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Mexico builds savings

Infrastructure spending will boost growth

BY **NATSUKO WAKI**
Reuters

Analysis

LONDON – Headline growth numbers are no longer enough to attract foreign capital to emerging markets as discriminating investors home in on countries with the most sustainable economic models.

Mexico and the Philippines are among those trying to ensure growth can be maintained long-term by encouraging domestic saving that can be used to fund infrastructure projects.

This transition to a new model is already underway, with equity and bond funds in both countries attracting net inflows in the past six months despite a sharp emerging market sell-off.

The Federal Reserve's plan to withdraw its massive monetary stimulus is dividing emerging markets fortunes, with capital draining rapidly out of countries with large financing needs.

To make themselves less vulnerable to the ebb and flow of foreign short-term money, some countries are beginning to invest in their economies, backed by a more stable financing base.

The Philippines, where remittances from overseas workers provide a steady flow of income, is channeling a pool of domestic money to build airports and roads in a project costing 3 percent of gross domestic product.

Mexico plans to spend almost a third of GDP on improving its infrastructure in the next six years and is among Latin American countries that have reformed their pension systems to encourage workers to save regularly.

That creates a base to finance infrastructure spending, which should boost domestic demand and potential growth.

"In emerging markets, you are no longer trying to find a winner but you're trying to find a survivor," said Salman Ahmed, global fixed income and FX strategist at Lombard Odier Investment Managers.

"We still think Mexico and Philippines are well placed ... Winners of yesterday, Brazil and Turkey, are looking trickier."

According to estimates by Lipper, dedicated Mexico equity and bond funds saw a combined inflows of $3.7 billion in the six months to end-June.

Philippine equity and bond funds attracted a combined net inflows of $2.56 billion.

Mexico's stock market has risen 1.6 percent since May 22, while the broader index MSCIEF has lost nearly 7 percent.

The Philippines' stock market has risen more than 14 percent in 2013 and its sovereign credit rating is on review for an upgrade by Moody's.

The ratings firm has cited stable and favorable government funding conditions and a strengthened government policy mandate among triggers for the rating review.

Latin America is a step ahead in building up an institutional domestic savings base, having reformed its pension systems following the debt crisis of the 1980s.

México, Chile, Perú, and Colombia all have relatively high savings rates of above 20 percent of GDP, according to the World Bank.

Chile is the highest-ranked emerging economy after Singapore and Taiwan in BlackRock's Sovereign Risk Index, which measures credit risk through a broad list of fiscal, financial and institutional metrics.

"It's interesting to know that a considerable number of emerging markets get very high ratings in that index because of domestic finance savings institutions," said Ewen Cameron Watt, BlackRock Investment Institute's chief investment strategist.

"Countries that are tending to find their financing of currencies more resilient are those who have deepened their domestic financial system, usually with the development of the domestic contractual financing and savings industry."

Mexico is beginning to channel domestic savings to building projects via its state pension funds, which have about 1.919 trillion Mexican pesos ($150.76 billion) in assets, representing about 23 percent of private savings.

They hold 1.5 percent of assets in domestic debt specifically labeled as infrastructure.

State funds may be key to its plans to spend $300 billion in the next six years to build highways, rail lines and communications infrastructure, and upgrade the country's ports.

After two decades without a passenger rail service, Mexico has earmarked 95 million pesos for three routes, including a 300-km line across the Yucatan peninsula, home to its famous Cancún beach resort and the ancient Maya pyramids.

The government has also promised to consider a second airport in Mexico City to ease pressure on the current sole hub, which is Latin America's second largest by traffic.

The Philippines government has offered private sector firms contracts to modernize at least five airports in two of its three main regions and will soon take bids for a $814 million toll road contract in two provinces just south of the capital.