

Mexico transition linker based on the 2026 framework

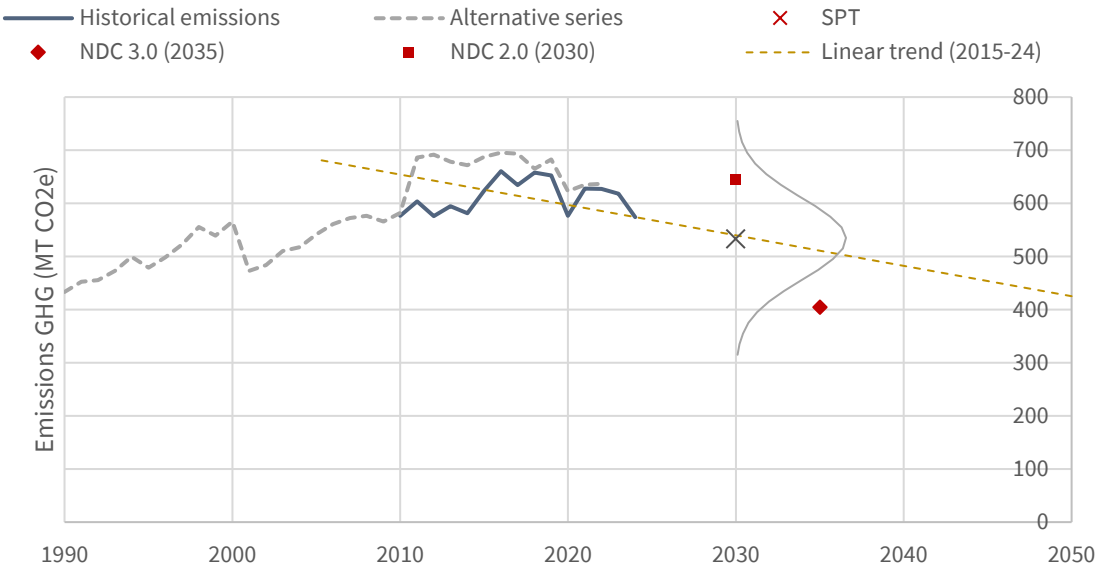
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Our analysis indicates that Mexico's recent performance-linked bond framework enables issuance of transition linked bonds that should price inside the current secondary curve, creating clear cost-of-capital incentives to achieve relatively ambitious short-term decarbonisation targets, and a payoff structure for investors appealing negative correlation features.

Mexico recently released a sustainability-linked framework detailing 7 KPIs to potentially be used in future performance-linked bond issuances.[1] The first KPI is absolute net greenhouse gas emissions, with a target level of 533 $MtCO_2e$ for 2030. Based on this, we propose a transition linked bond, with coupon step-ups and step-downs tied to the emissions reduction target and based on a twin bond structure to the MEX €5.125% 05/2037 (XS2991917613) bond.[2] The target level 533 $MtCO_2e$ is significantly more ambitious than the original 644 $MtCO_2e$ 2030 NDC target,[3] with a meaningful potential cost-of-capital effect for the issuer in a performance-linked structure.

Priced using a statistical analysis for target probabilities, **we estimate a 3bp running premium, 37 cent upfront value of the target and assuming 25bps step-up for missing the target/missing the target by 10% each, as well as 25bps step-down for -5%/-15% outperformance each**.

Figure 1. Mexico GHG emissions 1990-2024, SPT target and 2030/2035 NDCs, and estimated probability distribution for emissions outcome based on statistical analysis. Source: Government of Mexico, UNDP, UNFCCC, AFII.



[1] "Sustainability-Linked Framework Supplement", Mexico's Ministry of Finance and Public Credit, 2026.
[2] Also see "Transition linkers in Latin America", AFII, 1 Oct 2025, for an earlier proposal.
[3] Noting that the 2030 NDC was expressed as a %-age reduction versus Business-As-Usual (BAU) making the interpretation in terms of absolute emissions a matter of subjectivity.

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Transition linkers

A transition linked bond (TLB) is a performance-linked sovereign bond whose coupon adjusts according to a government's progress on its Nationally Determined Contributions (NDC) decarbonisation targets.[4] The instrument aims to optimise fixed income portfolios by lowering investors' exposure to transition risk if a sovereign fails to meet its climate commitments, while simultaneously reducing the cost of capital for governments that deliver stronger climate outcomes. The underlying investment premise is that unsuccessful transitions lead to higher risk and more volatile returns.

Structurally, the transition linker mirrors an inflation-linked bond - a US $5 trillion asset class - where better inflation performance translates into lower coupons. Similarly, successful decarbonisation could result in lower financing costs, aligning incentives between investors and sovereign issuers to support an effective climate transition.

Mexico transition linker calibration

Mexico's historical emissions and targets are illustrated in Figure 1 above. The solid line shows the GHG emissions time series which the framework SPT is based on, and the dotted line the longer historical time series we have used in earlier work. Earlier interpretations of NDC 2.0 language, where Mexico expressed emissions as % versus BAU, saw 644 $MtCO_2e$ emissions in 2030 as the unconditional target, which in turn makes the SPT of 533 $MtCO_2e$ look like an ambitious one. The latest data point in a comparable series show 574 $MtCO_2e$ of emissions in 2024. A recent UNDP opinion on the framework confirms the ambition level.[5]

The explicit SPT is ideal for building a transition linked bond structure, using the SPT as central point for designing step-up and step-down strike levels in terms of emissions and coupon variations. Moreover, Mexico being a frequent issuer in € markets with a batch of maturities across the 2030-2040 part of the curve provides good support in terms of building twin bond formats. We propose a structure based on MEX €5.125% 05/2037 (XS2991917613) bond[6] and with four strike levels and coupon steps of 25 basis points each: two on outperformance, leading to a maximum coupon reduction of 50bps, and two on underperformance, generating a potential coupon increase of up to 50bps. We calibrate the observation and coupon step date to end of 2033, allowing for adjusted coupons in 2034-2037. This structure is represented in Table 1 below.

Some summary points on the pricing:

- The full structure prices at -3bps versus the secondary curve, as the step-ups are estimated to be more likely to happen than the step-downs, thus providing an expected financial advantage to investors.
- The equivalent bond price difference is €0.37 (compared to a bond price of €100).
- The step-downs are valued at -6.2bps versus the step-ups at 9.3bps respectively.

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[4] The original paper "Transition linkers", AFII, 3 Dec 2024, outlines the motivation and pricing theory for TLBs. The Anthropocene Fixed Income Institute have developed TLB proposal for a number of sovereigns: Australia, the UK, France, Japan, Thailand, Chile and Slovenia. Non-technical summaries are provided in "Introducing transition linkers", NordSIP, Dec 2024, and "Asset owners and the transition portfolio allocation problem", Nomura Sustainability Quarterly 2025:2.

[5] See "Non-Binding Opinion of Mexico's Sustainability-Linked Framework Supplement", United Nations Development Programme, March 2026.

[6] We note that there is also a 2036 bond issued in 2026 that could be a good on-the-run candidate for this type of issuance.

Table 1.Transition linker structure for Mexico based on 2030 emissions SPT and the MEX €5.125 05/2037 bond. Pricing based on data from 2 April 2026, with a hypothetical bond pricing date of 10 April 2026. Source: AFII.

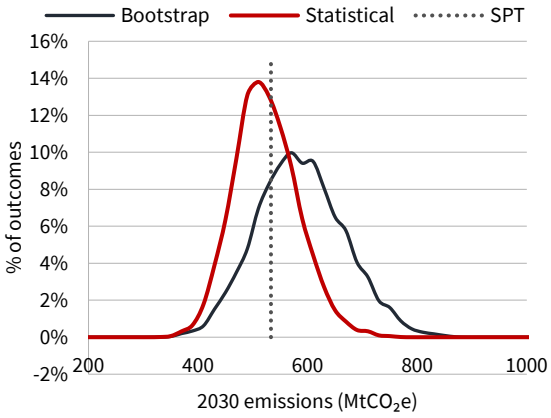
Dual incentive linker	**Emissions outcome**			
	Strong	Outperformance	Underperformance	Adverse
Coupon step	**-0.25%**	**-0.25%**	**0.25%**	**0.25%**
Strike (%) vs target	-15.0%	-5.0%	0.0%	10.0%
Absolute strike MT	453	506	533	586
Implied probability	15.3%	37.1%	50.4%	27.9%
Upfront value	-0.221%	-0.536%	0.728%	0.403%
Running value (bps)	-1.82	-4.40	5.97	3.31

Option values	Down+Up	Down only	Up only
Upfront	0.37%	-0.758%	1.131%
Running value (bps)	3.06	-6.22	9.28

Considering probability valuation methods

Core to the above pricing is the assumption around the distribution of outcomes, i.e. the likelihood that an investor (as well as the issuer) will be facing a certain amount of step-ups or step-downs. Our analysis is based on an interpolation of the emission reduction trend between 2015-2024 and historical volatility. As an alternative, consider Figure 2, where a bootstrapped probability distribution[7] is also shown in dark blue. This distribution indicates a substantially higher likelihood (more mass to the right of the SPT vertical line) of emissions coming in higher than the SPT, or equivalently, a higher likelihood of step-ups. Applying the bootstrapped distribution would suggest a higher value of the transition linked structure above, thus illustrating that there could definitely be a diversity of opinion about the true value for the bond.

Figure 2. Alternative probability distributions for Mexico 2030 emissions vis-à-vis the SPT. The bootstrap distribution is based on a Monte Carlo simulation with 10,000 iterations with draws based on the historical emissions data. Source: AFII.



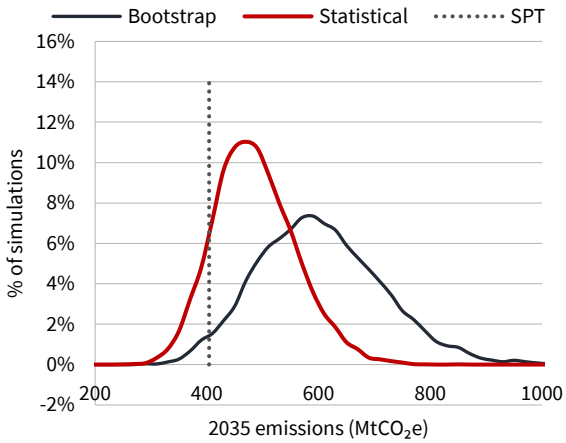
[7] The bootstrap method generates time-series by randomly drawing changes in emissions from the historical time-series and then generate new cumulative emission time-series. By repeating this process (in our case, 10 000 iterations), an probability distribution such as one in the graph can be generated. The bootstrap approach has the advantage of being agnostic on the underlying distribution and thus has capacity to better reflect non-normality such as excess kurtosis and skewness.

A TLB for 2035 targets

As part of the NDC 3.0 process, Mexico has also submitted a 2035 absolute emission target with an upper bound of 404 $MtCO_2e$ (-174 $MtCO_2e$, -30% from 2024). As illustrated by the red diamond in Figure 1 above, this commitment looks substantially more ambitious than the 2030 target. It implies an average annual emissions reduction of 3.14% from the baseline year.

Further quantitative analysis, see Figure 3, where the lion's share of the probability distributions is located to the right of the NDC/SPT level, indicating a high probability that the target will not be achieved. Or equivalently, the target is one that is not easily achieved looking at historical data, but will require substantial efforts/ambition on behalf of the sovereign.

Figure 3. Quantitative probability estimates for Mexico achieving the 2035 NDC of 404 $MtCO_2e$ of GHG emissions. Source: AFII:



For more analysis around a bond structure based on the 2035 NDC target, please contact the AFII team.

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