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**Statement by Mr. Huh, Mr. Becker, and Mr. Moaniba on Mexico
(Preliminary)
Executive Board Meeting
November 3, 2021**

We thank staff for a comprehensive and insightful report, as well as Mr. Guerra and Ms. Arevalo Arroyo for their very helpful BUFF statement. We broadly concur with the staff assessment and offer the following comments and questions.

We commend the authorities for successfully maintaining external, financial, and fiscal stability amid the deepest recession encountered in decades. Although Mexico continues to face the immense impact of the pandemic, exhibiting one of the highest Covid-19 case/fatality ratios globally, it has shown signs of gradual but prominent recovery over the year. This is in part due to the successful roll-out of vaccination programs to some of the most vulnerable groups and other efforts to contain the disease. However, uncertainty about the evolution of the pandemic raises downside risks to the economic outlook, especially if new variants of the virus were to emerge. Maintaining the good momentum of vaccinations recorded in recent months is therefore imperative in safeguarding the recovery. We agree with staff that the overall economic policy response to the pandemic may have been conservative and encourage the authorities to strike the appropriate balance between austerity and stimulus policies.

Fiscal policy has been subject to difficult trade-offs between austerity to maintain debt sustainability and provision of stimulus required to support the economic recovery. It does appear that the authorities have been relatively prudent in achieving the desired outcomes in terms of budget rules and limited debt accumulation. It is notable from the debt sustainability assessment that public debt is relatively contained at around 60 per cent of GDP. Taking the staff baseline assessment, debt will rise slightly over the forecast horizon, but we note that even under the adverse scenario, debt remains sustainable and would only increase to around 65 per cent of GDP. While debt carrying capacity is a valid consideration, there appears to be adequate fiscal space to support the staff recommendation for some additional government support going forward. We also note that the US recovery might confer some important positive spillovers onto the Mexican economy that could take some pressure off the budget.

Additional government spending should be targeted to be efficient, improve infrastructure, progress social security, advance provision of health services, while ensuring inclusion of the most vulnerable. The sequencing and extent of infrastructure and social spending should aim to address pockets of poverty and disadvantage that are holding back the productive capacity of the economy. Education, school attendance, and provision of childcare can help set a path for a more productive contribution from younger workers and women in the workforce.

Tax reform is a good compliment to the authorities' demonstrated fiscal discipline. Broadening the tax base and encouraging transition from the informal to the formal sectors would secure the revenue base. In particular, ensuring better tax administration to collect revenue and closing avoidance loopholes is a reform that can be undertaken relatively quickly.

Monetary policy settings are an interesting case given the close correlation between the real and financial cycles with the United States. With the self-imposed boundaries on fiscal policy to support the economy, it is notable that monetary policy did not do more in 2020 and that support is already being scaled back. Managing the temporary rise in inflation and providing monetary support to the economy is a difficult trade off to strike, especially given the risks to the inflation outlook for the United States. Choking off the nascent recovery could have severe consequences, and we urge a 'go slow and tread carefully' approach as indicated in BUFF.

Inflation outcomes have been higher than anticipated but, as the report notes, the central scenario remains for these pressures to be temporary—especially in the provision of services. *Could staff comment on the apparent correlation between services inflation and 12-month inflation expectations (Figure 4), and what this might mean for expectations when services inflation subsides, given that long-term expectations remain firmly anchored by central bank credibility?*

Given concerns raised about asynchronous recoveries between the United States and some other countries (e.g., WEO), how does that play out for Mexico in terms of possible disruptive capital flow reversals, and were these considerations discussed with the authorities in terms of appropriate monetary policy settings?

The rise in the minimum wage in recent years is a striking feature of reforms undertaken in Mexico. Given the low standard of living and slowing increase in income per capita, workers will benefit from such increases, especially as they are coming from a relatively low base. Mexico has now more than caught up to its peers and future increases need to be carefully considered. Wage increases that displace workers from the formal sector and force them into informal sectors, might prove to be counterproductive. It would be concerning if this were to disproportionately affect the most vulnerable, such as the unskilled, youth, and women. Policies that link minimum wage rises to productivity could avoid such undesirable unintended side effects.

Productivity enhancing policies would raise the potential production capacity of the economy. Employment growth could be accelerated to reduce underemployment of labor resources. One policy that we can support is the staff call for provision of broader childcare facilities that would enable women to either enter the workforce or shift from informal to formal sectors.

Well sequenced structural reform is imperative to secure sustainable development to advance the welfare of all Mexicans without undue reliance on external support. The growing gap in per capita GDP relative to advanced economies is a concerning indicator that signals more needs to be done to set the economy on a track that delivers better outcomes. Reform of the state-owned petroleum company is important to reduce the undue burden on the budget and allow the allocation of scarce resources to more productive public investment. There are several successful models in other countries where authorities have restructured the way that petrochemical enterprises are administered. Perhaps there are some important lessons that can be learned when the authorities approach making Pemex more efficient and viable. More broadly, the ease of doing business is an important measure of international and domestic confidence to invest in the economy. We support the staff indication that reducing regulatory costs and corruption would benefit the economy. Good governance is essential to achieve these objectives. Access to electricity at a low and stable price would assist private companies in structuring production and forward-looking investment plans.

Long-term reliance on support from Fund programs should not be considered to be a substitute for fundamentally based reforms that ensure that the economy is self-sustaining and resilient to external shocks.

Action taken to date on climate mitigation is to be commended. We support an approach to reduce emissions that best suits the circumstances of the Mexican economy. This might be through the adoption of new technologies and reduction of production that is associated with high CO₂ emissions but must also consider implications for equity to avoid unnecessary disadvantages for pockets of society during the adjustment.