FOR AGENDA

EBS/10/49
Correction 1

CONFIDENTIAL

March 24, 2010

To: Members of the Executive Board

From: The Acting Secretary

Subject: **Mexico—Arrangement Under the Flexible Credit Line and Cancellation of the Current Arrangement**

The attached corrections to EBS/10/49 (3/17/10) have been provided by the staff:

Factual Errors Not Affecting the Presentation of Staff's Analysis or Views

Page 3, para. 2, line 6: for "major tax reforms in 2007 and 2010"
read "major tax reforms in 2008 and 2010"
para. 4, line 6: for "outbreak of the H1N1 virus in May-"
read "outbreak of the H1N1 virus in April-"

Page 4, para. 7, line 3: for "and 4¾ percent for 2011"
read "and 4½ percent for 2011"

Page 8, Box 1, text table, line "Net exports, oil", 2006-2008: for "19.0 19.2 16.4"
read "19.4 17.5 15.0"

Typographical Errors

Page 7, para. 13, line 2: for "1,000 percent of quota in the context"
read "1,000 percent of quota) in the context"

Page 8, Box 1, text table: replaced to correct missing units (billions of US$)

Page 11, 4th bullet, penultimate line: for "passing two tax major reforms"
read "passing two major tax reforms"

Page 13, para. 18, line 4: for "(EBS/10/XX)"
read "(EBS/10/49, Supplement 1)"

Page 20, Table 5: replaced to correct missing line numbers

Questions may be referred to Mr. Haksar (ext. 37157) and Ms. Vladkova Hollar (ext. 39695) in WHD.

This document will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities.

Att: (7)

Other Distribution:
Department Heads

I. Context

Strong fundamentals

1. ***Mexico had a very strong macroeconomic performance for over a decade coming into the crisis***. Inflation was kept at low levels and expectations have remained well anchored. Public debt levels were reduced, including for public external debt. The external current account deficit was contained, while reserves were built to levels that were considered comfortable. Corporate sector balance sheets had likewise been strengthened, with low leverage and high profitability. Meanwhile, the banking system was highly profitable and well-capitalized, with low foreign borrowing and little exposure to structured financial products.

2. ***Underpinning this success has been a high level of policy credibility***. Banxico's inflation targeting regime has worked well and the central bank has developed strong anti-inflation credentials. This has allowed the flexible exchange rate to work as a key shock absorber. Fiscal policy has been guided by the balanced budget rule, as well as the demonstrated commitment of the authorities to take measures to bolster the structural fiscal position, including major tax reforms in 2008 and 2010. Meanwhile, the 2006 FSAP update acknowledged the strength and sophistication of the financial sector supervisory framework.

3. ***These broad strengths have been recognized by the Board in the 2010 Article IV consultation, concluded on March 10, 2010*** (see SM/10/50 and SUR/10/26). Directors commended the authorities for their sound policy frameworks and progress in strengthening public and private sector balance sheets, which had enabled an effective counter-cyclical policy response and helped preserve stability during the crisis. Their swift action to secure contingent credit lines—from the U.S. Federal Reserve and the Fund—also helped maintain external confidence. Directors welcomed the progress in fiscal reforms over the past three years and the agenda to seek expenditure savings and further strengthen tax administration. They agreed that monetary policy and communication had been appropriate, with the flexible exchange rate playing an important role in the adjustment process. Directors also noted the resilience of the financial system, underpinned by strong regulation and supervision.

Crisis impact and policy response

4. ***The crisis generated a sharp output contraction in Mexico during the first half of 2009 reflecting a confluence of severe shocks***. Close trade and financial linkages exposed Mexico to strong spillovers from the plunge in manufacturing production and asset prices in the U.S. The unanticipated large losses on corporate foreign currency derivative exposures added to market concerns about Mexican firms, further undermining their access to financing. In addition, Mexico experienced a serious outbreak of the H1N1 virus in April–June 2009, which is estimated to have reduced annual GDP by ½ percentage point. Thus, despite having entered the crisis with very strong fundamentals, Mexico's real GDP fell around 6½ percent in 2009—the sharpest contraction among Latin American peers.

5. ***Nonetheless, stability has been maintained, in part reflecting forceful and broad-based policy responses***. For the first time in many years, a substantial countercyclical macro policy response was possible. A fiscal impulse of about 2½ percent of GDP was delivered in 2009 and policy rates reduced by a cumulative 375 bps since mid-2008. The authorities took prompt and effective steps to maintain orderly conditions in a variety of market segments, providing liquidity as needed and taking more direct steps where required. This has yielded a broad stabilization of domestic financial markets. Banxico has also intervened to provide liquidity to the foreign exchange market while preserving the most essential elements of the flexible exchange rate regime. Stability was also supported by arranging contingent external finance through a US$30 billion swap line with the Federal Reserve—which expired on February 1, 2010 in Mexico as well as in the other countries that reached similar agreements with the Federal Reserve—and a US$47 billion (1,000 percent of quota) arrangement under the Flexible Credit Line (see also discussion in SM/10/50).

Emerging from the crisis

6. ***Mexico has emerged from the downturn with continued strong fundamentals***. Public debt levels have risen only moderately on the back of stimulus financed to a large degree with nondebt creating flows, and debt levels remain at the lower end of other G-20 members (with gross debt at 44½ percent of GDP and net debt at 39 percent of GDP). Inflation expectations remain well-anchored. Reserves have been rebuilt to pre-crisis levels, benefiting from strong public sector forex cash flows in late 2009. Meanwhile, banks have thus far seen only a modest rise in NPLs and maintained healthy capital ratios.

7. ***Indeed, the near-term outlook is positive***. With manufacturing exports providing impetus, the recent upward trend in output is expected to continue, leading to projected growth of 4 percent for 2010 and 4½ percent for 2011, with short run risks to the upside, especially if additional stimulus measures are implemented in the United States. While headline inflation is expected to increase in the short term as a result of recent increases in taxes and administered prices, it is expected to come down to the 3 percent target by end-2011. Financial inflows are projected to gradually resume, reflecting a normalization of global liquidity conditions.

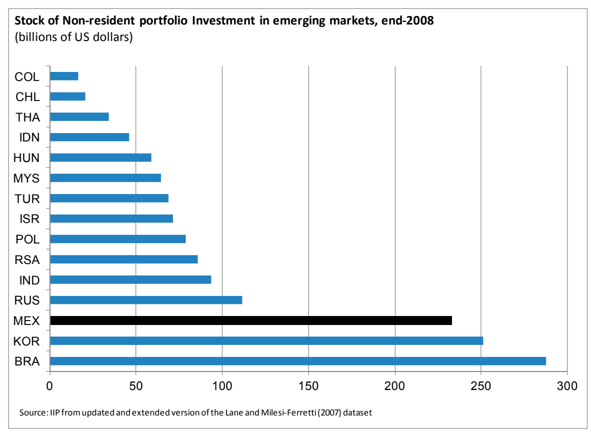
8. ***In addition, the authorities are taking steps to address concerns underscored by the crisis***. To ensure medium term fiscal sustainability, a significant tax package (yielding over one percent of GDP) was approved in late 2009, even in the context of a cyclically very weak economy, to offset the impact of declining oil production. Measures to further strengthen the financial stability framework are under consideration, and steps have been taken to strengthen monitoring and control of corporate derivative positions. On the structural side, significant steps have recently been taken to improve the efficiency of the electricity sector, and reforms to strengthen competition and improve labor market flexibility are at an advanced stage of preparation. (For a further discussion of these issues, see SM/10/50).

13. ***Access under a precautionary FCL for Mexico is proposed to remain at the current level of some US$48 billion (SDR32 billion, 1,000 percent of quota) in the context of a one-year arrangement***. Factors to take into account when considering the proposed access include the following:

- **No Fed swap**. The expiration of the US$30 billion Fed swap line has substantially reduced contingent insurance. Recourse to high access FCL resources would provide an important signal of continuity and help ensure a continued smooth adjustment to the new equilibrium without the Fed swap line;

- **Downside risks.** Continued high access is needed to provide credible assurances of sufficient liquidity under a severe stress scenario. While tail risks have diminished in the last year, the staff's preliminary analysis suggests that even a moderate stress scenario could yield a reserve drain of some US$20 billion, reflecting downside risks to the private capital account on bond issuance, portfolio and direct investment flows (see the discussion in Box 1);

- **Non-resident exposures**. While the stress scenarios above take into account some portfolio outflows, these are hard to predict, and the scenario is moderate. Mexico continues to have very large non-resident investments in portfolio equity and domestic and external debt instruments, both in absolute terms and relative to reserves. This generates additional tail risks, especially in the face of a global systemic shock—pointing to the need for additional buffers;



Stock of Non-resident portfolio Investment in emerging markets, end-2008
(billions of US dollars)

Source: IIP from updated and extended version of the Lane and Milesi-Ferretti (2007) dataset

- **Reserve coverage**. The authorities' goals of increasing reserves to assuage concerns about weaker coverage relative to peers versus balance sheet risks. This will happen only gradually and in this period, contingent access to FCL resources would provide needed assurance against downside tail risks.

Box 1. Adverse Scenario

An adverse illustrative scenario developed by staff suggests a possible financing shortfall of some US$20 billion. This scenario draws on the current WEO and GFSR analysis of downside risks and assumes that the growth momentum arising from stimulus in advance countries peters out in late 2010, with large post-crisis financing needs from other sovereigns generating pressures on Mexico (as well as other EMs). The underlying assumptions in this scenario (relative to the baseline) are as follows:

Mexico. Calculations of financing shortfalls in 2010
(In billions of U.S. dollars)

	Baseline						Adverse scenario		Financing
	2006	2007	2008	2009	2010	Rollover	2010	Rollover	Shortfalls
Current account	-4.4	-8.4	-15.9	-5.2	-14.0		-17.9		-3.9
Net exports, oil	19.4	17.5	15.0	10.4	4.5		3.8		-0.7
Net transfers (incl. remittances)	25.9	26.4	25.5	21.5	21.5		18.2		-3.3
FDI	14.0	19.1	22.0	3.8	17.5		14.4		-3.1
Public sector, MLT flows	23.5	32.3	32.9	32.9	20.4	2.3	19.0	2.1	-1.4
Private sector, MLT flows	14.9	19.8	12.6	20.2	19.0	1.2	15.6	1.0	-3.4
Short-term financing	20.7	22.5	25.2	28.5	24.3	1.1	20.6	0.9	-3.7
Portfolio and other investment assets	-12.2	-21.8	-7.9	-11.3	-6.0		-10.5		-4.5
Total identified shortfall									**-20.1**

- Current account pressures arise from lower U.S. growth and depressed oil prices. While non-oil net exports are expected to be unaffected (as import content of exports remains high), the assumed 15 percent decline in oil prices (about 20 percent probability based on latest futures distribution) over the baseline of US$70.8 per barrel is projected to reduce net oil exports by US$¾ billion. Further, a slowdown in the U.S.—and continued high Hispanic unemployment rate—would lower remittance receipts by some US$4 billion.
- FDI is assumed to fall almost 20 percent relative to the baseline, yielding a gap of about US$3¼ billion. Foreign direct investment has tended to be volatile, with net investment in 2009 declining not only due to lower FDI inflows, but also due to a few large investments abroad by Mexican firms seeking expansion opportunities.
- While high sovereign financing requirements may be a likely driver of heightened global stress, the Mexican public sector would remain largely insulated due to its limited external amortization needs in 2010. For public sector financing from capital markets, the scenario assumes 100 percent rollover of projected amortization needs and ¥150 billion of pre-financing for 2010, with no additional bond issuance. MLT financing from multilaterals is unaffected. This yields a modest financing shortfall of US$1½ billion.
- The private sector is assumed to be more constrained in meeting its financing needs, accounting for some US$12 billion of the total financing need:
  - On MLT flows, rollover rate is at 100 percent, with no new net financing assumed. This represents a decline of 20 percent from baseline for 2010—but around the preliminary estimate for rollover in 2009—and yields a financing shortfall of US$3½ billion.
  - On short-term financing, rollover declines to 90 percent—the average level observed pre-crisis—creating a financing shortfall of US$3¾ billion.
  - Portfolio and other flows experienced the most stress during the 2008–09 period, and the adverse scenario assumes a milder resumption of such pressures. Given the volatility of the series, the scenario assumes a two standard deviation shock, yielding a shortfall of almost US$4½ billion. At the height of the recent global crisis—over 2008Q4–2009Q1—outflows in portfolio investment alone accounted for about US$6¾ billion.

- **Capital account position dominated by private flows**. The overwhelming majority of debt financing in Mexico's balance of payments is from private creditors—debt to official creditor's accounts for about 10 percent of the total external debt stock, and 7 percent of gross flows in 2009.

- **Steady sovereign external access at favorable terms**. Mexico is among the highest-rated emerging markets—notwithstanding last year's rating downgrades by Fitch and S&P's—reflected in a track record of low sovereign external borrowing spreads, including during periods of stress such as during the 2001 recession. While external sovereign spreads have increased since the outbreak of the crisis—as in the case of other highly rated emerging markets—Mexico has retained access at reasonable terms, as demonstrated by the successful placement of US$1 billion in a 10-year bond deal in January 2010 at a yield of 5¼ percent.

- **Reserve position**. Mexico's reserves more than cover short-term debt falling due and were viewed as comfortable for normal times before the crisis. Moreover, reserves have been rebuilt to pre-crisis levels of over US$90 billion. However, since the crisis investors have drawn attention to lower coverage on balance sheet exposures relative to peers and, as discussed in ¶12, it is now believed prudent for reserves to be increased going forward.

- **Sustainable public debt and sound finances**. Fiscal policy is underpinned by the balanced budget rule as well as the authorities' commitment to keep the augmented public sector deficit (including development banks and other levels of government) at a level that stabilizes the overall public debt. Reflecting this, post-crisis projections for public debt and deficits are only somewhat higher (about 2½ and ½ percentage points of GDP, respectively, on average during 2011–13), further supported by the expected stabilization in oil production levels. The staff's DSA analysis discussed in SM/10/50 shows public debt in Mexico remaining manageable, with public sector gross financing requirements set to continue their trend decline as a share of GDP. No significant contingent liabilities have been incurred thus far in the crisis, with credit guarantees extended by public banks amounting to only about 1 percent of GDP. The authorities' stated medium term agenda includes further efforts to compensate for the projected decline in oil revenues as a share of GDP and to prevent compression of public investment. The authorities have clearly demonstrated their ability to deliver on difficult reforms, passing two major tax reforms since 2007 to begin the process of fiscal consolidation and bringing debt levels down gradually.

- **Low and stable inflation**. Inflation has fallen on a sustained basis in Mexico, including since the introduction of the inflation targeting framework, in the context of a floating exchange rate regime. While headline inflation is rising in 2010, due to the effect of one-off increases in taxes and domestic fuel prices, medium-term inflation expectations have remained well anchored.

- **Absence of systemic bank insolvencies**. The banking system remains liquid and well capitalized. The authorities have moved quickly to address emerging problems in some small institutions, and there are no bank solvency problems that pose an imminent systemic threat. Analysis by Banxico in its 2009 *Financial Stability Report*, and stress tests conducted by staff, show that the system remains well placed to cope with a range of further shocks to credit and market risk.

- **Effective financial sector supervision**. The 2006 FSAP update noted the underlying strength of the regulatory framework and supervisory authorities in Mexico, as well as the substantial progress made since the original FSAP in 2002. Successive Article IV consultations since have echoed these views. The authorities have taken further steps to strengthen the framework for bank resolution and planned to establish a permanent financial stability committee with representatives from the SHCP, Banxico and CNBV. They are also considering tightening the limit on lending by bank subsidiaries based in Mexico to parents abroad, and the disclosure requirement regarding corporates' derivative exposures has also been substantially strengthened.

- **Data transparency and integrity**. The overall quality of Mexican statistics is good, as acknowledged by the 2003 data ROSC. A data ROSC update was conducted in February 2010, and the draft report is being reviewed by the authorities. Mexico has been a subscriber to the SDDS since 1996 and the authorities provide a wealth of data to the public over the internet, with periodicity and timeliness exceeding SDDS requirements in a number of cases. Further measures have been taken to increase the transparency of corporate sector data.

16. ***The authorities' letter (Attachment) highlights their continued commitment to implementing very strong economic policies***. The authorities note that their policy priorities are to support the ongoing recovery, maintain macroeconomic and financial stability, and continue to lay the basis for strong and sustainable medium term growth. In broad terms, fiscal policy remains anchored by the balanced budget rule and medium term budgetary framework, while monetary policy will remain guided by the inflation targeting framework which has effectively anchored medium-term inflation expectations.

17. ***The policy strategy for the period ahead encompasses the following, as discussed during the 2010 Article IV consultation***.

- **Fiscal policy**. The 2010 budget includes the implementation of a major tax reform to offset the permanent revenue losses from the fall in oil production, along with a temporary easing of the balanced budget rule by ¾ percentage point of GDP to cover the cyclical deterioration in tax revenues. As the economy recovers, the authorities plan to return to a balanced budget under the rule by 2012. The authorities are continuing with efforts to restrain and rationalize current expenditure and further strengthen tax administration, to help offset pressures from rising pension and social expenditures, and finance priority public investment.

- **Monetary and exchange rate policy**. Monetary policy will remain guided by the inflation targeting framework. The absence of signs of a strong rally in consumption or investment combined with the fiscal consolidation in 2010 argues for a supportive monetary policy stance. The large output gap and the authorities' clear communication strategy should contain second round effects. Nonetheless, Banxico is watching closely the development of expectations. Consistent with the monetary framework, the authorities will also maintain the flexible exchange rate regime, which has proved to be an important shock absorber during the crisis.

- **Financial stability**. Over the last year's, the authorities have moved quickly to address pressures in some small institutions, and manageable risks to the sector are expected to remain. The authorities are planning to widen the regulatory perimeter to better monitor these entities and gather more information on their size, soundness and linkages to the rest of the system. The authorities are also considering establishing a committee of supervisory and regulatory institutions in Mexico to monitor systemic risks, tightening regulations on related party lending by Mexican subsidiaries of foreign banks, and strengthening collaboration with supervisors in other countries.

- **External insurance**. The authorities intend to gradually increase external insurance. This will be achieved through a combination of retaining public sector foreign exchange receipts—mainly from PEMEX—and a rules-based intervention mechanism consistent with the context of the freely floating exchange regime (see SM/10/50).

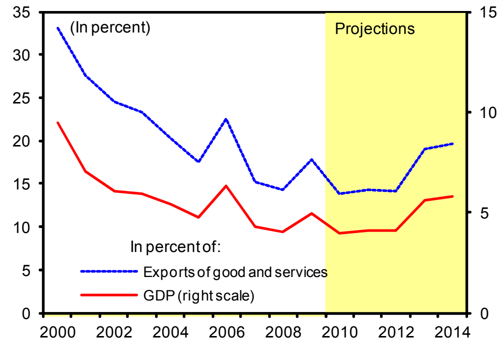
III. Impact on Fund Finances, Risks, and Safeguards

18. ***Access under the proposed FCL for Mexico of 1,000 percent of quota (SDR 31.528 billion) is large but manageable***. The Fund's liquidity is expected to remain adequate after the approval of the FCL arrangement for Mexico, as further discussed in the supplement assessing the impact on the Fund's finances and liquidity position (EBS/10/49, Supplement 1).

19. ***Risks to the Fund are expected to be low***. The authorities have given clear indications that they intend to treat the facility as precautionary. Even if a full drawing under the facility were to be made on approval, Mexico's external debt would remain moderate at

about 27 percent of GDP and at 21 percent of GDP in 2014, when debt service peaks (Table 7). Further, as the Text Chart shows, even peak debt service ratios would be lower than in recent years, and remain well within the range seen in other emerging market countries. Moreover, Mexico has a demonstrated excellent track record of meeting its obligations to the Fund.

External Debt Service Assuming Full Draw of FCL 1/



Source: IMF staff calculations.
1/ The projections assume that the full amount of access under the FCL is drawn in 2010.

20. ***Safeguards***. The 2008 audited financial statements and audit information regarding Banxico was provided to staff. There were no material audit findings or significant control or accounting weaknesses identified. The 2009 audit of financial statements has not been completed yet. The authorities have indicated that they will provide authorization for staff to have access to the Banxico's 2009 external audit report and to hold discussions with the external auditors, as required under the Fund's safeguards policy for the FCL.

IV. Staff Appraisal

21. ***A successor FCL arrangement could continue to play an important role in supporting Mexico's economic policy strategy***. While Mexico's underlying fundamentals are very strong, the expiration of the Fed swap line, and the continued risks in the global environment—in the context of Mexico's large and open capital markets—make a strong case for keeping contingent financing from the Fund in place. A successor FCL arrangement for 1,000 percent of quota—which the authorities intend to treat as precautionary—could continue to play an important role in supporting confidence and the authorities' economic policy strategy, given still persistent downside risks and the expiration of the Fed swap line which has reduced the availability of contingent insurance.

22. ***The staff assesses that Mexico meets the qualification criteria for access to FCL resources and recommends approval of an FCL arrangement for Mexico of SDR 31.528 billion for a period of 12 months***. The authorities have reacted flexibly and appropriately in response to the effects on Mexico of the global financial crisis. Their letter reaffirming a commitment to maintaining such policies in the future, and their track record, provide very strong reassurance that they would react appropriately to any future balance of payments difficulties. Risks to the Fund are contained by the very strong policy setting, the authorities' intent to treat the FCL arrangement as precautionary, Mexico's very strong repurchase track record with the Fund, as well as the manageable external debt service profile even if the authorities were to draw the full amount available up-front. Moreover, as explained in ¶15, Mexico meets the qualification criteria for use of FCL resources, which dovetails with the very positive assessment of policies by the Executive Board in the context of the 2010 Article IV consultation with Mexico.

Table 4. Mexico: External Financing Requirements and Sources, 2005-10

(In billions of U.S. dollars)

	2005	2006	2007	2008	2009	2010
					Est.	Proj.
Gross financing requirements	59.2	70.0	70.4	80.0	68.1	76.9
Current account deficit	4.5	4.4	8.4	15.9	5.2	14.0
Public sector medium and long term amortization 1/	16.4	33.3	15.2	14.4	11.1	9.0
Public sector bonds 2/	8.8	13.8	8.8	6.9	4.9	5.5
Public sector MLT debt	5.3	16.5	2.9	4.2	6.2	3.5
PIDIREGAS 3/	2.3	3.0	3.5	3.2	0.0	0.0
Private sector medium and long term amortization 4/	11.5	12.8	13.9	15.5	20.6	16.0
Private sector bonds 4/	4.6	5.7	6.0	6.7	6.0	5.8
Private sector medium and long term debt	6.9	7.1	8.0	8.8	14.7	10.2
Short term financing	19.5	20.4	22.6	26.8	25.7	22.9
Public sector 2/	6.3	6.7	7.0	9.4	7.2	2.1
Private sector 4/ 5/	4.4	5.8	6.2	7.1	6.9	9.2
Trade credit 6/	8.9	7.9	9.4	10.2	11.6	11.6
Change in international reserves	7.2	-1.0	10.3	7.5	5.4	15.0
Available financing	59.2	70.0	70.4	80.0	68.1	76.9
FDI, net	15.9	14.0	19.1	22.0	3.8	17.5
Public sector MLT flows 1/	21.3	23.5	32.3	32.9	32.9	20.4
Public sector bonds 2/	2.1	3.3	3.3	3.5	11.0	8.5
Public sector MLT debt	4.7	6.6	3.3	6.5	18.3	8.7
PIDIREGAS 3/	11.1	10.0	16.7	16.1	0.0	0.0
Private sector MLT flows 4/	12.3	14.9	19.8	12.6	20.2	19.0
Private sector bonds	7.6	6.5	9.0	4.1	5.6	4.8
Private sector MLT debt	4.7	8.4	10.8	8.5	14.7	14.2
Short-term financing	17.2	20.7	22.5	25.2	28.5	24.3
Public sector 2/	3.5	5.1	5.2	6.6	7.7	2.1
Private sector 4/ 5/	5.8	6.2	7.1	6.9	9.2	10.6
Trade credit 6/	7.9	9.4	10.2	11.6	11.6	11.6
Other flows	-7.4	-3.2	-23.3	-12.6	-17.4	-4.3
of which:						
Increase in portfolio and other investment assets	-7.7	-12.2	-21.8	-7.9	-12.0	-6.0
of which: Oil price hedge					5.1	

Sources: Mexican authorities and IMF staff estimates.

1/ Including PIDIREGAS.

2/ On a BoP basis.

3/ Includes bonds and loans. For 2003-08, staff estimates based on the stock of debt at original maturity, estimated duration, and net financing data from the Balance of Payments. In 2009, assets from the PEMEX's Master Trust were used to pay down the stock of PIDIREGAS debt.

4/ Gross financing figures for 2003-08 are staff estimates based on data on the stock of debt by residual maturity, estimated duration, and net financing data from the Balance of Payments.

5/ Loans and money market instruments, estimates on original maturity basis.

6/ Includes accounts payable to suppliers and long-term trade credit.

Table 5. Mexico: Gross Public Sector Debt Sustainability Framework, 2005-2015
(In percent of GDP, unless otherwise indicated)

	Actual					Projections						
	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	**Debt-stabilizing primary balance 9/**
1 **Baseline: Gross public sector debt 1/**	39.8	38.3	38.2	43.3	44.6	**44.6**	**44.2**	**43.4**	**42.8**	**42.5**	**42.4**	**-0.5**
o/w foreign-currency denominated 7/	12.8	10.2	10.3	12.9	12.0	10.9	10.0	9.1	8.4	7.8	7.2	
2 Change in gross public sector debt	-1.6	-1.5	-0.1	5.2	1.2	0.0	-0.4	-0.8	-0.6	-0.3	-0.1	
3 Identified debt-creating flows (4+7+12)	-2.6	-3.8	-2.0	1.0	3.4	-0.8	-0.6	-1.0	-0.8	-0.5	-0.3	
4 Primary deficit	-1.6	-2.2	-1.2	-0.9	1.9	1.4	0.9	0.4	0.4	0.3	0.2	
5 Revenue and grants	20.8	21.4	21.4	22.9	22.3	21.4	21.3	21.3	21.1	20.9	20.7	
6 Primary (noninterest) expenditure	19.2	19.2	20.2	22.0	24.1	22.8	22.2	21.7	21.5	21.2	20.9	
7 Automatic debt dynamics 2/	-0.8	-1.3	-0.1	2.6	2.8	-1.7	-1.0	-1.0	-0.7	-0.4	-0.1	
8 Contribution from interest rate/growth differential 3/	-0.1	-1.6	-0.2	-0.1	4.0	-1.7	-1.0	-1.0	-0.7	-0.4	-0.1	
9 Of which contribution from real interest rate	1.1	0.3	1.0	0.3	1.1	-0.1	0.8	1.1	1.3	1.4	1.5	
10 Of which contribution from real GDP growth	-1.2	-1.8	-1.2	-0.5	2.9	-1.6	-1.8	-2.1	-2.0	-1.7	-1.6	
11 Contribution from exchange rate depreciation 4/	-0.7	0.2	0.1	2.8	-1.2	...	...	...	...	...	...	
12 Other identified debt-creating flows	-0.2	-0.3	-0.6	-0.7	-1.3	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	
13 Privatization receipts (negative)	-0.2	-0.3	-0.6	-0.7	-1.3	-0.5	-0.4	-0.4	-0.4	-0.4	-0.4	
14 Recognition of implicit or contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
15 Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
16 Residual, including asset changes (2-3) 5/	1.0	2.3	1.8	4.2	-2.1	0.9	0.2	0.2	0.2	0.2	0.2	
Gross public sector debt-to-revenue ratio 1/	191.3	179.1	178.4	189.3	200.3	207.9	207.4	203.8	202.7	203.7	204.6	
Gross financing need 6/	10.3	7.7	8.1	11.4	15.7	13.0	12.2	10.8	10.7	10.5	10.3	
in billions of U.S. dollars	87.8	73.4	83.1	123.9	138.4	129.5	130.7	124.4	132.5	138.5	144.5	
Scenario with key variables at their historical averages 7/						**44.6**	**43.2**	**41.8**	**40.3**	**38.9**	**37.4**	**-0.8**
Scenario with no policy change (constant primary balance) in 2010-2015						**44.6**	**43.9**	**44.0**	**44.5**	**45.2**	**46.2**	**-0.5**
Key Macroeconomic and Fiscal Assumptions Underlying Baseline												
Real GDP growth (in percent)	3.2	5.1	3.3	1.3	-6.6	4.0	4.5	5.2	4.9	4.4	4.0	
Average nominal interest rate on public debt (in percent) 8/	7.6	7.8	7.5	7.7	7.4	6.3	6.3	6.3	6.5	6.7	6.9	
Average real interest rate (nominal rate minus change in GDP deflator, in p	3.0	1.1	3.0	1.0	2.1	0.1	2.2	2.9	3.3	3.6	3.8	
Nominal appreciation (increase in US dollar value of local currency, in perc	4.8	-1.6	-1.0	-21.1	8.9	...	...	...	...	...	...	
Inflation rate (GDP deflator, in percent)	4.6	6.7	4.5	6.6	5.3	6.3	4.1	3.4	3.3	3.1	3.1	
Growth of real primary spending (deflated by GDP deflator, in percent)	9.6	5.1	8.3	10.6	2.5	-1.7	1.6	3.0	3.7	2.9	2.8	
Primary deficit	-1.6	-2.2	-1.2	-0.9	1.9	1.4	0.9	0.4	0.4	0.3	0.2	

1/ Public sector includes federal government, Pemex, and other public companies, development banks, Pidiregas, IPAB, debtor's program, and Farac.

2/ Derived as $[(r - \pi(1+g) - g + \alpha\varepsilon(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with r = interest rate; π = growth rate of GDP deflator; g = real GDP growth rate; α = share of foreign-currency denominated debt; and ε = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

3/ The real interest rate contribution is derived from the denominator in footnote 2/ as $r - \pi(1+g)$ and the real growth contribution as -g.

4/ The exchange rate contribution is derived from the numerator in footnote 2/ as $\alpha\varepsilon(1+r)$.

5/ For projections, this line includes exchange rate changes.

6/ Defined as public sector deficit, plus amortization of medium and long-term public sector debt, plus short-term debt at end of previous period.

7/ The key variables include real GDP growth; real interest rate; and primary balance in percent of GDP.

8/ Derived as nominal interest expenditure divided by previous period debt stock.

9/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

Corrected: 3/24/10