

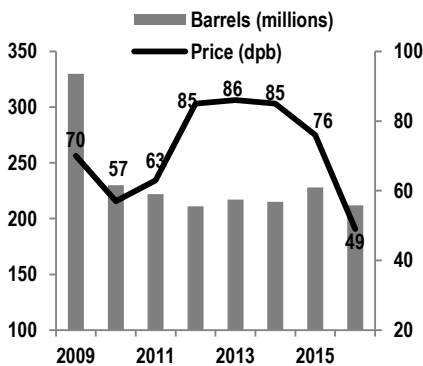
## Oil price hedges - Shielding Mexican oil revenues for 2016

- The Ministry of Finance (MoF) recently announced their oil price hedging program for 2016
- The hedging strategy in 2016 covers 212 million of barrels at an exercise price of USD49 per barrel (dpb)
- This strategy is part of 2016 Economic Package, to be presented in Congress in the first week of September
- In addition, the federal government has the oil stabilization funds, while the gasoline price differential with the U.S. will also help to compensate for lower oil revenues
- In our view, the government’s hedging strategy, coupled with spending cuts and a zero based budget shows its commitment to strong public finances

The Ministry of Finance (MoF) announced its oil hedging program for 2016. This program aims to shield the government’s oil revenues from volatility in energy prices. The hedging strategy includes the acquisition of *put options* at an average exercise price of US\$49 per barrel of Mexican crude oil exports.

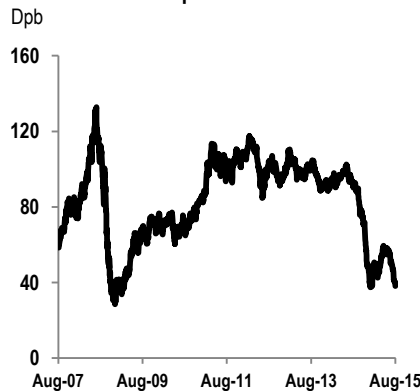
**Lower price and lower volume hedged.** A total of 44 operations in international derivatives markets were made to cover 212 million barrels, which represents the federal government estimate exposure of oil revenues to price reductions in 2016. The cost of the option amounted to US\$1,090 million (MXN\$17,503mn). We highlight that the strike price is 35% lower than the obtained by this strategy last year, while the number of barrels included is also lower (228 million barrels in 2015 vs. 212 million barrels), as shown in the following charts. This reflects the current situation of Mexico’s oil market, which includes a combination of lower prices, as well as lower production.

Oil price hedge



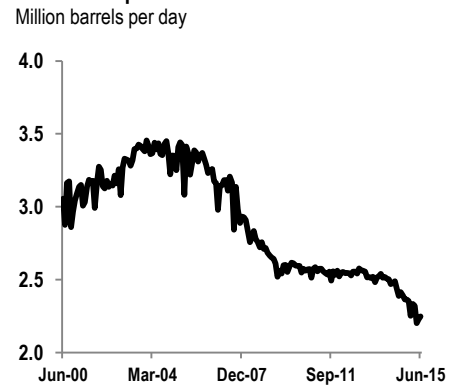
Source: SHCP

Mexican crude oil price



Source: Bloomberg

Production platform



Source: SENER

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www.banorte.com  
www.ixe.com.mx  
@analisis\_fundam

**Gabriel Casillas**  
Chief Economist and Head of Research  
gabriel.casillas@banorte.com

**Delia Paredes**  
Executive Director of Economic Analysis  
delia.paredes@banorte.com

**Saúl Torres**  
Analyst, Mexico  
saul.torres@banorte.com

Fixed income and FX Strategy

**Alejandro Padilla**  
Head Strategist - Fixed-Income and FX  
alejandro.padilla@banorte.com

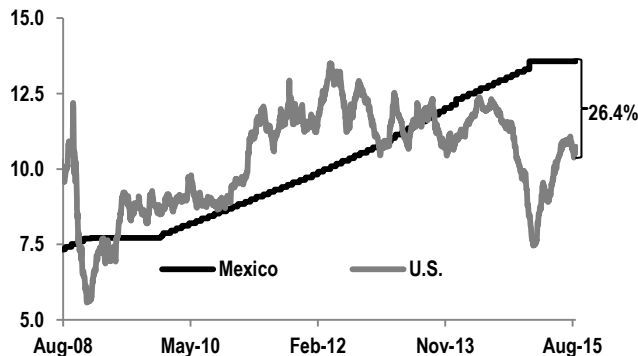
**Juan Carlos Alderete, CFA**  
FX Strategist  
juan.alderete.macal@banorte.com

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**This announcement is part of 2016 Economic Package.** According to the *Fiscal Responsibility and Budget Law*, the Federal Government must submit the *Economic Package*, before September 8. Such package includes the *Revenue Law*, the project for a *Spending Budget* and the *General Economic Policy Guidelines*. The Lower-House has until October 20 to approve the *Revenue Law*, while the Senate has until October 31 to approve it. In terms of the spending budget, it is reviewed only by the Lower-House, which has until November 15 to approve it.

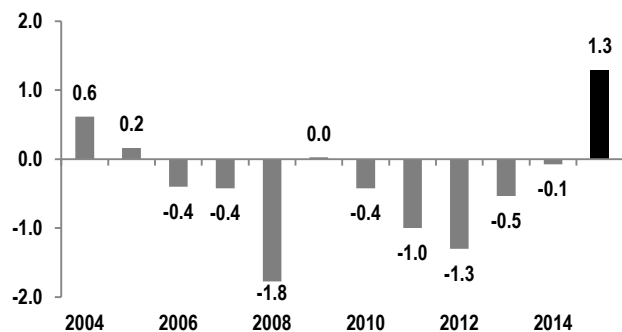
**The oil hedging program is part of the government’s strategy to protect its revenues.** Additionally, the government has *Oil Stabilization Fund (FEIP)*, which currency has a balance of MXN44,219 million (~US\$2.6bn). On top of this, there is the infrastructure stabilization fund and the fund for federal entities, which sum to a total of MXN124.5bn. In addition, the exchange rate and the price differential between domestic and international gasoline prices, partially offset for the lower revenues derived from lower levels of production prices. Year to date, domestic gasoline prices have been 41% higher than the average reference price in the U.S. (refer to the chart on the left) –this differential is currently 26.4%-, which resulted in a positive *IEPS* revenue, as shown in the chart on the right.

**Low-grade gasoline price**  
Pesos per liter



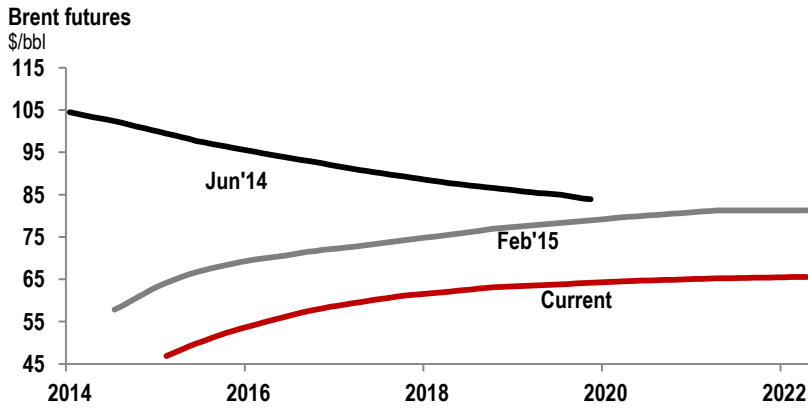
Source: Banorte-Ixe with data from PEMEX and Bloomberg

**Gasoline IEPS revenues**  
% of GDP



Source: Banorte Ixe with data from MoF and INEGI

**Looking ahead, the situation for oil prices remains complicated.** The downward trend in energy prices that began last year –and has worsened in recent weeks-, will continue to be a source of risk for the markets in the coming months. The decline in energy prices remains explained by both supply factors (increased production by traditional producers and new participants in the market) and demand (lower global growth, particularly by China). In our opinion, the situation of oil prices in the short term remains difficult, with a reduced probability of seeing a significant reversal of the current trend. In fact, the Brent futures' curve, suggests a price below 65dpb in the next three years, as seen in the chart below.



Source: Bloomberg

**In our view, oil hedging strategy shows the government's commitment with healthy public finances.** One of the pillars of the Mexico's macroeconomic framework is to maintain the stability of public finances. Given the difficult situation in the international backdrop, we consider that the hedging strategy will contribute to reduce some uncertainty to government revenues. Additionally, we highlight the development of based-budget –aiming to have a more efficient government spending-, as well as the spending cuts announced as part of the overall strategy of the government to keep public finances under control.

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**GRUPO FINANCIERO BANORTE S.A.B. de C.V.**
**Research and Strategy**

Gabriel Casillas Olvera	Chief Economist and Head of Research	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godínez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967

**Economic Analysis**

Delia María Paredes Mier	Executive Director of Economic Analysis	delia.paredes@banorte.com	(55) 5268 - 1694
Alejandro Cervantes Llamas	Senior Economist, Mexico	alejandro.cervantes@banorte.com	(55) 1670 - 2972
Katia Celina Goya Ostos	Senior Global Economist	katia.goya@banorte.com	(55) 1670 - 1821
Miguel Alejandro Calvo Domínguez	Economist, Regional & Sectorial	miguel.calvo@banorte.com	(55) 1670 - 2220
Juan Carlos García Viejo	Economist, International	juan.garcia.viejo@banorte.com	(55) 1670 - 2252
Rey Saúl Torres Olivares	Analyst	saul.torres@banorte.com	(55) 1670 - 2957
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611

**Fixed income and FX Strategy**

Alejandro Padilla Santana	Head Strategist – Fixed income and FX	alejandro.padilla@banorte.com	(55) 1103 - 4043
Juan Carlos Alderete Macal, CFA	FX Strategist	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Santiago Leal Singer	Analyst Fixed income and FX	santiago.leal@banorte.com	(55) 1670 - 2144

**Equity Strategy**

Manuel Jiménez Zaldivar	Director Equity Research — Telecommunications / Media	manuel.jimenez@banorte.com	(55) 5268 - 1671
Víctor Hugo Cortes Castro	Equity Research Analyst	victorh.cortes@banorte.com	(55) 1670 - 1800
Marissa Garza Ostos	Senior Equity Research Analyst – Conglomerates/Financials/ Mining/ Chemistry	marissa.garza@banorte.com	(55) 1670 - 1719
Marisol Huerta Mondragón	Equity Research Analyst – Food/Beverages	marisol.huerta.mondragon@banorte.com	(55) 1670 - 1746
José Itzamna Espitia Hernández	Equity Research Analyst – Airports / Cement / Infrastructure / Fibras	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Equity Research Analyst – Auto parts	valentin.mendoza@banorte.com	(55) 1670 - 2250
María de la Paz Orozco García	Analyst	maripaz.orozco@banorte.com	(55) 1670 - 2251

**Corporate Debt**

Tania Abdul Massih Jacobo	Director Corporate Debt	tania.abdul@banorte.com	(55) 5268 - 1672
Hugo Armando Gómez Solís	Analyst, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Idalia Yanira Céspedes Jaén	Analyst, Corporate Debt	idalia.cespedes@banorte.com	(55) 1670 - 2248

**Wholesale Banking**

Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(55) 1670 - 1889
Alejandro Eric Faesi Puente	Head of Global Markets and Institutional Sales	alejandro.faesi@banorte.com	(55) 5268 - 1640
Alejandro Aguilar Ceballos	Head of Asset Management	alejandro.aguilar.cebillos@banorte.com	(55) 5268 - 9996
Arturo Monroy Ballesteros	Head of Investment Banking and Structured Finance	arturo.monroy.ballesteros@banorte.com	(55) 5004 - 1002
Gerardo Zamora Nanez	Head of Transactional Banking, Leasing and Factoring	gerardo.zamora@banorte.com	(81) 8318 - 5071
Jorge de la Vega Grajales	Head of Government Banking	jorge.delavega@banorte.com	(55) 5004 - 5121
Luis Pietrini Sheridan	Head of Private Banking	luis.pietrini@banorte.com	(55) 5004 - 1453
René Gerardo Pimentel Ibarrola	Head of Asset Management	pimentelr@banorte.com	(55) 5268 - 9004
Ricardo Velázquez Rodríguez	Head of International Banking	ricardo.velazquez@banorte.com	(55) 5268 - 9879
Víctor Antonio Roldan Ferrer	Head of Corporate Banking	victor.rolan.ferrer@banorte.com	(55) 5004 - 1454