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October 29, 2020

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

We thank staff for the informative papers, and Mr. Guerra and Ms. Arevalo Arroyo for their helpful, clear and detailed buff statement.

Mexico has suffered severe health and economic disruption as a result of COVID-19. Staff's assessment is sobering. Already in a "mild recession" at the start of 2020, Mexico then faced a cocktail of COVID-associated shocks over the first half of the year, as global risk aversion prompted capital flight, the oil price deteriorated, activity stalled in key trading partners, and the health crisis took root within Mexico. While some parts of the economy have recovered, this remains partial, uneven and unstable. Staff note that by end-2020, real per capita GDP will be at pre-global financial crisis levels, and that the working poverty rate has risen from 36% pre-pandemic to 48% now. Unemployment and underemployment are both likely to rise. There remains considerable uncertainty about the path of the virus as well as the economy.

Against this backdrop, staff's call for a package of further support has some compelling logic, particularly given some of the vulnerabilities in Mexico. Last year, we highlighted Mexico's balanced and prudent fiscal approach, its robust monetary policy framework and its flexible exchange rate as key tools for managing risks. These have all been leant on to help manage the COVID-19 shocks. Yet the high share of labor informality and gaps in the social safety net system leave many people exposed to the disruptions associated with the pandemic, and are also likely to exacerbate weak domestic demand. There is scope for additional temporary, targeted fiscal measures to play a role in supporting lives and livelihoods. Meanwhile, a further boost in focused and efficient public investment also has some merit, especially where it can also help to promote more sustainable long-run growth.

But we also recognize that implementing the raft of measures advocated by staff (and crucially, doing so effectively) would not be straightforward. The staff report itself notes a balancing act in pursuing more supportive policies. We share staff's assessment that Mexico has some fiscal space and enjoys comfortable market access, but this cannot be taken for granted. The credibility of the medium-term fiscal stance is important, as is the authorities' continued commitment to maintaining their track record of very strong policies and policy frameworks. While delivering near-term support of the scale and type staff suggest may be possible, doing so effectively and without impacting expectations about medium-run debt levels would be difficult for any country. We also note the authorities' concern about simplistic comparisons between countries on the scale of policy responses: while the effectiveness of health and economic measures is hard to gauge ex-ante, it is ultimately what matters, rather than the volume of financing. Country-specific circumstances and constraints are relevant.

Similarly, on monetary policy, the report acknowledges the difficult trade-offs facing the authorities. Staff conclude that the monetary stance is accommodative but that there is space for further easing; the authorities agree but point to reduced space (given the substantial cuts to the policy rate since mid-2019) amid high uncertainty. The report observes that several other large emerging markets have pursued additional monetary stimulus through asset purchase programs. *Do staff see scope for the central bank to pursue alternative easing policies beyond further cuts to the headline policy rate?* We note staff's recommendation that an independent review of the monetary framework may be merited, but also recognize the authorities' observations that Mexico's challenges are different to those faced by the US Federal Reserve and the European Central Bank in particular. *Could staff clarify whether their recommendation to review the monetary framework is driven by Mexico-specific concerns, or is part of a more general push to look again at monetary policy frameworks across inflation-targeting economies?*

We agree with staff that when considering trade-offs, particularly when it comes to medium-term recovery and ultimately some fiscal consolidation, addressing longstanding structural issues may offer the best way of managing the fiscal gap while supporting sustainable growth. There do seem to be risks around further cuts to public services provision (indeed, there are arguments for *strengthening* service provision, particularly to the most vulnerable). We think staff are right to highlight the importance of public capital investment – in volume but also in efficacy – as a driver for growth. We share staff's concern about the low level of non-Pemex capital expenditure (though again, outcomes are more important than public spending figures). Measures to encourage private sector investment in the energy sector, in a sustainable fashion, could also help harness growth potential while also freeing up space for other forms of public investment. The buff statement suggests some helpful steps in this regard, as well as on governance and anticorruption; we look forward to further progress. We also agree that comprehensive tax reform is a key objective. We welcome the authorities' efforts to step up tax enforcement in recent months. *Across all the policy recommendations, we would welcome staff's views on prioritization, sequencing and implementation, recognizing political economy and practical pandemic-related constraints.*

This report rightly focuses on the COVID-19 shocks, but we believe that as the authorities design plans for the recovery phase, they should do so with broader long-run objectives in mind. For example, this time last year, we noted the limited discussion of climate-related issues in recent staff reports on Mexico. There are only brief references in this report, tied to the reversal of energy reforms and the worrying promotion of "public brown energy providers over private green ones". Mexico's scale makes it a significant global actor on climate change. We urge staff and the authorities not to miss the opportunity to focus on ensuring a green and durable recovery. There could be some path dependency associated with the decisions governments make over the coming months; locking in the right policy choices is important.