

# Mexico Stands to Benefit From Reforms and Navigate Fed's Tapering With Relative Ease

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Federal Reserve Bank of Dallas

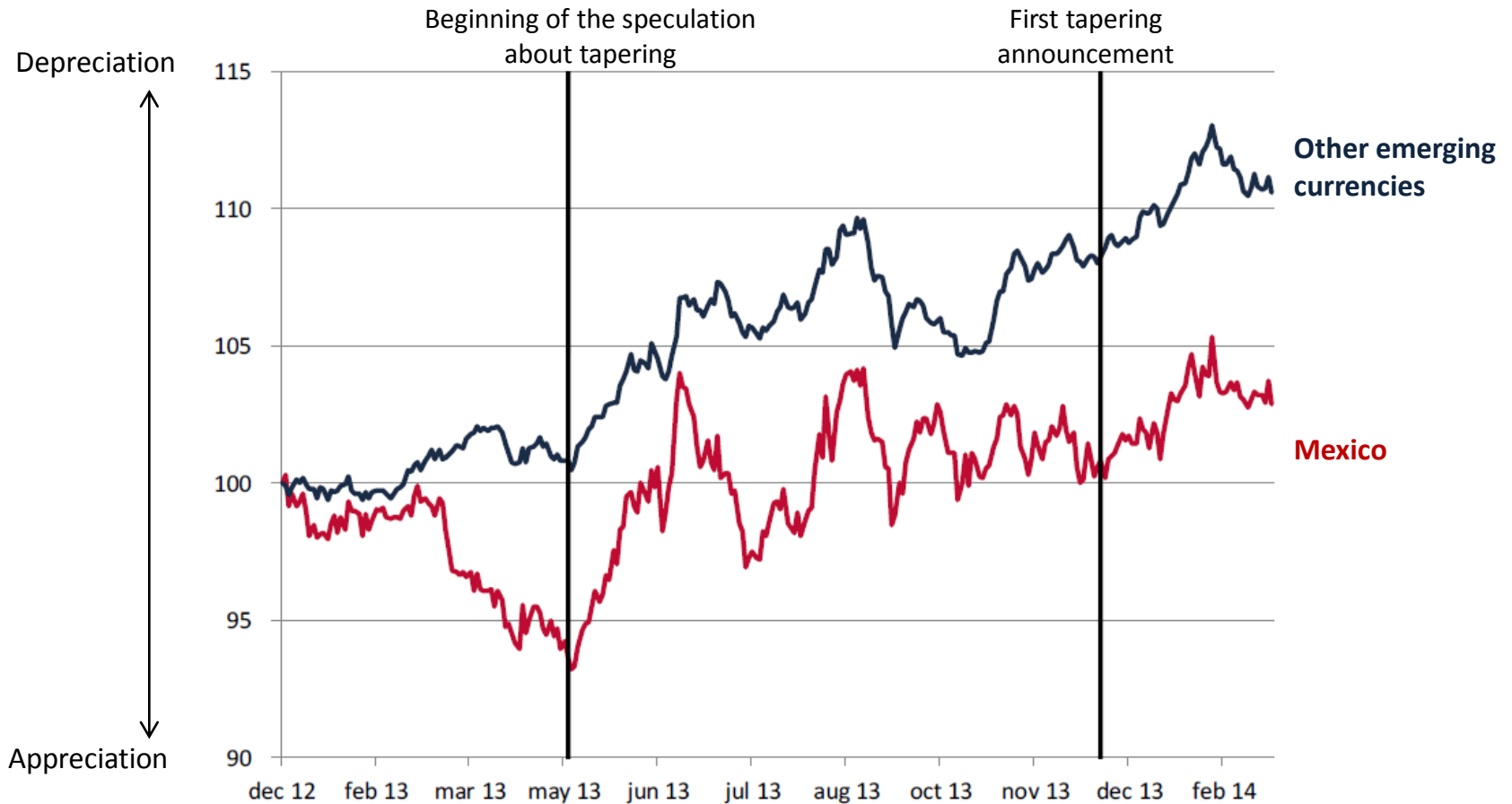
Laredo, Texas

May 2014

# Outline

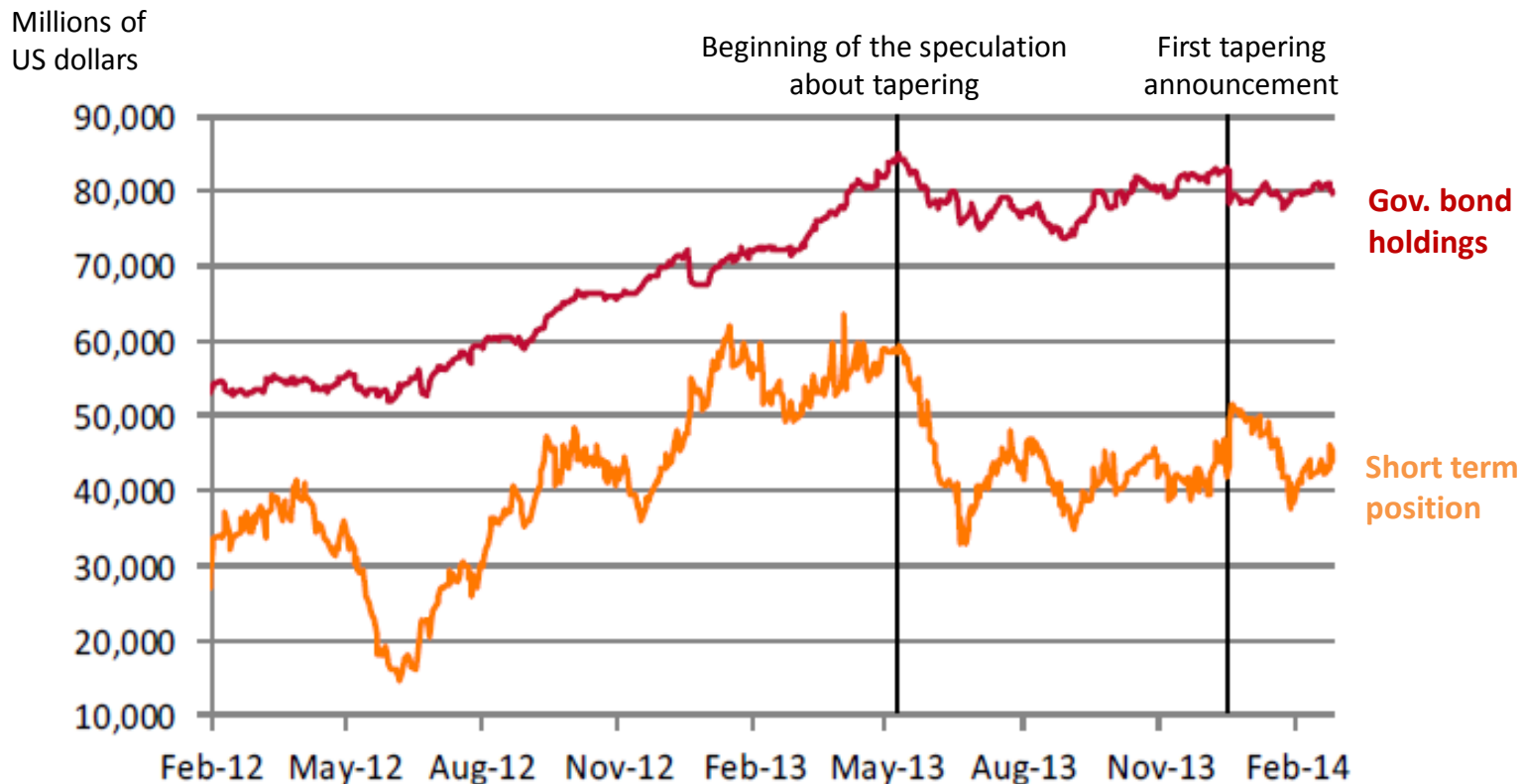
- Mexico and Fed's Tapering
- 2013 worst than expected
- Economy back on growth track in 2014
  - Why we care about Mexico
- Reforms will help, but ...
  - Fiscal
  - Energy
- The potential of the energy reform (*The Texas example*)
- Conclusions

# Peso holding up well despite tapering



Source: Banco de México and Bloomberg.

# Foreign investors hold on to their Mexican government debt



Source: Banco de México & CME.

# Mexican economy decelerates in 2013

Q4/Q4 Annualized growth, real and s.a.



SOURCE: Instituto Nacional de Estadística y Geografía, International Center Library/ Texas A&M International University

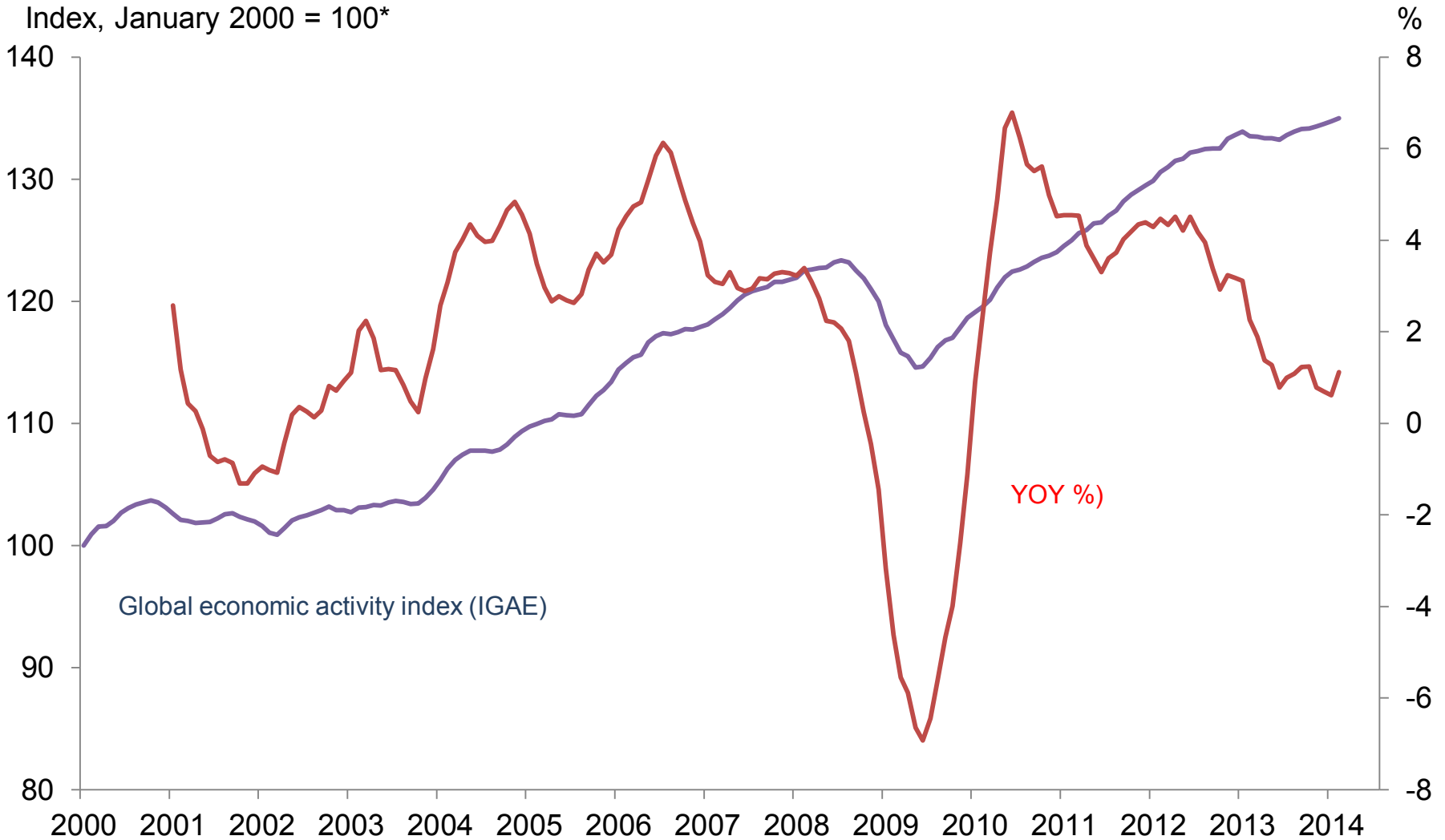
# Deceleration of the Mexican economy in 2013

- Slowing preceded tapering

Due to:

- Low growth, weak trade in the global economy
- Lower public spending as new administration takes office
- Gas shortages slowing manufacturing in central Mexico
- Deep seated weakness in the construction sector

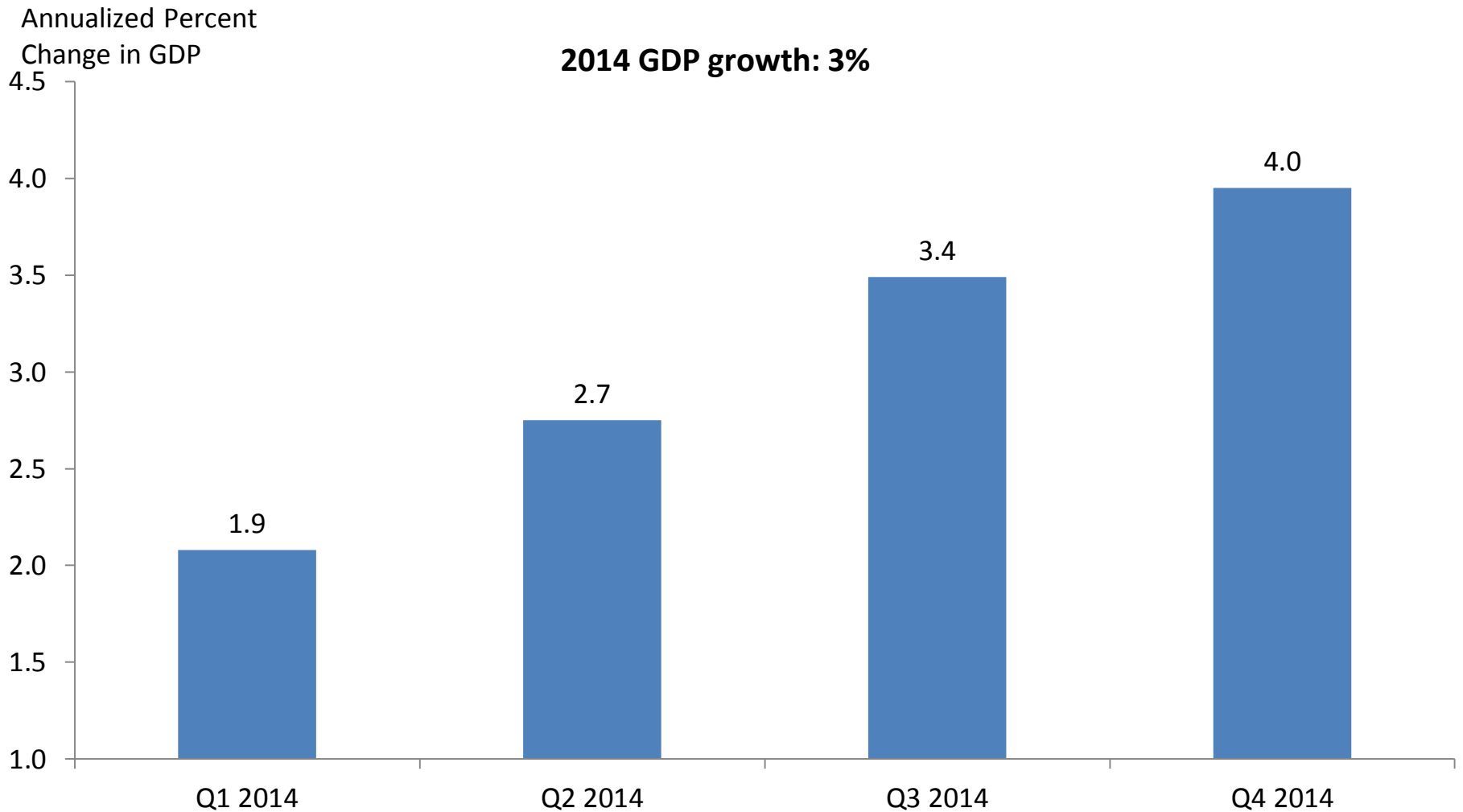
# Economy Back on Growth Track in 2014



\*Seasonally adjusted, three-month moving average.

SOURCE: Instituto Nacional de Estadística y Geografía.

# Mexico's Growth Picks Up Pace

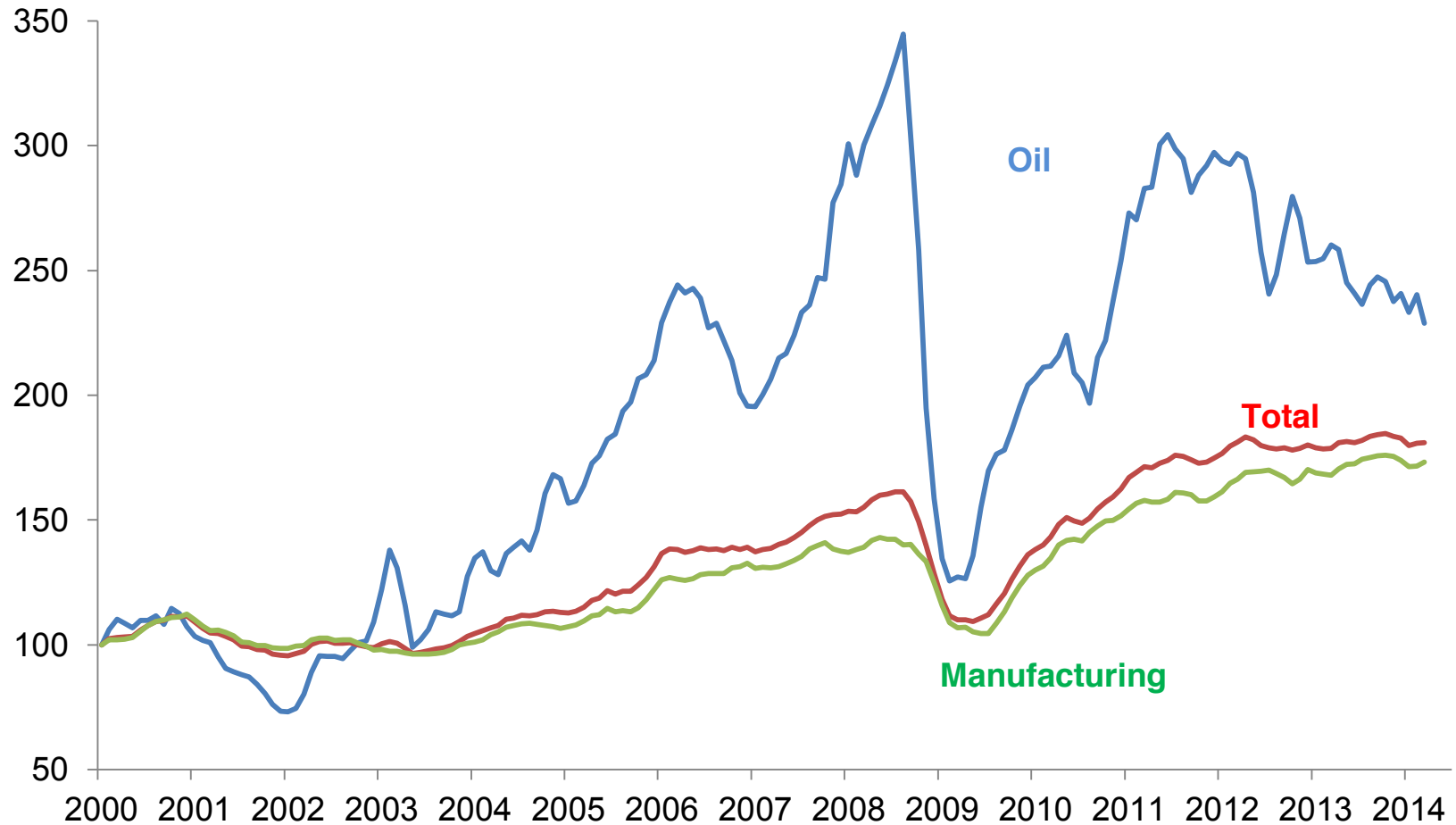


Source: Banco de Mexico Survey of Economic Forecasters, April 2014.



# Total Exports Improve while Oil Exports Continue Falling

Index, January 2000 = 100\*

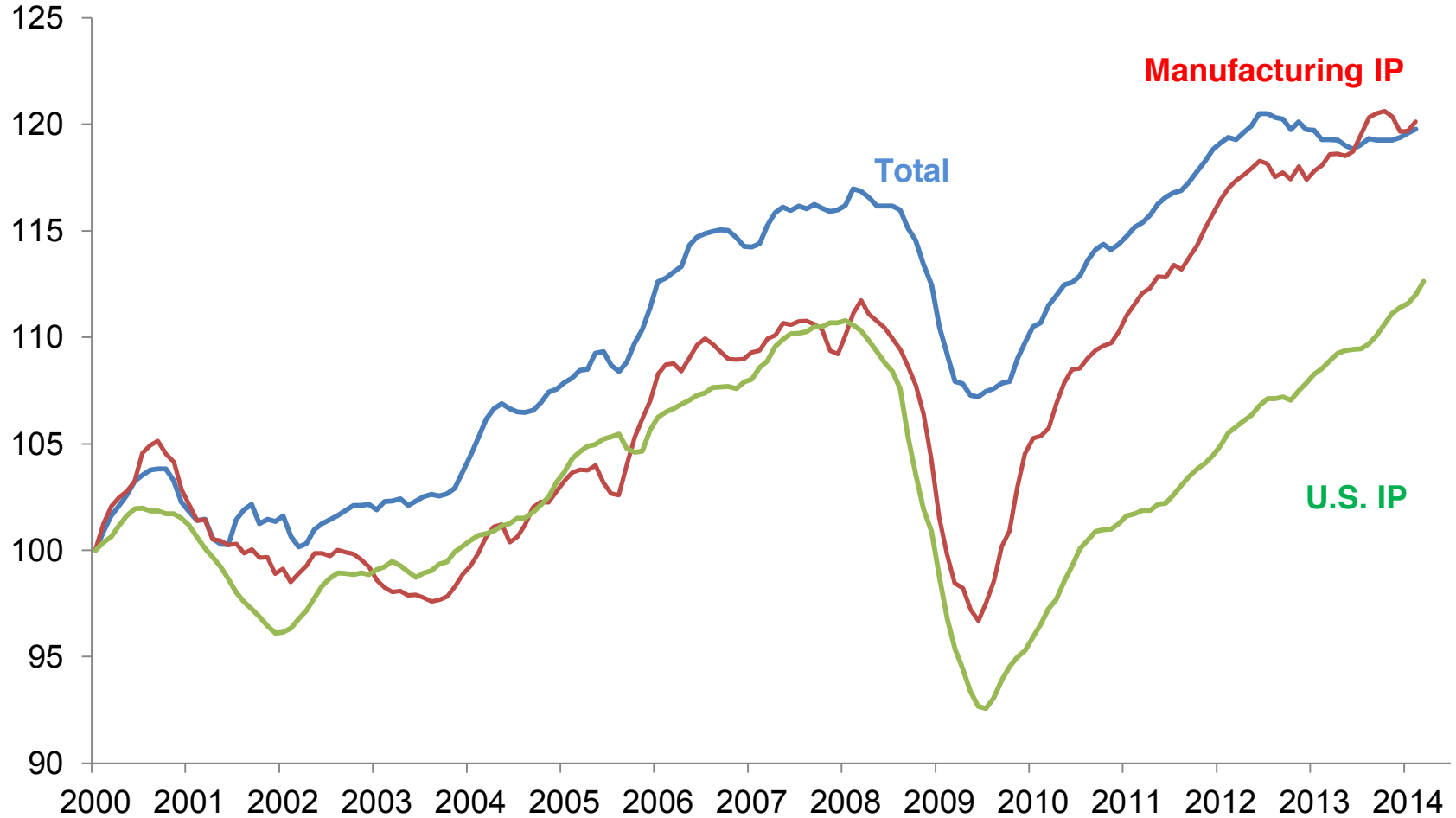


\*Seasonally adjusted, three-month moving average; real dollars.

SOURCE: Banco de México.

# Industrial Production Improving in 2014

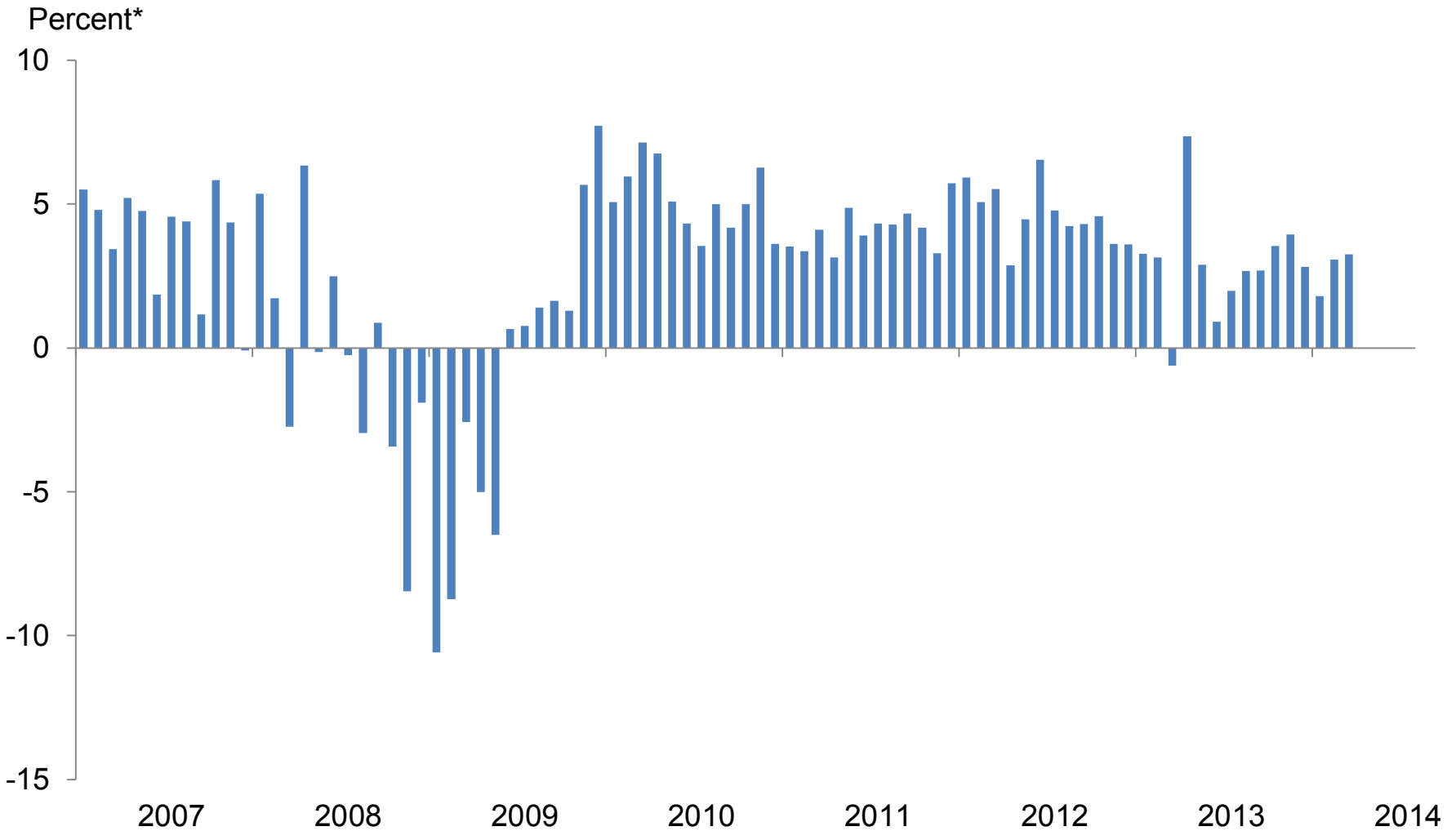
Index, January 2000 = 100\*



\*Seasonally adjusted, three-month moving average.

SOURCES: Instituto Nacional de Estadística y Geografía; Federal Reserve Board.

# Job Growth Improves in February and March



\*Month/month; seasonally adjusted, annualized rate.

SOURCE: Instituto Mexicano del Seguro Social.

# Peso Appreciates into 2014

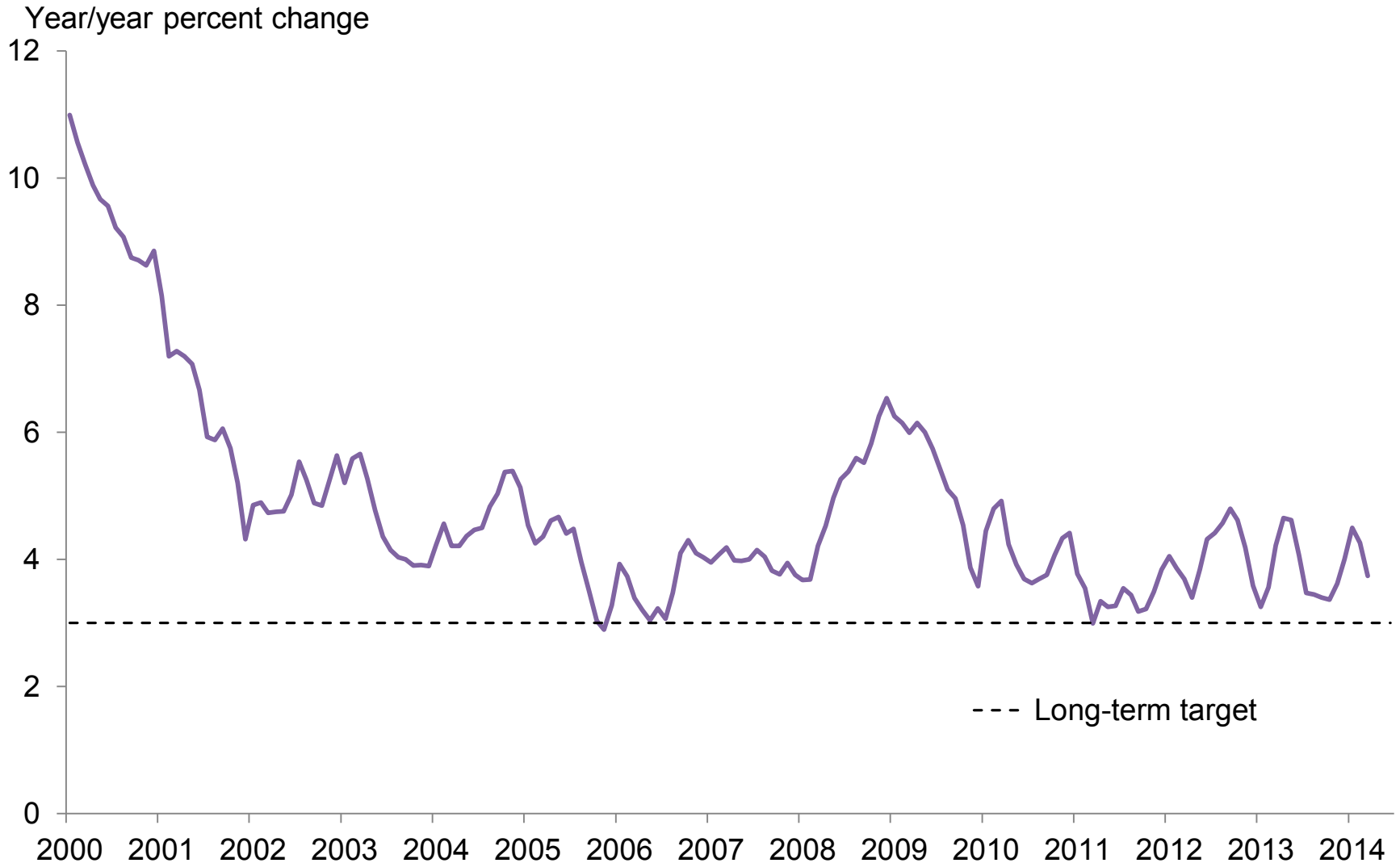
Peso/dollar average



SOURCE: Banco de México.

Binational Center Library/ Texas A&M  
International University

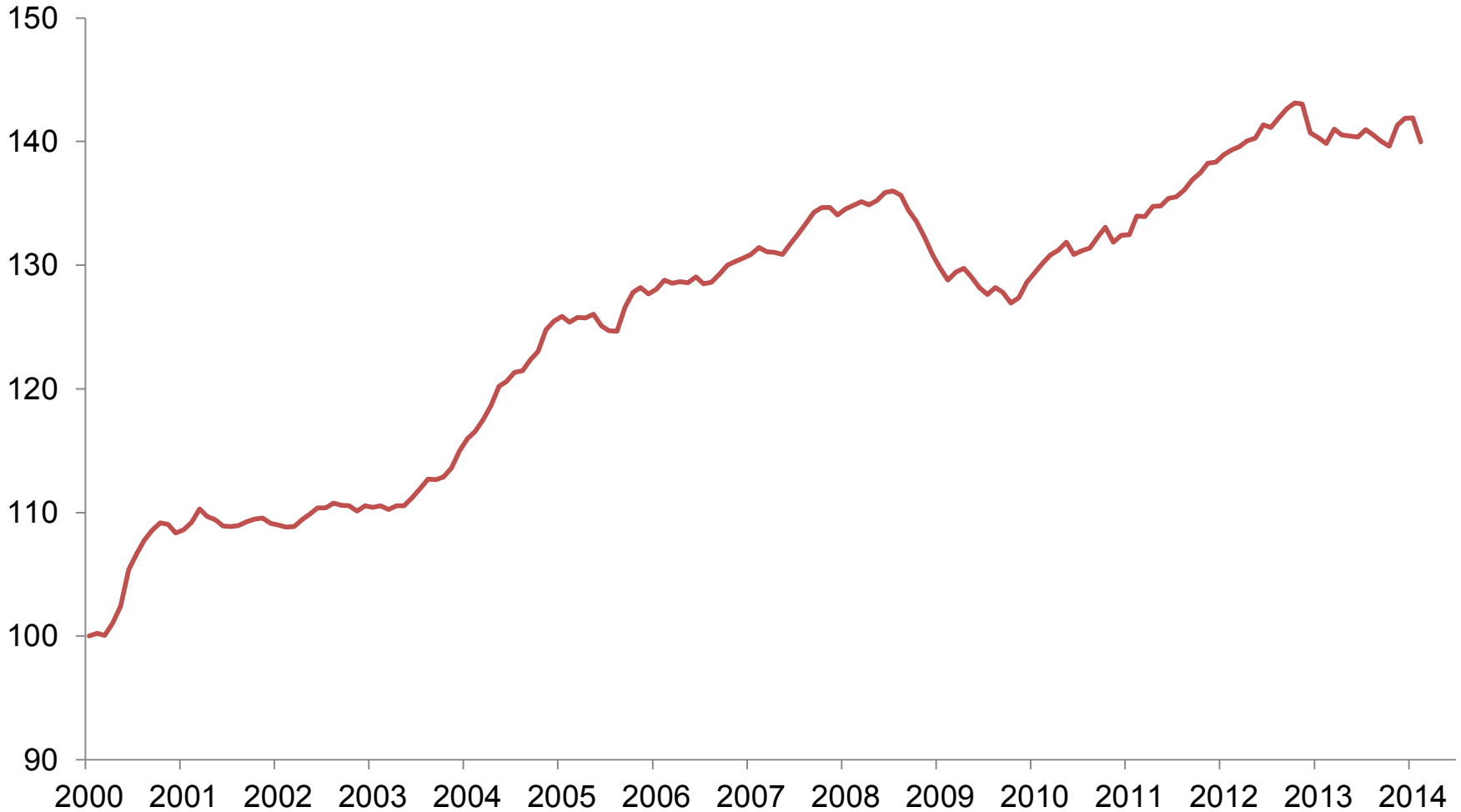
# Inflation Falls in March



SOURCE: Instituto Nacional de Estadística y Geografía.

# Retail Sales Take a Dip

Index, January 2000 = 100\*

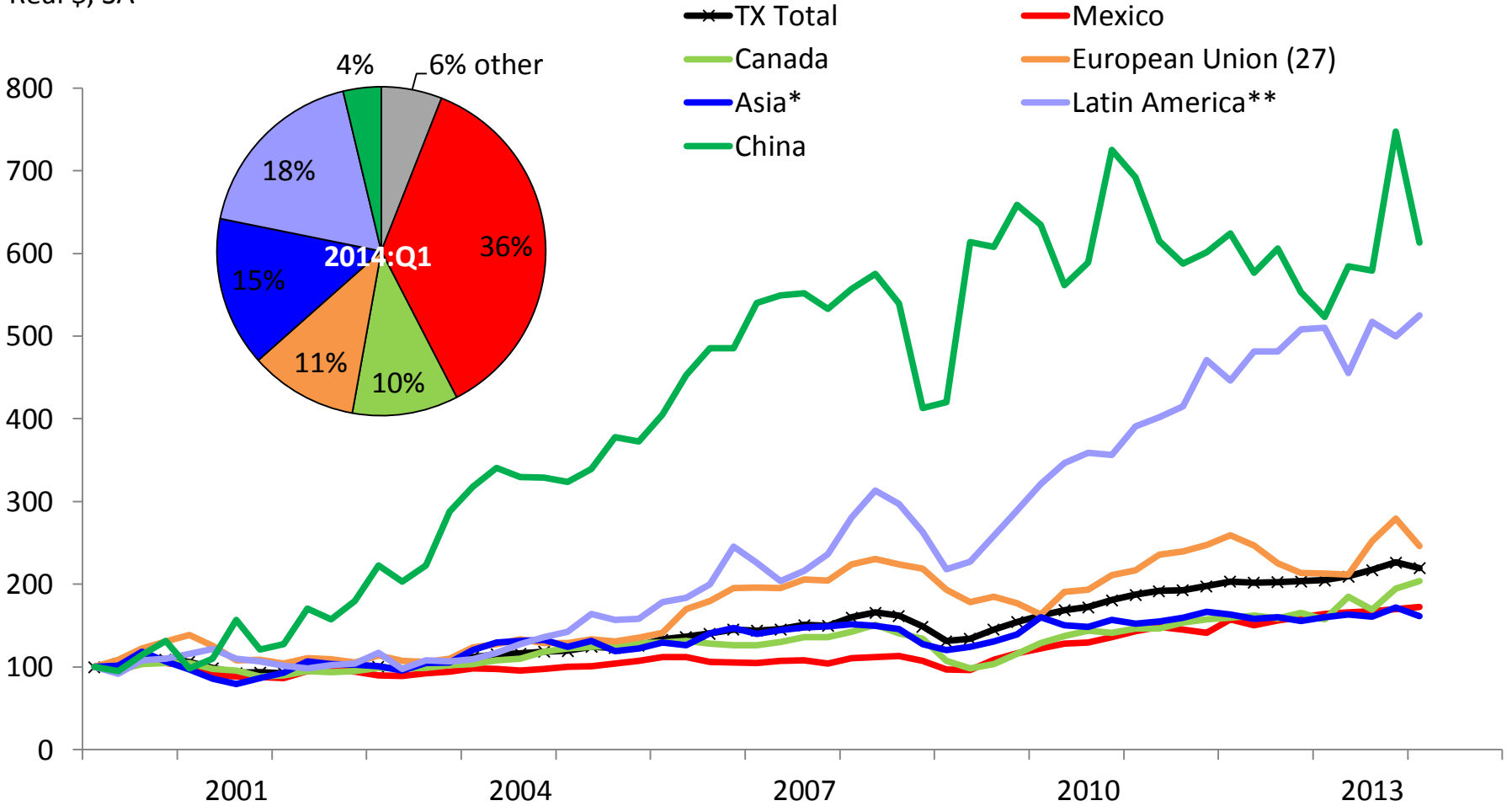


\*Seasonally adjusted, three-month moving average; real pesos.

SOURCE: Instituto Nacional de Estadística y Geografía.

# Texas Exports to the World

Index '00Q1=100  
Real \$, SA

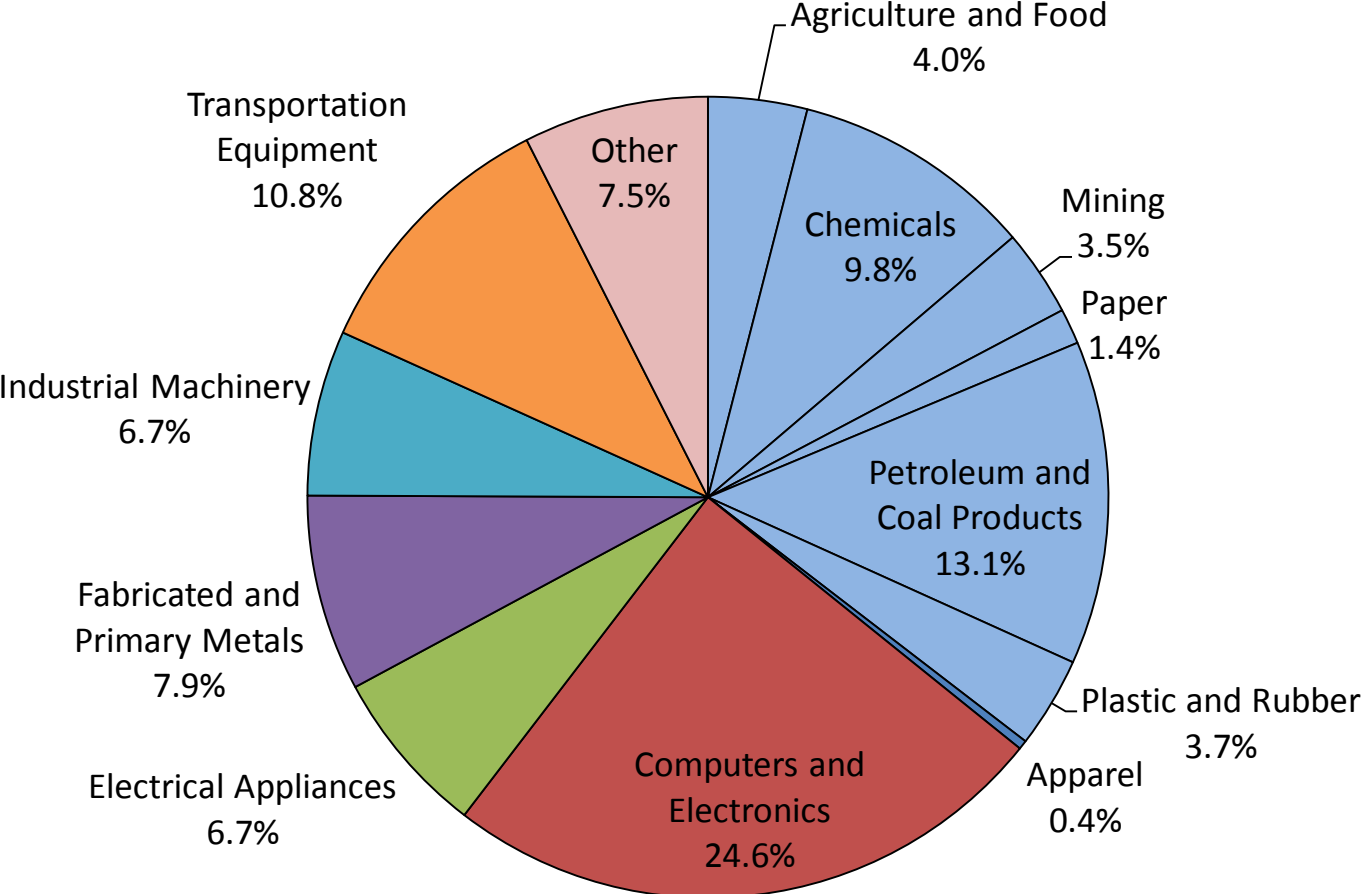


\*Asia excludes China

\*\*Latin America excludes Mexico

Source: Census Bureau; WisierTrade.

# Non-Maquiladora-Related Products Represent 35% of Total Texas Exports to Mexico



Note: Categories shaded in blue are non-maquiladora related.

Sources: U.S. Census Bureau; Wisetrade. Binaltional Center Library/ Texas A&M International University



# US-Mexico trade by top 10 land ports

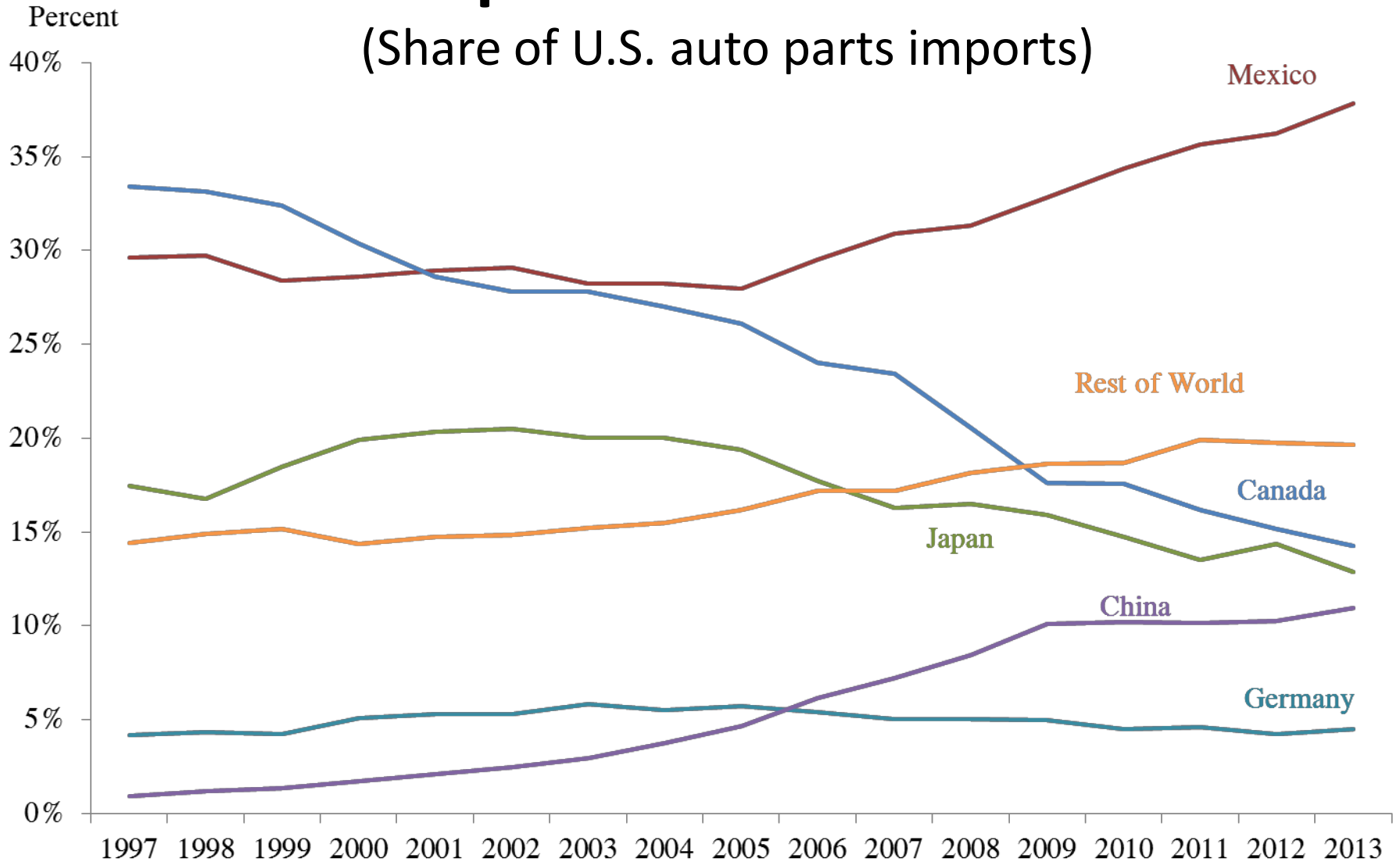
## 2013 (billions of U.S. \$)

Rank	City	Total Trade	Share of Total (%)
1	Laredo, TX	168.79	43.06
2	El Paso, TX	66.85	17.06
3	Otay Mesa – San Ysidro, CA	34.75	8.87
4	Hidalgo, TX	26.84	6.85
5	Nogales, AZ	23.52	6.00
6	Eagle Pass, TX	21.65	5.52
7	Santa Teresa, NM	19.89	5.07
8	Brownsville – Cameron, TX	15.39	4.00
9	Calexico, CA	7.28	1.86
10	Del Rio, TX	4.11	1.05
11	Other	2.87	0.73

Source: Texas Center for Border Economic and Enterprise Development, Texas A&M International University

# ... and it has been the top exporter of auto parts since 2001

(Share of U.S. auto parts imports)

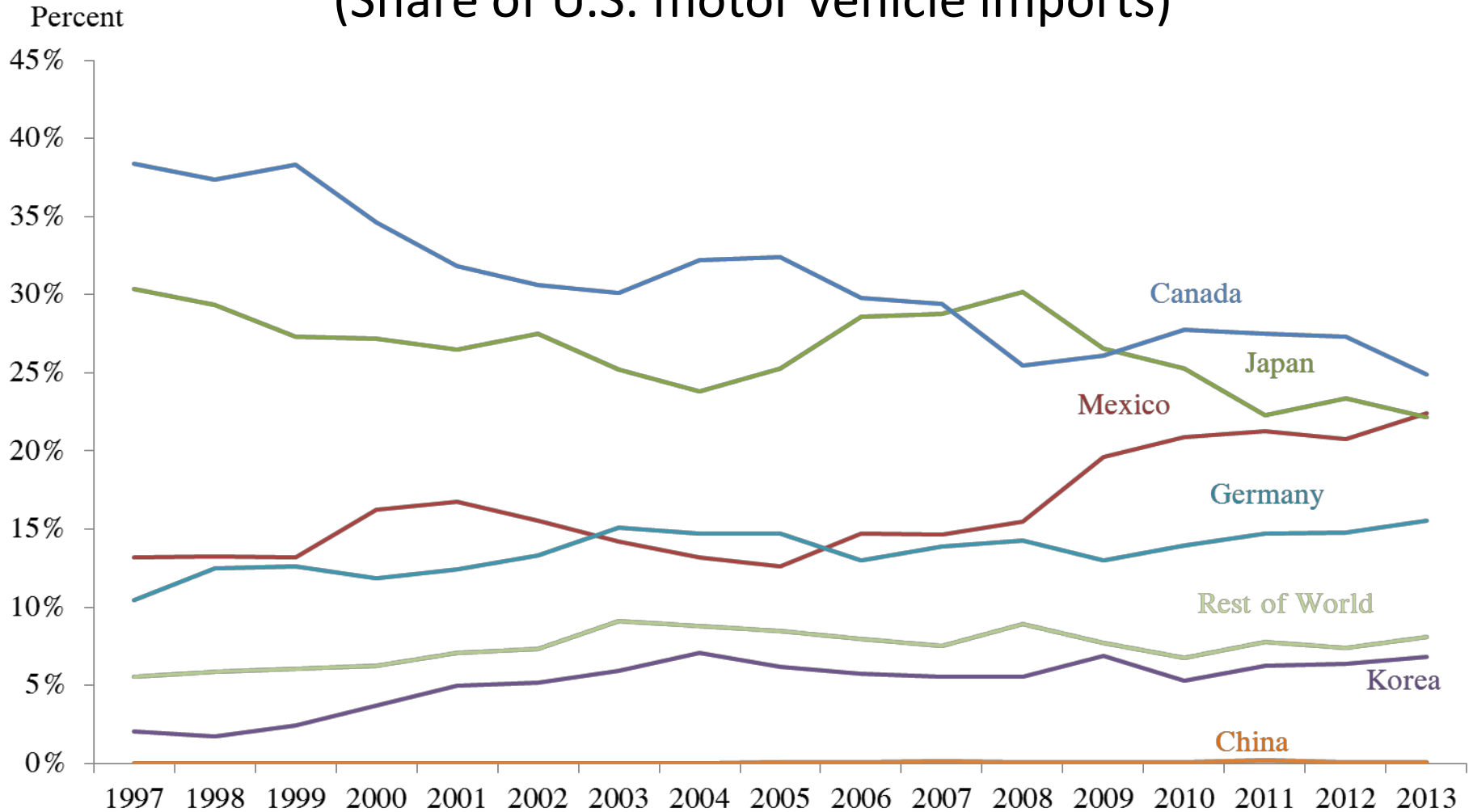


Source: U.S. International Trade Commission and author's calculations.

Binational Center Library/ Texas A&M  
International University

# Mexico Tops Japan as the No. 2 Supplier of Motor Vehicles to the US

(Share of U.S. motor vehicle imports)



Source: U.S. International Trade Commission and author's calculations.

# Maquiladoras impact by border city

- 10 percent increase in maquiladora output leads to an increase in the adjacent U.S. city as follows:
  - 3 percent increase in total employment in El Paso
  - 3.6 percent increase in total employment in Laredo
  - 1.9 percent increase in total employment in Brownsville
  - 5.9 percent increase in total employment in McAllen

# Reforms will help, but in the medium to long term

- **Energy**
  - Open whole production chain to private investment
- **Financial**
  - Boost access to credit
- **Telecom and Competition**
  - Boost market competition and break dominant firms
- **Labor**
  - Enhance flexibility in the labor market
- **Education**
  - Seeks to improve education quality
- **Fiscal**
  - Increase tax revenue by increasing VAT and close loopholes

# Growing pains from the reforms in the short run

## Consumer confidence

(Quarterly observations, s.a.)

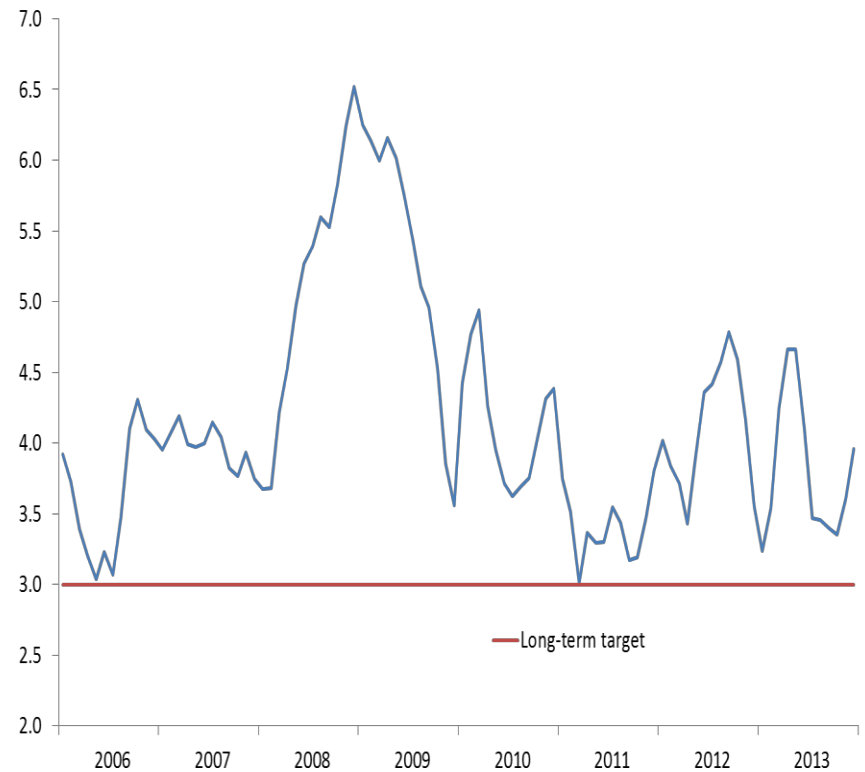
Index, Jan. 2003=100



SOURCE: Instituto Nacional de Estadística y Geografía.

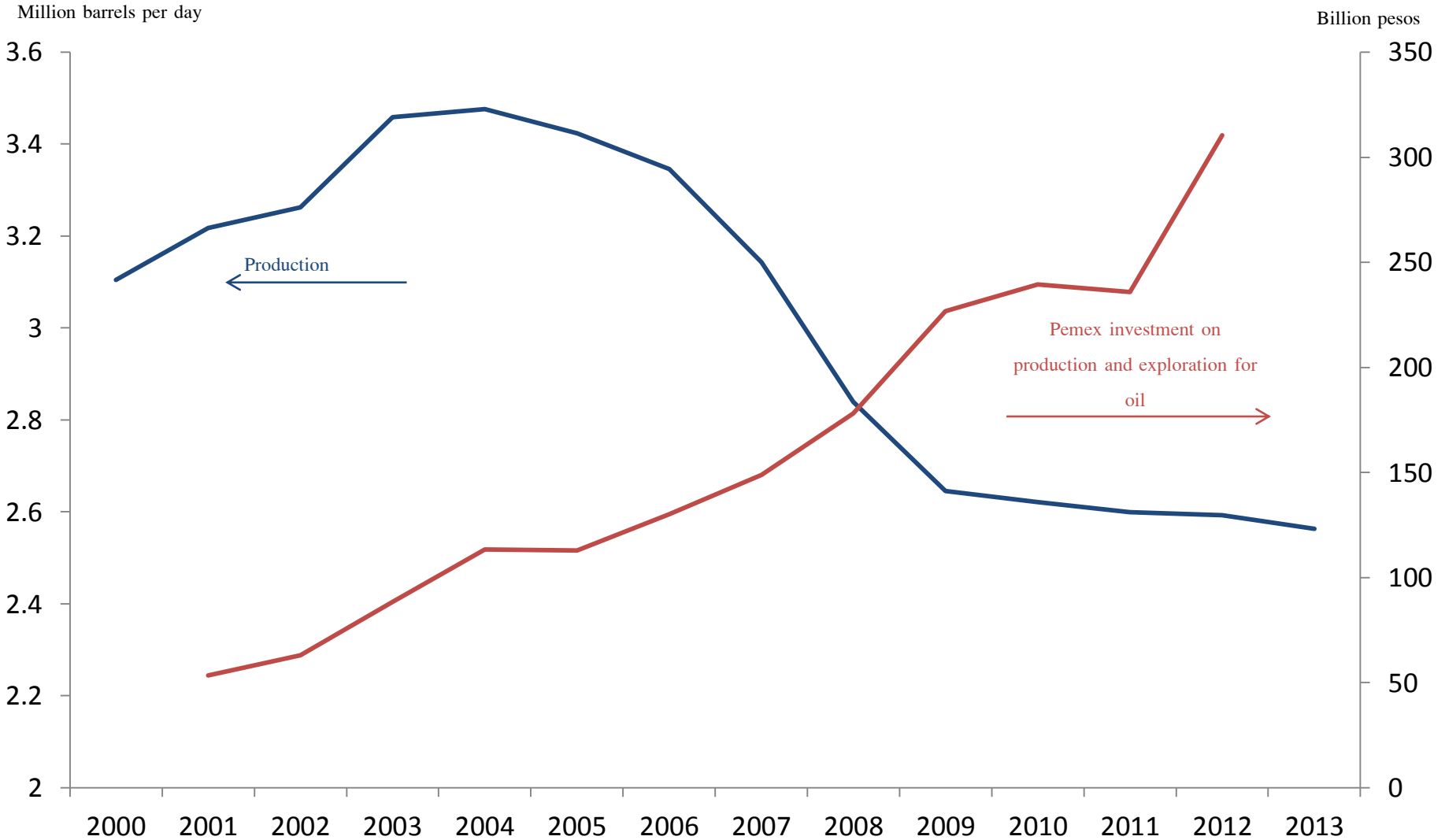
## Consumer price index

(Year-over-Year growth, s.a.)



SOURCE: Instituto Nacional de Estadística y Geografía.

# Pemex Investment Doesn't Reverse Mexican Crude Production Decline

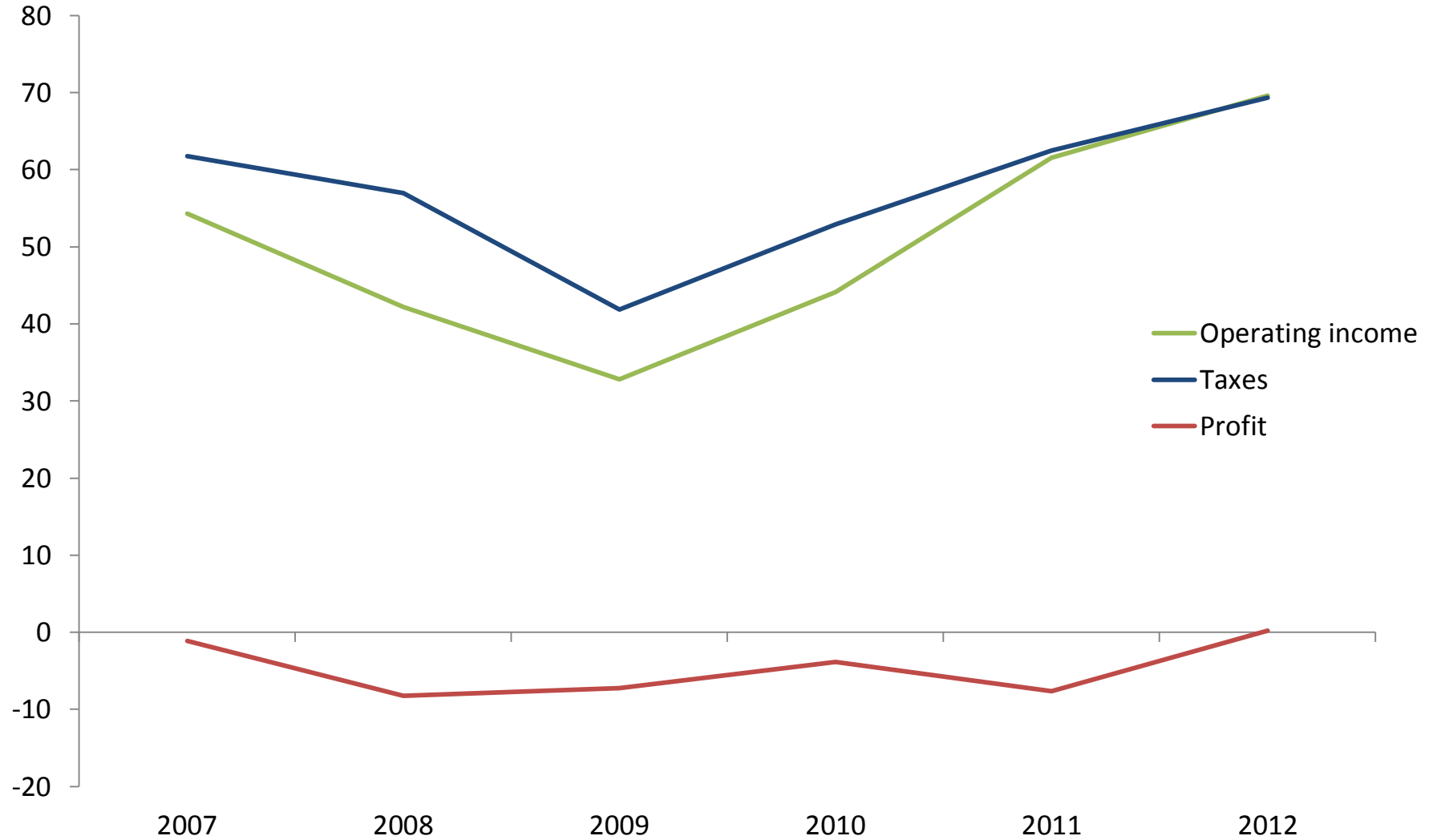


SOURCES: U.S. Department of Energy; Bloomberg.

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International University

# Pemex Loses Money Due to Heavy Tax Burden

Billion dollars

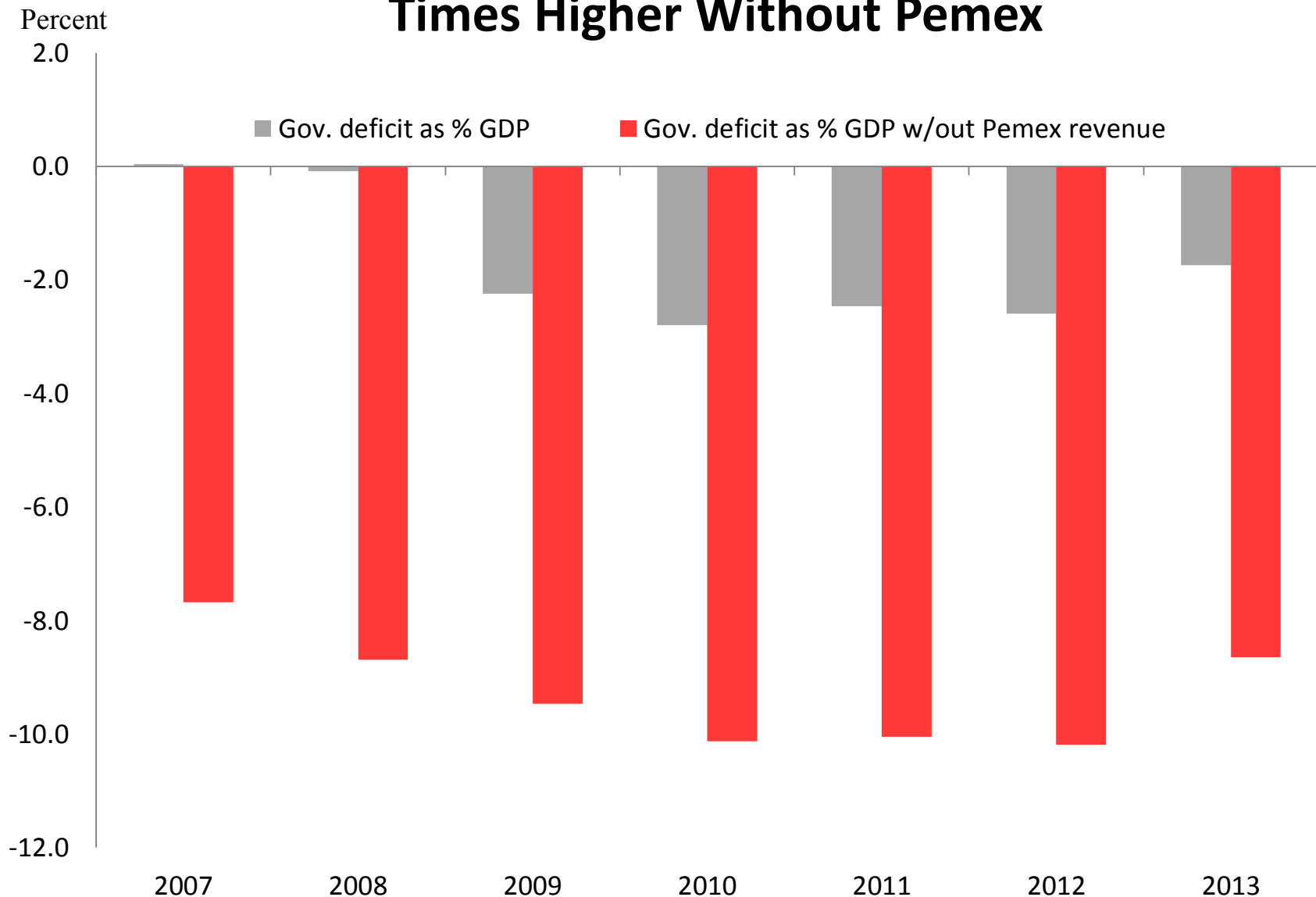


SOURCES: Bloomberg ; IMF.

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# Mexico's Government Deficit More Than Three Times Higher Without Pemex

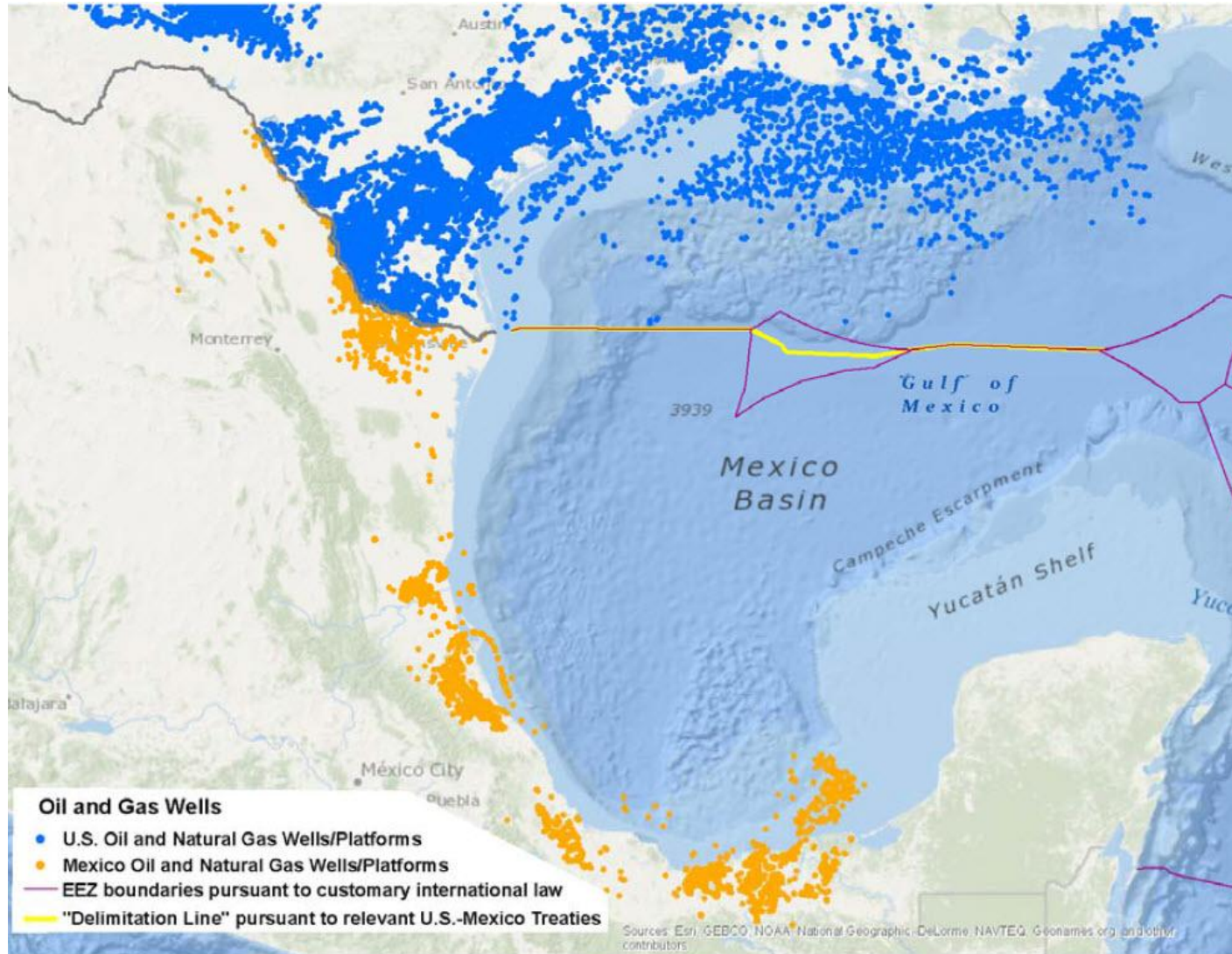


SOURCES: Secretary of Housing and Public Credit (SHCP) and author's calculations.

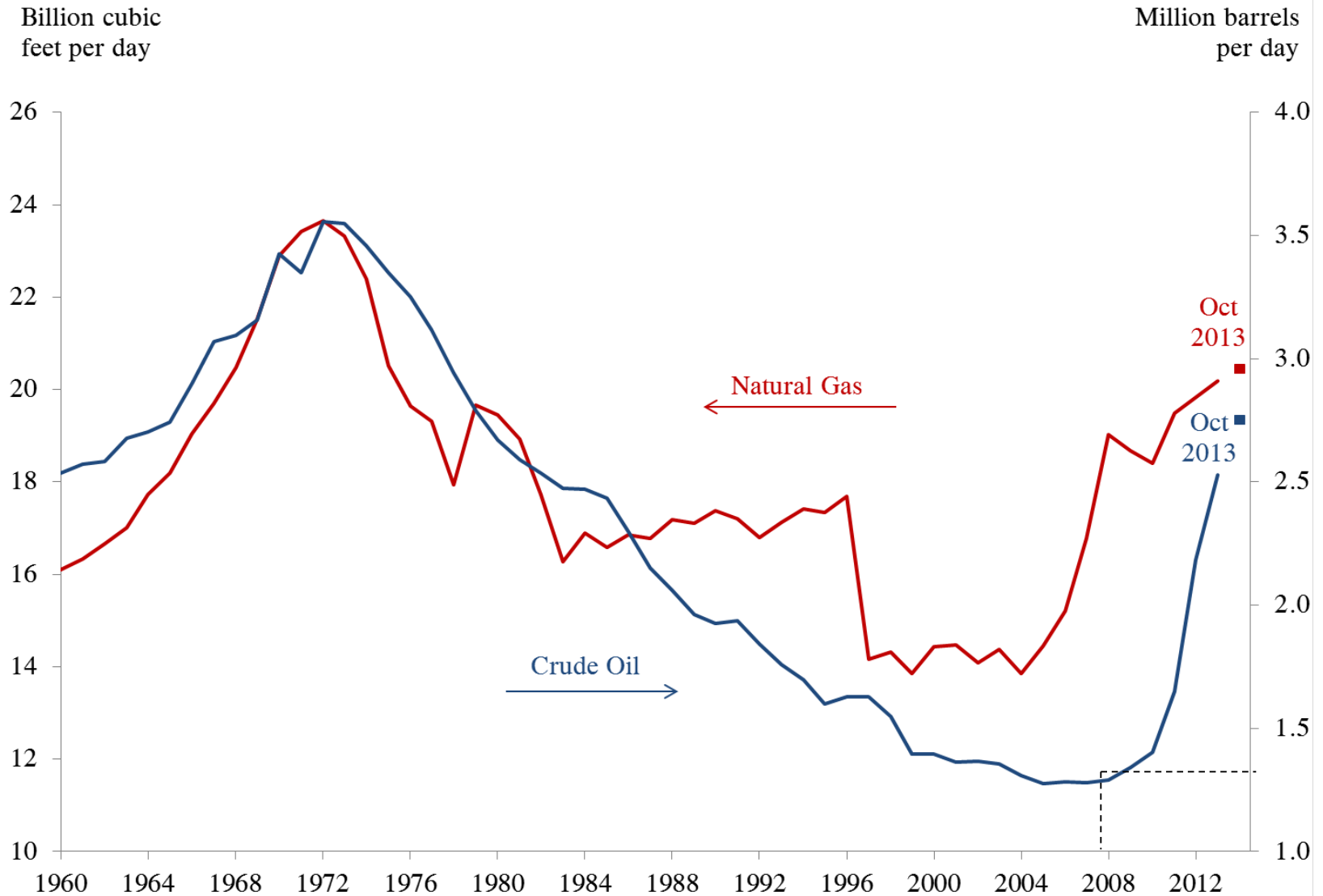
# Reforma Energética

- Profit-sharing envisions government payment to oil companies based on a % of the revenue generated after exploration and production costs are recovered. The outside firms would not own a share of production.
- Production sharing will provide for participating companies to be compensated based on a % of production, after cost recovery.
- Licensing will allow companies to acquire possession of hydrocarbons at the wellhead, upon the payment of taxes, if commercial production occurs.
- Service contracts call for cash payment to companies that undertake exploration and production activities. The firms will be paid even if production never occurs.

# The Potential...



# The Texas Example



# Oil and gas production

## Crude Oil (mb/d)

- World 75.6
- Russia 9.9
- Saudi Arabia 9.8
- **U.S. 8.1 (Jan 2014)**
- Canada 3.1
- **Texas 2.8 (Nov 2013)**
- Mexico 2.6
- Venezuela 2.2
- Norway 1.6
- Libya 1.4
- Qatar 1.3

## Natural Gas (tcf)

- World 122.8
- **U.S. 25.3**
- Russia 23.8
- **Texas 7.5**
- Iran 6.1
- Canada 5.7
- Qatar 4.9
- Norway 3.7
- Saudi Arabia 3.6
- Algeria 3.5
- Mexico 1.8

# Outlook: 5 percent growth by the end of sexenio

Effects of the structural reforms on annual potential GDP growth rates  
Percentage points

	Average in the next 5 years
Energy Reform	0.70
Financial Reform	0.36
Telecommunications Reform	0.24
Fiscal Reform	0.18
<b>Total Effect</b>	<b>1.48</b>

Source: SHCP Criterios Generales de Política Económica 2014

# Conclusion

- Mexico strong fundamentals
  - Past reforms paying off so handle tapering well
- New reforms hurt in short term
  - Promise to pay off in the medium to long run
  - *If carefully and deliberately implemented*





# Maquiladoras drive employment growth in Texas border cities

Estimation method: IV	El Paso	Laredo	McAllen	Brownsville
City Level	2.77*	4.62	6.58*	2.21
Construction	0.20	3.19	4.04*	1.29*
Manufacturing	-1.28	1.02	1.64	0.66
Transportation	<b>5.30*</b>	<b>7.21*</b>	<b>6.63*</b>	<b>4.6*</b>
Wholesale	0.43	1.96	4.01*	0.84
Retail	1.31	0.66	3.21*	1.34*
FIRE	<b>2.12*</b>	<b>8.23*</b>	<b>4.63*</b>	<b>0.64</b>
Services	<b>1.84*</b>	<b>5.93*</b>	<b>7.38*</b>	<b>3.89*</b>

**Notes:** This table shows elasticity estimates. That is the table shows the percentage increase in local employment from a 10 percent increase in maquiladora production for each Texas Border Cities. \* indicates significant at the 10% level.

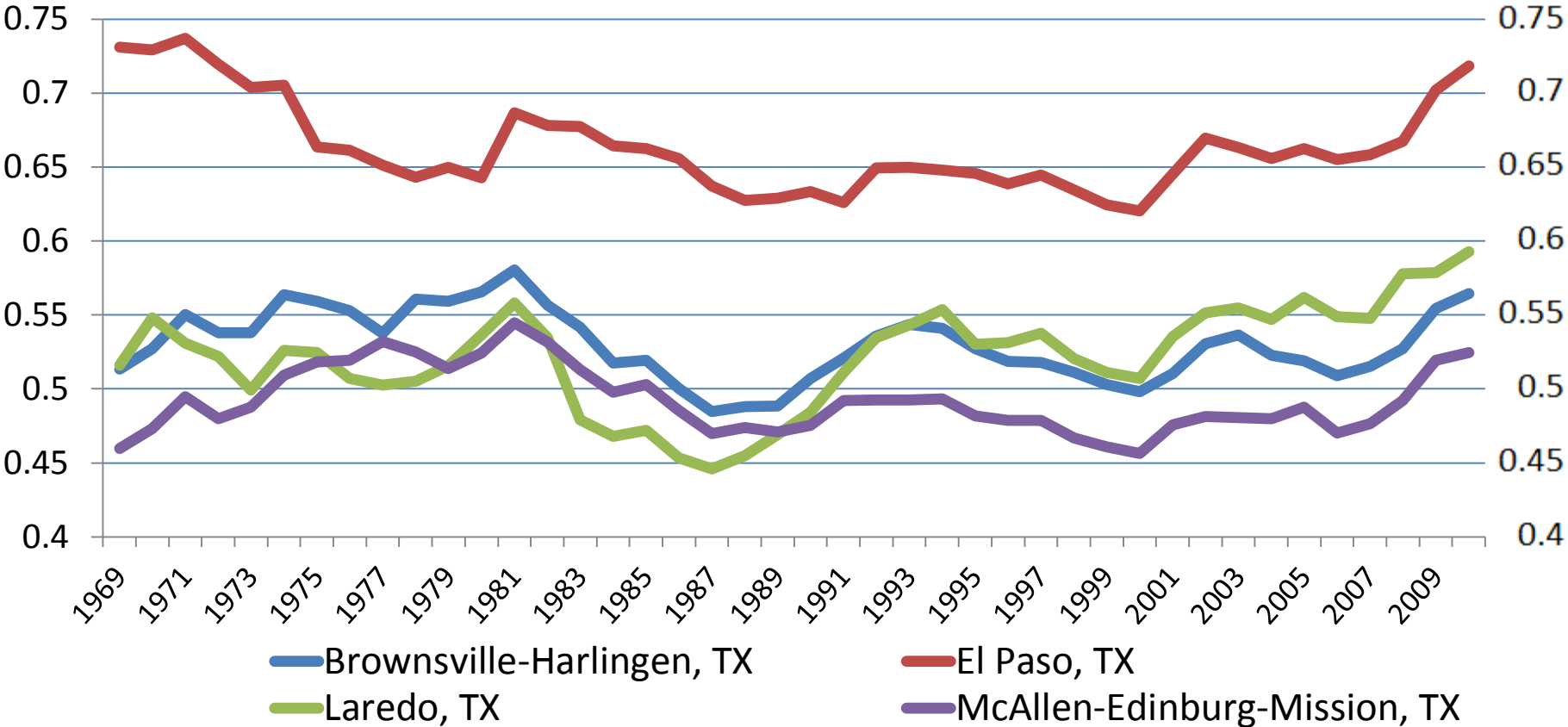
**Source:** J. Cañas, R. Coronado, R. Gilmer, E. Saucedo (2011) “The Impact of Maquiladoras on U.S. Border Cities”, Federal Reserve Bank of Dallas, working paper.

# Maquiladoras impact changed over time...

- The impact has switched from manufacturing to services
- Texas border cities supply maquiladoras business services such as accounting and legal, transportation and warehousing
- Good news since these type of jobs pay higher wages

# Per capita income in Texas border cities,

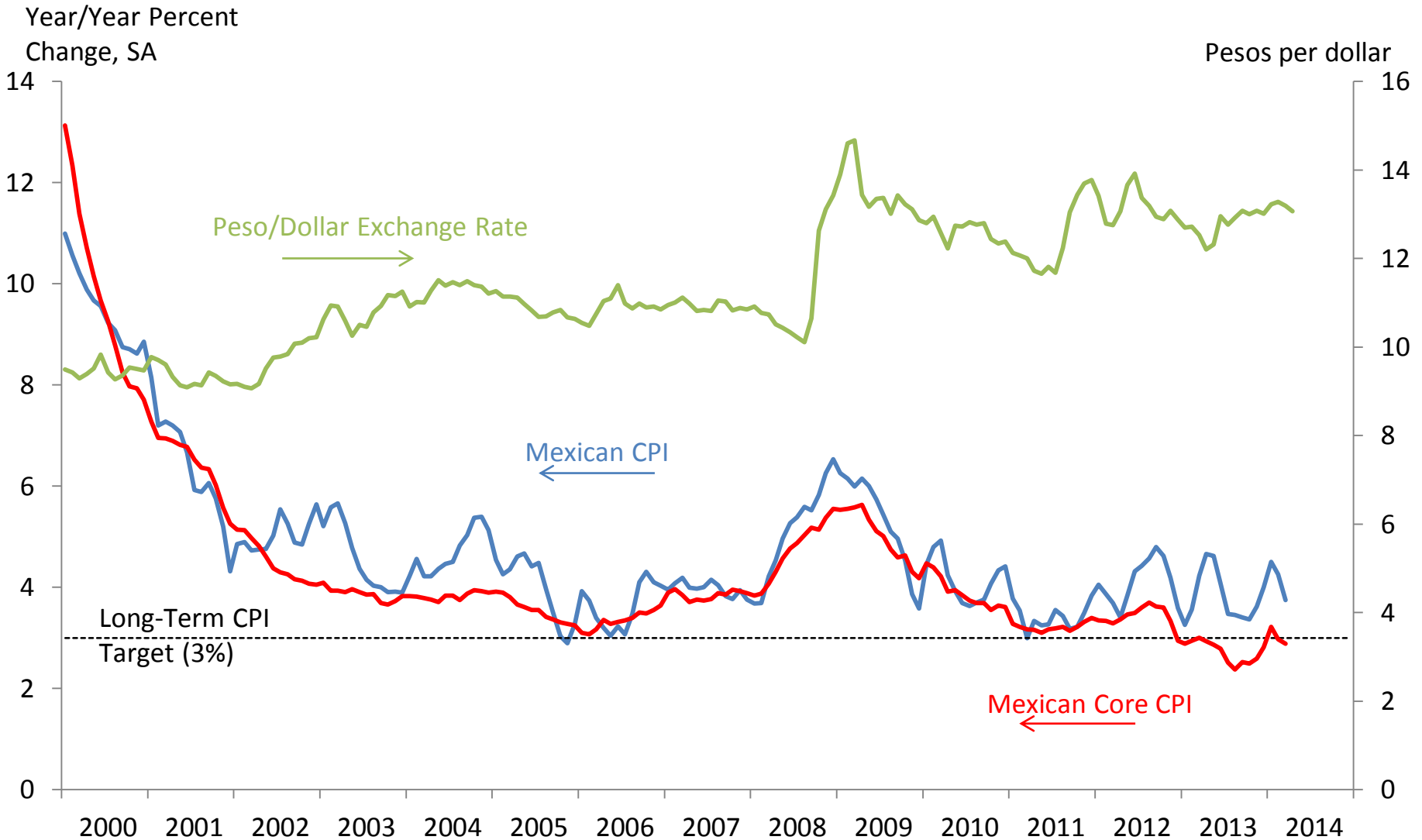
(As a share of the US level)



Source: Bureau of Economic Analysis, Haver Analytics

# Chart 15

## Mexican Inflation In a Downward Trend As the Peso Gains Some Ground



Sources: Banco de Mexico; INEGI.