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October 29, 2020

**Statement by Mr. Geadah and Ms. Choueiri on Mexico
(Preliminary)
Executive Board Meeting
November 2, 2020**

1. Mexico is being affected severely by the COVID-19 pandemic. Activity is expected to contract sharply in 2020 and, similar to many other countries, the burden is being borne disproportionately by the poor and the vulnerable despite the authorities' response to the crisis. The authorities have focused on addressing the health emergency and on mitigating the adverse impact on the most vulnerable households, workers, and firms. In addition, the central bank expanded or established several facilities to support market functioning and credit provision. At the same time, the flexible exchange rate has facilitated an absorption of shocks, and monetary policy has been eased steadily.

2. The discussions appropriately focused on the competing challenges that Mexico faces, including preserving lives and livelihoods, safeguarding medium-term fiscal sustainability, and advancing the reform agenda. We welcome the details, conveyed by Mr. Guerra and Ms. Arevalo Arroyo in their helpful Buff statement, on the authorities' policy initiatives in these areas. In an environment where all three rating agencies downgraded Mexico's sovereign rating, partly as a result of the projected increase in the public debt-to-GDP ratio and in borrowing costs, we can understand the authorities' relatively prudent approach in the face of the pandemic. Emerging market countries typically have limited fiscal space and higher interest rates than advanced economies, and they face more volatile conditions. In light of the above, staff's assessment in the appraisal that "the macroeconomic policy response has been very conservative" may be somewhat severe. We will focus the remainder of our comments on issues in the fiscal and monetary areas.

3. In response to the pandemic, the authorities announced fiscal measures amounting to 0.7 percent of GDP, below-the-line measures of about 1.1 percent of GDP—through loans, reallocated expenditure items, front-loaded spending for social pension payments to the elderly and the disabled, and accelerated procurement processes—as well as tax policy and tax administration measures. The authorities and staff have divergent views on the merit of

additional near-term fiscal support to be followed by comprehensive medium-term tax reforms. Staff makes a case that larger near-term support could be used for enhancing health care services and increasing the coverage of the social safety net to include eligible individuals that are not receiving any benefits and informal workers in hard-hit sectors. *In light of the authorities' concern about their fiscal space amidst high-interest rates constraints, we would appreciate further details on Mexico's fiscal space and fiscal response relative to peer countries.* We concur with staff that a credible medium-term tax reform is essential to close fiscal gaps, lower public debt, and finance public investment and social spending going forward. Nonetheless, we understand the authorities' concern about the communication challenges associated with announcing broad-based tax increases in the middle of a pandemic. The authorities' prudent approach to date would enable them to respond with additional support measures to a recurrence of outbreaks and related adverse economic shocks.

4. In an effort to balance support for the economy with anchoring inflation and safeguarding external financial stability, Banco de Mexico has cut the policy rate significantly—by 275 basis point since March—and supported financial market functioning. Staff calls for further monetary easing, which will undoubtedly provide further relief to the economy. Nonetheless, the environment is complex and Banco de Mexico faces difficult trade-offs, notably the increase in inflation and inflationary expectations above the central banks' target, high uncertainty, and unsettled financial conditions, particularly those that are relevant drivers of risk appetite for emerging markets assets, as argued by the authorities. *We would appreciate further elaboration by staff on the trade-offs facing monetary policy decision-making.*

With these remarks, we wish Mexico and its people well in these challenging times.