DOCUMENT OF INTERNATIONAL MONETARY FUND AND FOR OFFICIAL USE ONLY

The contents of this document are preliminary and subject to change.

GRAY/20/3206

October 29, 2020

Statement by Mr. Massourakis and Ms. Quaglierini on Mexico
(Preliminary)
Executive Board Meeting
November 2, 2020

We thank staff for an informative report and Mr. Guerra and Ms. Arevalo Arroyo for their insightful Buff statement. We agree with staff that it is important to attune Mexico's macroeconomic policy stance to the challenging COVID-19 situation but understand there are differences in views at play to best evaluate the authorities' policy response so far. We are less sanguine about introducing a comprehensive tax reform, or labor market reforms, at the present conjuncture. As concerns structural reforms over the medium term, we underscore the importance of reducing labor informality and poverty rates, broadening social safety nets, fostering innovation and financial inclusion, and improving governance frameworks. We would like to add the following comments.

- Policy credibility and effectiveness are of the utmost importance during this unprecedented crisis. Policy measures should remain adaptive to the evolving situation and consider the trade-offs of policy actions in a comprehensive and forward looking way.

- We see merit in staff's strategy that Mexico should take a proactive macroeconomic stance to foster the economic recovery, prevent scarring and reduce the currently large estimated output gap. If effective, such a strategy will ultimately strengthen public debt sustainability by facilitating the absorption of the still large job losses and defusing the risks of hysteresis in unemployment, which was apparent in past Mexico's recessions. Given the more cautious policy stance expressed by the authorities and the possible tradeoffs for emerging countries, we would recommend staff to maintain a close dialogue with Mexico's authorities to better assess the timing, the areas and the overall magnitude of an additional fiscal support.

- We are less persuaded by staff's proposal of a credible medium-term tax reform to be announced at the current juncture and would recommend focusing selectively on improving tax compliance, broadening the tax base, reducing tax expenditures and other similar interventions. We welcome the progresses already achieved by Mexico on a higher degree of tax efficiency, as shown in the Buff.

- As far as monetary policy is concerned, on balance, we would put more emphasis on the implementation of policy support measures to extend credit to firms, particularly SMEs given the (dispersed) structure of Mexico's economy, including a stronger role by development banks through guarantees. We appreciate the initiative in this direction mentioned in the Buff.

- The flexible exchange rate has served Mexico well as first shock absorber and note that foreign exchange reserves have increased compared to last year and, at 130 percent, stand well above the Fund adequacy metric. Both the Flexible Credit Line and the swap provided by the Federal Reserve further strengthen the resilience of Mexico to external shocks.

- We note that Mexico's financial sector is sound, and banks are generally sound. We concur with staff that, given the uncertainty, suspending bank profit distribution would be appropriate.

- We appreciate the concise Annexes focused on important policy issues. We underscore Annex VI on scarring which presents the transition matrix in Mexico's labor market. In this context, policies to reduce informality, although growth-enhancing in the long run, may be not as effective when forthcoming demand recovery is weak and at a time when it is imperative to deal with high incidence of labor redundancies and working poverty. We consider that the pension reform as envisaged by the authorities can represent a step in the right direction.

- Regarding Pemex, considering its loss of investment grade, the scenario for prolonged lower oil prices and the need to promote private investment, we see merit in improving its governance, as indicated in Annex II, para 6.