Financial Vulnerability in Mexico: Then and Now
A history of crises

(US$/peso exchange rate, % change in monthly average)
Crises hurt
(Real GDP per capita growth, percent)
What leads to crises?

- Large capital inflows
- Lots of short-term debt
- Credit boom
- Deterioration of banks’ balance sheets
- A fixed-exchange rate
Large capital inflows
(Percent of GDP)

- Capital inflow, net
- Portfolio inflow, net
Lots of short term debt
(Percent of total external debt)
Credit boom

Loans to private sector

Percent of GDP

1985 1987 1989 1991 1993 1995 1997 1999 2001 2003 2005
Bad loans pile up

Loans to private sector
Nonperforming loans
Mexico today

- Capital inflows (% GDP)
- Short-term debt to reserves
- Credit growth (%)
- Nonperforming loans (% of lending)
Mexico grows a yield curve

Percent

0 10 20 30 40 50 60

O/N 28D 3M 6M 1Y 3Y 5Y 7Y 10Y 20Y

1995

1999

2000

2003

2004
Inflation is tamed
(Annualized CPI inflation rate, percent)
Fiscal house is in order
(Budgetary deficit, percent of GDP)
Where’s the sexenio?
(Country premium, basis points)

Pre-Tequila flare-up

Mexico

Brazil

Pdt. Lula takes lead in polls
Then and now

- Crises have hurt Mexico’s ability to grow
- But the country is in a much stronger situation today than it was a decade ago
- Key challenge now: structural reforms
Where is the growth you all?
(Real GDP per capita, 1996 US$)
Bigger concerns

• Human capital deficit
• Inefficient institutions
• Needed: Tax reform
• Needed: Energy reform
• Needed: Labor market reform
• ...

Mexico’s human capital deficit
(Educational attainment of working population, percent)

Korea, 1960
Korea, 2000
Mexico, 2000

Secondary+
Primary
None
Mexico’s legal system is inefficient
(Days required to collect on a bad check)
Mexico’s financial sector is small
(Loans to private sector, percent of GDP)
Tax evasion is high
(Central government tax revenues in 2005, percent of GDP)
Is China Eating Mexico’s Lunch?
Market Share of U.S. Imports

- Mexico
- China

At-risk sectors

• Unskilled labor intensive
• Low transportation costs (high value to weight ratio)
• Standardized products
Summary

• Lots of progress
• Mexico doesn’t have much to show for it yet
• Reforms are direly needed
## Short-term economic outlook

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<td>Government consumption</td>
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<td>-0.4</td>
<td>0.5</td>
<td>6.6</td>
<td>0.2</td>
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<tr>
<td>Gross fixed capital formation</td>
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<td>Exports</td>
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<tr>
<td>Real GDP</td>
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