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## Mexico

# 2020 public budget proposal – Still conservative, Pemex risks persist

**The budget proposal for 2020 suggests that the government approach of adjusting the fiscal accounts with expenditure control has its limitations. The lower primary balance for 2020 would imply that the 2019 objective was too aggressive under the current economic circumstances of low growth, low oil production and no tax changes. In terms of Pemex, we believe the budget proposal is still too optimistic on production and showing very little change on investment, suggesting a persistence of risks on that front. We do not expect rating actions this year as net public debt will remain stable around 46% of GDP.**

**The 2020 fiscal goal is reduced to 0.7% of GDP from 1.3% in the April proposal.** Yesterday, the government submitted its proposal for the 2020 budget. The macroeconomic assumptions are relatively conservative and it does not consider major changes to the tax regime. It proposes a primary balance of 0.7% of GDP – in line with expectations – from the 1.0% of GDP this year but lower than the initial proposal (1.3% of GDP). The projections for this year make clear that the government will likely use the stabilization funds to meet the fiscal goal of 1.0% of GDP as the Public Sector Borrowing Requirements estimation for 2019 increase to -2.7% of GDP from -2.5%, the broadest fiscal measures that consider the net change in government assets.

**The weakest assumption is oil production, which is rather optimistic**: 1.9mn barrels from the 1.6mn barrels per day produced today. The potential loss in revenues if oil production does not meet this goal is $5bn or 0.30% of GDP. On the other hand, the price assumption is conservative (USD 49 per barrel) and the policy guidelines suggest that there is a hedge in the price of oil. Any excess of revenue from higher oil prices will be allocated to Pemex. The rest of revenues are estimated showing very little change, as tax revenues only are expected to increase to 13.3% of GDP from 13.1% in 2019.

**Expenditures are being cut by 0.2 percentage points of GDP at 16.6% from 16.8% estimated for 2019 with no additional support to Pemex.** Fixed public spending falls 5.4% y/y and Pemex investment only improves to $14bn from $13bn previously. The support of the government continues to be limited by construction, since oil revenues are kept constant and investment does not increase substantially. In addition, the budget includes a tax reduction to PEMEX DUC rate to 54% from 65% previously. This is not new but it makes the change permanent in the law. Finally, if the fiscal goal remains at 0.7% of GDP over the next few years, with an average annual GDP growth of 2.0% over 2021-24, gross debt should decline.

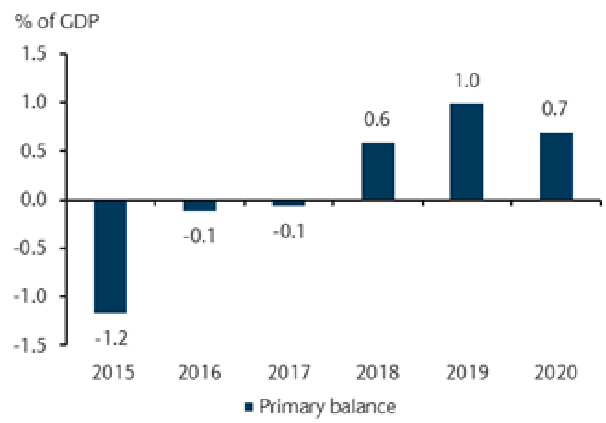
**This is a confirmation that the Lopez Obrador Administration will remain conservative on the fiscal front but limitations are clear.** The budget confirms that fiscal orthodoxy is a priority for this government, however, as we mentioned, the current approach has its limitations given the low growth environment. The lack of public investment is likely to continue taking a toll on growth, making the adjustment unsustainable and a fiscal reform could be discussed next year. Also, since there are no major changes in the level of support to Pemex from the government, the risks of rating action on Pemex is still high; however, we do not expect a change in the sovereign rating this year, since at the end, public debt might continue to remain stable even under a low growth environment. Congress could approve the revenues law by October 31 (Lower House and Senate) and the Lower House should vote on expenditures by November 15. We do not expect major changes in Congress.

**Macroeconomic parameters**

| Macroeconomic parameters | 2019 | 2020 |
|---|---|---|
| GDP growth (% y/y) | 0.9 | 2.0 |
| Oil price (USD per barrel) | 55 | 49 |
| Oil production (mbd) | 1,727 | 1,951 |
| Oil exports (mbd) | 1,115 | 1,134 |
| FX (average - MXN per USD) | 19.80 | 20.00 |
| Nominal rates (%) | 7.8 | 7.1 |

Source: SHCP, Barclays Research

**Fiscal consolidation would continue**



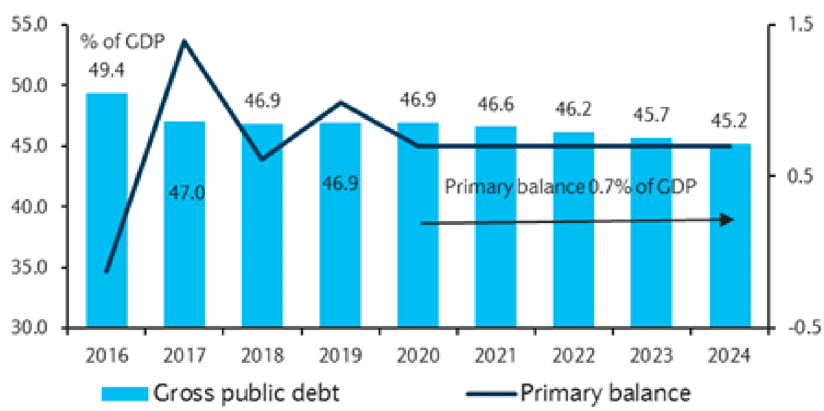

Source: SHCP, Barclays Research

**Fiscal projections do not show much change with respect to 2019**

| Public Revenues (% of GDP) | 2018 | 2019E | 2020B | Difference |
|---|---|---|---|---|
| **Total revenues** | **21.2** | **21.4** | 21.0 | -0.4 |
| Oil revenues | 4.1 | 3.7 | 3.8 | 0.1 |
| Tax revenues | 13.1 | 13.1 | 13.3 | 0.2 |
| Non tax non oil | 0.7 | 1.3 | 0.6 | -0.7 |
| Public entities other than Pemex | 3.3 | 3.3 | 3.3 | 0.0 |
| **Total expenditure** | **23.8** | **23.3** | **23.1** | -0.2 |
| Programmable | 17.3 | 16.8 | 16.6 | -0.2 |
| Public investment | 2.6 | 2.6 | 2.6 | 0.0 |
| *Investment in Pemex* | 0.8 | 1.1 | 1.1 | 0.0 |
| Financial cost | 2.6 | 2.9 | 2.9 | 0.0 |

Source: SHCP, Barclays Research

**If the primary balance stays at 0.7% of GDP, gross debt should decline over time**




Source: Barclays Research

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