

FY2020 Budget – Focused on social spending, with fiscal responsibility

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- Earlier today, the Lower House of Congress approved the spending budget for 2020 (PEF 2020)
- It should be noted that, on November 5th, the Senate sent the *Revenue Law (LIF 2020)* to the Executive branch for signature, with the original approval taking place on October 30th
- Regarding measures to combat tax evasion and make more efficient collections, we highlight lower tax rates on digital services and those related to punish fake invoices, among others
- Congress increased revenues by MXN11.4bn (~US\$587mn) from the original proposal of the Ministry of Finance (MoF), on the back of higher estimates for income tax collection and other unspecified revenues
- Regarding expenses, the Lower House allotted most of the new resources, as well as additional ones freed-up from spending in autonomous branches, to the administrative sector (Federal ministries)
- In particular, Ministries with the largest upward adjustments included Welfare, Finance, Education, and Agriculture
- It should be noted that these modifications were made with no corresponding changes to the *General Economic Policy Criteria (GEPC)* submitted by the MoF
- In our view, the *2020 Budget* reflects the priorities of the Federal Government in terms of boosting social spending, while maintaining the commitment with healthy public finances

Budget for 2020 approved by Congress. With the approval of both the revenue side –LIF 2020–, by the Senate on October 30th, and the spending budget –PEF 2020– agreed earlier today by the Lower House, the process of approval of the government’s *2020 Budget* is now complete. This process began on September 8th, when the Minister of Finance, Arturo Herrera, submitted it to Congress (for more details see: *“Fiscal responsibility continues in 2020, with some optimism in underlying assumptions”*, published on September 9th, 2019 <[pdf](#)>). In a strict sense, the PEF was not approved in the time limit required by both Article 74 of the Constitution and the Federal Law for Budget and Fiscal Responsibility¹ (*Ley Federal de Presupuesto y Responsabilidad Hacendaria*, in Spanish), as the deadline for the Senate’s approval for the LIF was October 31st and for the House’s go-ahead in terms of expenditures was on November 15th.

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¹ Article 42, Fractions IV y V http://www.diputados.gob.mx/LeyesBiblio/pdf/LFPRH_301215.pdf (available only in Spanish)

Upward adjustment in revenues for 2020. Congress made several adjustments to the proposal sent by the MoF, resulting in an MXN\$11.4bn (~US\$587mn) increase in total revenues. Particularly, MXN\$6.4bn will come from higher tax collection, with the remaining MXN\$5.0bn of higher income from sources other than tax contributions and services by state-owned companies and decentralized entities (“*aprovechamientos*”, in Spanish). Within the former, the increase came from narrower fiscal benefits to providers of ground transportation services who use the *Toll Highway System*. Previously, all these providers could deduct up to 50% of expenditures in tolls. Starting next year, this benefit will only apply to those with less than MXN\$60 million in revenues. Regarding the latter, the adjustment was in the category of other income, without enough information to know the specific source of these resources. The revenue breakdown by main concepts is shown in the table below:

2020 – Revenues and debt
MXN\$bn

	MoF	Approved	Difference
Total	6,096.3	6,107.7	11.4
<i>Taxes</i>	3,499.4	3,505.8	6.4
Income tax	1,846.5	1,852.9	6.4
VAT	1,007.5	1,007.5	0.0
Excise taxes	515.7	515.7	0.0
Others	129.7	129.7	0.0
<i>Social security payments</i>	374.0	374.0	0.0
<i>Contributions from improvements</i>	0.0	0.0	0.0
<i>Rights</i>	51.7	51.7	0.0
<i>Products</i>	10.1	10.1	0.0
<i>Others</i>	98.7	103.7	5.0
<i>Asset sales, services and other income</i>	1,065.2	1,065.2	0.0
<i>Transfers, subsidies and pensions</i>	412.8	412.8	0.0
<i>Debt</i>	584.5	584.5	0.0

Source: MoF, Senate

During the approval process, the Lower House had contemplated higher income from water usage rights of big agricultural businesses, which would have added about MXN\$585 million. They also proposed the regularization of illegally imported used vehicles. In the end, these proposals were rejected by the Senate, leaving both subjects without changes.

Changes in some fiscal rules. It should be noted that they proposed a series of measures to combat tax evasion and increase efficiency in collection (see document referenced above). In this context, we highlight a modification in the range of taxes that businesses would have to retain from persons on income from digital platforms. Originally, the project contemplated a range from 3-17%, depending on their income level, which was reduced to 0.4-5.4%. In addition, the collection of income taxes related to catalogue sales was eliminated, favoring the implementation of rules that streamline its payment. Lastly, measures were approved to combat the use of fake invoices, cataloguing them as organized crime if they damage public finances in an amount equal or higher than MXN\$7.8mn, apart from other requirements. This crime could be punished with preventive custody. However, a ‘grace period’ was incorporated to correct irregularities, while the collection agency has assured that tax payers that incur in basic and common offenses would not be categorized as such.

Strong reduction in spending of autonomous entities. Although total spending increased in the same amount as revenues, its composition shifted significantly. In our opinion, one of the most important developments is the MXN\$4.5bn downward adjustment in spending by autonomous branches relative to the MoF's proposal, while administrative branches (Federal ministries) increased by MXN\$16.2bn. Within the former, the highest reduction was in the Attorney General's Office (MXN\$1.5bn) followed by the Judicial branch (-MXN\$1.3bn). Within the latter, we highlight more money for the Ministry of Welfare (MXN\$8.4bn), reflecting the current administration's priorities in terms of boosting social spending. Programs with the highest increase included "Sowing Life", along pensions for persons with disabilities and the elderly. Other Ministries with considerable upward adjustments include Finance, Education, and Agriculture.

More resources for states. On top of the adjustments already mentioned at the federal level, we highlight increases in most of the categories related to states' resources. The total raise by the Lower House was of MXN\$7.7bn, distributed in three categories: (1) Federal tax collection corresponding to state and municipal governments (Ramo 28), with MXN\$7.2bn; (2) Federal transfers to state and municipal governments (Ramo 33), with MXN\$376mn; and (3) Social transfers to state and municipal governments (Ramo 23), with MXN\$177mn. Total spending arising from these three concepts will reach MNX\$1.8tn.

2020 – Spending proposal

MXN\$bn

	MoF	Approved	Difference
Total	6,096.3	6,107.7	11.4
<i>Autonomous branches*</i>	142.9	138.4	-4.5
Legislative branch	13.5	13.5	0.0
Judicial branch	68.6	67.3	-1.3
National Electoral Institute	17.7	16.7	-1.1
Attorney General's Office	18.2	16.7	-1.5
Federal Tribunal of Administrative Justice	3.1	2.8	-0.3
Others	21.7	21.4	-0.3
<i>Administrative branches</i>	1,132.2	1,148.4	16.2
MoF	21.2	23.7	2.5
Education	324.7	326.3	1.6
Health	128.6	128.8	0.2
Welfare	173.1	181.5	8.4
Defense	94.0	94.0	0.0
Public Security	59.2	60.2	1.0
Labor	28.8	28.9	0.1
Agriculture	46.3	47.6	1.3
Others	256.5	257.6	1.0
<i>General branches</i>	3,367.1	3,366.8	-0.3
Social transfers to state and municipal governments (Ramo 23)	131.3	131.5	0.2
Federal transfers to state and municipal governments (Ramo 33)	759.4	759.8	0.4
Federal tax collection corresponding to state and municipal governments (Ramo 28)	944.3	951.5	7.2
Others	1,532.1	1,524.1	-8.0
<i>Entities under direct budgetary control</i>	1,174.5	1,174.5	0.0
<i>State-owned companies</i>	1,125.6	1,125.6	0.0
<i>Others**</i>	-846.0	-846.0	0.0

*Includes the budget for INEGI and the FTAJ

** Subtraction of ISSSTE's transfers, and subsidies and transfers to entities under direct control and state-owned companies

Source: MoF, Lower House

No changes to General Economic Policy Criteria (GEPC). Macroeconomic variables used for the estimation of the budget did not change relative to the MoF's proposal. We highlight that GDP growth is in line with the latest forecast range from Banxico, presented in the 2Q19 *Quarterly Report* (QR), at 1.5-2.5% yoy (mid-point: 2.0%). Nevertheless, in the latest monetary policy decision the central bank hinted strongly that they will revise downward their estimate in the 3Q19 QR, to be published next Wednesday. It is also above our own 1.4% and the median among analysts' in the latest central bank survey, at 1.2%. We believe this represents a risk for non-oil tax revenues. On the other hand, we reiterate our view that the interest rate forecast of 7.8% (28-day CETES, end of period) is conservative, considering our reference rate forecast of 6.00% by year-end 2020, with cuts expected to be front-loaded during the first half. The situation is similar for the exchange rate, estimated to close at 20.0 per dollar against our forecast of 21.3. It is worth remembering that a higher USD/MXN tends to increase revenues as oil exports outweigh for higher debt servicing payments of foreign-currency debt.

Regarding other estimates, it is our take that they are realistic and close to market expectations. These include inflation at 3.2% (current: 3.1%) and the Mexican oil mix at 49 US\$/bbl (current: 51.25). Regarding the latter, there has not been any update yet on the oil hedge program for 2020, although government officials have stated that it will continue next year.

General Economic Policy Criteria (GEPC) - 2020

	GEPC (Sep'19)	Consenso*
GDP (% yoy)		
Range	1.5 - 2.5	-0.4 - 2.2
Mid-point	2.0	1.2
Inflation (%)		
December / December	3.0	3.5
Nominal exchange rate		
End of period	20.0	20.1
Average	19.9	--
Interest rate (28-day CETES)		
% nominal, end of period	7.1	6.8
% nominal, average	7.4	--
Current Account Balance		
% of GDP	-1.8	--
Fiscal Accounts (% of GDP)		
PSBR**	-2.6	-2.7
Public Balance		
with high-impact investments	-2.1	-2.2
without high-impact investments	-0.1	--
Primary balance	0.7	--
HBPSBR***	45.6	--
Mexican oil mix		
Price (average, US\$/bbl)	49	--
Production (average, kbpd)	1,951	--
Exports (average, kbpd)	1,134	--

* According to the latest Banxico survey. For GDP, the mid-point corresponds to the survey median

** Public Sector Borrowing Requirements

*** Historical balance of the PSBR, which is the broadest measure of the country's public debt

Source: MoF, Banxico

Social focus, with fiscal responsibility. In our opinion, the *2020 Budget* reflects the government's priority of boosting spending in social programs. In particular, this situation is clearly reflected in the increase in spending by the Welfare Ministry, with greater benefits for a series of programs for which this institution is responsible. We also consider as positive some of the measures that aim to increase efficiency in tax collection, albeit with more moderate adjustments to some of them in addition to the enactment of procedures for the solution of irregularities. Nevertheless, we believe that the upward revision in estimated revenues, in tandem with a higher GDP estimate than both our forecast and consensus, maintains risks for tax revenues. In this sense, both income tax and VAT have been below the budget so far this year (at -2.6% and -0.6% yoy in real terms at the end of 3Q19, respectively). Despite of the latter, we believe the federal government will continue to take a prudent stance regarding spending, and will not increase the deficit relative to 2019. Specifically, we consider that in case of significant deviations from those outlined in these documents, the Government will step in to make sure that fiscal goals are achieved, particularly regarding the primary surplus and overall debt. Moreover, the conservative estimate for the USD/MXN exchange rate at 20.0 per dollar (Banorte: 21.3) also offers some leeway to compensate for revenues that might not materialize in case of lower economic activity. Particularly, given that a depreciation of the Mexican peso increases nominal income from oil exports more than its impact in terms of debt servicing costs for foreign debt payments.

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