

2020 Budget: does not help growth, does not build buffers; is a fiscal deterioration

Key takeaways

- 2020 budget lowers the primary deficit target to 0.7% of GDP from 1.3% in the guidelines. We think it overestimates revenues.
- The budget reaffirms our views of low growth and credit rating downgrades in the following months.

Five key points in the 2020 budget

The Ministry of Finance (MoF) presented the 2020 budget to Congress on 8 September. The revenue portion needs to be approved by both houses by 31 October. The spending portion only needs lower house approval by 15 November. We expect little modifications to what the MoF submitted. Here we highlight five key points.

1. **Low growth assumptions, but still overly optimistic:** The MoF estimates GDP growth of 0.9% for 2019 and 2.0% for 2020, both above consensus and our own estimates (BofA 0.5% and 1.0% respectively, Table 1, Table 2).
2. **Lower primary surplus, a fiscal deterioration with respect to guidelines:** The MoF is using [0.5% of GDP from savings](#) (FEIP) to achieve the 1% primary surplus approved in 2019, increasing the overall deficit to 2.7% of GDP (Chart 1). For 2020 the MoF proposes a primary surplus of 0.7% of GDP, almost half of what it had announced in the guidelines (1.3%, pre-criterios). Debt is increasing even under MoF's optimistic assumptions (Chart 2).
3. **Revenues overestimated:** The MoF estimates revenues of 21% of GDP for 2020, lower than the 21.4% of 2019 (Chart 3). But even these low revenues are overestimated, in our view. Noticeable, oil revenues assume a more than 10% increase in oil production, which in our view is unlikely, and uses an oil price (US\$49/bbl) that has not yet been hedged.
4. **Lower expenditure, and low capital expenditures, again:** The MoF estimates expenditure of 23.1% of GDP for 2020, a drop from 23.3% of GDP for 2019, which will not support growth. Even more problematic, capital expenditure continues to be very low at 2.9% of GDP (Chart 4).
5. **Less resources to Pemex than what rating agencies see as needed:** The budget considers a total transfer to Pemex of US\$4.4bn (2.4bn in a capital transfer, the rest in lower taxes). This is below the US\$17bn Moody's estimates Pemex needs and is also below BofAML fundamental analyst's estimates (Anne Milne, US\$14bn).

A budget with no view and with many risks

The 2020 budget is NOT a countercyclical budget aimed to support an [economy that is not growing](#). It is a budget that reduces expenditure (% of GDP). So growth will likely remain low. The 2020 budget is NOT building buffers anticipating further global slowdown given the US-China trade war. It rests on the idea that Mexico will benefit from the trade war. So it increases Mexico's vulnerabilities. The budget has as downside risks lower GDP growth, lower oil production and lower oil prices. The budget is in line with our view that rating agencies will continue to downgrade Mexico and Pemex ratings.

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Timestamp: 09 September 2019 05:54AM EDT

GEM Economics
LatAm | Mexico

Carlos Capistran
Canada and Mexico Economist
BofAS
+1 646 743 2921
carlos.capistran@baml.com

LatAm FI Strategy & Economics
BofAS

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Table 1: Economic outlook 2019

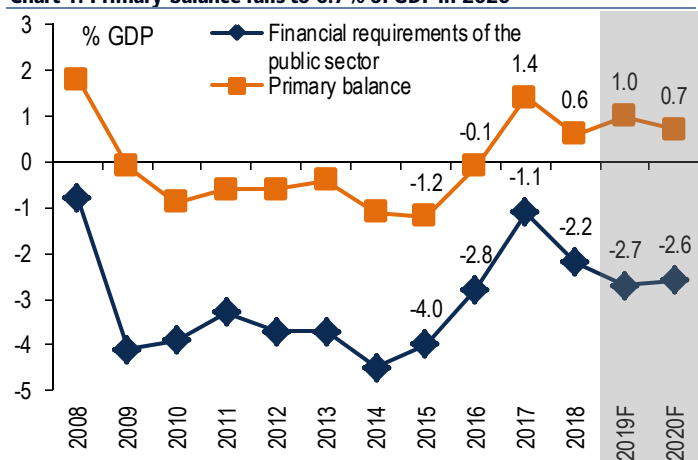
2019 Outlook	2020 Budget (criterios)	BofAML	2020 Guideline (pre-criterios)	Banxico survey (median)	Banxico quarterly report
GDP growth (% avg)	0.6 - 1.2	0.5	1.1 - 2.1	0.5	0.2 - 0.7
CPI inflation (% eop)	3.2	2.9	3.4	3.4	3.0
	7.80 (Cetes 28)				
Overnight interest rate (% eop)	28	7.25	8.00	7.75	--
MXN (eop)	19.8	20.2	19.9	19.8	--
Mexican crude price (\$USD/bbl, avg)	55	59.2	57	--	--
Oil production (mn bpd)	1.73		1.92	--	--
US growth (%)	2.4	2.3	2.8	2.3	--
Fed funds rate (up. bound, eop)	-	1.50	2.4	--	--

Source: BofA Merrill Lynch Global Research estimates, Banxico's survey of professional forecasters (August), Banxico's quarterly report (2Q19), MoF

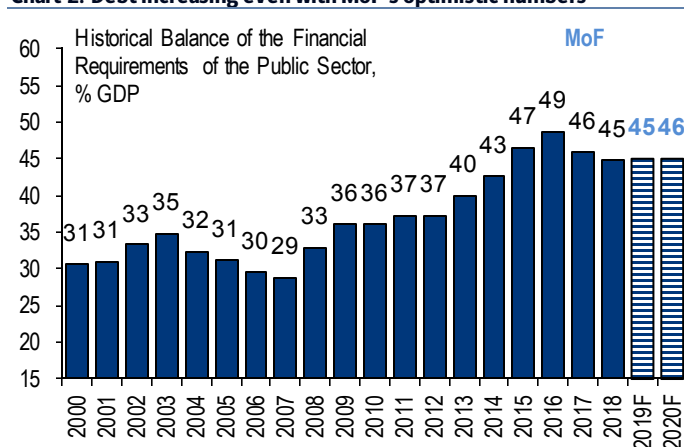
Table 2: Economic outlook 2020

2020 Outlook	2020 Budget (criterios)	BofAML	2020 Guideline (pre-criterios)	Banxico survey (median)	Banxico quarterly report
GDP growth (% avg)	1.5 - 2.5	1.0	1.4 - 2.4	1.4	1.5 - 2.5
CPI inflation (% eop)	3	3.5	3.0	3.6	3.0
Overnight interest rate (% eop)	7.1 (Cetes 28)	7.25	7.6	7.0	--
MXN (eop)	20	20.7	20.1	20.3	--
Mexican crude price (\$USD/bbl, avg)	49	54.6	55	--	--
Oil production (mn bpd)	1.95		1.92	--	--
US growth (%)	1.8	1.5	1.9	1.85	--
Fed funds rate (up. bound, eop)	-	1.50	2.3	--	--

Source: BofA Merrill Lynch Global Research estimates, Banxico's survey of professional forecasters (August), Banxico's quarterly report (2Q19), MoF

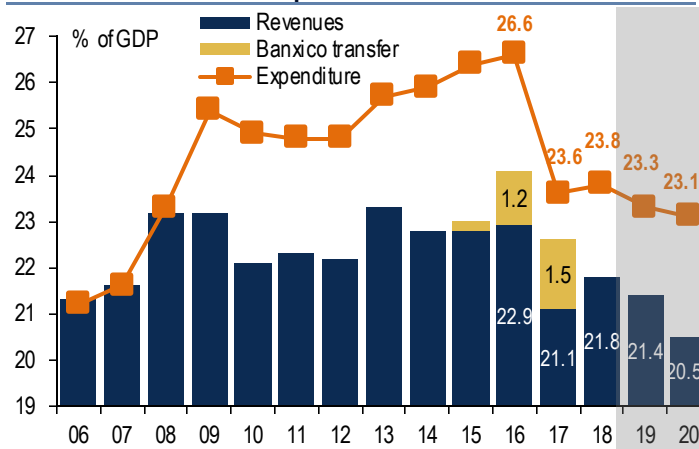
Chart 1: Primary balance falls to 0.7% of GDP in 2020


Source: BofA Merrill Lynch Global Research estimates, MoF

Chart 2: Debt increasing even with MoF's optimistic numbers


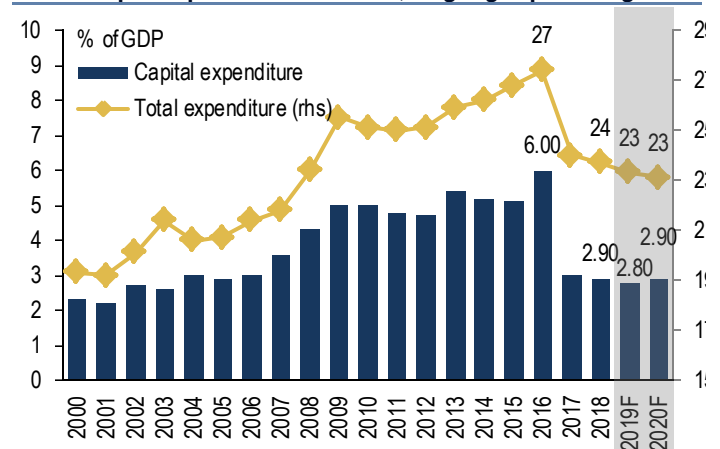
Source: BofA Merrill Lynch Global Research estimates, MoF

Chart 3: Both revenues and expenditure continue to fall



Source: BofA Merrill Lynch Global Research estimates, MoF

Chart 4: Capital expenditure remains low, weighing on potential growth



Source: BofA Merrill Lynch Global Research estimates, MoF

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