Mexico Flash

Moody's raised Mexico's sovereign rating to A3 from Baa1 based on the approval of government's reform agenda

- The rating agency stressed that four factors led to the upgrade:

    1. The approval of a comprehensive reform agenda, which reflects political will to address longstanding structural issues. According to Moody's, this approval of reforms represents a structural shift comparable to that of NAFTA over the years in terms of the rating profile.

    2. The reform package will lead to a higher potential growth of around 3-4% from its pre-reform level of 2-3%, even though the economic impact will become more evident over the medium to long term.

    3. The increase in fiscal savings and buffers stemming from the fiscal chapter of the reforms. The spending cap on primary current expenditures will contribute to a gradual build-up of fiscal savings, while the newly created Oil Fund will create a new fiscal buffer by ensuring that an increased portion of total oil revenues are captured in a "stabilization bucket".

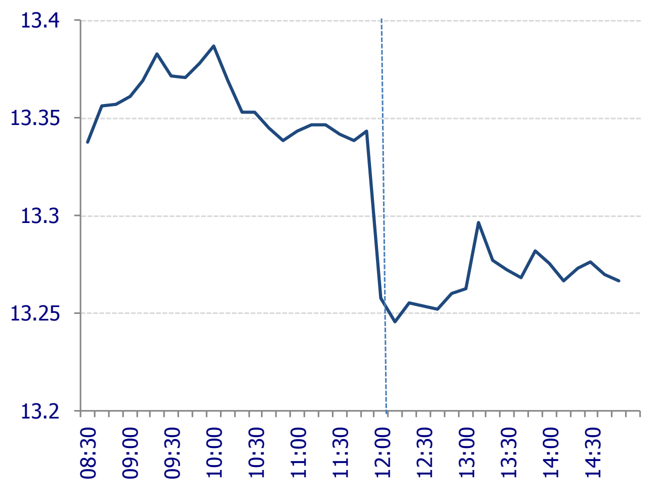
    4. Mexico's credit profile, in light of its improved economic prospects, becomes similar to those of A2-rated Poland and A3-rated Malaysia, solid benchmarks in the A peer group. It is worth noting that this upgrade places Mexico among the best sovereign ratings in LATAM just behind Chile.

- According to the rating agency, the outlook is stable as the implementation of the reforms will result only gradually in more favorable economic, fiscal and financial indicators. However, it points out that an extended period of below-potential growth or a deterioration in the country's fiscal discipline could lead to downward rating pressure. Other rating agencies have stressed that an improvement in the country´s rating would depend crucially on the approval of the secondary legislation and on an efficient implementation of reforms.

- Markets reaction. Immediately after the announcement the Mexican peso appreciated around 14 cents against the USD, while the stock market hiked 1.24%, and the long-term sovereign yields decreased around 4bp on average.

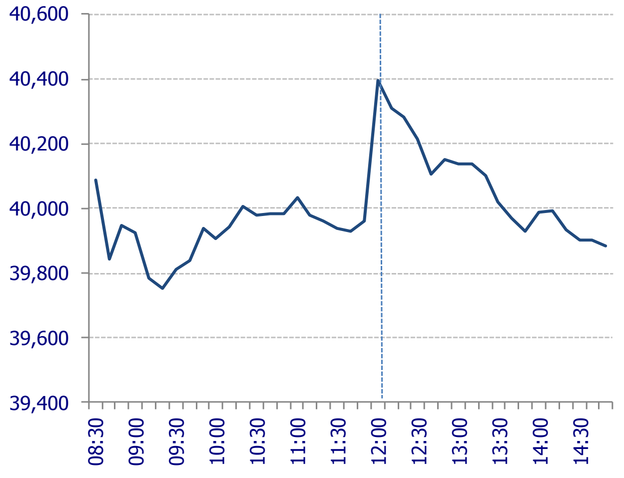
- Bottom-line: In the current emerging markets sell-off this rating upgrade could contribute to differentiate Mexican assets from those of its peers. As a result, the government and firms could face lower funding costs than its international peers, promoting higher investment in the economy. However, for this differentiation to be long lasting it will be important that the new balanced budget rule effectively keeps the government from increase its current expenditures during high growth episodes, increases the Oil Fund, and takes the deficit back to lower levels.

Graph 1
Exchange rate (pesos per dollar)



Source: BBVA Research and Bloomberg

Graph 2
Mexican stock market (index)



Source: BBVA Research and Bloomberg

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