Date of Release: May 6, 2022

DBRS Morningstar Confirms Mexico at BBB Stable

Industry Group: Public Finance – Sovereigns
Region: Americas

DBRS Inc. (DBRS Morningstar) confirmed the United Mexican States' (Mexico) Long-Term Foreign and Local Currency – Issuer Ratings at BBB. At the same time, DBRS Morningstar confirmed the United Mexican States' Short-Term Foreign and Local Currency – Issuer Ratings at R-2 (high). The trend on all ratings is Stable.

KEY RATING CONSIDERATIONS

The Stable trend reflects DBRS Morningstar's view that the Mexican government's commitment to sustainable public finances will continue to support macroeconomic stability amid a challenging global economic backdrop. While we remain concerned about the quality of public spending, tight fiscal policy is expected to keep public debt-to-GDP on a stable trajectory over the next five years. The Mexican economy is recovering, albeit in a slow and uneven manner. Output in the first quarter of 2022 was still 2.5% below its level in the fourth quarter of 2019. Improving labor market conditions and a recovery in high-contact sectors should support activity in the near term, but the overall economy is expected to grow at a moderate pace, as higher inflation erodes consumers' purchasing power, financing conditions tighten, and the investment outlook remains weak. The IMF expects GDP growth of 2.0% in 2022 and 2.5% in 2023.

The BBB ratings balance Mexico's track record of sound macroeconomic policymaking with the country's deep governance and growth challenges. The economy has maintained solid macroeconomic fundamentals through a series of shocks, due in large part to its strong policy framework – comprised of exchange rate flexibility, prudent fiscal management, and a credible inflation-targeting regime. The financial system has demonstrated resilience through the pandemic, and the country's external position appears broadly consistent with economic fundamentals.

However, significant structural challenges weigh on the credit profile. Poor education outcomes, widespread informality, and far-reaching governance problems have led to decades of weak economic growth. Given the policy orientation of the López Obrador (AMLO) administration, we do not expect growth prospects to improve over the medium term.

RATING DRIVERS

The rating could be upgraded if (1) the government reorients economic policy or strengthens governance in a manner that materially improves Mexico's investment outlook, and (2) public debt dynamics are put on a firm downward trajectory over the medium term.

The ratings could be downgraded if there is (1) a material deterioration in Mexico's medium-term growth prospects, or (2) a weakening in the country's macroeconomic policy framework.

RATING RATIONALE

Mexico's Fiscal Strategy Allays Sustainability Concerns But Raises Allocation Concerns

The government's fiscal response to the pandemic has been austere. Additional spending and foregone revenue totaled just 0.7% of GDP in 2020; measures included accelerating some social transfer payments, extending low-interest credit to SMEs and households, and moving ahead with previously announced large infrastructure projects. At the same time, changes to the tax regime and stepped-up tax collection efforts contributed to positive real revenue growth in 2020, even as there was a sharp decline in economic activity. As a result, the deficit only increased from 2.3% of GDP in 2019 to 4.4% in 2020. As the economy recovered in 2021 and oil-related revenues increased, the deficit narrowed to 3.8% of GDP. The government plans to maintain a relatively tight fiscal stance. The IMF projects that the deficit will decline to 3.2% of GDP in 2022 and remain at that level in 2023. We think the government's commitment to fiscal sustainability should help preserve stable macroeconomic conditions in a challenging global environment.

However, low and poorly-targeted public investment raises concerns about future economic growth. Of key concern is Pemex's business strategy, which in DBRS Morningstar's view, is unlikely to improve operational efficiency or rebuild its reserve portfolio. Consequently, Pemex could increasingly weigh on public finances, either by crowding out other higher-yielding investment or contributing to higher deficits.

Tight fiscal policy will keep the government debt ratio on a stable trajectory, albeit at a higher level than before the pandemic. General government debt increased from 53% of GDP in 2019 to 60% in 2020. The increase was largely due to the recession, although exchange rate depreciation also contributed. Assuming moderate economic growth and small primary surpluses, the debt ratio will likely remain close to 60% over the next five years. The composition of the public debt mitigates risks stemming from global market volatility. The long average maturity of the debt softens the impact of rising borrowing rates, and the high share of debt denominated in local currency reduces risks stemming from currency depreciation.

Strong Policy Frameworks Support The Economy's Resiliency Amid Shocks

Mexico's central bank is tightening monetary policy in response to rapidly rising prices. Year-over-year inflation increased from 3.2% in December 2020 to 7.5% in March 2022, well above the central bank's target of 3%, plus or minus 1 percent. Global food and energy price shocks, supply disruptions, and the reopening of hard-hit services (i.e. hotels and tourist expenses) are contributing to higher inflation across most categories. Core inflation reached 6.9% in March 2022. In response, the central bank has raised the policy rate by 250 basis points since June 2021, taking the policy rate to 6.5% in April 2022. More rate hikes are expected in 2022, which we think will put monetary policy in a clearly restrictive stance by the end of the year. The pace of tightening and peak rate will largely depend on the behavior of inflation expectations. According to the median forecast in the Survey of Expectations of Private Sector Economists

(April 2022), expected inflation in two years increased to 3.7% from an average of 3.5% in 2021. If expectations continue to rise, the central bank may need to tighten monetary policy more aggressively.

The financial system appears well-positioned to support the real economy. Increased provisioning across the banking system lowered profitability in 2020, but profitability recovered in 2021 due to an improvement in asset quality and higher earnings. Non-performing loans accounted for 2.1% of gross loans at the end of 2021, which is slightly lower than before the pandemic. The banking system remains well-capitalized, with adequate buffers to absorb unexpected losses. In addition, exchange rate fluctuations have not adversely affected banks' balance sheets nor do they appear to have affected asset quality in the corporate sector. Household leverage is also low, with limited foreign exchange exposure.

Mexico's sound policy framework should help the economy adjust to a series of international shocks, including tighter global financing conditions. External accounts do not present any clear imbalances. The current account shifted from a deficit of 0.3% of GDP in 2019 to a surplus of 2.4% in 2020 on the back of strong demand from the US, large remittance inflows, and a deep recession in Mexico. The surplus returned a modest deficit of 0.4% of GDP in 2021, in line with the recovery in domestic demand. External debt levels are moderate and primarily long-term in tenor. Exchange rate flexibility enhances the economy's resilience to episodes of market turbulence. The central bank also holds $207 billion in net reserves and has a $50 billion Flexible Credit Line from the IMF, which provide some protection against global tail risks. Notwithstanding these buffers, the large stock of foreign portfolio liabilities leaves the economy exposed to capital flow volatility.

Mexico's Lackluster Growth Record Is Unlikely To Improve With The Current Policy Mix

Mexico's growth performance over the last three decades has been poor. From 1989 to 2019, the economy grew at an average rate of 2.5 percent. Given the current administration's policies and the backtracking on prior economic reforms, we think Mexico's growth trajectory is unlikely to improve. The government's decisions to cancel energy auctions, limit cooperation between Pemex and private firms, scrap a partially-built airport in Mexico City, and renegotiate private contracts related to several natural gas pipelines have damaged business confidence. In addition, government efforts to overhaul the electricity sector and strengthen the market power of state-owned energy companies will likely discourage private investment and lead to more expensive and carbon-intensive energy production. All of this points to lower and poorer-quality investment, which will adversely impact medium-term growth prospects. The IMF estimates potential growth at 2.0 percent.

Notwithstanding the weak growth outlook, there is upside risk if Mexico can materially improve the investment climate. Mexico appears well-positioned to take advantage of potential shifts in global supply chains, especially with the passage of the United States-Mexico-Canada trade agreement in 2020: Mexico is located next to the U.S. market, connected to the U.S. with well-developed transport infrastructure, open to international trade and investment, and cost competitive. Geopolitical tensions between the U.S. and China, along with pandemic-related supply disruptions, could also push firms to shift production from Asia to Mexico. However, in order to attract greater investment as supply chains reorganize, Mexico may need to upgrade worker skills and training, increase competition in network industries, and strengthen the rule of law.

Strengthening The Rule Of Law Is A Critical Challenge

The most significant challenge facing Mexico's credit profile relates to governance. According to the Worldwide Governance Indicators, Mexico scores poorly on the rule of law relative to emerging market peers, both globally and in Latin America. Corruption and cronyism, which are perceived to be entrenched and widespread, constrain economic growth by encouraging rent-seeking behavior and misallocating resources. Elevated levels of criminality, combined with perceived deficiencies in the judicial system and law enforcement, also weaken the investment climate.

Efforts by the AMLO administration to address corruption and improve public security have focused on poverty alleviation schemes, budgetary cuts for programs perceived to be subject to graft, and the creation of a National Guard to replace the Federal Police. In DBRS Morningstar's view, it is not clear that the strategy will yield any benefits in terms of strengthening the rule of law or improving the country's institutional quality.

The results of June 2021 mid-term elections were mixed for AMLO's Morena party. Morena retained its status as the largest single party in the lower house and extended its influence at the state level. However, Morena lost seats in the lower house and its coalition is now further away from the super majority needed to pass constitutional amendments. One source of credit strength, in our view, has been the broad political support through the electoral cycle for Mexico's sound fiscal and monetary policy frameworks. This has enhanced the economy's resilience to shocks and influences positively our "Political Environment" building block assessment.

ESG CONSIDERATIONS

Human Capital & Human Rights (S), Bribery, Corruption & Political Risks (G), Institutional Strength, Governance & Transparency (G), and Peace & Security (G) were among key drivers behind this rating action. Similar to other emerging market economies and many of its regional peers, per capita GDP is relatively low, at US$10.0k (US$20.7k on a PPP basis). According to World Bank Governance Indicators, Mexico ranks in the 21st percentile for Control of Corruption, the 44th percentile for Voice & Accountability, the 26th percentile for Rule of Law, and the 46th percentile for Government Effectiveness. Mexico is trying to address violence and criminality issues through reform, but still ranks low (17th percentile) on Political Stability and the Absence of Violence/Terrorism. These considerations have been taken into account within the following Building Blocks: Fiscal Management and Policy, Economic Structure and Performance, and Political Environment.

A description of how DBRS Morningstar considers ESG factors within the DBRS Morningstar analytical framework can be found in the DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings at https://www.dbrsmorningstar.com/research/373262.

For more information on the Rating Committee decision, please see the Scorecard Indicators and Building Block Assessments: https://www.dbrsmorningstar.com/research/396519.

Notes:

All figures are in U.S. dollars unless otherwise noted. Public finance statistics reported on a public sector basis; this excludes state and local governments but includes state-owned enterprises and public development banks. The fiscal balance is the Public Sector Borrowing Requirement.

The principal methodology is the Global Methodology for Rating Sovereign Governments https://www.dbrsmorningstar.com/research/381451/global-methodology-for-rating-sovereign-governments (July 9, 2021). Other applicable methodologies include DBRS Morningstar Criteria: Approach to Environmental, Social, and Governance Risk Factors in Credit Ratings https://www.dbrsmorningstar.com/research/373262/dbrs-morningstar-criteria-approach-to-environmental-social-and-governance-risk-factors-in-credit-ratings (February 3, 2021).

Generally, the conditions that lead to the assignment of a Negative or Positive trend are generally resolved within a 12-month period. DBRS Morningstar's outlooks and ratings are monitored.

The primary sources of information used for this rating include the Secretária de Hacienda y Crédito Público, Banco de México, INEGI, BIS, OECD, IMF, World Bank, Tullet Prebon Information, and Haver Analytics. DBRS Morningstar considers the information available to it for the purposes of providing this rating was of satisfactory quality.

This rating was not initiated at the request of the rated entity.

The rated entity or its related entities did participate in the rating process for this rating action. DBRS Morningstar did not have access to the accounts and other relevant internal documents of the rated entity or its related entities in connection with this rating action.

For more information on this credit or on this industry, visit www.dbrsmorningstar.com.

DBRS, Inc.
140 Broadway, 43rd Floor
New York, NY 10005 USA
Tel. +1 312 696-6293

Issuer	Debt Rated	Rating Action	Rating	Trend
United Mexican States	Long-Term Foreign Currency - Issuer Rating	Confirmed	BBB	Stable
United Mexican States	Long-Term Local Currency - Issuer Rating	Confirmed	BBB	Stable
United Mexican States	Short-Term Foreign Currency - Issuer Rating	Confirmed	R-2 (high)	Stable
United Mexican States	Short-Term Local Currency - Issuer Rating	Confirmed	R-2 (high)	Stable

Contacts

Michael Heydt
Senior Vice President – Global Sovereign Ratings
+1 212 806 3210
michael.heydt@dbrsmorningstar.com

Thomas R. Torgerson
Managing Director
Co-Head of Sovereign Ratings
+1 212 806 3218
thomas.torgerson@dbrsmorningstar.com

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Mexico

Scorecard Indicators

Fiscal Management and Policy	2016	2017	2018	2019	2020	2021	2022	2023	2024	Source	Current Scorecard Input	
Overall Fiscal Balance (% of GDP)	-2.8%	-1.1%	-2.2%	-2.3%	-4.4%	-3.8%	-3.2%	-3.2%	-2.9%	IMF WEO	13 year average	-3.2%
Government Effectiveness (Percentile Rank)	58.7	55.3	47.6	45.7	46.2	-	-	-	-	World Bank	5 year average	50.7
Debt and Liquidity	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**			
General Government Gross Debt (% of GDP)	56.7%	54.0%	53.6%	53.3%	60.3%	57.6%	58.4%	58.9%	59.2%	IMF WEO	5 year projection	59.8%
Interest Costs (% of GDP)	3.1%	3.7%	3.8%	3.7%	3.9%	3.8%	4.5%	4.2%	4.2%	IMF WEO	5 year average	4.0%
Economic Structure and Performance	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**			
GDP per Capita (USD thousands)	8.8	9.3	9.8	10.0	8.5	10.0	10.2	10.5	10.9	IMF WEO	10 year average	9.8
Output Volatility (%)	2.5%	3.2%	3.1%	3.1%	3.1%	3.0%	3.0%	3.0%	3.0%	IMF WEO	Latest	3.0%
Economic Size (USD billions)	1,078	1,159	1,222	1,269	1,087	1,295	1,323	1,380	1,445	IMF WEO	5 year average	1,207
Monetary Policy and Financial Stability	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**			
Rate of Inflation (%, EOP)	3.4%	6.8%	4.8%	2.8%	3.2%	7.4%	5.9%	3.4%	3.1%	IMF WEO	13 year average	4.2%
Total Domestic Savings (% of GDP)	104%	106%	96%	100%	118%	111%	-	-	-	BdM/OECD/IMF	Latest[1]	111%
Change in Domestic Credit (% of GDP)	3.0%	-0.2%	-0.8%	-0.7%	3.1%	-3.9%	-	-	-	BIS/IMF	7 year average[1]	0.6%
Net Non-Performing Loans (% of Capital)	-6.5%	-6.2%	-5.9%	-5.1%	-6.8%	-6.2%	-	-	-	IMF IFS	Latest[1]	-6.2%
Change in Property Price/GDP Index (%)	-1.0%	-1.0%	1.5%	4.4%	10.8%	-4.0%	-	-	-	OECD/IMF	7 year average[1]	1.8%
Balance of Payments	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**			
Current Account Balance (% of GDP)	-2.2%	-1.7%	-2.0%	-0.3%	2.4%	-0.4%	-0.6%	-0.7%	-0.8%	IMF WEO	8 year average	-0.5%
International Investment Position (% of GDP)	-50.1%	-49.9%	-48.9%	-49.7%	-48.4%	-45.1%	-	-	-	IMF	5 year average[1]	-48.4%
Share of Global Foreign Exchange Turnover (Ratio)	124.0%	130.4%	134.7%	120.2%	124.8%	127.1%	-	-	-	BIS/IMF	Latest	127.1%
Exchange Rate Classification (see footnote)	1	1	1	1	1	1	-	-	-	IMF	Latest	1
Political Environment	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**			
Voice and Accountability (Percentile Rank)	43.8	42.9	45.4	45.9	44.9	-	-	-	-	World Bank	5 year average	44.6
Rule of Law (Percentile Rank)	31.7	31.7	28.8	27.4	26.9	-	-	-	-	World Bank	5 year average	29.3

See DBRS Morningstar's Global Methodology for Rating Sovereign Governments for additional details on the methodology behind the scorecard indicators and associated scoring thresholds. Exchange Rate Classifications: Freely floating exchange rate = 1; Float = 2; Crawls, banded pegs, and other managed = 3; Stabilized = 4; Pegs, currency unions and dollarized arrangements = 5.

[1] *Scores for 2021 have been computed using the most recent data when year-end data is not available.*

Rating Committee Date: 4-May-2022

Mexico

Building Block Assessments and Rating Committee Summary

4-May-2022

Building Blocks	Scorecard Result	Quantitative Assessment	Net Impact of Qualitative Factors	Building Block Assessment
Fiscal Management and Policy	10.25	Moderate	N/A	Moderate
Debt and Liquidity	9.50	Moderate	N/A	Moderate
Economic Structure and Performance	10.43	Moderate	N/A	Moderate
Monetary Policy and Financial Stability	16.09	Strong/Good	N/A	Strong/Good
Balance of Payments	13.54	Good	N/A	Good
Political Environment	3.99	Weak/Poor	+ 2 Categories	Poor/Moderate
Overall Assessment	**Composite Scorecard Result**	**Scorecard Rating Range**	**Composite Building Block Assessment**	**Indicative Rating Range**
	53.2	BBB - BB (high)	56.5	BBB (high) - BBB (low)

Mexico's Long-Term Foreign Currency - Issuer Rating BBB

Main topics discussed in the Rating Committee include: the economic recovery and medium-term growth outlook, fiscal performance, and the political landscape. For additional details on DBRS Morningstar analysis and opinions, please see the accompanying rating report.

DBRS Morningstar Scorecard: Scoring Ranges and Associated Assessment Categories

Lower Bound	0.00	1.00	3.00	5.00	7.00	9.00	11.00	13.00	15.00	17.00	19.00
Upper Bound	0.99	2.99	4.99	6.99	8.99	10.99	12.99	14.99	16.99	18.99	20.00
Assessment Category	Very Weak	Weak	Weak/ Poor	Poor	Poor/ Moderate	Moderate	Good/ Moderate	Good	Strong/ Good	Strong	Very Strong

United Mexican States
ESG Checklist

ESG Factor	ESG Credit Consideration Applicable to the Credit Analysis:	Y/N	Extent of the Effect on the ESG Factor on the Credit Analysis: Relevant (R) or Significant (S)*
Environmental	**Overall:**	**Y**	**R**
Emissions, Effluents, and Waste	Do the costs or risks result in changes to a government's financial standing or relationship with other governments, and does this affect the assessment of credit risk?	N	N
Carbon and GHG Costs	Does a government face coordinated pressure from a higher-tier government or from numerous foreign governments as a result of its GHG emissions policies, and does this affect the assessment of credit risk?	N	N
	Will recent regulatory changes have an impact on economic resilience or public finances?	N	N
	Carbon and GHG Costs:	**N**	**N**
Resource and Energy Management	Does the scarcity of key resources impose high costs on the public sector or make the private sector less competitive?	N	N
	Is the economy reliant on industries that are vulnerable to import or export price shocks?	Y	R
	Resource and Energy Management:	**Y**	**R**
Land Impact and Biodiversity	Is there a risk to a government's economic or tax base for failing to effectively regulate land impact and biodiversity activities?	N	N
Climate and Weather Risks	Will climate change and adverse weather events potentially destroy a material portion of national wealth, weaken the financial system, or disrupt the economy?	N	N
Social	**Overall:**	**Y**	**S**
Human Capital and Human Rights	Compared with regional or global peers, is the domestic labour force more or less competitive, flexible, and productive?	Y	S
	Are labour or social conflicts a key source of economic volatility?	N	N
	Are individual and human rights insufficiently respected or failing to meet the population's expectations?	Y	S
	Is the government exposed to heavy, coordinated international pressure as a result of its respect for fundamental human rights?	N	N
	Human Capital and Human Rights:	**Y**	**S**
Access to Basic Services	Does a failure to provide adequate basic services deter investment, migration, and income growth within the economy?	N	N
Governance	**Overall:**	**Y**	**S**
Bribery, Corruption, and Political Risks	Does widespread evidence of official corruption and other weaknesses in the rule of law deter investment and contribute to fiscal or financial challenges?	Y	S
Institutional Strength, Governance, and Transparency	Compared with other governments, do institutional arrangements provide a higher or lesser degree of accountability, transparency, and effectiveness?	Y	S
	Are regulatory and oversight bodies insufficiently protected from inappropriate political influence?	Y	R
	Are government officials insufficiently exposed to public scrutiny or held to insufficiently high ethical standards of conduct?	N	N
	Institutional Strength, Governance, and Transparency:	**Y**	**S**
Peace and Security	Is the government likely to initiate or respond to hostilities with neighboring governments?	N	N
	Is the government's authority over certain regions contested by domestic or foreign militias?	N	N
	Is the risk of terrorism or violence sufficient to deter investment or to create contingent liabilities for the government?	Y	S
	Peace and Security:	**Y**	**S**
	Consolidated ESG Criteria Output:	**Y**	**S**

* A **Relevant Effect** means that the impact of the applicable ESG risk factor has not changed the rating or rating trend on the issuer.
A **Significant Effect** means that the impact of the applicable ESG risk factor has changed the rating or trend on the issuer.

If any factor is proposed to have a Significant Effect, this should be reflected in the Press Release

United Mexican States: ESG Considerations

May 6, 2022

Environmental

The subfactor Resource and Energy Management is considered relevant to the ratings assigned to Mexico. Petroleum products account for a low share of export receipts (5-10% of goods exports), but have greater relevance for public finances (10-20% of government fiscal revenues). However, the importance of oil-related revenue has decreased over the last decade. The subfactor Carbon and Greenhouse Gas Costs does not affect the rating. Under the 2015 Paris Agreement, Mexico seeks to reduce its greenhouse gas (GHG) emissions by 22% by 2030 when compared to projected 2030 emissions under a "business-as-usual" scenario. Mexico's ability to meet its Paris commitments could be inconsistent with the current government's preference for fossil fuel generation over renewables. DBRS Morningstar will continue to assess the impact on public finances and the economy if the government decides to more rapidly transition toward a less carbon-intensive economy.

Social

The subfactor Human Capital & Human Rights affects the ratings assigned. Similar to other emerging market economies and many of its regional peers, Mexico's per capita GDP is relatively low, at US$10.0k (US$20.7k on a PPP basis). This reflects the relatively low level of labor productivity. In addition, criminal organizations continue to commit human rights abuses, especially attacks against journalists and human rights activists. The Subfactor Access to Basic Services does not affect the ratings. Mexico has universal healthcare coverage. The overall quality of service is good, although it varies across the country.

Governance

The three governance subfactors affect the ratings assigned. First, the Bribery, Corruption and Political Risks subfactor affects the ratings. According to World Bank Governance Indicators, Mexico ranks in the 21st percentile for Control of Corruption and in the 26th percentile for Rule of Law. Second, Institutional Strength, Governance, and Transparency affects the ratings. According to World Bank Governance Indicators, Mexico ranks in the 44thpercentile for Voice & Accountability and in the 46th percentile for Government Effectiveness. The third subfactor, Peace and Security, also affects the ratings. Elevated levels of violence and criminality weaken the investment climate. Mexico is trying to address violence and criminality issues through reform, but still ranks low (17th percentile) on Political Stability and the Absence of Violence/Terrorism.