

MoF 2016 Budget assumptions facing persistently low oil prices

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- Yesterday, the Ministry of Finance (MoF) submitted to Congress the *2016 Fiscal policy preliminary criteria*
- In our opinion, the MoF made a responsible exercise to face the new macroeconomic reality in Mexico, where we highlight three aspects:
 - (1) A lower oil prices and lower production platform;
 - (2) Lower economic growth in 2016; and
 - (3) The MoF estimates a public spending cut by MXN135,000mn (US\$ 8,928mn) in the programmable spending for 2016
- On the other hand it was confirmed that the MoF will take place the reengineering of public spending with a view to zero-based budget for 2016, in order to optimize public spending
- In our opinion, *Fiscal policy preliminary criteria* reflects a consistent exercise with the new situation that exists nowadays in the Mexican economy, particularly after the sharp fall in oil prices ...
- ... and it denotes a clear attitude of government responsibility to maintain healthy public finances

Fiscal policy preliminary criteria. The Ministry of Finance (MoF) submitted yesterday to Congress in accordance with the Article 42 of the Federal Budget and Fiscal Responsibility Law, the Mexico's *2016 Fiscal policy preliminary criteria*. In our opinion, MoF made a responsible exercise to face the new macroeconomic reality in Mexico, particularly after the sharp fall in oil prices and their likely persistence at low levels, as well as the high probability of volatility that could experience the international financial markets.

A lower price and production of oil with lower growth and spending cut. In particular, we highlight three aspects: (1) A lower Mexican mix crude oil projected price from \$88 dollars per barrel (dpb) -as expressed in the General Economic Policy Criteria (*CGPE*) 2015- to \$55dpb, with a lower production platform of 2.4 million barrels per day (MBD) instead of 2.5 MBD; (2) lower economic growth for 2016, which was reduced from 4.9% (*CGPE 2015*) to a projected between 3.3% and 4.3%; and (3) The MoF estimates a public spending cut by MXN135,000mn (US\$ 8,928mn) in the programmable spending for 2016 (0.8% of GDP).

Impact of lower oil prices. In the 2015 budget negotiations, oil fiscal revenues were reduced by MXN7,516mn (US\$ 497mn) due to the change in the projected price of the Mexican crude oil from \$81dpb to \$79dpb. Using this sensitivity, with the price of oil estimated at \$55dpb for 2016, oil revenues should decrease MXN90,192mn (US\$ 5,964mn). Clearly it does not take into account a drop in oil production platform and slower economic growth, which is why it was important to announce a further cut to 2016.

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The meaning of the recent spending cut and the need for another cut in 2016. The recently-announced MXN124,300mn (US\$ 8,220mn) spending cut (0.7% of GDP) was not necessary to comply with this year's budget target, because the government contracted a \$79 dollars per barrel oil hedging program. Nevertheless, excluding Pemex's investments, the government pledged to reduce the public deficit by 1.5% of GDP in 2014 to 1% of GDP this year and 0.5% of GDP in 2016. Because the MoF does not have oil hedging for 2016 and which could probably hire with a much lower price this year -in the absence from an increase in taxes-, a very significant spending cut for 2016 was necessary to keep the commitment to end the year with a deficit of 0.5% of GDP. It was very appropriate to carry out the cut this year and thus "share the pain" in two years. So 2016 spending cut will be by MXN135,000mn (US\$ 8,928mn) or 0.8% of GDP, instead of MXN260,000mn (US\$ 17,195mn), it would have been close to 1.5% of GDP.

The macroeconomic estimates expect a Mexican GDP growth between 3.3% to 4.3% for 2016 and a USD/MXN14.50 exchange rate. The estimated for Mexico's economic growth this year was unchanged in a range between 3.2% and 4.2%, while the MoF reduced its growth forecast for 2016 from 4.9% to a range between 3.3% and 4.3%. Moreover, the exchange rate for 2016 is estimated at USD/MXN14.50, while the inflation estimate for 2015 and 2016 is at 3%, as shown in the following table.

Ministry of Finance economy overview 2015 – 2016

	2015	2016e
GDP		
%; GDP–real growth rate (range)	3.2 - 4.2	3.3 - 4.3
Nominal (billions of pesos)	18,180	19,533.30
GDP deflator	3.3	3.5
Inflation		
December / December	3.0	3.0
Nominal exchange rate		
End of period	14.5	14.5
Average	14.8	14.5
Interest rate (CETES 28 días)		
% Nominal end of period	3.5	4.5
% Nominal average	3.2	4.1
% Actual cumulative	0.2	1.2
Current account balance		
Millions of dollars	-28,360	-31,600
% of GDP	-2.3	-2.4
Fiscal balance (% of GDP)		
With inversion	-3.5	-3.0
Without inversion	-1.0	-0.5
Mexican petroleum		
Average price (dls. / barrel)	50	55
Average production platform	2,288	2,400
Average export Platform	1,014	1,065

Source: SHCP
e = estimate data

Reengineering in the public spending with a zero-based budget perspective for 2016 will allow an adequate evolution of public finances. To prepare the Federal Spending Budget of 2016, all specific items of government spending and the units of public administration will be analyzed. This analysis will perform considering 3 main points: (1) Identify complementarities and similarities in programs and structures; (2) prioritizing budgetary programs based on the *National Development Plan 2013-2018*; and (3) establish additional criteria for priority investment projects in the search of a better social and economic profitability.

Continue the fiscal responsibility. In our opinion, we believe that the statement of the Ministry of Finance denotes a clear attitude that allows the government to comply with its commitment to reduce the deficit in 2016 in the absence of more taxes, adjusting to external shocks of the persistence of lower oil prices and the potentially higher costs of short-term financing, and lower oil production platform.

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