



# Challenges for Emerging Markets in a Changing Environment

FT Growth Markets Summit

December, 2015



BANCO DE MÉXICO

# Outline

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**Recent Shocks Faced by the  
Emerging Economies**

**2**

**Mexico's Three Pillar Approach**

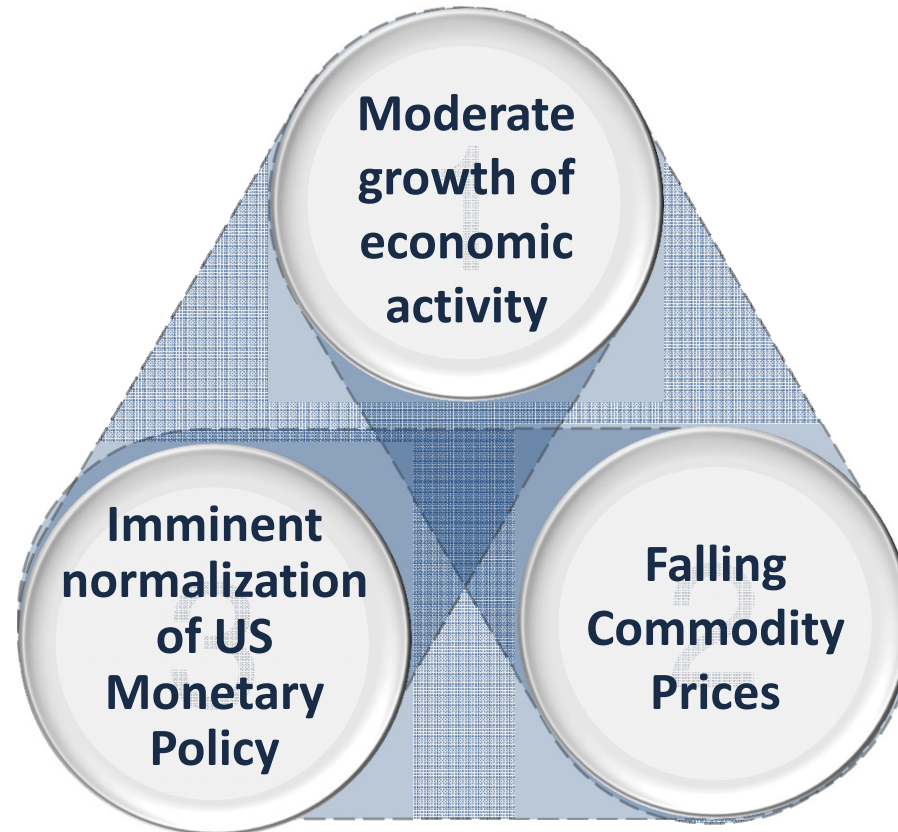
**3**

**Recent Economic Developments in  
Mexico**

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**Final Remarks**

**Emerging Market Economies (EMEs) are facing a difficult economic situation**



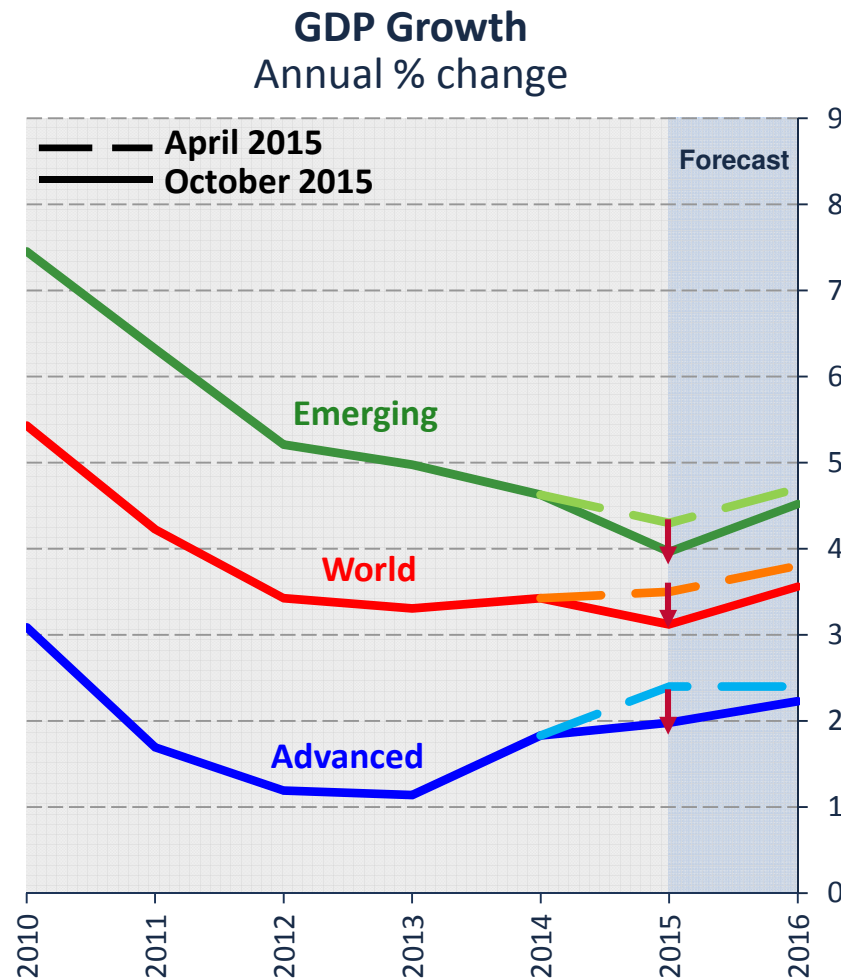
**Decline of economic growth prospects for many EMEs**

**Weakening of their macroeconomic policy stances**

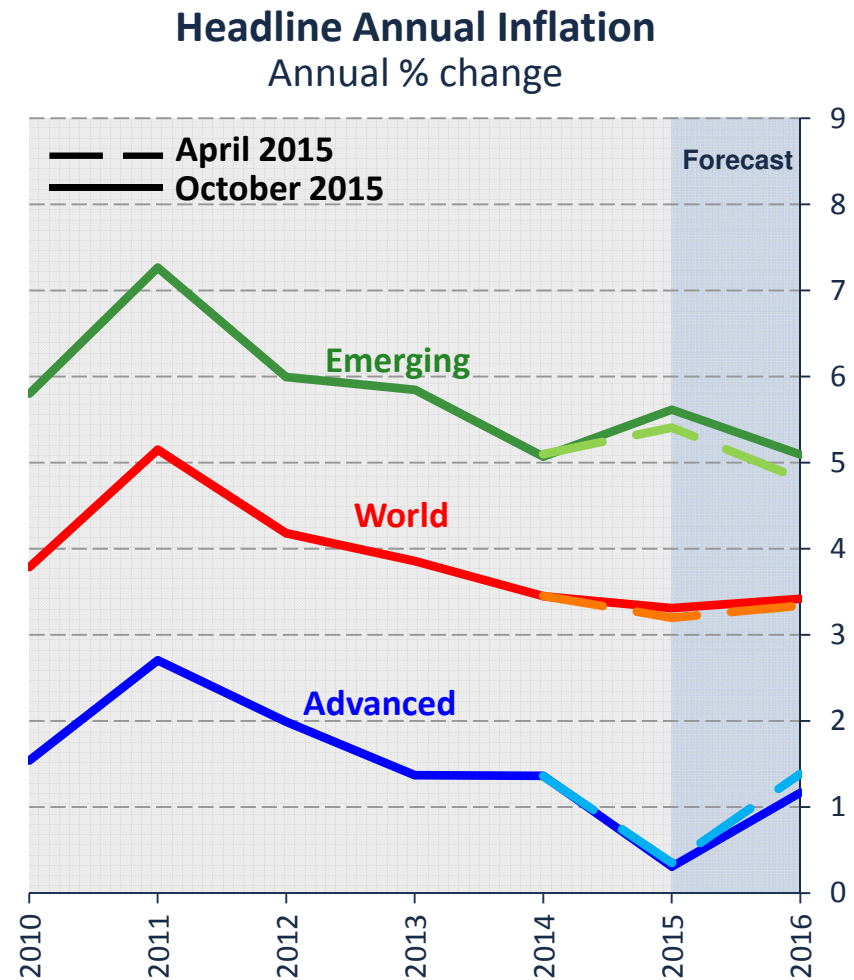
**Tightened financing conditions.**

# ① World economic activity continued weakening.

## World Economy



Source: IMF, WEO April and October 2015.

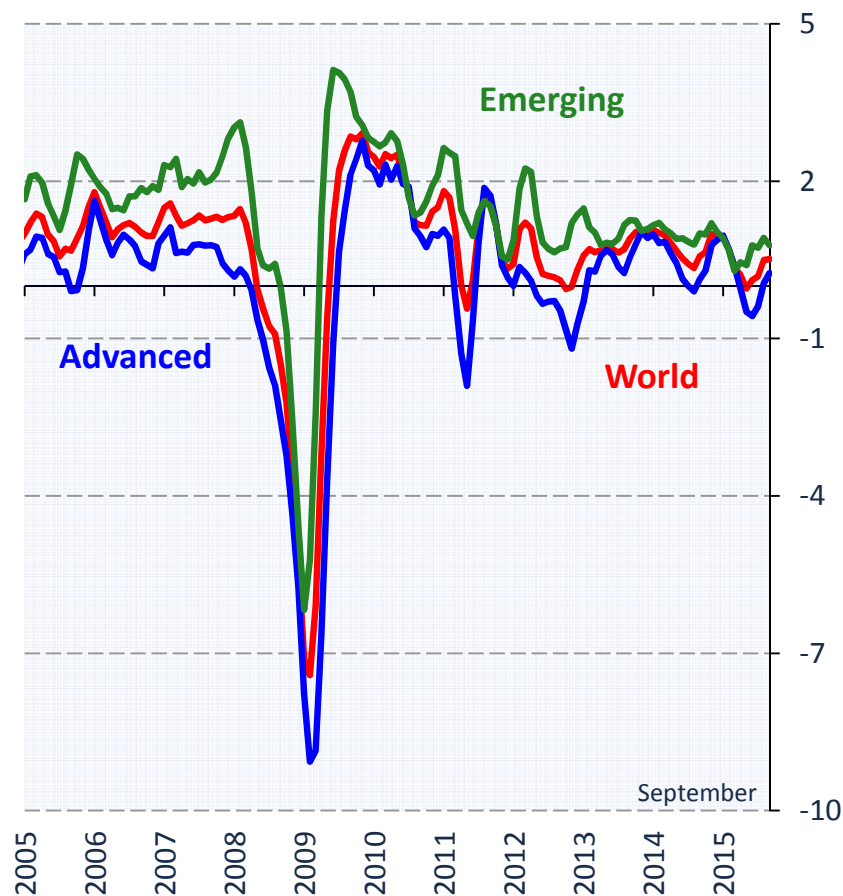


Source: IMF, WEO April and October 2015.

# 1 Under this environment, world trade and global industrial production has decelerated.

## Global Industrial Production

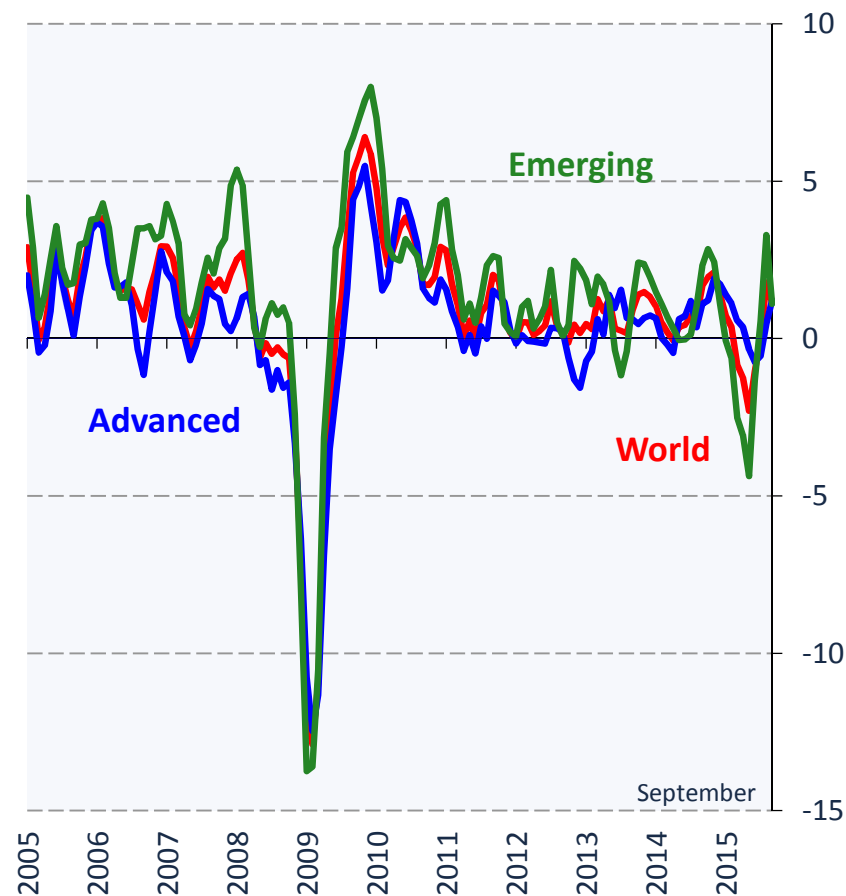
Quarterly change of 3-month moving average in percent, s. a.



s.a./ Seasonally adjusted data.  
Source: Haver Analytics.

## Global Trade Volume

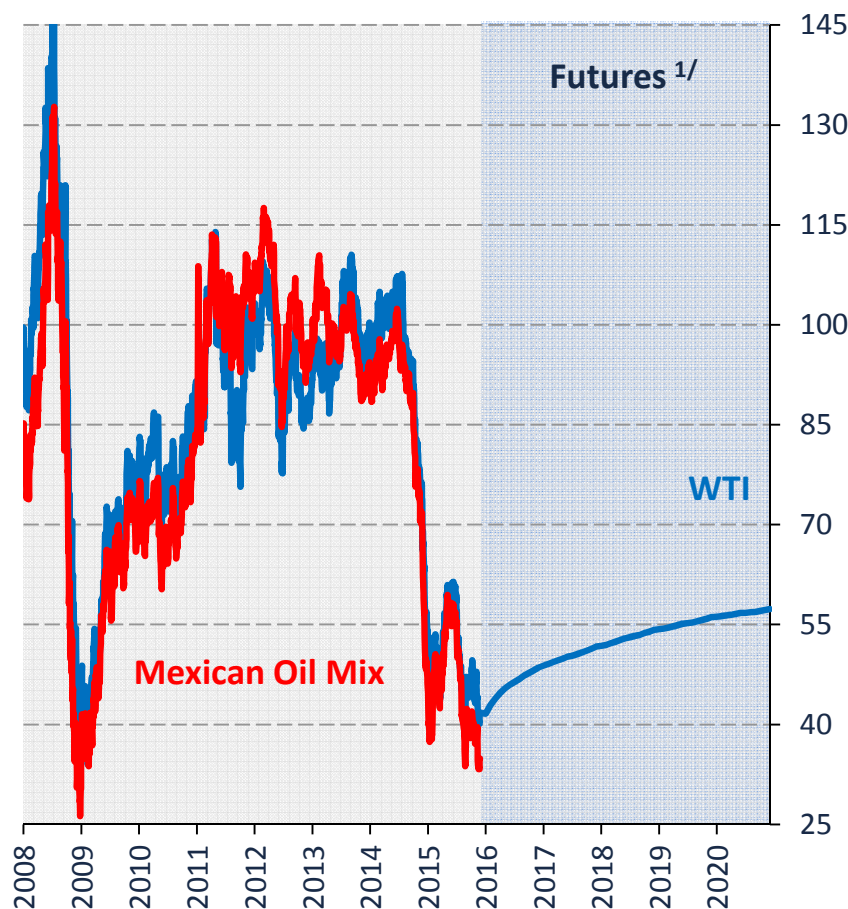
Quarterly change of 3-month moving average in percent, s. a.



s.a./ Seasonally adjusted data.  
Source: Haver Analytics.

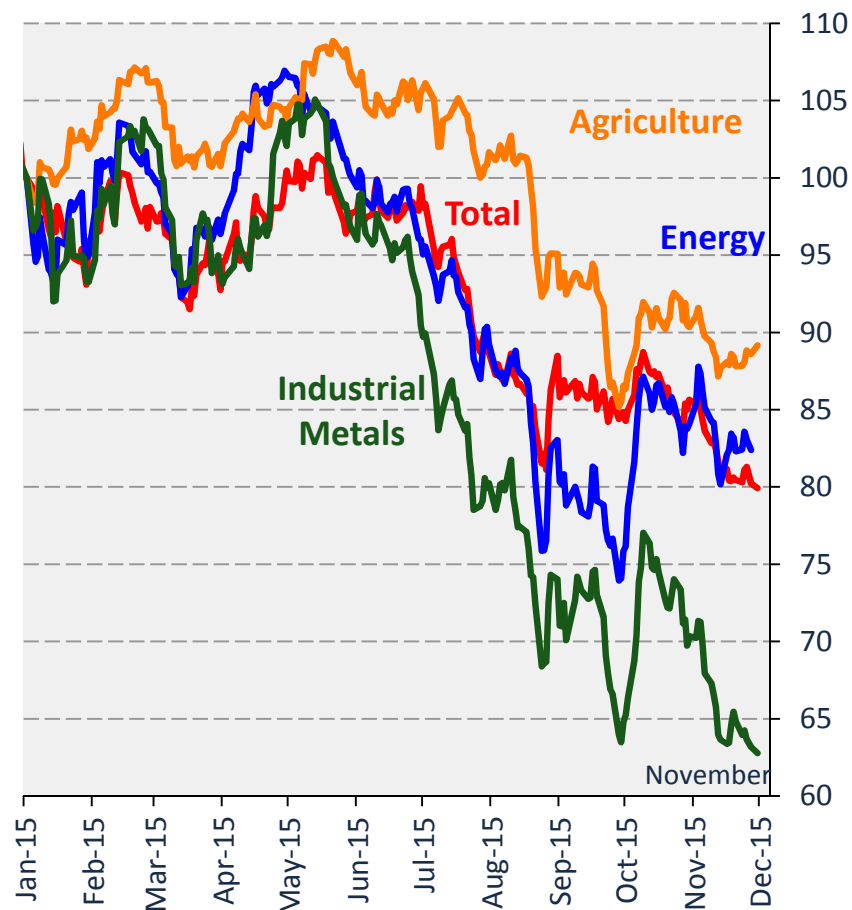
## 2 Energy and other commodity prices have continued falling.

**Crude Oil Prices**  
USD per barrel



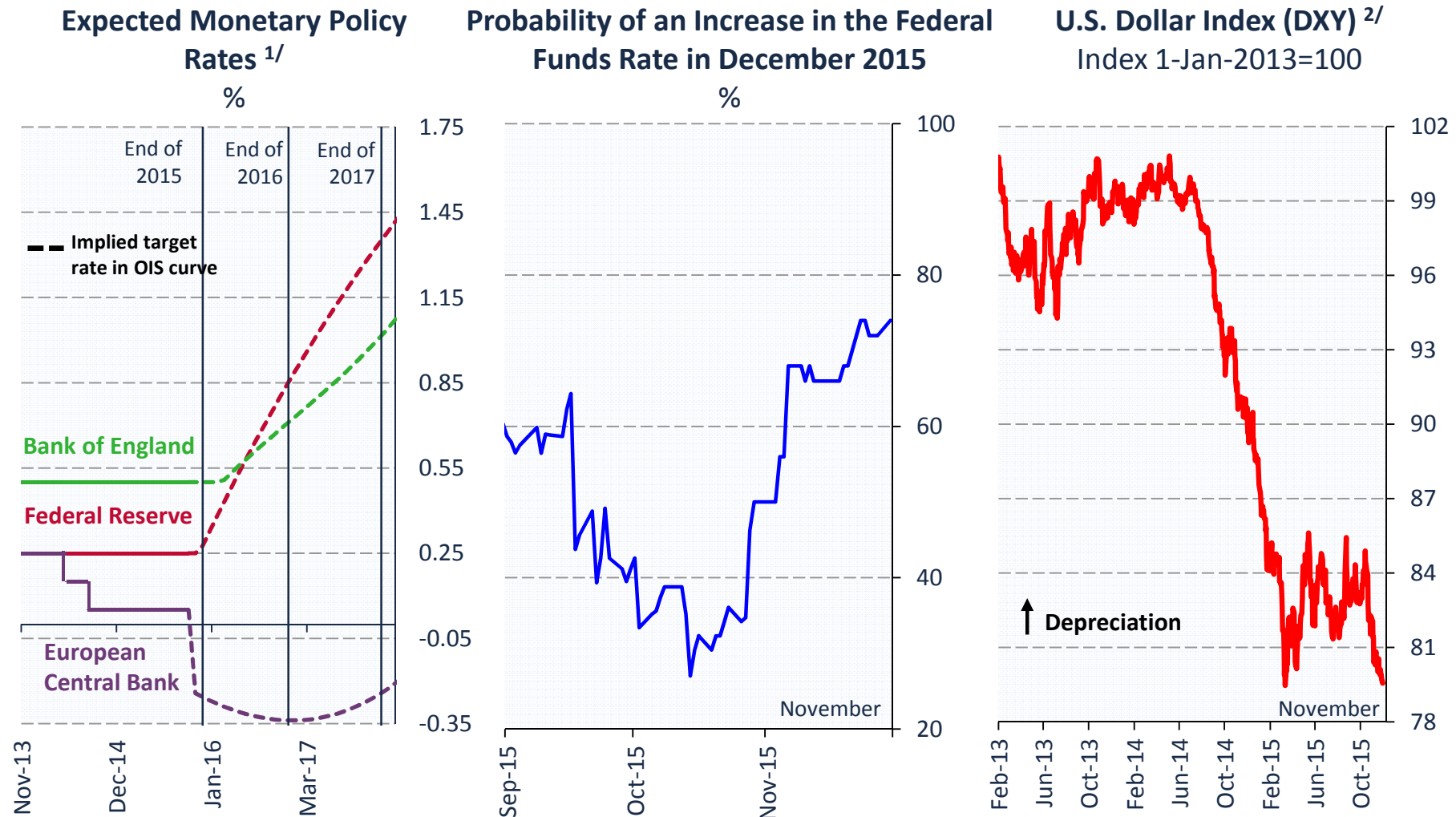
1/ Data up to November 30, 2015.  
Source: Bloomberg.

**Commodities Prices <sup>2/</sup>**  
Index Jan-2005=100



2/ It refers to the Thomson Reuters' CRB index composed by 19 raw materials divided in 4 groups: energy (39%), agriculture (41%), precious metals (7%) and industrial metals (13%).  
Source: Bloomberg.

### 3 In international financial markets, it is expected an imminent normalization of US monetary policy.



1/ The expected rates are the trajectories implicit in OIS Curves (Overnight Index Swap).  
Source: Bloomberg with estimates from Banco de México.

Source: Bloomberg.

2/ DXY index is estimated by the Intercontinental Exchange (ICE) based on the weighted geometric mean of the dollar's value compared with a basket of 6 other major currencies which are: EUR: 57.6%, JPY: 13.6%, GBP: 11.9%, CAD: 9.1%, SEK: 4.2%, and CHF: 3.6%. Source: Bloomberg.



In an extremely complex international environment, EMEs currencies have depreciated in a context of high volatility in financial markets.

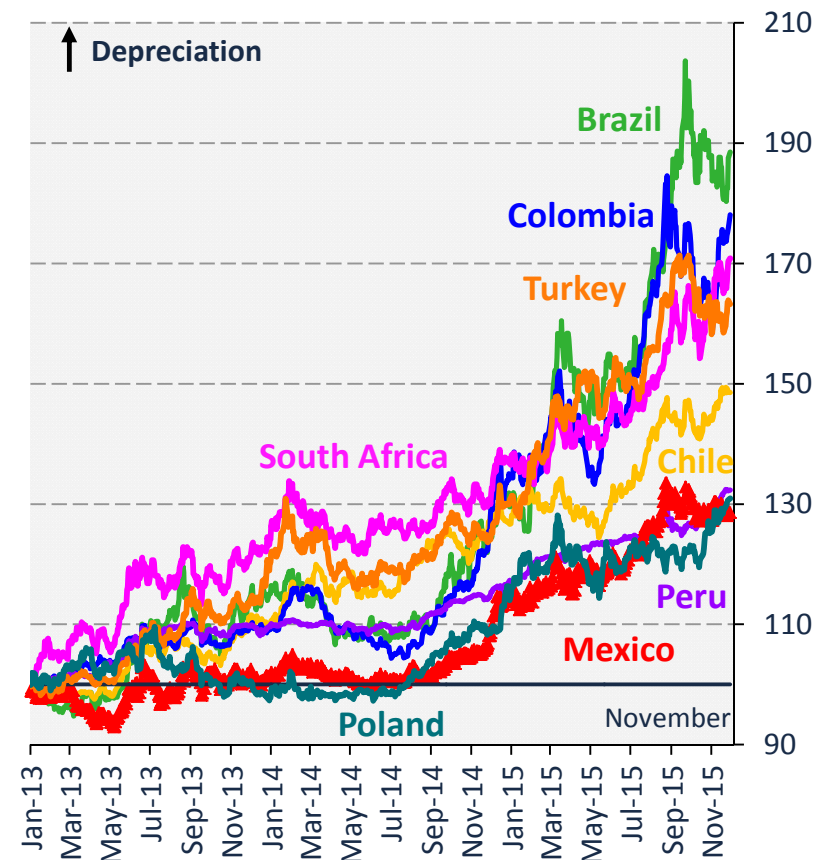
### Emerging Economies

Foreign Exchange Market Volatility<sup>1/</sup>  
%



1/ Average of the implied volatility in *put* options for one month of the exchange rate for the following countries: Brazil, Chile, Korea, India, Mexico, Peru, Poland, South Africa, and Turkey.  
Source: Bloomberg.

Nominal Exchange Rate against USD  
Index 01-Jan-2013 = 100



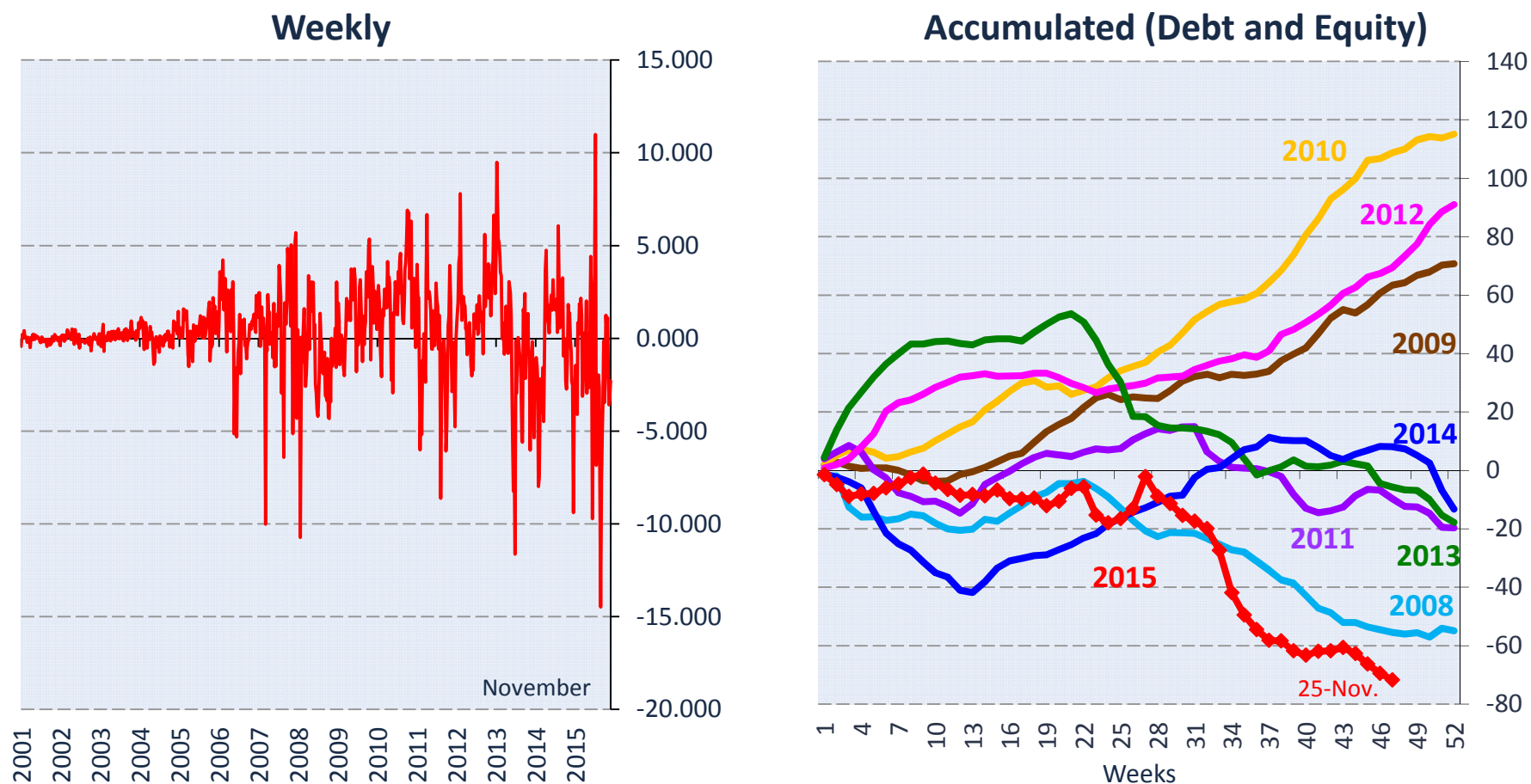
Source: Bloomberg.



With respect to changes in the portfolio allocations of the global investors, capital outflows from emerging economies have been observed.

### Emerging Markets: Capital Flows <sup>1/</sup>

Billions of dollars



<sup>1/</sup> The sample covers funds used for the buying-selling of stocks and bonds from emerging countries, recorded in advanced countries. Flows exclude portfolio performance and changes in the exchange rate.

Source: Emerging Portfolio Fund Research.

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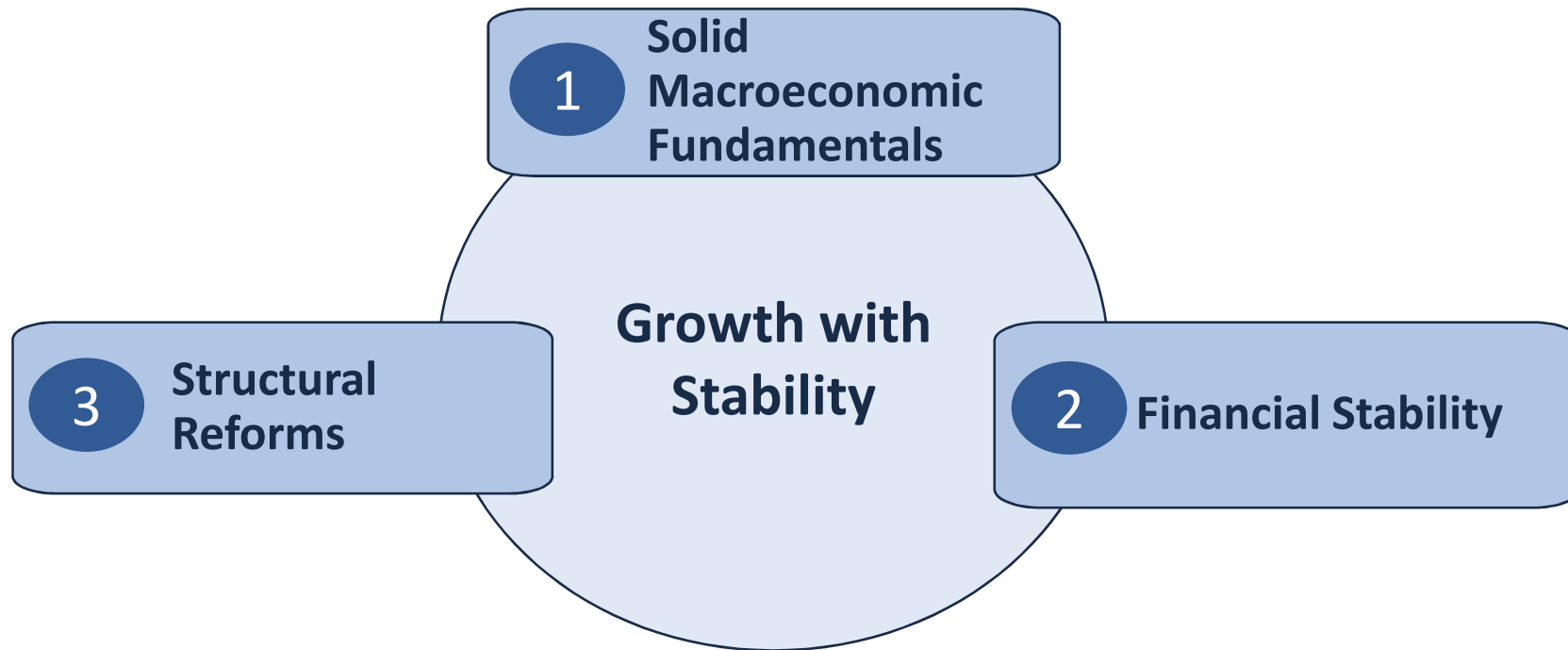
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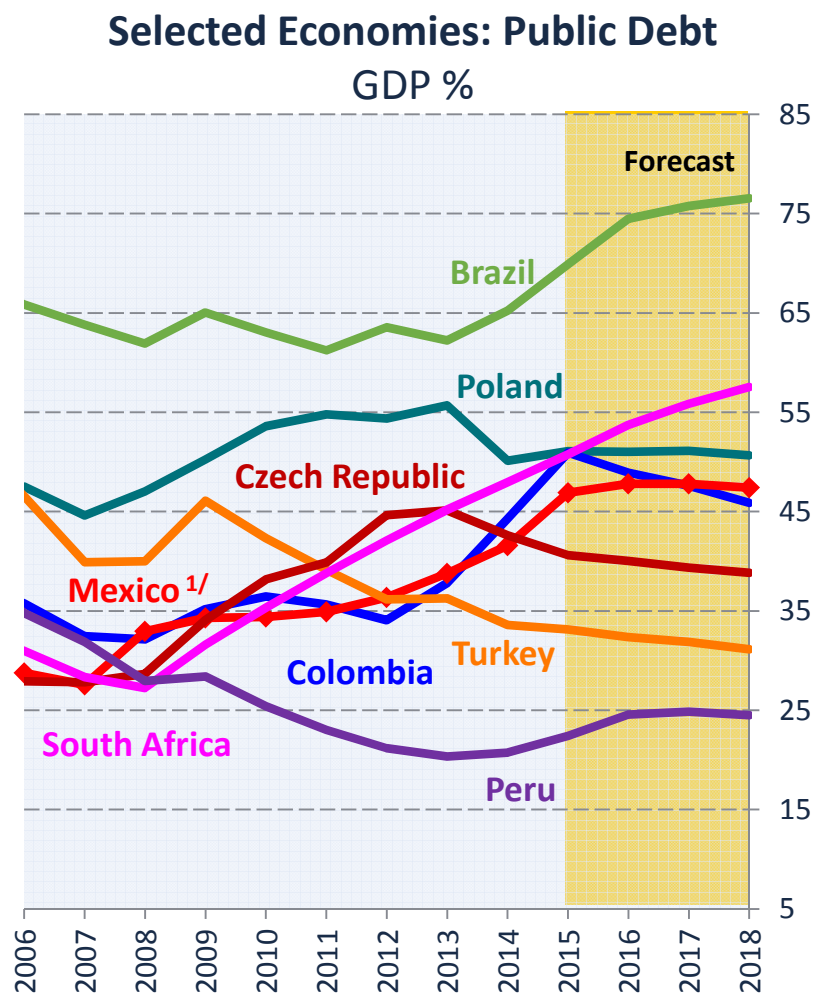
**Final Remarks**

In Mexico, authorities have followed a **Three Pillar Approach** to face the challenges posed by the shocks described before:

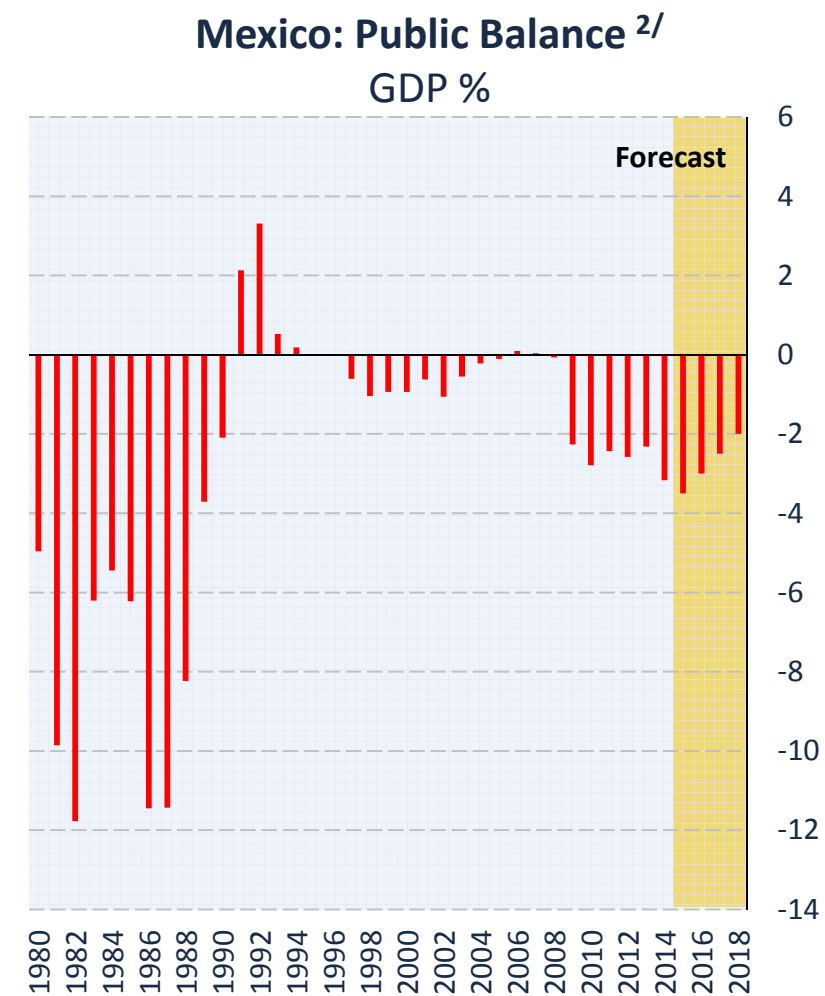


# 1 Comprehensive Strategy: Solid macroeconomic fundamentals

## Fiscal adjustment: Ongoing fiscal consolidation process.



1/ Public Sector Borrowing Requirements Historical Balance.  
Source: Fiscal Monitor (IMF) and Mexico's Ministry of Finance (SHCP).

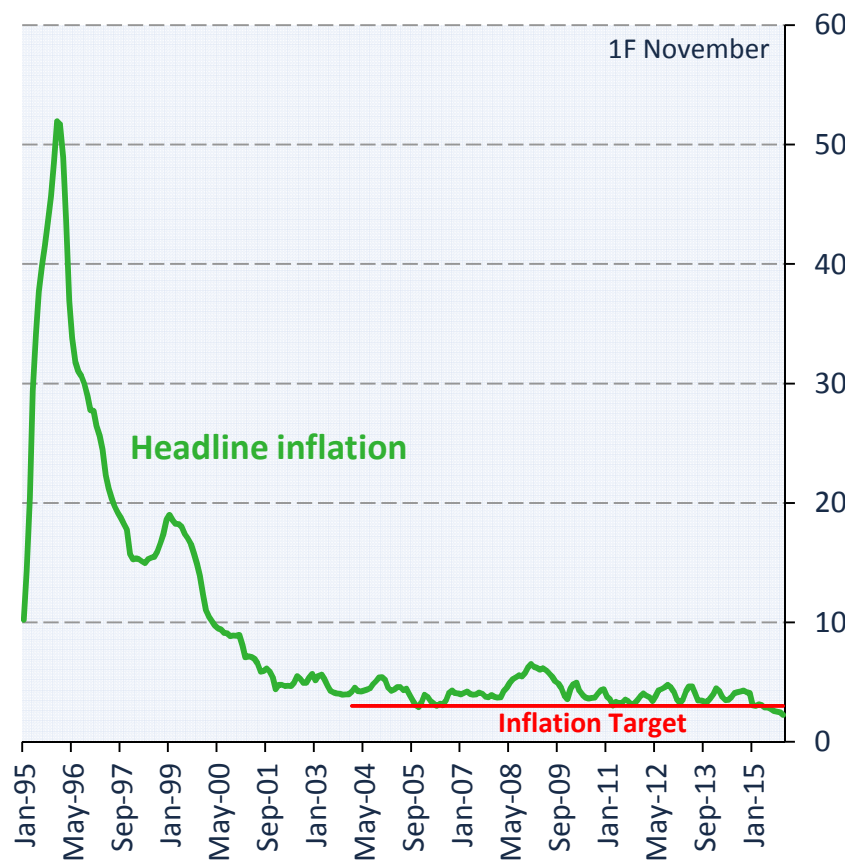


2/ It refers to Economic Balance. A negative (positive) sign means deficit (surplus).  
Source: Mexico's Ministry of Finance (SHCP).

# 1 Comprehensive Strategy: Solid macroeconomic fundamentals

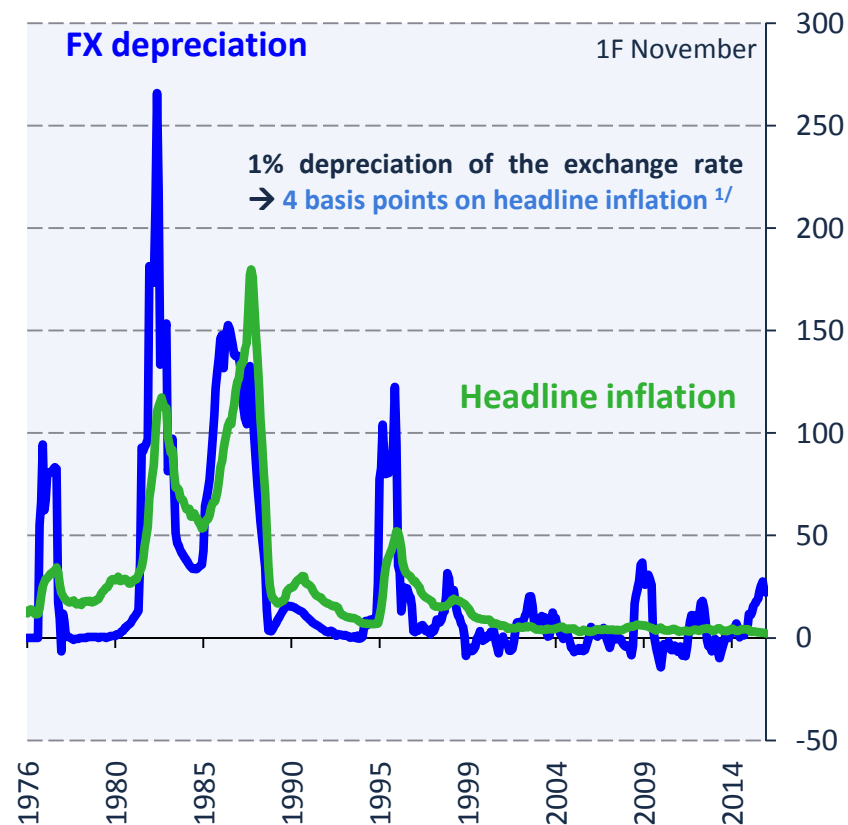
**Monetary Policy focused on price stability:** Inflation has converged to the 3 percent target and a low passthrough from FX depreciation to prices has been observed.

**Headline Inflation**  
Annual %



Source: Banco de México and INEGI.

**Headline Inflation and Nominal Exchange Rate Depreciation: 1976-2014**  
Annual % change

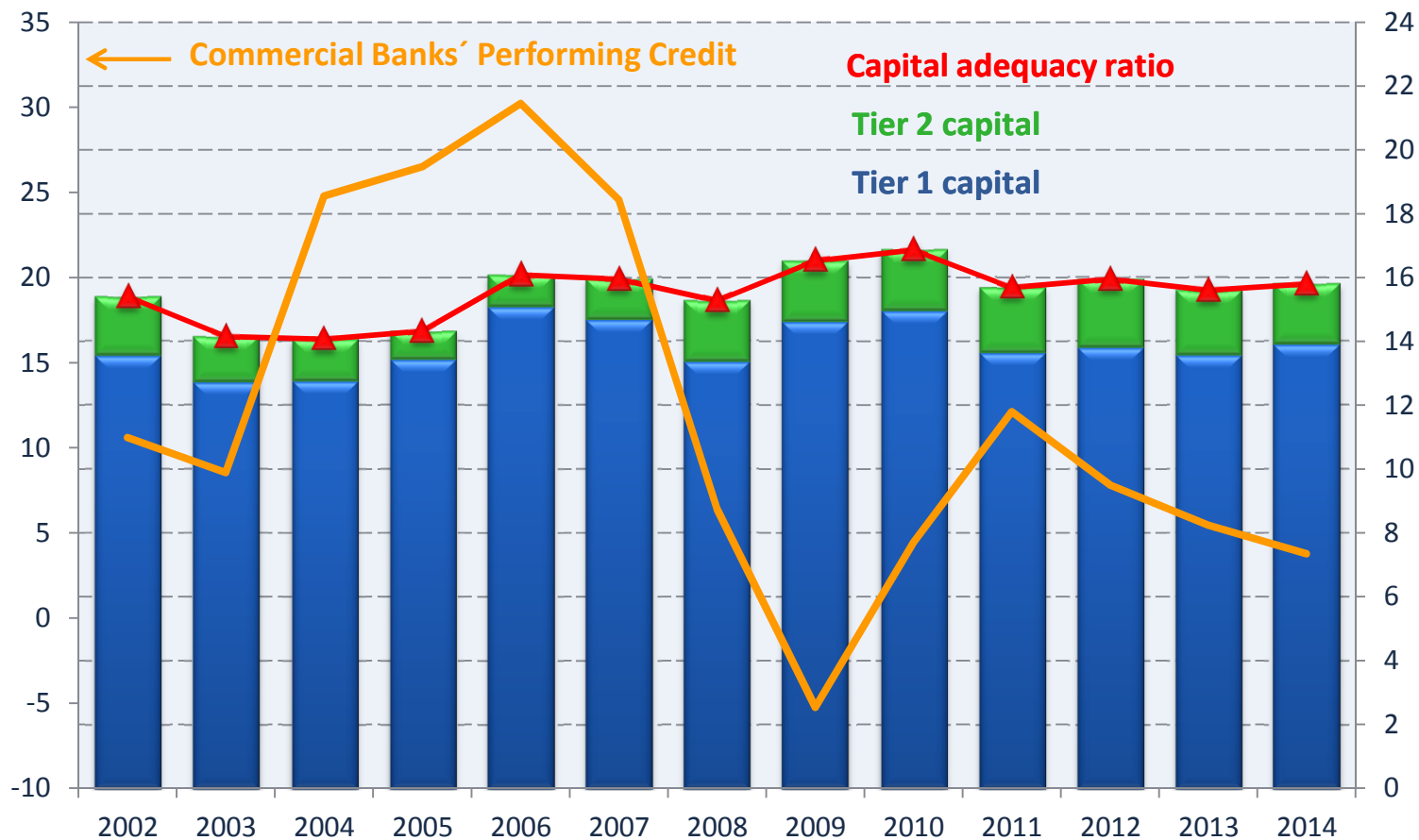


1/ Quarterly Inflation Report, July-September 2012, Box 1. Estimating the Effect of the Exchange Rate Adjustment on Inflation. Banco de México.  
Source: INEGI and Banco de México.

## 2 Comprehensive Strategy: Financial Stability

Well-capitalized banking system, with adequate regulation and supervision.

### Banks' Capital Adequacy Ratio and Performing Credit % and real annual % change



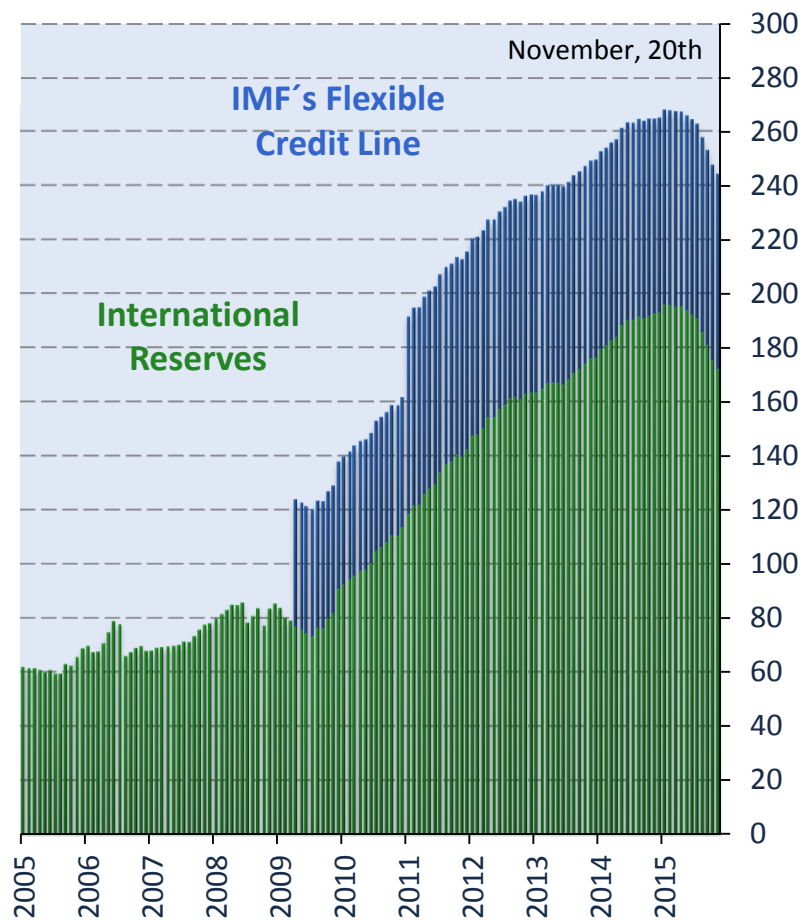
Source: Comisión Nacional Bancaria y de Valores (CNBV) and Banco de México.

## 2 Comprehensive Strategy: Financial Stability

In order to strengthen financial stability in Mexico, a number of measures have been undertaken.

### International Reserves

USD billion



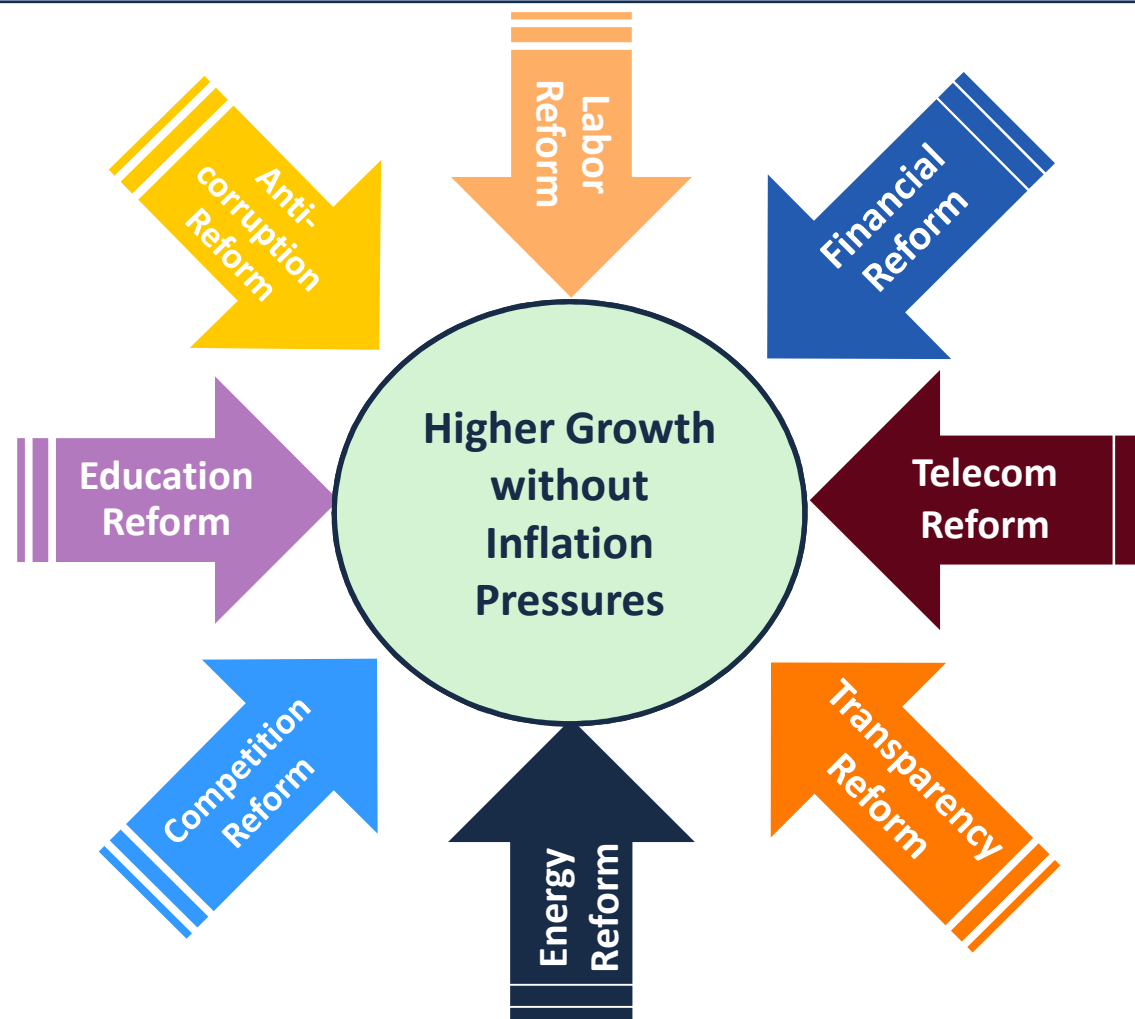
Source: Banco de México and International Monetary Fund.

### Strengthening Financial Stability

- ✓ Coordinated analysis: Financial System Stability Council (2009).
- ✓ Hedging of oil price risk.
- ✓ Active external debt management.
- ✓ Availability of IMF's FCL.
- ✓ Rules based FX interventions.
- ✓ Full implementation of international financial reforms.



### 3 Comprehensive Strategy: Structural Reforms



Already approved structural reforms offer a great opportunity to enhance economic growth. So far, some encouraging signs have been observed in key sectors. However, great challenges remain in their implementation, thus there is no room for complacency.

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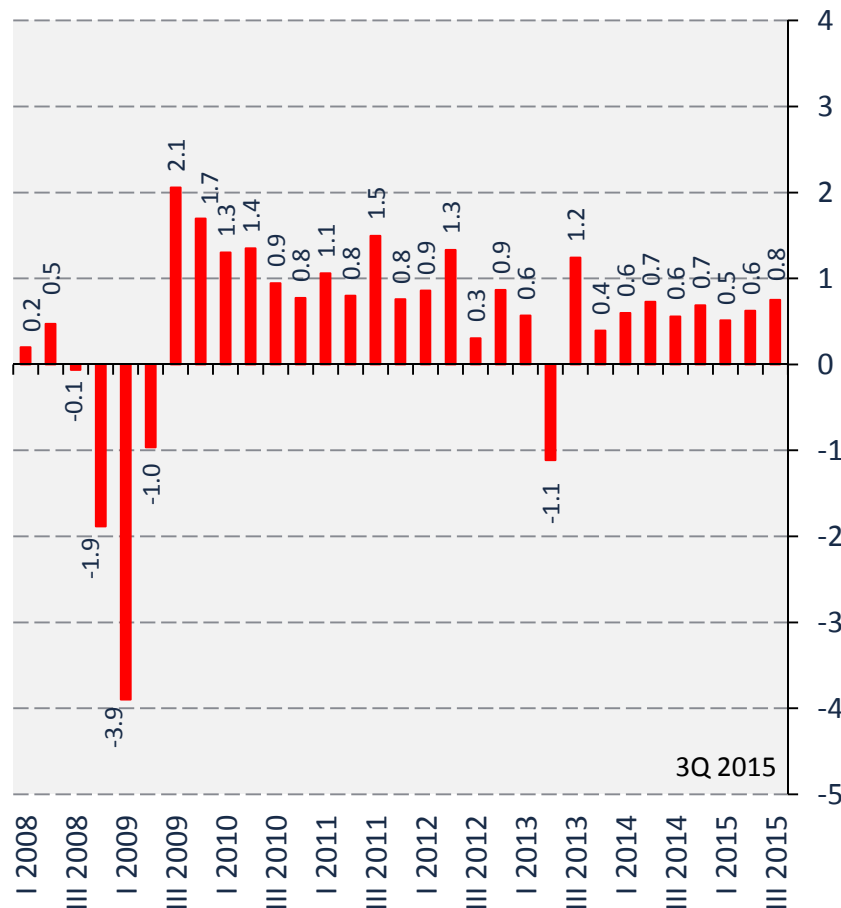
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## Economic activity in Mexico has exhibited a moderate growth rate.

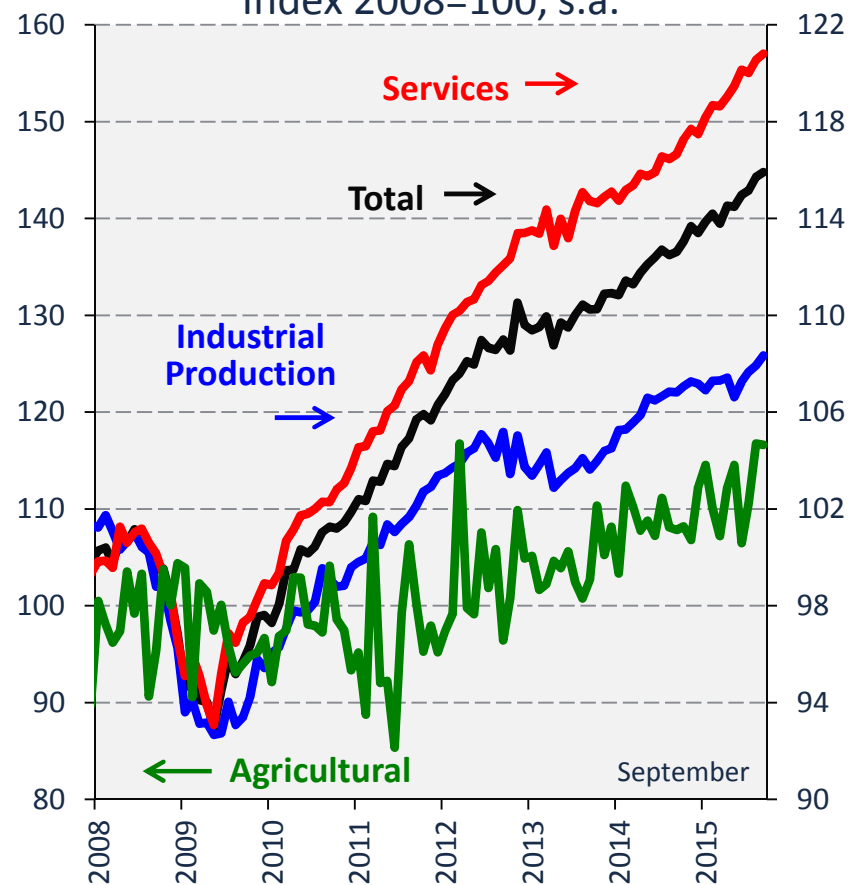
**Gross Domestic Product**  
Quarterly % change, s.a.



s.a. / Seasonally adjusted data.

Source: Mexico's System of National Accounts, INEGI.

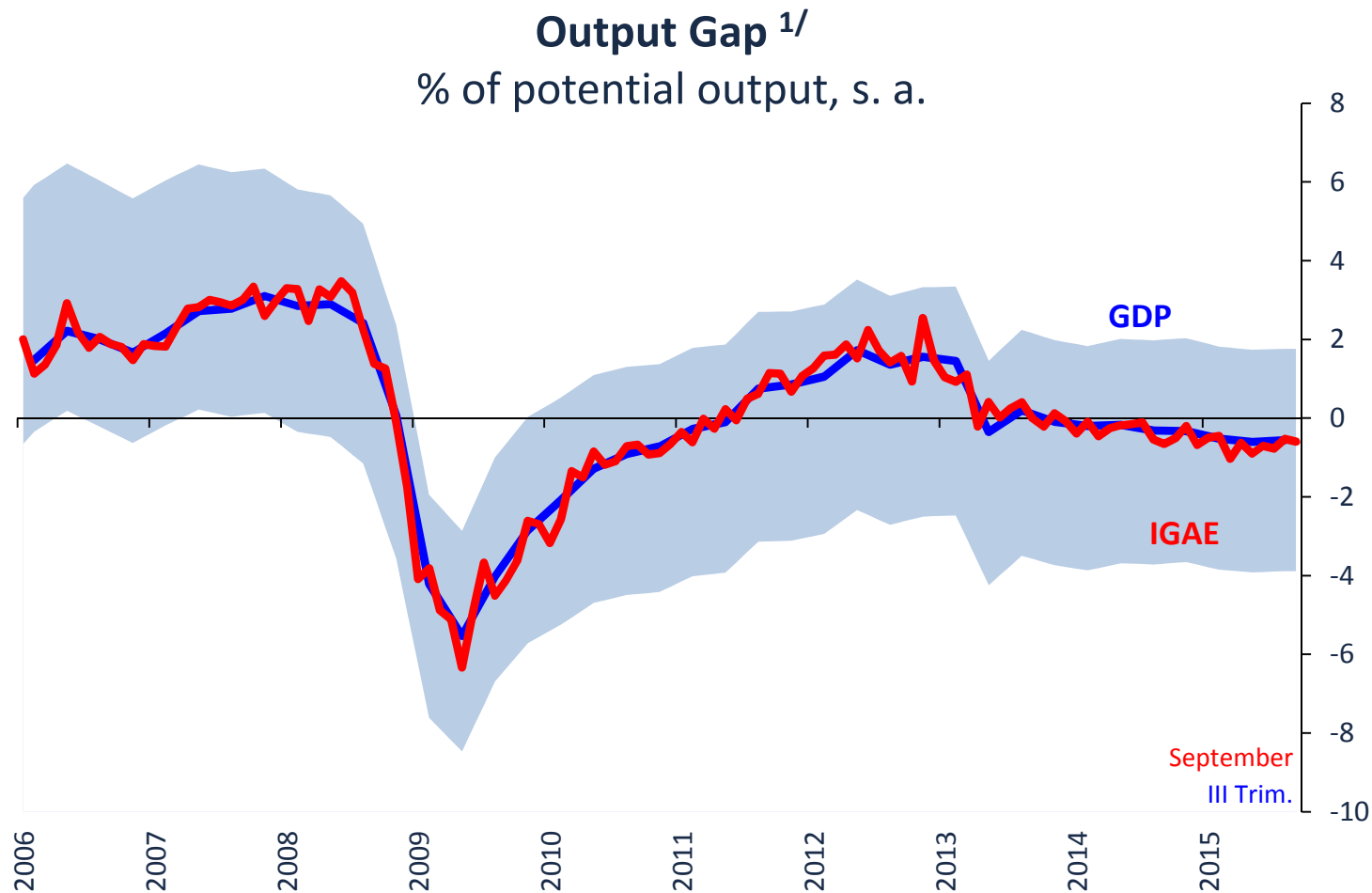
**Global Indicator of Economic Activity**  
Index 2008=100, s.a.



s. a. / Seasonally adjusted data.

Source: Mexico's System of National Accounts, INEGI.

In light of the abovesaid, slack conditions are expected to persist in the economy in the coming years, although gradually declining.



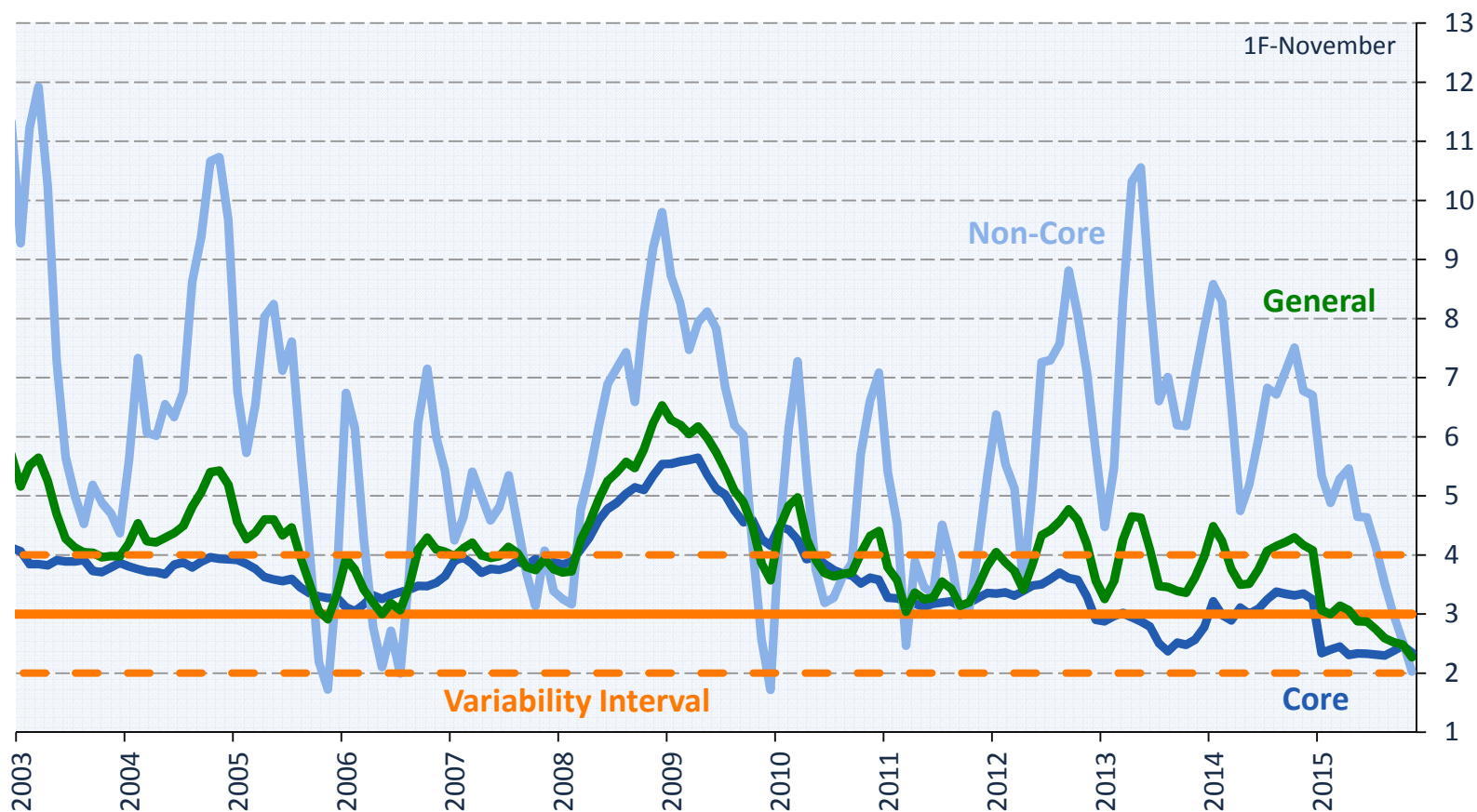
s.a. / Calculated with seasonally adjusted data.

1/ Estimated using the Hodrick-Prescott (HP) filter with tail correction method; see Banco de México (2009), "Inflation Report April-June 2009", p.69. The shaded area is the 95% confidence interval of the output gap, calculated with an unobserved components method.

Source: Calculated by Banco de México with data from INEGI.

Annual headline inflation has been declining and locates below the 3 percent inflation target, at new historical minimum levels.

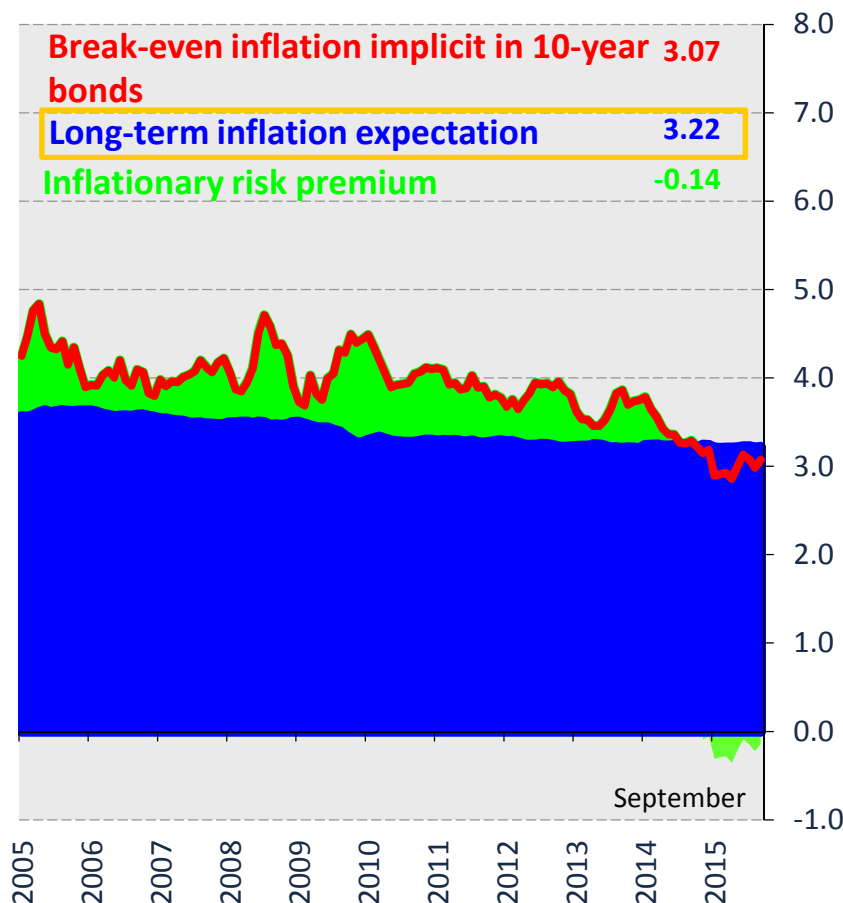
### Consumer Price Index Annual % change



Source: Banco de México and INEGI.

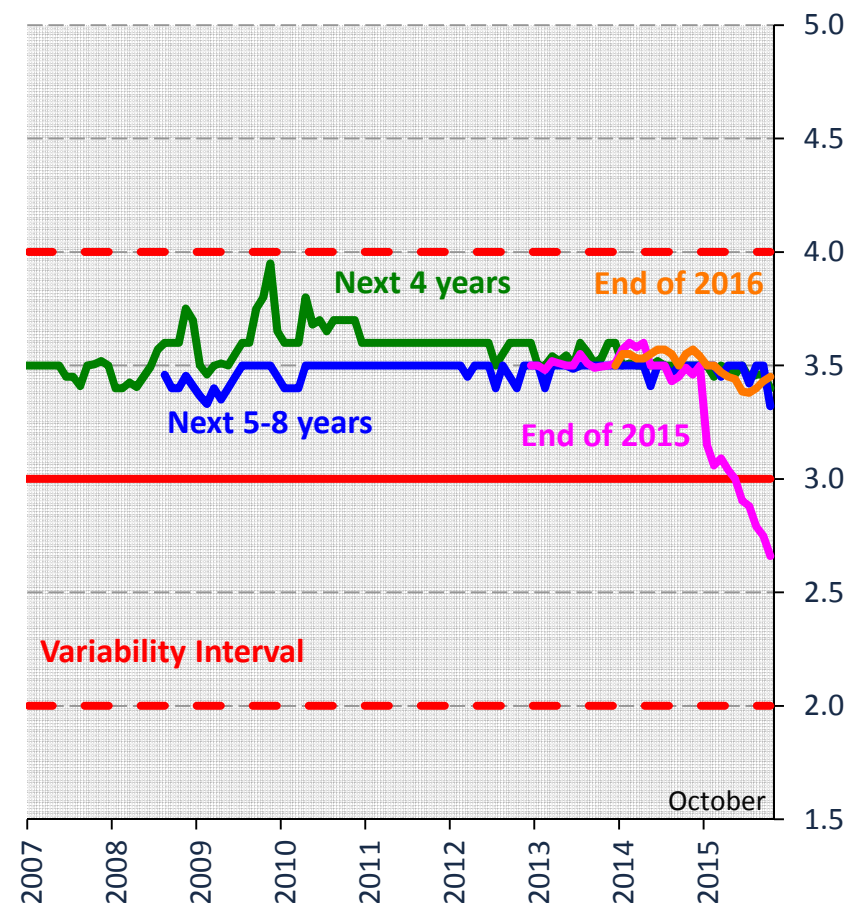
Inflation expectations implicit in long-term market instruments have remained stable, while survey-based ones for the end of 2015 kept decreasing.

Break-even Inflation Decomposition <sup>1/</sup>  
%



<sup>1/</sup>The inflation risk Premium is calculated with data from Valmer and Bloomberg, based on the methodology described in Box 1 "Decomposition of the Break-even Inflation" of the Quarterly Report October-December 2013.

Annual Headline Inflation Expectations  
Median, %



Source: Survey of private sector economic analysts' expectations, Banco de México.

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# Final Remarks

- ① Emerging Market Economies (EMEs) are facing a **difficult economic situation** in the light of a moderate growth of economic activity, falling commodity prices and the expectation of higher interest rates.
- ② **Macroeconomic fundamentals in a number of EMEs have deteriorated** given the external shocks that these economies have faced and the accumulation of some macroeconomic unbalances in the last years.
- ③ In spite of the recent shocks, Mexico has preserved its **strong macroeconomic fundamentals**. There are **no macroeconomic and/or financial imbalances** in Mexico.
- ④ In Mexico, **long term prospects are favorable** as it is one of the few economies that could consolidate higher growth rates with macro and financial stability.
  - ✓ *Structural reforms potential.*



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