2023 Preliminary Budget Criteria – Fiscal outlook still favorable despite relevant changes

April 4, 2022

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- **Last Friday, the Ministry of Finance (MoF) published their preliminary macroeconomic forecasts for 2023 and updates for the 2022 framework**
- **We highlight the downward revision to 2022's GDP, from 4.1% to 3.4% y/y, still above consensus, impacted by shocks related to the pandemic and the geopolitical conflict in Ukraine**
- **The price of the Mexican oil mix was modified upwards (92.9 US$/bbl), with a marginal adjustment in production (1,820kbpd). According to the MoF, higher revenues will allow the implementation of the program to subsidize fuels**
- **In addition, other variables were changed, including the exchange rate (USD/MXN 20.70), interest rate (7.8%) and inflation (5.5%). Thus, they expect both higher revenues –oil, with non-oil revenues falling– and an expansion in expenditures**
- **The estimate of the *Public Sector Borrowing Requirements* (PSBR) deficit for the end of the year would increase to 3.7% of GDP (previous: 3.5%), although with the Historical Balance of the PSBR (HBPSBR) lower, reaching 49.6% of GDP (previous: 51.0%). For 2023, these same variables would stand at 3.3% and 49.6% of GDP, in the same order**
- **The document reaffirms the commitment to maintain healthy public finances, fostering macroeconomic stability in a very uncertain environment**

Lower growth, with higher oil prices. The Ministry of Finance (MoF) published the *2023 Preliminary Economic Policy Criteria* (PCGPE in Spanish), and an update of its macroeconomic framework for 2022. This complies with Article 42 of the *Federal Budget and Fiscal Responsibility Law*. We highlight the downward revision in the GDP growth forecast for 2022, to 3.4% (previous: 4.1%), although with a strong upward adjustment in oil prices. The latter would support this type of income but will also require higher fiscal stimulus for fuels. This, along other adjustments, results in both higher income and expenditures, with a wider deficit (see table below).

Macroeconomic framework and fiscal variables[1]
Selection

2022	GDP 3.4% (Previous: 4.1%)	USD/MXN: 20.70 (Previous: 20.40)	Crude oil price: US$/bbl 92.9 (Previous: 55.1)	Public deficit*: 3.7% (Previous: 3.5%)	Public debt**: 49.6% (Previous: 51.0%)	Primary balance 0.0% (Previous: -0.3%)
2023	GDP 3.5% (Previous: 3.4%)	USD/MXN: 20.90 (Previous: 20.60)	Crude oil price: US$/bbl 61.1 (Previous: 60.2)	Public deficit*: 3.3% (Previous: 3.2%)	Public debt**: 49.6% (Previous: 51.0%)	Primary balance 0.4% (Previous: 0.3%)

Source: MoF
1. GDP: Real annual growth rate; Nominal exchange rate at the end of the year; Public deficit, public debt y and primary balance as a percentage of GDP. *Public Sector Borrowing Requirements (PSBR). **Historical Balance of Public Sector Borrowing Requirements (HBPSBR)

Less economic dynamism amid external and domestic challenges. The MoF adjusted the growth forecast for 2022 from 4.1% (range: 3.6% to 4.6%) to 3.4% (range: 1.4% to 3.4%). In the document, they mention that the review responds to the persistent impact of the pandemic on supply and demand conditions (alluding to the effects on supply chains and the lack of a recovery in some sector within services), as well as the escalation in the conflict between Russia and Ukraine. We believe this comes on top of less global dynamism (captured in lower growth expectations for the US) and other local challenges (greater inflationary pressures). Despite the downward adjustment, the number is still more optimistic than expected by the market –with the latest Banxico survey putting consensus at 1.8%– and even international organizations such as the IMF (2.8%). In this regard, they argue that they see further relief of supply problems in 2H22, with greater control of the pandemic and a positive base effect after an adverse shock in the previous year. For 2023, the MoF anticipates a 3.5% expansion (range: 2.5% to 3.5%), improving on the previous estimate of 3.4%. This is also above consensus, noting that they assume a favorable impact of public sector investment on top of positive signs on this front from the private sector.

Macroeconomic framework 2022 and 2023

	2022			2023		
	Current	Previous	Banxico survey	Current	Previous	Banxico survey
GDP (% y/y)*	3.4	4.1	1.8	3.5	3.4	2.0
Exchange rate (USD/MXN, year-end)	20.70	20.40	21.31	20.90	20.60	21.67
Inflation (% y/y, year-end)	5.50	3.4	5.80	3.30	3.0	4.00
Interest rate (%, year-end)	7.80	5.3	8.00	8.00	5.3	8.25
Oil price (US$/bbl)	92.9	55.1	--	61.1	60.2	--
Oil production (kbpd)	1,820	1,826	--	1,851	1,905	--
GDP US (% y/y)	3.6	4.5	3.3	3.0	2.1	2.4

Source: MoF, Banxico and Banorte *MoF publishes an interval: 2022: Current: (1.4% - 3.4%); Previous: (3.6% - 4.6%). 2023: Current: (2.5% - 3.5%); Previous: (2.9% - 3.9%)

Oil-sector estimates mostly higher, triggering adjustments in both revenues and expenses. In line with the most recent market performance, the MoF adjusted higher its forecast for the Mexican oil mix from 55.1 US$/bbl to 92.9 US$/bbl. In our view, this is reasonable considering recent shocks and the year-to-date average of 90.3 US$/bbl. For 2023, the forecast was lowered to 61.1 US$/bbl (previous: 60.2), consistent with the backwardation structure in commodity futures. The adjustment in output for this year was marginal, down 6kbpd to 1,820kbpd. To put this figure in context, average production so far this year (through February) according to the National Hydrocarbons Commission (CNH in Spanish) is 1,643kbpd. In addition, one of the key aspects to consider is the deployment of subsidies to fuel excise taxes in order to smooth price adjustments, resulting in lower revenues for this category. This is important given that, since March 5th, not only a 100% subsidy to excise taxes was introduced, but also an additional mechanism was established to provide outright stimulus to reduce prices. Although there wasn't much detail considering the large degree of uncertainty these estimations entail, they mentioned in the text that higher revenues should offset for this. This is due to the additional income that would be obtained by both Pemex and the government.

Meanwhile, they elaborated on the first capitalization effort of $45.4 billion to Pemex for amortizations payments. Finally, they anticipate production in 2023 at a lower level, at 1,851kbpd (previous: 1,905).

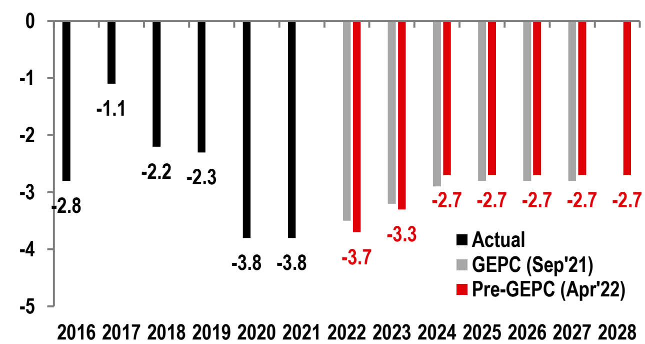
Relatively stable MXN, with higher inflation and interest rates. The estimate for the exchange rate by year-end was adjusted marginally, to USD/MXN 20.70 from 20.40. Its implications are mostly positive, considering that higher oil revenues when expressed in local currency more than offsets higher financial costs in foreign debt. Using MoF estimates, the net effect on the public balance is +0.3% of GDP (~$867.5 million). At the margin, they mention that, despite high volatility, fundamentals would manage to maintain strength in this variable. Meanwhile, for 2023 it was adjusted to USD/MXN 20.90 (previous: 20.60). In our opinion, these forecasts appear conservative relative to market expectations. Regarding inflation, the MoF expects higher levels than in the previous estimate for both years. As usual, they used the path anticipated by the central bank. Therefore, the level at the end of 2022 would be 5.5%, with 2023 at 3.3%. We must remember that this has an adverse impact on financial costs for debt issued in real terms. Lastly, and in line with expectations, they anticipate a higher interest rate, with the Cetes 28 forecast at 7.8% by the end of the year. This is lower than the tightening expected by both the market and us, especially given adverse conditions for prices and the current financial environment. By 2023, it would increase to 8.0%. While we could have seen much stronger adjustments, overall, we view the changes as prudent and trending towards market expectations.

Higher revenues and expenditures in 2022. Considering adjustments to the previous variables, the MoF now expects revenues of $6.5 trillion in 2022, equivalent to 22.5% of GDP. This represents 0.5%-pts more to what was approved in the Revenue Law. The net positive effect (+$328.8 trillion) comes from adjustments to oil variables, with an estimated reduction in non-oil variables of $206.8 trillion (-1.2%-pts of GDP). This is due to: (1) The downward adjustment in expected GDP growth; and (2) less fuel excise tax collection on efforts to smooth price changes. This would happen despite efforts to reduce tax evasion. On spending, the total amounts to $7.4 trillion (25.5% of GDP), which represents $336.3 billion more relative to the Spending Budget (+0.5%-pts of GDP). Out of these, $224.8 billion will go to programmable spending. In non-programmable, there is an increase of $13.6 billion in participations –federal transfers to states–, on top of +$77.9 billion in financial costs due to adjustments in the financial variables detailed above.

Marginal moderation in revenues and spending for 2023. The document considers total revenues of $6.7 trillion next year, which represents a setback of 0.2% y/y in real terms compared to updated figures for 2022. Oil revenues would fall sharply on lower prices (-25.4%), while non-oil income would increase 8.2%, mainly because of taxes (+11.0%). Meanwhile, spending would reach $7.6 trillion, which translates into -0.6% y/y in real terms. Here, programmable spending would decline 3.7%, with non-programmable higher at 8.0%. Within the latter, participations are expected at +4.8%, and financial costs at +11.0%.

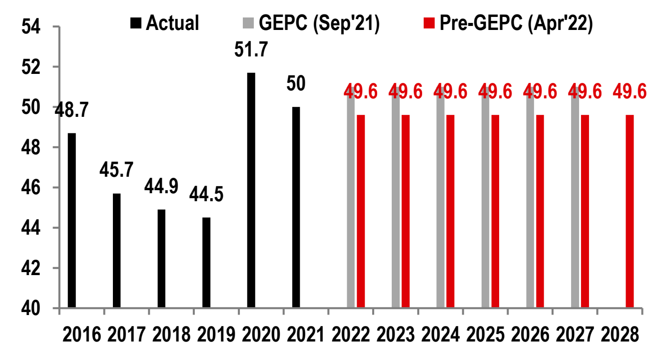
Mixed adjustments on fiscal aggregates and total debt. It should be noted that, with the changes to revenues and expenditures in 2022, the total amount of *Public Sector Financial Requirements* (PSBR) –the broadest measure of the public balance– incorporates a wider deficit of $1,074.6 billion ($78.1 billion more than anticipated). The latter, along a more modest view on economic growth, yields a forecast of -3.7% of GDP (previous: -3.5%; see chart below on the left). Meanwhile, for 2023 it was revised moderately, to -3.3% of GDP (previous: -3.2%). Regarding debt, the *Historical Balance of Public Sector Borrowing Requirements* (HBPSBR) would stand at 49.6% of GDP at the end of the current year. This represents an improvement over the previous estimate of 51.0%, mainly explained by a lower starting point in 2021, with debt at 50.0%. For 2023 and the rest of the forecast horizon, debt levels would remain stable (graph below, right), in line with the provisions of the *Fiscal Responsibility Law*.

Public balance*
% GDP



Source: PGEPC 2022, MoF.
*Measured by the Public Sector Borrowing Requirements

Public debt*
% of GDP



Source: PGEPC 2023, MoF
*Measured with the Historical Balance of the Public Sector Borrowing Requirements

Relevant comments within the conference call and dates to watch ahead. The call was carried out by MoF Chief Economist, Rodrigo Mariscal Paredes. Regarding estimates, they expect a faster reactivation of activity to have a favorable impact on consumption, although acknowledging a more complex backdrop globally. Specifically, their annual GDP path for the year (in annual terms) is as follows: 1Q22: 1.7%; 2Q22: 2.9%; 3Q22: 4.8%; and 4Q22: 4.0%. On the impact of additional stimulus to excise taxes on fuels, he mentioned that there is uncertainty about the total cost given price volatility. At the margin, current estimates consider excise tax collections would reach very close to zero (although positive remembering that they already had revenues for this concept in 1Q22). He mentioned there is a breakeven point in which the government could lose by granting this stimulus. For example, if the price of the Mexican oil mix reached 115 US$/bbl, the loss for the federal government could be 1.5% of GDP, although with gains for Pemex. Going forward, and as required by law, the 2022 Budget Proposal should be delivered to the Lower House no later than September 8th, which includes: (1) The *General Economic Policy Criteria* –which states the macroeconomic projections used to estimate the budget–; (2) the *Revenue Law*; and (3) the *Spending Budget*. In the first two cases, they must be approved by both the Lower House (October 20th) and the Senate (October 31st), while the spending budget should be approved only by the Lower House no later than November 15th (see table below).

Main deadlines for FY2023 Fiscal Budget

Deadline	Document
April 1	Preliminary Fiscal Year 2023 Economic Assumptions
September 8	2023 Budget Proposal
October 20	Lower House approval of the Revenue Law
October 31	Senate approval of the Revenue Law
November 15	Lower House approval of the *Spending Budget*

Source: Ministry of Finance

The commitment to fiscal prudence is maintained. In our view, the document reinforces the strategy of maintaining healthy public finances, supporting macroeconomic stability in a very challenging global backdrop and with strong risks from several fronts. Overall, we consider forecast adjustments as adequate, although with some optimism on GDP growth. Nevertheless, and as on previous occasions, we believe the government will react with spending cuts to maintain a balanced budget in case of revenue shortfalls. In that sense, we expect the credit rating to remain in 'investment grade' in the horizon, considering continuing efforts to maintain favorable balances and to strengthen Pemex's financial position. Lastly, we reaffirm that actions that provide further certainty about the investment climate would be very positive. This would be especially helpful in a backdrop in which doubts and unhappiness about globalization trends has been on the rise. However, businesses continue to look for more competitive conditions and the minimum degree of uncertainty to satisfy their clients' demands. In addition, it would help to consolidate Mexico's position in the mind of both domestic and foreign participants, possibly providing and additional boost to potential GDP through productivity growth which would be reflected in an improvement of general conditions for the population.

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We, Alejandro Padilla Santana, Juan Carlos Alderete Macal, Alejandro Cervantes Llamas, Manuel Jiménez Zaldívar, Marissa Garza Ostos, Francisco José Flores Serrano, Katia Celina Goya Ostos, José Luis García Casales, Yazmín Selene Pérez Enríquez, José Itzamna Espitia Hernández, Carlos Hernández García, David Alejandro Arenas Sánchez. Paola Soto Leal, Víctor Hugo Cortes Castro, Hugo Armando Gómez Solís, Daniela Olea Suárez, Miguel Alejandro Calvo Domínguez, Luis Leopoldo López Salinas, Leslie Thalía Orozco Vélez, Gerardo Daniel Valle Trujillo and Isaías Rodríguez Sobrino, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

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