Mexico Infrastructure

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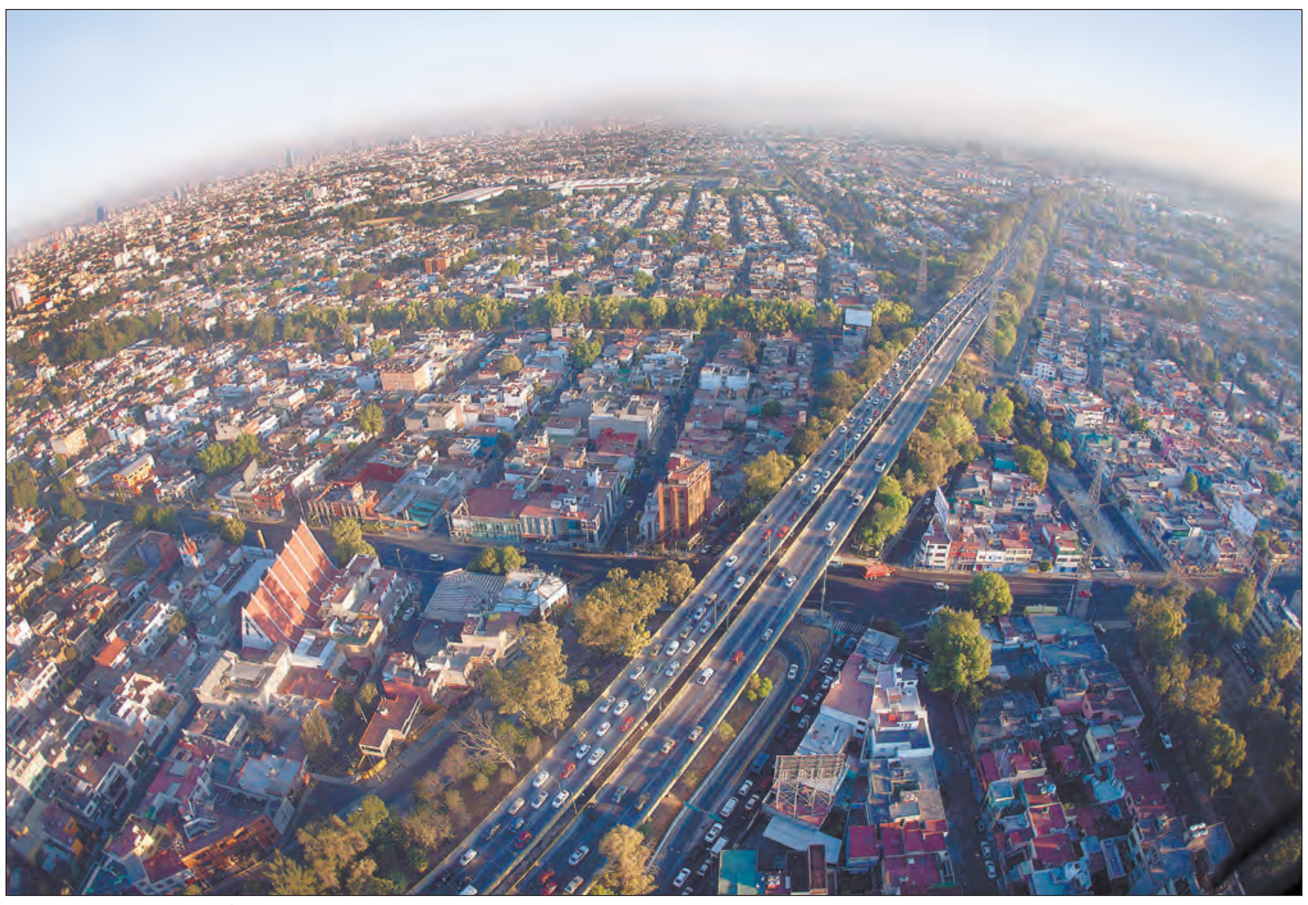
Aztec tiger begins to sharpen its claws

Prudent economic management has built the foundations of a bright future that needs to be secured by investment, writes *Adam Thomson*



Direct route: Mexico City's urban highway, carving its way from north to south, has been the focus of investment Bloomberg

A few years ago, as Mexico reeled from one of the worst recessions in living memory, the future looked grim – if not just plain menacing.

By regional standards, at least, the 2 per cent average annual growth rate in the years preceding the downturn appeared anaemic. Political stalemate in Congress had all but erased any hope of passing economic structural reforms. A violent war on organised crime had some voices in Washington suggesting that Mexico could even be heading down the path towards becoming a failed state.

Fast-forward to today and Mexico is one of the brightest prospects in Latin America. No longer in the shadow of Brazil, where growth has slowed dramatically, the region's second-largest country suddenly appears strong and confident. The economy is likely to expand at more than 3 per cent this year after growing 3.9 per cent in 2012. International investors have rekindled their love for Mexico. Between the start of this year and May 8, the country received a net US$5.6bn in fixed-income and equity flows, three times the amount that went to Brazil. Before June's generalised emerging markets sell-off, this new-found favour helped push Mexican sovereign borrowing costs to record lows, and the stock market to record highs..

"Mexico is in a completely different place from where it was a few years ago," says Gabriel Casillas, chief economist at Banorte, the country's largest domestically owned bank. "We are very optimistic."

So what happened to turn such an gloomy future into the seemingly bright one that Mexico faces today? One reason is the country's reputation for prudent macroeconomic management.

The result is a total government debt of equivalent to about 36 per cent of gross domestic product, which is enviably low by almost any standards.

At the same time, inflation, at over 4 per cent, is above the central bank's target ceiling, but is also under control, with core inflation at less than 3 per cent. "The prudent and responsible handling of fiscal policy has allowed us to eradicate the large and persistent imbalances in the public finances that the country suffered in the past," Agustín Carstens, central bank governor, said recently.

The new administration headed by centrist President Enrique Peña Nieto has this year balanced the budget after a fiscal deficit following the deep recession in 2009.

All of this has helped to expand the middle classes, and the consequent – though insufficient – improvement in the numbers of formal-sector workers, bank accounts and even changes in consumer patterns.

In a sign of the times, the central bank has adjusted its inflation index to give greater weight to items such as cars, domestic employees and even perfume. "What does that tell you?" says Sergio Martin, HSBC's chief economist in Mexico City. "These things are what the middle class spends its money on."

Another factor that explains Mexico's improved fortunes is its competitiveness. By the first half of last year, the country accounted for 14.2 per cent of US manufactured imports, compared with just 11 per cent in 2005.

To keep all of this going, economists agree that Mexico's infrastructure needs work. While government spending on roads, ports and other such vital areas of activity has increased significantly, there is still a long way to go. As Shannon O'Neil, a senior fellow at the Council on Foreign Relations points out in this special report, less than 40 per cent of the country's roads are paved.

Severe bottlenecks remain on the 2,000-mile border that separates the US and Mexico. A trip to the border, with its seemingly interminable lines of cars and lorries waiting to cross into the US, quickly leaves the impression that bilateral trade has

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Inside »

Bottleneck at frontier chokes opportunities to boost trade

Border A lack of checkpoints is seen as a big factor blocking the smooth passage of goods to and from the US, says *John Paul Rathbone*

Trucks stopped: vehicles in line at the Tijuana border Reuters

Borders are always strange places and few are stranger than the US-Mexico border, the busiest in the world.

More than $1bn worth of goods cross it every day. Indeed, last year bilateral US-Mexico trade topped $500bn, about the same as total US-European trade – which puts the vaunted US-EU free trade deal in context.

Not that you would realise the importance of US-Mexican trade in Tijuana, one of the busiest cargo crossing points on the 1,954-mile border. On a recent afternoon, long queues of cars, trucks and pedestrians stretched back into Mexico and its huge *maquiladora*, or assembly, sector that makes the country, among other things, the world's largest producer of flatscreen televisions.

Goods sat. Produce rotted. Flowers wilted. A near-fiesta of street vendors – selling chewing gum, soft drinks and statuettes of the Virgin of Guadalupe – did little to relieve the tedium of waiting in the sun among petrol fumes for up to four hours to cross US immigration. Even members of trusted traveller and shipper programmes such as SENTRI – which allows pre-vetted individuals and companies expedited passage – were waiting hours to cross a border suffering from infrastructure that, on average, is 40 years old.

Eduardo Salcedo, general manager at DJO Global, a California-based prosthetics maker with $1bn of sales a year that has its manufacturing operations in Mexico, is just one Tijuana businessman who rues the difficulty that crossing times have on his business and broader investment.

Like many peers, he complains that the state of the US border – a lack of checkpoints, for one – is a trade bottleneck that represents a growing economic cost to both countries.

"The length of the crossing can make people think twice about investing here. Even our own executives in Vista California sometimes have to wait hours when they visit," he says.

Analysts agree. One California study in 2006 estimated that cargo border waits between Tijuana and San Diego cost the US and Mexico $6bn in lost output a year. A broader 2008 study by the US Department of Commerce estimated that every minute of delay at the border costs the US $100m and more than 500 jobs.

DJO Global's example illustrates how booming bilateral trade can work the other way. The relocation of its manufacturing activities to Mexico several years ago helped save the company from bankruptcy – and thus preserved 2,000 high-end jobs in the US. But more efficient border crossing could create more jobs still.

"Tijuana is a cradle of world manufacturing," says Mr Salcedo. "Every big company has a presence here, one way or another."

The reason why even small border glitches can have large effects is because of the depth of US-Mexican economic integration. Close-knit manufacturing supply chains, and the widespread use of "just in time" inventory management, means that goods often cross the border several times while being produced. This frequent criss-crossing multiplies the effects of gains and losses in border efficiency.

That being so, why has not more money been ploughed into better infrastructure? The US Customs and Border Protection estimates $6bn is required to "fully modernise" land ports of entry along the border. One reason, as the Wilson Centre's Mexico Institute in Washington points out, is because it requires co-ordination between local and federal governments within and between each country. Without "strong and co-ordinated planning, infrastructure investments on one side of the border or in one region can simply feed traffic into a bottleneck in another area," said the 172-page report.

> 'The length of the crossing can make people think twice about investing here'
> **Eduardo Salcedo, DJO Global**

Another reason is a continued US focus on border security over cross-border trade. This can be seen in the gleaming new fences and infrared cameras along the *linea*, as the border is known, and in the quintupling of US Border Patrol staff since the 1990s.

Yet net migration from Mexico to the US has fallen to zero, according to a Pew Research Centre Study last year, and illegal immigrant seizures have tumbled. Last year, San Diego apprehensions were 28,461 versus a peak of 565,581 in 1992. "While it is difficult to predict the future flow of migrants, overall we seem to be at or past a point of diminishing returns in terms of border patrol staffing," the report adds.

Nonetheless, a new US bill that would reform immigration laws has earmarked $6.5bn for enhanced border security. In an era of restricted federal budgets and high US debt, however, there is not a similar provision for enhanced border crossings.

To be sure, poor infrastructure is not a huge problem for all of Mexico's *maquiladoras*.

"We can still import parts that we need in two hours," says Raul Perez, general manager of Zodiac Aerospace, which makes cabin furniture for planes. High energy costs and long shipping times also look set to continue the "re-shoring" of manufacturing to the Americas from China.

"It takes 23 days to ship goods from China versus three hours from Tijuana," said Martin Gutierrez, spokesperson for TPV Technology, a leading manufacturers of flatscreen televisions.

"That is why we are expanding capacity here." Yet if the US and Mexico want yet faster and more efficient economic growth, investing in border infrastructure seems a no-brainer. "The best way for the US to boost growth is to boost trade," says Federico Serrano, president of Tijuana's *maquiladora* association. As things stood, he added, the US was "investing in the wrong place".

Bright shipping forecast follows investment plan

Ports

Programme reflects aim of doubling capacity, writes *Adam Thomson*

When Fidel Castro set sail from Tuxpan bound for Cuba on the 60ft cabin cruiser, Granma, he could never have imagined the port would become an important hub in Mexico's globalised economy.

Today, the Gulf coast city that played such an emblematic role in the start of the Cuban revolution is undergoing a revolution of its own. Thanks to a $1bn investment to modernise and expand facilities, Tuxpan is fast-becoming a meeting point between Mexico and the rest of the world.

"Ports have to be slick entry and exit points, not bottlenecks," says Guillermo Ruiz de Teresa, who oversees port infrastructure at Mexico's transport and telecommunications ministry. "The word we are concentrating on is 'logistics'."

Mr Ruiz de Teresa says that over the next six years, Mexican ports will receive investment of about 50bn pesos ($3.7bn) as the country bids to become one of the most important logistics hubs in the region.

The idea, he says, is to double capacity by the end of the government's term of office in 2018, in order to keep pace with an economy that officials forecast will grow at average annual rates of 6 per cent by that time.

Mexico's 16 federal ports have undergone modernisation. During the past six years, the government and private sector invested about 49.6bn pesos in a near complete overhaul of Mexico's most important shipping hubs on both the Pacific and Gulf coasts.

The government constructed a new industrial complex at the port of Manzanillo, on Mexico's Pacific coast, to handle liquefied natural gas imports that the country's federal electricity commission (CFE) uses for energy generation.

This 4.6bn peso investment, the largest single ports project in about 30 years, aims to provide cheaper energy to the industrial zone that is growing up around Guadalajara, Mexico's second city.

As Francisco Suarez, equity research analyst at HSBC in Mexico City says, "projects like these give you a real structural change. It makes an industry that was already competing effectively even more competitive".

There has also been private investment. In November, for example, APM Terminals, a port operator based in The Hague in the Netherlands, broke ground at Mexico's Lázaro Cárdenas port, where it won the contract to build a facility to handle growing trade on the country's Pacific coast.

The three-stage container terminal project, which the company will construct, operate and maintain, is expected to boost annual throughput capacity at the port by 4.1m 20ft equivalent units (TEU), compared with the port's 2.2m TEU capacity today.

In total, APM Terminals expects to invest $900m. "This new port will increase the country's international trade competitiveness, attract more foreign investment and reduce logistics costs through higher operational efficiency,"

Kim Fejfer, the group's chief executive officer, said after winning the bid. "We simply believe strongly in the Mexico market." Such investment has helped Mexico absorb the growth in shipping, particularly containers. According to the American Association of Port Authorities, a trade association, container shipping handled by Mexican ports jumped to 3.7m TEU in 2010 compared with 2.7m in 2006 and just 1.3m in 2000.

It has also helped Mexico improve its performance in world rankings in terms of port infrastructure.

There are still plenty of problems. One of them is a concentration of port activity in a small number of facilities. Mexico has 117 ports and terminals along its extensive coasts but 67 per cent of maritime trade passes through just 16 of them. Moreover, 96 per cent of all container shipping pass through four.

In part, that is because only a few of Mexico's ports can handle the huge vessels that have become a standard of the international shipping industry. As Mexico's national development plan, a six-year road map of the government's intentions, concludes: "It limits the opportunities for the growth in demand, competitiveness and of diversifying international trade."

> 'Ports have to be slick entry and exit points, not bottlenecks. The word is logistics'

Mr Ruiz de Teresa of the transport ministry admits there are also problems of efficiency. It still takes 12 days on average for a container arriving in a Mexican port to get unloaded from the ship, clear customs and leave the port compared with half that time in the US.

But there is room for optimism. With the government's detailed infrastructure plans due to be published in coming weeks, and with estimates suggesting that spending on infrastructure will climb as high as 5.5 per cent of GDP in the coming years, the chances are high that Mexico's port capacity will rise.

As for efficiency and paperwork, Mr Ruiz de Teresa says that authorities are working on a plan that aims to reduce the time that it takes a container to leave port to six days: "If we manage to do that, as well as double the volume of our ports, then I think we can feel satisfied."

Regulation aims to rein in communication titans

Telecoms

Reforms will open the field to foreign investors, writes *Benedict Mander*

Mexico's most powerful business leaders are poised to battle it out for control of the country's telecoms, as an ambitious reform programme attempts to boost competition in a sector dominated by one of the world's richest men.

As soon as he took office last December, President Enrique Peña Nieto began to push through sweeping changes to the fast-growing sector. The Senate this month voted overwhelmingly in support of laws aimed at lowering charges for consumers and businesses, as well as updating and expanding telecoms infrastructure.

"Infrastructure is the name of the game," says Mony de Swaan, who heads Mexico's telecoms regulator, Cofetel, adding that Mexico's telecoms infrastructure compares very poorly to other countries. Prices were "absurd".

One of the main aims of the reform is to guarantee all Mexicans access to information and telecommunications technology. That includes extending the backbone of the country's telecom network from 20,000km to 50,000km in three years, requiring an investment of around 10bn pesos, so that it can reach 95 per cent of the population.

The reform will strengthen the regulatory framework by introducing what Mr de Swaan described as an "all-powerful" regulator, to be called the federal telecoms institute (Ifetel).

It will be able to classify as "dominant" any company with a market share greater than 50 per cent. Another important goal is to open the field to foreign investors, who will be able to own up to 49 per cent of telecoms companies.

The new regulations have been seen as an attempt to curb the power of Mexico's three "telecom titans", namely Carlos Slim, head of the mobile giant América Móvil, Emilio Azcárraga of the mass media Grupo Televisa, and Ricardo Salinas Pliego of the multimedia conglomerate TV Azteca.

Although the government hopes that increased competition in telecoms will help to boost Mexico's flagging growth, some are worried that they could hit infrastructure investment.

"Regulation can have unintended consequences. Sometimes pushing too hard to maximise consumer benefits penalises the larger players, and can have the effect of discouraging investment by those companies most capable of providing it," said Richard Dineen, a telecoms equity analyst at HSBC. "There is a danger that this process can go too far."

"Despite the reform's potential benefits, it won't be sufficient to boost growth by itself," wrote analysts at Standard & Poor's.

"Carriers must continue investing to improve their telecom infrastructure and service quality. Therefore, a robust financial muscle will also be needed to grow and succeed." Concerns over the likely effect on Mr Slim's América Móvil are reflected in a 20 per cent drop in its share price since February. Its Mexican subsidiaries Telcel, a mobile company, and Telmex, a fixed line company, control 70 and 80 per cent of their markets respectively.

> One of the main aims is to guarantee all Mexicans access to information

Also affected will be Movistar, Spain-based Telefonica's mobile phone operator, which has 22 per cent of market share, and Grupo Iusacell, the third-largest player, with 5 per cent.

Iusacell is half-owned by Grupo Televisa. The other half is owned by Grupo Salinas, which also owns Grupo Televisa. The latter controls about 70 per cent of Mexico's broadcast market. TV Azteca controls the remaining 30 per cent.

But analysts agree that the greatest impact will be felt by América Móvil, which is halfway through a five-year $50bn investment plan to expand broadband, mobile and fixed-line networks. Asked whether there was a risk that new regulations could pose a risk to the investment plan, América Móvil's chief financial officer, Mr Carlos García Moreno, said: "If you're offering greater access and a better service at lower prices, there is no regulator that can be against that."

Mr de Swaan adds: "It could well be that América Móvil's investment falls. That doesn't worry me, since this is about diversifying investment, not concentrating it." He argues that the company's investment is lower in Mexico than in other countries in which it operates.

Even so, there are concerns that Mexico may follow the deregulation of European markets more than a decade ago. This clipped the wings of former state-backed telecom monoliths such as BT, France Télécom and Deutsche Telekom, which still complain about declining prices, revenues and market shares after regulators forced their networks to open up to competition.

Mr de Swaan says Mexico is "only partially" following the European model in its bid to reduce tariffs. He says it will be a hybrid model, adopting aspects of models in use in Asia and Australia. "Anyway, it can't be worse than the Mexican model, which has failed."

The Aztec tiger begins to sharpen its claws

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grown, in spite of the problems, rather than thanks to any concerted effort on the part of authorities to speed things up. The US Customs and Border Protection estimates that $6bn is required to "fully modernise" Mexico's land ports of entry.

Tourism is an industry of obvious potential for Mexico, with its historic sites, benevolent weather and long coastlines. But work has to be done. Decades have passed since Fonatur, the state-run office that plans and develops tourism infrastructure, came up with the successful Cancún development on the Yucatán peninsula. While plans are afoot to diversify offerings to international travellers, experts agree that Mexico should redouble its efforts in the coming years if it truly intends to become a top international destination.

Mexico must overcome other problems if it is to develop into the Aztec tiger that some commentators suggest it can become.

One of the clear threats is the international context, which remains one of the toughest in living memory. For all its attempts to diversify its trading partners, Mexico still relies heavily on US growth for its own economic health. If the US falters, economists agree that Mexico is all but destined to follow.

Then there are the domestic challenges, not least of which is to reduce the violence that has resulted from the war on drugs. In the past six years or so, the country's murder rate has shot up to about 22 per 100,000 from roughly eight per cent in 2006. The near-constant headlines of beheadings, mass kidnappings and massacres have pushed public security to the top of Mexican people's concerns.

As part of a significant policy shift – which involves prioritising a reduction in violence over combating the cartels head-on – Mr Peña Nieto has lobbied for the idea of a gendarmerie to police the worst-affected areas of the country.

On the political front, Mexico looks more promising than it has done for decades. Mr Peña Nieto's Pact for Mexico, a cross-party alliance created in December with the express aim of pushing through an ambitious list of economic and social reforms, has got off to an impressive start. The pact has produced a badly needed education reform, it has agreed this year's budget remarkably quickly, and passed a constitutional reform that stands to curb the powers of the country's biggest private companies in the telecommunications and broadcasting sectors.

Analysts agree that the pact may not prove strong enough to withstand the political pressures that will inevitably emerge as Mr Peña Nieto takes on the biggest reforms of all: energy and tax.

Both are needed urgently: oil production has fallen by about one-quarter since 1994 – a worrying reality, given that oil accounts for about a third of all federal government revenues; non-oil taxes, meanwhile, are a paltry 10 per cent of government revenues – hardly enough to invest sufficiently in everything from social security to bridges, ports, tunnels and border infrastructure.

In Mr Peña Nieto's short time in office, he has shown himself to be what many political analysts consider the most politically skilled president in years, forging alliances when needed and patching up fissures as soon as they have appeared.

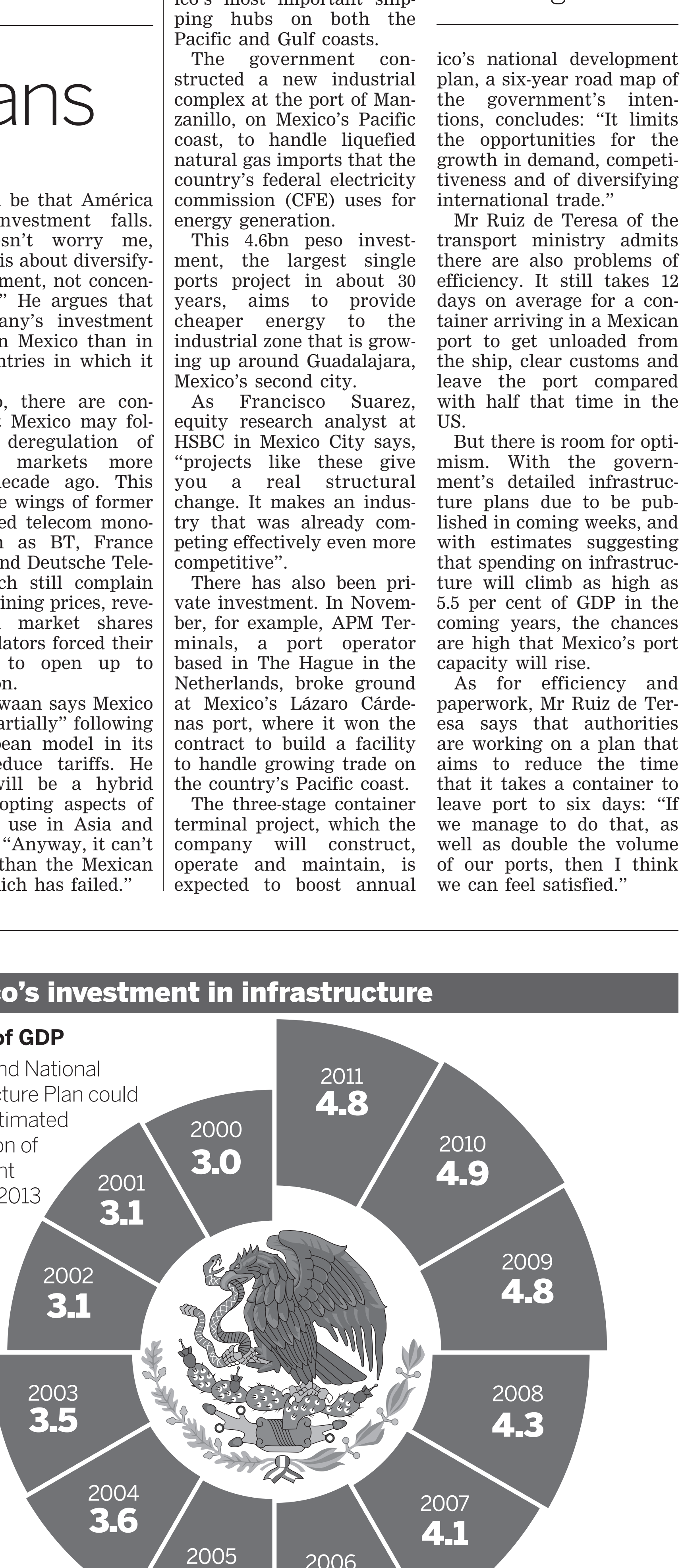
That, combined with economic resurgence, has handed Mexico the best chance in decades to make the leap towards becoming a fully industrialised country.

To do so, the president will need to keep up his impressive record on the political front. Mexico, as a highly open trading nation exposed to a global economy that is still struggling, will also need a dose of good fortune.

Mexico's investment in infrastructure

As a % of GDP

The second National Infrastructure Plan could see an estimated US$400bn of investment between 2013 and 2018



Source: naftamexico.net

Focus on Pemex raises hopes of private investors

Energy

Benedict Mander finds state company stretched to limit

Although some Mexicans celebrated the anniversary of the 1938 nationalisation of their oil and gas this year, there are high hopes that the industry is on the brink of important constitutional reform.

If successful, the reforms will enable an influx of private investment in long-needed projects. This could transform the industry and boost the country's economic competitiveness after decades of meagre investment contributed to the gradual decline of Pemex, the state oil monopoly that was once a source of national pride.

"Pemex's infrastructure is stretched to the limit," says Marcelo Mereles, a partner at Mexico City-based energy consultancy, EnergeA. "There is desperate need for investment," he says, explaining that Pemex has become increasingly inefficient, with debilitating losses and steep production declines.

With the election of Enrique Peña Nieto as president, winds of change have begun to blow. The construction of a $2.4bn gas pipeline that will connect Mexico with the US is under way, representing the country's biggest energy infrastructure investment in 40 years. The Ramones project plan is for it eventually to meet one-fifth of Mexico's demand for natural gas.

With the threat of gas shortages looming, Mexico's electricity commission announced in May that it was importing 18 cargoes of liquefied natural gas from Trafigura, the international trading company, over the next two years at about four times the price of US pipeline imports.

But the Ramones project will allow Mexico to tap cheap gas imports from Texas. This could help meet growing demand in Mexico's industrial heartland in the northeast, especially the booming automotive and aerospace industries.

"We can't have people fighting over gas . . . A big part of our development and growth depends on it," Alejandro Martinez, the director of Pemex's gas subsidiary, said shortly after announcing the start of the bidding process for the construction of the second phase of the pipeline.

The Ramones project, which will stretch 750 miles, has already attracted interest from at least five groups, including companies from the US, China, Russia, India, Brazil, Spain and Italy, according to Mr Martinez.

In addition to funds going to Ramones, he said more than $3.5bn in private investment in pipelines was needed.

"We are more than convinced that integration with the US gas system must be much greater," said Mr Martinez.

Pemex transports about half of its refined products by road with private trucks. This is about 12 times more costly than transport by pipeline and also more dangerous, comments Mr Mereles, a former adviser at Pemex.

Storage infrastructure is in dire need of expansion, he adds, as Pemex has the capacity to store only two days' worth of stocks of gasoline and diesel, which can fall to as little as a few hours' worth at peak times.

> 'We don't know if it's going to change enough for it to be attractive to invest'

Considerable scope exists for investment in Mexican petrochemicals. That said, experts suggest that the country's refining capacity is unlikely to expand in the near future since there is ample to spare in the US.

Perhaps the greatest opportunities are in exploration and production. There is huge promise in the deep waters of the Gulf of Mexico, where more than 40 per cent of Mexico's "possible" oil and gas reserves lie. Also, the country's reserves of shale gas are the fourth largest in the world. There is little to no existing infrastructure in either area.

The development of these reserves is becoming increasingly urgent since Mexico's oil production has fallen from 3.4m barrels a day in 2004 to about 2.5m b/d, in large part because of over-dependence on its massive Cantarell oilfield, which is running dry.

But the ability of foreign oil companies to help reverse this trend will depend on the success of constitutional reform. Mr Peña Nieto has made this a priority, since foreign companies have been prohibited from getting Mexican oil out of the ground since the 1938 nationalisation.

While many see this as Mexico's best chance for energy reform in the past 75 years, it is far from being a done deal. A reform package is expected to be submitted to Congress by September. It remains unclear what it will contain.

"We don't know if it's going to change enough for it to be attractive to invest," says an executive at an international oil company.

Pemex's capital investment in the past decade has quadrupled to almost $25bn, with most of it destined for exploration and production.

That may be a huge amount for one company, but it is not nearly enough for the development of the oil sector of a country the size of Mexico, comment analysts.

Just to start producing in deep waters would require investments of $10bn a year, according to Mr Mereles.

"It's just not possible for Pemex to do this alone. We are going to need hundreds of companies coming in," says one industry insider.

Policy moves put builders in tough position

Homes

A change in priority from low-rise to high-rise fuels worry, says *Adam Thomson*

Higher growth rates and the prospect of economic reform under the new administration had whetted investors' appetite for everything Mexico. Bonds have fallen to record lows while the stock market has hit record highs.

But there was one Mexican investment that they continued to abandon with alarming speed: the country's biggest homebuilders.

Bonds issued by the three companies Homex, Urbi Desarrollos Urbanos and Geo have plunged on average by 55 per cent this year. Having traded as much as 3 per cent above par in January, bonds in Urbi, Mexico's third-biggest homebuilder by sales, are now trading at just 20 cents to the dollar.

All three have defaulted on at least one part of their debt. Homex, Mexico's largest homebuilding company by sales last year, and Urbi have hired investment banks to advise them on debt restructurings.

The change of fortune is all the more puzzling for its speed. Even last year, the groups, which account for about 20 per cent of the country's low-income housing market, entered international capital markets with ease. Investors appeared eager to gain exposure to a sector catering for Mexico's incipient middle classes in a housing market worth about $15bn a year.

But things started to unravel before that. In 2010, and under former president Felipe Calderón, the government began to shift its policy for low-income families from a low-rise model to one based on high-density, high-rise construction as well as the use of existing, inner-city housing.

In particular, Infonavit, the government-backed mortgage lender, last year more than doubled the number of loans it offered for home improvement to 152,771 or 26 per cent of its total new loans in 2012. The agency, which accounts for 70 per cent of all mortgages in Mexico, expects to make 545,000 loans this year. Roughly 145,000 will be for used houses while 90,000 are expected to be for borrowers to make improvements to their own homes.

There were other changes, too. Most important was the fact that location of housing developments before 2008 was not an issue and did not affect homebuilders' and borrowers' ability to access the available pool of subsidies and credit. Today, by contrast, location is a critical factor in accessing finance. In addition, homebuilders now have to compensate for poor location by investing more in infrastructure.

Talking to Marlén Rodríguez, it is easy to understand the government's thinking. Two years ago, Ms Rodríguez and her family took out an eight-year mortgage through Infonavit to buy a 32 sq m house in Urbi's Del Rey development, 70km from Mexico City. "It was our dream to have our own house," she says. "We were very excited."

Today, the reality of living such a distance from the capital, separated by an expensive toll road, has set in. Services are poor, she says, and there is no supermarket in the development. "We want to sell and leave," she says.

For the homebuilders, the shift in the government's priorities, reiterated in February by the present administration, represents a serious challenge. For one thing, they now have large portfolios of land of questionable value.

For another, says Mark David Levy, investor-relations director at Urbi, they have to put up with much higher working capital costs because vertical construction has a much longer build-and-sell cycle than horizontal housing.

"With a low-level home, you can go from zero to have it finished and ready for sale in 30 days," he says. "But with higher-rise housing, you can take between six months and a year. Why? Because you have to build the entire building before you can get the deeds and sell." The result of all this has been a serious cash burn in the sector. Homex's housing business, for example, spent 3bn pesos in 2012, a far cry from the company's guidance of 500m-800m pesos of positive free cash flow. The company's net debt to equity ratio is 122 per cent.

It is a similar story at Geo where the net-debt-to-equity ratio stands at 126 per cent. Urbi bled 3.4bn pesos of cash in 2012, bringing its net debt to 15.6bn pesos.

Yet the sector appears cautiously optimistic. Mr Levy says that negotiations with creditors are "going well" and that a standstill agreement, if creditors accept one, would soon see the company recover.

More broadly, some analysts predict that, overall, sales this year will grow between 10 and 15 per cent. They also point out that the big three only represent up to 20 per cent of the low-income market.

Impressive: the Baluarte bridge, as well as being a feat of engineering, is a vital part of the interoceanic highway, which, when open, is expected to have a big economic impact Reuters

Funding for connections gets a boost

Roads

Spending on highways has increased sharply of late and is destined to keep rising, writes *Adam Thomson*

Here is a question that could earn you a pound or two in a friendly bet: what is the world's highest cable-stayed bridge?

A few years ago, the answer would have been the Millau viaduct in southern France. Today, it is the 403m Baluarte bridge in north western Mexico.

Inaugurated last year, the structure is not only one of the world's most impressive feats of civil engineering – take off the antenna, and the Empire State building could fit comfortably underneath it – but it is also a vital link in Mexico's highway 40, which connects the Gulf of Mexico with the Pacific-coast mega port of Mazatlán.

Once finished, the interoceanic highway, as the 40 is known, will make it possible to drive from Reynosa, on the Gulf, through the key industrial city of Monterrey and on to Mazatlán in about 12 hours.

"It's going to have a huge economic impact," says Francisco Suárez, an analyst at HSBC in Mexico City. "It links productive regions of the country that were cut off from each other before."

In the past six years or so, Mexico has raised spending on road infrastructure as part of a wider plan to become a logistics hub for the region.

Under Felipe Calderón, who served for six years as president until 2012, the country spent 288.6bn ($21.3bn) pesos on the construction and modernisation of roads. This was a 44 per cent increase in spending compared with the previous president's six year term.

The investment resulted in the construction of 748.5km of new roads last year against just 81km in 2007. This was part of the most significant boost in infrastructure investment in recent history, with spending increasing from 3.1 per cent of gross domestic product to 4.6 per cent last year.

Since centrist President Enrique Peña Nieto took office in December last year, Mexico has started to prepare for a second wave.

In roads alone the budget for the next six years will be 36 per cent higher than during the last government, says Raúl Murrieta, undersecretary for infrastructure at the transport and telecommunications ministry. "We think it is one of the most important levers of the economy," he says.

For many experts, that is just as well. Even with all its potential, Mexico, like the rest of Latin America, has considerable room for improvement.

> 'You can no longer talk about roads without ports, railways, clusters'
>
> **Raúl Murrieta, infrastructure undersecretary**

According to the World Economic Forum's Global Competitive Index, the country occupies 50th place in the world in terms of road infrastructure. "Mexico is relatively well ranked," says José Coballasi of Standard & Poor's, the rating agency. "But it is still not up there."

Indeed, there are only 49,100km of federal highways out of the total network of 374,000km. That is significant given that the federal roads form the country's transportation backbone and have the greatest impact on the manufacturing-for-export sector.

Not only that, but there are about 50 per cent more unpaved rural roads than there are federal roads.

So what is the government planning? At least 76 of the 266 pledges that Mr Peña Nieto signed, in front of a public notary during last year's presidential campaign, concern road projects at both the state and federal levels.

Then there is a push to finish the last section of a highway linking Mexico City with the Gulf port of Tuxpan, an increasingly important entry and exit point for grain as well as oil-related services used by Pemex, the state oil company.

Once completed – work is finishing on the San Marcos bridge, just one pillar of which is 225m tall and contains more concrete than the capital's 105,000-capacity Azteca stadium – the highway will cut journey times from six hours to just two-and-a-half hours.

Mr Murrieta says the administration is also planning 80 strategic projects to create "logistics corridors" linking manufacturing centres with markets. He adds that the details are to be published shortly in the government's national infrastructure plan, the blueprint covering the present presidential term to 2018.

"You can no longer talk about roads without ports, railways, clusters," he says.

"It's about creating points of access to dynamise the economy . . . it's about which country can place its products most efficiently in the country where the product is to be consumed."

While more than 80 per cent of the spending on roads will come from the public sector, the idea is to use an increasing amount of public-private partnerships.

Thanks to a law passed last year that defines such partnerships, and provides greater transparency and guarantees, the administration intends to use such partnerships as alternative sources of project finance.

Already, the government is eyeing two projects – the Tuxpan-to-Tampico highway and a first stage of the Cardel-Poza Rica highway – as candidates for public-private partnership. Total investment? An estimated $1bn.

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Investment is vital on the long and potholed path to prosperity

Commentary
SHANNON O'NEIL

Take a trip to see the famed monarch butterfly's winter grounds, one of Mexico's most prized tourist destinations and a Unesco world heritage site, and the desperate straits of Mexican infrastructure come into full view.

The first stretch of the trip from Mexico City to the western state of Michoacán begins smoothly enough. But once you turn off the main highway, the potholes multiply, slowing drivers to a crawl. On reaching the final road to the butterfly sanctuary, only the sturdiest of vehicles can pass, forcing visitors to hire local drivers for the four-mile, 45-minute drive along the narrow dirt road, steering hard lefts and rights to miss the huge potholes and other obstacles along the way. Though just 100 miles from Mexico's capital, it takes nearly four hours to reach the site.

This trip is not an anomaly. According to the World Bank, less than 40 per cent of Mexico's roads are paved, unchanged over the last decade.

Other infrastructure also suffers serious problems. Much of Mexico's 27,000km of rail were laid over a century ago. Ports, airports, and highways have not kept pace with the growing population and economy. As far as basic services are concerned, nearly a third of Mexicans lack adequate sanitation.

The investments necessary to overcome these deficits (an estimated $40bn) have not materialised.

The World Economic Forum's annual competitiveness reports reveal how much Mexico's infrastructure deficit holds the country back. Though ranked 53rd overall in terms of competitiveness, on infrastructure Mexico falls to 68th position. This is better than some peers – most notably Brazil – but lags behind other emerging markets such as China and South Africa.

The differences within Mexico illuminate the importance of quality infrastructure. The southern states of Oaxaca, Chiapas, and Guerrero are much poorer compared with their better connected (via roads, ports, and rails) northern neighbours.

One of the reasons behind the explosion in higher value added manufacturing (including aerospace, automotive and appliance industries) in the country's central states are their relatively robust infrastructure networks.

In the past few years, investment has picked up, reaching nearly 5 per cent of GDP according to the Mexican finance ministry. New and expanded roads, ports, airports, water systems, and electricity infrastructure have helped chip away at the backlog. But after years of under-investment, this is just a start.

Mexico should and could do more. Public debt is a low 35 per cent of GDP (compared with 73 per cent in the US or 88 per cent in the UK).

And Mexico is a darling of the global financial markets – with strong macroeconomic fundamentals, a solid banking system, and a liquid currency – enabling it to borrow at attractive long-term rates.

Mexico also passed its public-private partnership law a year ago that should make it easier for the government and the private sector to finance infrastructure projects together.

Finally, President Enrique Peña Nieto's history suggests a predilection towards infrastructure investment. As former governor of the state of Mexico, he inaugurated hundreds of public works projects over six years.

As president, Mr Peña Nieto has laid out an ambitious economic reform agenda, and made good on many campaign pledges during his first months in office.

Congress has passed reforms in labour, education and telecommunications. It is working on a financial reform. The president has said he will propose both energy and fiscal reforms by the year's end.

As the administration works to transform Mexico's economy, it has also signalled its global direction – hitching itself economically ever more closely to the US by seeking to deepen regional integration and transform North America into a more competitive manufacturing platform.

Infrastructure, as much as any domestic area set for reform, will make or break this vision.

Shannon O'Neil is senior fellow of Latin America studies at the Council on Foreign Relations

Developers extend their reach beyond Cancún

Tourism New resorts are integral to plans for attracting visitors from countries such as Brazil, Russia, India and China, writes *Benedict Mander*

Diversification: Cancún, left, has reached saturation point, while Ixtapa, below, is earmarked for expansion Dreamstime

In 1970, Cancún was little more than a fishing village surrounded by glorious, deserted white-sand beaches. Thanks to Fonatur, which plans and develops infrastructure for Mexico's tourism projects, it has grown into a world-class tourist destination.

But Mexico's holiday hub on the Yucatán peninsula is reaching saturation point, as is the country's other top beach getaway of Los Cabos on the southern tip of the Baja California peninsula. So state-run Fonatur is turning its gaze elsewhere.

"Both in Cancún and Los Cabos we're finishing up. We've got very little merchandise left," says Salvador Romero Dominguez, Fonatur's commercialisation director, who expects the last remaining plots of land in both places to be sold this year.

Now, Fonatur is prioritising destinations such as Loreto, about 300 miles (500km) north up the Baja California peninsula from Los Cabos on the shores of the sheltered Sea of Cortes, and projects in the lusher state of Nayarit, which is further south on Mexico's Pacific coast.

Loreto – the first Spanish settlement in Baja California and founded by Jesuit missionaries in 1697 – already has infrastructure largely in place. In Nayarit, Fonatur is developing the Costa Capomo resort, investing about 300m pesos ($25m) in infrastructure this year, in order to put 290 hectares on sale by January 2014, with capacity for about 4,800 hotel rooms, according to Mr Romero Dominguez.

Fonatur is also concentrating on consolidating existing destinations on the Pacific coast that have been less successful than Cancún. Cases in point include Ixtapa, a resort created by the agency at the same time as Cancún, and Huatulco, about 800km further down the coast, with its series of nearby bays pounded by crashing Pacific rollers.

Over the next year, Fonatur is planning to sell lots in Huatulco that will enable the resort's total of hotel rooms to increase from 4,500 to 6,000 within three years. It will require private investment of about $225m.

This is all part of Mexico's strategy to diversify its tourism industry, not only by expanding the range of destinations beyond the more traditional getaways of Cancún and Los Cabos, but in terms of the countries of origin of its visitors.

"We are betting on diversification," says Rodolfo Lopez-Negrete, the head of Mexico's tourism board. He adds that since the country suffered a big drop in visitors from the US after the financial crisis struck in 2008, the government has aimed to attract tourists from further afield, especially the large and growing markets of the Bric countries, Brazil, Russia, India and China.

"We are trying to evolve from a strategy of few feeder markets and few destinations to multiple feeder markets and multiple destinations," says Mr Lopez-Negrete.

So far, the strategy is working. That is in spite of persisting concerns about safety in Mexico, which has been wracked by a war against drug cartels that has left more than 80,000 dead since the violence began to escalate in 2006. Although grim news stories have dominated headlines, tourist numbers are rising.

"Business is good. There's an appetite for Mexico in every major market we go to," says Mr Lopez-Negrete, who points out that arrivals are increasing from almost all of Mexico's important markets, including a significant rebound in visitor numbers from the US.

He is more excited about the growth in tourists from markets such as Russia, which "continues to explode", with visitors increasing by 78 per cent in the first quarter of this year to over 30,000, compared with less than 3,000 five years ago.

Visitor numbers from countries in Latin America have also been rising fast – arrivals from Peru were up by 57 per cent in the first quarter. Other huge markets such as China so far remain largely untapped owing to a lack of international flights, although a growth of 16 per cent in visitors from South Korea in the first quarter suggests there is considerable Asian interest. "Our biggest challenge is to improve air connectivity from our long-haul markets," says Mr Lopez-Negrete.

The fact that the growing number of tourists visiting Mexico – there were more than 23m arrivals last year – is putting pressure on the government to develop its tourist infrastructure has not escaped the private sector. Both national and international investors are responding to this demand, and they are encouraged by the attitude towards tourism of the new government of Enrique Peña Nieto.

"There is much clearer focus on investment around infrastructure for tourism," says Juan Vela Ruiz, the vice-president of Velas Resorts, a Mexican luxury hotel group based in the Pacific coastal resort of Puerto Vallarta. "The government finally realises that to keep up destinations that have been successful in the past you have to keep investing in infrastructure. That's something that did not happen in the past."

'Our biggest challenge is to improve air connectivity from long-haul markets'

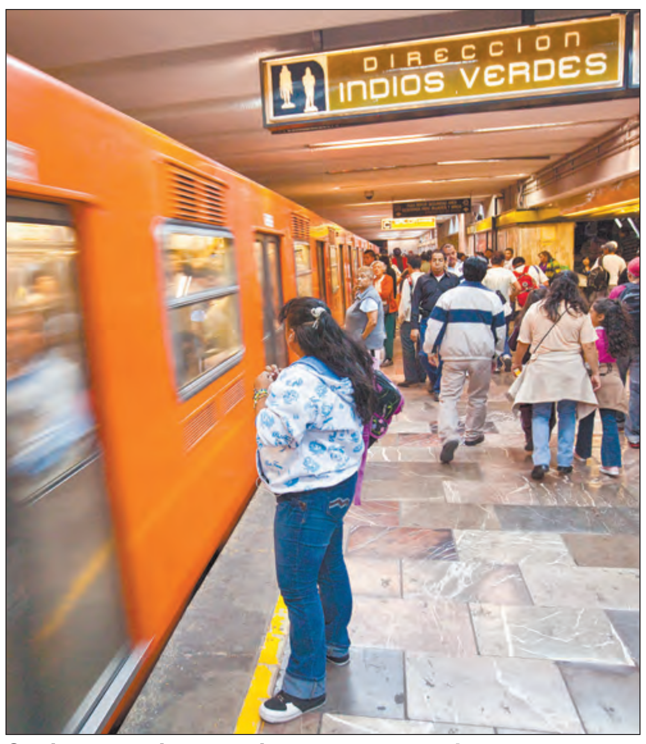
InterContinental Hotels Group (IHG), which opened its first Mexican hotel in Acapulco over 40 years ago and is the country's largest hotel company by hotel count and number of rooms, is continuing to grow. IHG, which hosted US President Barack Obama when he visited Mexico this year, has 121 hotels open in Mexico, with 33 more in the pipeline.

The country's tourism has a "bright future", says Kirk Kinsell, IHG board member and president for the Americas. "We are very confident of the long term growth prospects in Mexico."

Public transport upgrade raises quality of metropolitan lives

Mexico City

Adam Thomson reports on biggest expansion of capital's system since 1969



On the move: the metro has cut commute times Alamy

Angela Molano used to take several buses to zigzag her way from her home in Tláhuac, on Mexico City's rough eastern fringes, to the Eje Central in the downtown area. Depending on the traffic, the journey could take up to two hours.

Today, the 37-year-old, who works in a clothes shop, whips out her electronic metro card and jumps on the number 12 line of the city's expanding metro system to travel the 14 stops to her destination. Her journey time? Just over half an hour.

"It's so quick I can't believe it," she says. "It is not just about the convenience, it also means I can spend more time at home with my children. I feel like I'm living a different life to the one I had before."

Ms Molano and about 400,000 other passengers who, since its inauguration in October last year, now use the number 12 line every day, are benefiting from Mexico City's most significant expansion of public transport since the first metro line was built in 1969.

The line, which is 26km long and cost almost $2bn, extends the network to more than 200km of track with a daily usage in excess of 5m passengers – rivalling the New York City subway. Authorities say the plan is to roll out five more metro lines in the coming years to make a total of 17.

Investing in public transport infrastructure is critical. The city already has about 4m registered private cars. This is thanks largely to a metropolitan-area population in excess of 20m people and also to low interest rates and low inflation, which have made buying a car easier.

That number of cars could grow to as many as 10m in the not distant future unless programmes are put in place today to dissuade people from using them more, experts say.

To improve public transport for those without a car, and to encourage those who do have one to leave it at home, the local government has over the past few years introduced the so-called Metrobus, a system of fuel-efficient bendy buses that traverse the city using dedicated lanes with purpose-built stops on raised platforms.

Fuel-efficient buses have cut CO2 pumped into the city sky by 110,000 tonnes a year

Three more lines have been added to the original north-south line. The latter alone cost the government $62.5m and another five routes are planned during the next six years. Since the first line was opened in 2005, the system, which borrowed from the experiences of countries such as Colombia, Brazil and even South Korea, transports an estimated 800,000 people throughout the city on a typical workday.

In a speech this month, Luis Alberto Rábago Martínez, the city's public works minister, said the local government planned to spend 9bn pesos on the system between now and 2018. That, he said, would add about 100km to the existing network, which is already 95km long.

"All the lines that we build during this six-year administration [of Mexico's current leader, President Enrique Peña Nieto] will be designed using new concepts . . . in which we shape streets for all users, pedestrians, cyclists, motorists and people using public transport, all of them on equal terms," he said.

One important effect of the dedicated bus lanes and the fuel-efficient vehicles using them is a cut in emissions. The capital's local government estimates that the system has reduced the carbon dioxide pumped into the Mexico City sky each year by 110,000 tonnes.

That has helped the authorities to register the project with the UN's Clean Development Mechanism (CDM), the carbon market ushered in by the Kyoto protocol and which allows industrialised nations to offset their carbon emissions by investing in pollution-reduction projects elsewhere.

But with Mexicans' love of private cars, the city government has also invested heavily in expanding the existing road network.

Fly over the nation's capital and one of the most striking new features is a high-rise highway that now stretches from the city's southern fringes to its northern border and into the surrounding state of Mexico.

The southern end of the project, which was constructed by ICA, a local company, is more than 11km long and creates a strategic link between an original length of raised southern highway and the exit to the city of Cuernavaca. In the process, it has raised average speeds of motorists from between 7kmph-23kmph to about 80kmph today.

The $450m urban southern highway, as the new stretch is called, is also the country's first prefabricated overhead highway.

Pret, ICA's construction arm, carried out 60 per cent of the work that went into building the highway – it consists of almost 20,000 prefabricated components – off-site and positioned the concrete pillars and supports at night to keep traffic congestion to a minimum.

Combined, these infrastructure investments are rapidly changing the face of one of the world's largest metropolises, making journey times quicker, raising productivity and improving the city's air quality.

While Mexico City's growing population will pose new problems in the future, the transport changes are for now making a big difference.

VIDEO ON FT.COM

Mexico City's fight to end its over-reliance on the car through public transport innovation
www.ft.com/metropolis