Mexico faced with global financial volatility

El Financiero (Mexico)

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04 Jun 2018

The global economy is going through a spell of rising interest rates in the USA, with the dollar strengthening and international oil prices rising. In the past, this combination of events has led to periods of financial turbulence and capital outflows from emerging markets, which Mexico has not been able to avoid. Indeed, these events may have caused, at least in part, the exchange rate depreciation and capital outflow we have observed in Argentina and Turkey over the last few weeks. Also, these interest rate increases in the USA and the strengthening of its currency have brought these periods of financial volatility with them because they signal that the assets in the USA are becoming more attractive than those of the emerging countries.

In this context, the relevant question is: is Mexico that vulnerable in these circumstances? I believe that this time the country is much better prepared that in the past, also compared to other emerging economies. There are several reasons for this: 1. Today we have a flexible exchange rate regime in which external shocks can be absorbed through exports. 2. The levels of debt as a percentage of Gross Domestic Product (GDP) are lower than those observed in the past and lower than those of several emerging countries. It is not just that debt levels are lower, the composition is more solid.

In the past, as occurred in 1994, most of the debt was short-term and was denominated in US dollars. Now the debt is more long-term and around three-quarters of it is held in Mexican pesos. 3. Corporations and banks have a limited exposure to foreign currency debt. 4. The bank system has high capital and liquidity levels. Indeed, it is one of the most solvent banking systems in the world in which all banks fully comply with the Basel III capital requirements. 5. Unlike other emerging markets, the increase in oil prices entails an improvement for the country's fiscal position. 6. The better performance of the US industrial sector has led to an improvement in Mexico's exports. Last year these increased by more than 10% measured in dollars and this year a similar trend is expected.

This means an improvement in external accounts. While the country had a current account deficit of 3% of GDP less than two years ago, it is now less than 2%, which considerably reduces the external vulnerabilities. It is a deficit that can be fully financed with direct foreign investment; no capital flows are required. 7. Public finance has already shown an improvement. After nine consecutive years in which the country had a primary fiscal deficit, in 2017 there was a surplus, which meant that the debt as a percentage of the GDP started to fall. This year we will also see a primary surplus and an additional fall in the debt.

8. The Bank of Mexico's monetary policy came ahead of the normalisation of the monetary policy of the US, with which Mexico has a higher risk-adjusted rate differential than most large emerging countries. This means that the country is a more attractive destination for international investors than most other emerging countries. 9. Inflation is under control and falling with its forecasts well anchored.

In view of the above, it seems to me that Mexico is well-positioned in face of the panorama of volatility and reduced risk appetite that is prevailing in the world's financial markets and that is causing turbulence in some emerging economies. This does not mean that we can lower our guard. The fiscal consolidation process must continue, the implementation of the energy reform must not be held up (which will help strengthen the fiscal and external accounts) and the prudential financial regulatory framework must be maintained. This will enable the country to sail these waters of global financial uncertainty.