

Fiscal Budget 2018 preliminary assumptions – Credible commitment to achieve fiscal targets beyond 2017

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- The Ministry of Finance (MoF) submitted to Congress its updated assumptions for fiscal year 2017 and the preliminary ones for 2018 budget
- For 2017, the MoF now expects economic growth between 1.3% and 2.3% (vs. 2%-3% previously)
- They still expect Public Sector Borrowing Requirements (PSBR) at 2.9% of GDP, along with a primary surplus of 0.5% of GDP by year-end 2017
- With this number, the Historical Balance of Public Sector Borrowing Requirements (HBPSBR) will represent 49.5% of GDP this year
- We highlight that the MoF expect these targets to be met in 2017 even without taking into account recent transfer coming from Banxico's operational surplus (BOS) amounting to MXN\$535.3bn (≈US\$28.5bn)
- For 2018, they expect a primary surplus and a fiscal balance equivalent to 0.5% and 2% of GDP, respectively
- This would imply a 1.2% reduction in programmable spending
- Moreover, the government expects the price of the Mexican oil mix oil in the area of US\$46 per barrel; along with an increase of the production platform from 1,947mbpd to 2,006mbpd in 2018
- In terms of economic growth, the MoF is forecasting an economic expansion in the range of 2% - 3% and a USD/MXN19.1 average exchange rate in 2018
- In our opinion, MoF assumptions are yet another evidence of the government's commitment to sound fiscal accounts

Government updates assumptions for 2017 and presents 2018 guidelines for budget. The Ministry of Finance (MoF) submitted to Congress, according to Article 42 of the *Federal Budget and Fiscal Responsibility Law*, the document denominated *Fiscal year 2017 economic assumptions*. The document updates the economic criteria for 2017 and incorporates the fiscal and macroeconomic assumptions for 2018.

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Commitment with sound fiscal policy. In this context, the MoF now expects economic growth between 1.3% and 2.3% (vs. 2%-3% previously). Despite lower growth, they still expect PSBR equivalent to 2.9% of GDP, along with a primary surplus of 0.5% of GDP and a public deficit of 2.4% of GDP. With this number, HBPSBR will represent 49.5% of GDP. We highlight that the MoF expect these targets to be met in 2017 even without taking into account recent transfer coming from Banxico's operating remnant (BOR) amounting to MXN\$535.3bn (\approx US\$28.5bn), as shown in the table below. Moreover, the MoF also updated their estimations for inflation (4.9% from 3%); the exchange rate (USD/MXN19.0 for year-end from USD/MXN18.2 previously); and nominal interest rates (7% from 5.3%). We highlight that these targets will be met in 2017 even without taking into account recent transfer coming from Banxico's operating remnant (BOR) amounting to MXN\$535.3bn (\approx US\$28.5bn).

Ministry of Finance public debt forecasts: 2017

| | Approved | Estimates | |
|---|----------|-------------|----------|
| | | Without BOS | With BOS |
| 1. Public Sector Borrowing Requirements | -2.9 | -2.9 | -1.4 |
| 2. Fiscal deficit | -2.4 | -2.4 | -1.3 |
| 3. Without PEMEX investment | 0.1 | 0.1 | 1.1 |
| 4. Primary balance | 0.4 | 0.5 | 1.6 |
| 5. Historical Balance of the Public Sector Borrowing Requirements | 50.2 | 49.5 | 48.0 |

Source: Ministry of Finance

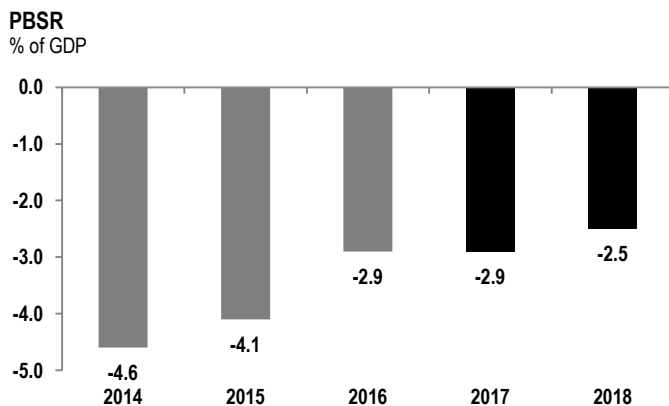
Preliminary assumptions for next year. Economic growth is expected to be in the range between 2-3%, with the price of the Mexican mix of oil at around US\$46/BBL and an output platform of 2,006 thousand barrels per day. With these numbers, they expect a primary surplus and a fiscal balance equivalent to 0.5% and 2% of GDP, respectively. PSBR will be equivalent to 2.5%, while HBPSBR will edge down to 49.2% of GDP from 49.5% expected in 2017. To achieve these targets, the government has to cut programmable spending in MXN43.8bn (\sim 0.2% of GDP) with respect to the budget approved for 2017. Nevertheless, non-programmable spending –which includes transfers to states and financial costs-, will increase 8.3% y/y in real terms as a result of an increase of 11% of central government's financial costs, along with a 41.6% increase in the debt from previous fiscal years (ADEFAS).

Ministry of Finance economy overview 2017 – 2018

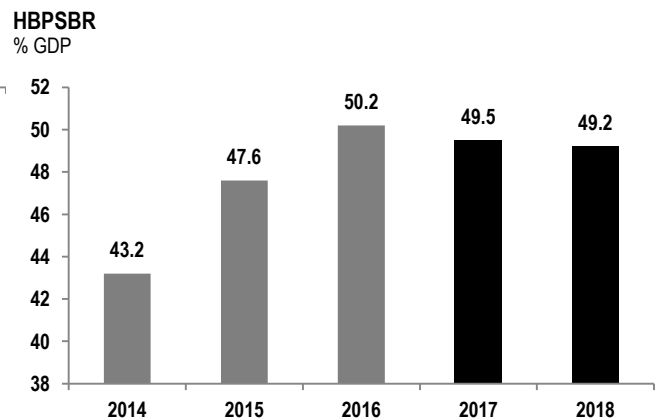
| | 2017e | 2018e |
|--------------------------------------|-----------|-------|
| GDP | | |
| %; GDP–real growth rate (range) | 1.3 – 2.3 | 2 – 3 |
| GDP Deflator | 5.2 | 4.0 |
| Inflation | | |
| December / December | 4.9 | 3.0 |
| Nominal exchange rate | | |
| End of period | 19.0 | 19.1 |
| Average | 19.5 | 19.1 |
| Interest rate (CETES 28 días) | | |
| % Nominal end of period | 7.0 | 7.3 |
| % Nominal average | 6.5 | 7.1 |
| % Actual cumulative | 1.6 | 3.9 |
| Current account balance | | |
| % of GDP | -2.5 | -2.5 |
| Fiscal balance (% of GDP) | | |
| With high-impact investments | -2.4 | -2.0 |
| Without high-impact investments | 0.1 | 0.0 |
| Mexican petroleum | | |
| Average price (US\$ BBL) | 42 | 46 |
| Average production platform | 1,947 | 2,006 |
| Average export platform | 904 | 850 |

Source: MoF
e = estimate data

With these assumptions, the Ministry of Finance estimates that the HBPSBR will start trending downwards as soon as in 2017. We believe that the guidelines presented are consistent with the fiscal consolidation efforts that the government has undertaken since it took office. According to the MoF, Mexico’s government has the tools to make adjustments without damaging the economic growth and maintains a commitment to not increase public debt or raise taxes. We highlight that the HBPSBR increased in recent years as a result of the significant depreciation of the Mexican currency, which impacted external debt balances.



Source: MoF



Source: MoF

In our view, Government actions continue to show a deep commitment with sound fiscal accounts. Notwithstanding an adverse backdrop, the government has remained committed to achieve fiscal targets, adjusting to a new scenario with lower levels of oil prices and production and in the absence of further tax overhaul.

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