower expected inflation, and a shielded economy against international volatility, the Bank has incentives to maintain their target in 3.5%, since the economy could suffer the impact of a rise in interest rates.

14. Forecasts for the Mexican peso (MXN) reflect a solid and stable currency, since there was no change of expected exchange rate from March to April survey. The USD/MXN year-end exchange rate for 2014 is 13.01. The probability of the exchange rate overshooting is very low, since the effects of QE are starting to vanish, at least for Mexico.

Consensus Forecast (Jan 2014)	**2014**	**Vs. Dec 2013**	**2015**	**Vs. Dec 2013**
GDP (growth)	3.01%	⇩	3.91%	⇩
Inflation	3.85%	⇩	3.58%	⇧
Exchange Rate (year-end)	13.01	=	12.97	⇧
Source: Bank of Mexico survey on private sector expectations				