

Government budget 2017 – Continuous and credible consolidation effort

September 9, 2016

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- Yesterday the Minister of Finance delivered the government budget proposal for fiscal year 2017 to the Lower House
- This includes the proposal for the *2017 General Economic Policy Assumptions*, the *Revenue Law*, and the *Government Spending Proposal*
- We highlight the following features from the document sent to Congress:
 - (1) **Realistic and even conservative assumptions.** The government expects economic growth rates between 2% and 3% for 2017, an average exchange rate of USD/MXN18.2, an average oil price of US\$42 per barrel, and an a crude oil export platform of 775 thousand barrels per day;
 - (2) **Significant government spending cutback.** A 1.7% reduction in public spending, on the back of a 6.2% reduction in programmable spending; and
 - (3) **Achieves the promised goals towards fiscal consolidation:** (a) A fiscal deficit –including Pemex and CFE’s capital spending-, equivalent to 2.4% of GDP in 2017 (commitment: 2.5%); (b) the first primary surplus since 2008 (of 0.4% of GDP); and (c) stops the government debt upward trend in year 2017
- In our view, the government budget proposal shows a full commitment to gradually balancing the budget, sending yet another message of fiscal responsibility
- The budget process will run until mid-November, over this period, Congress will likely endorse the fiscal discipline proposed by the federal government, taking into account the widespread claim of society for fiscal consolidation

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

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

Alejandro Cervantes
Senior Economist, Mexico
alejandro.cervantes@banorte.com

Sensible economic package for 2017. The newly-appointed Minister of Finance, Jose-Antonio Meade, delivered the government budget proposal for fiscal year 2017 to the Lower House. Such package includes the proposals for 2017’s: (1) General Economic Policy Assumptions; (2) the Revenue Law; and (3) the spending budget. We highlight the following features from the document sent to Congress: (1) The government expects economic growth rates between 2% and 3% for 2017, an average exchange rate of USD/MXN18.2, an average oil price of US\$42 per barrel, and an a crude oil export platform of 775 thousand barrels per day; (2) the Ministry of Finance (MoF) estimates a 0.4% increase in revenues, amid higher tax collection (+4.8%) that will offset for the 15.7% expected fall in oil revenues; (3) a 1.7% reduction in public spending, on the back of a 6.2% reduction in programmable spending; and (4) a fiscal deficit –incl. Pemex and CFE’s capital spending-, equivalent to 2.4% of GDP in 2017.

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General Economic Policy Assumptions (CGPE) 2017

	CGPE	Consensus*
GDP (% yoy)	2.0 - 3.0	2.5
12-month CPI inflation (% yoy)	3.0	3.4
USD/MXN (average)	18.20	18.20
28-day Cetes interest rate (%)	5.3	
Public balance (% GDP)	-2.4	--
Ex. Pemex investments (% GDP)	+0.1	--
Primary balance (% GDP)	+0.4	
Mexican mix crude oil price (dpb)	42	--
Oil production platform (mbd)		
Total output	2,130	--
Exports	976	--

*Banamex's survey.

Source: SHCP, Banxico and Banorte-Ixe

Lower tax revenues on the back of persistently low oil prices. Estimated budget revenues for 2017 amount to MXN4,309bn. This implies a 0.4% y/y reduction vs. 2016 budget (in real terms) and it is explained by the assumption that oil prices will remain below 50dpb as shown above. We highlight that the government recently announced that it has completed its oil hedge strategy for next year consisting of two parts: (1) Put options at a 38dpb strike price; and (2) MXN18.2bn coming from the Oil Revenues Stabilization Fund, so that a 42dpb price was warranted. Moreover, government expects an increase of 4.8% in non-oil revenues, particularly on the back of 9.7% increase in tax collection.

2017 budget proposal

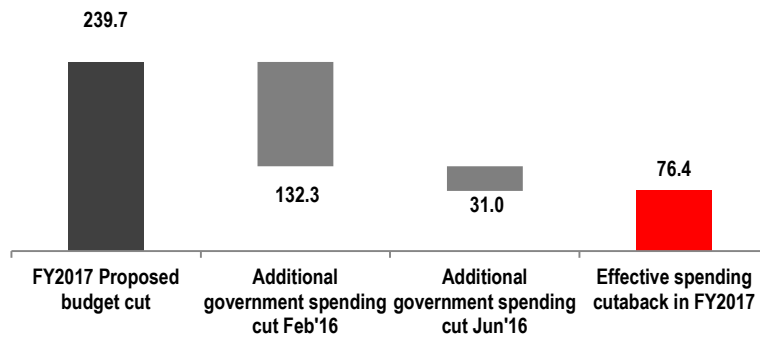
MXNbn

	MXN million (nominal)		% GDP		% yoy (real)
	2016	2015	Approved 2016	2017	
Economic balance	-577,192.0	-494,872.5	-3.0	-2.4	-17.0
Ex. High impact investments	-96,703.1	12,634.7	-0.5	0.1	-112.6
Budget balance	-577,192.0	-494,872.5	-3.0	-2.4	-17.0
Revenues	4,154,633.4	4,309,533.6	21.7	21.2	0.4
Oil revenues	884,439.6	769,947.4	4.6	3.8	-15.7
Non-oil revenues	3,270,193.8	3,539,586.1	17.1	17.4	4.8
Federal Government	2,616,393.6	2,842,844.0	13.6	14.0	5.2
Tax collection	2,407,206.0	2,729,347.9	12.6	13.4	9.7
Spending	4,731,825.4	4,804,406.1	24.7	23.7	-1.7
Programmable	3,574,657.0	3,464,553.5	18.6	17.1	-6.2
Non-programmable	1,157,168.4	1,339,852.6	6.0	6.6	12.1
Public sector financial costs	462,872.5	568,697.6	2.4	2.8	18.9
Primary balance	-114,319.5	73,825.1	-0.6	0.4	n.a.
Public sector borrowing requirements	-664,202.9	-596,687.3	-3.5	-2.9	n.a.

Source: Ministry of Finance

Spending reduction. As expected, government is putting on the table a 1.7% reduction in outlays vs. 2016 budget. Programmable spending will be cut in 6.2% yoy in real terms while non-programmable spending will expand 12.1%. It is worth noting that the reduction in programmable outlays is equivalent to MXN239.7bn. Taking into account the anticipated cuts already announced for MXN132.3bn (February); and for MXN31bn (June), the effective amount to be reduced in 2017 is around MXN76.4bn, as shown in the chart below. Thus, fiscal consolidation in 2017 will be smaller than the one in 2016, allowing the government to achieve better fiscal goals, but without such a negative impact on economic activity.

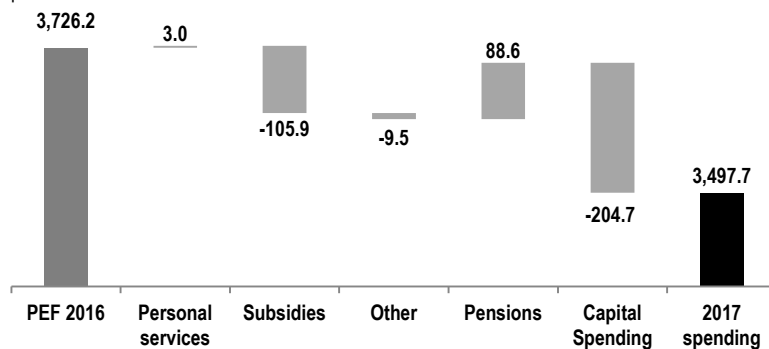
2017 Spending cuts
MXNmn



Source: Ministry of Finance

Programmable spending cut focused on capital spending. Spending cuts amount to MXN228.6bn (-6.1%) vs. last year's Budget (2016 PEF). From this amount, MXN112.5bn (-4.8%y/y) will come from lower current spending and another MXN204.7bn will come from lower capital spending (-26.8%). Meanwhile, pension spending edges up 14%, as shown in the chart below.

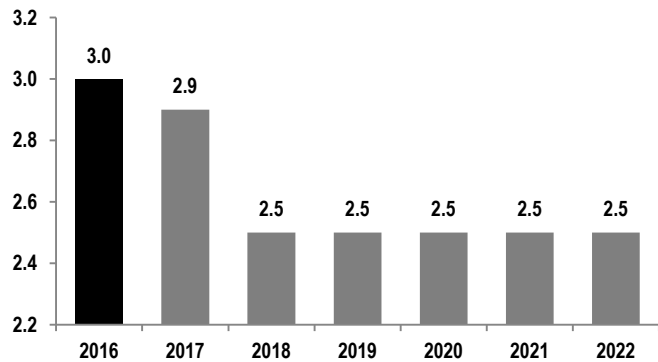
2017 Programmable spending cuts
mmp



Fuente: SHCP

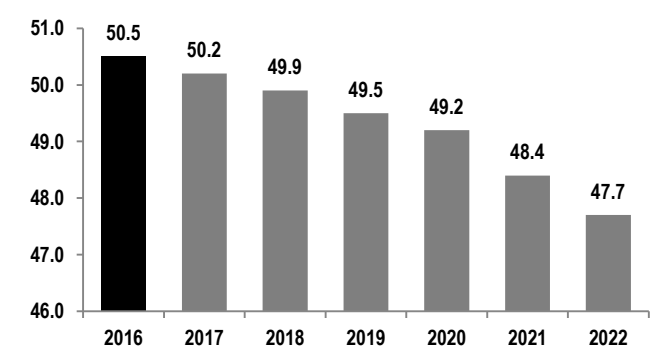
MoF meets deficit reduction commitment. With this numbers budget balance will show a surplus equivalent to 0.1% of GDP in 2017, lower than the 0.5% deficit for 2016. When factoring in Pemex and CFE's capital investments as well as other high social impact projects, the deficit proposed is equivalent to 2.4% of GDP in 2017, with Public Sector Borrowing Requirements (PSBR) in the area of 2.9% of GDP. Looking ahead, the MoF estimates that PSBR will converge to 2.5% of GDP in the medium term, so that historical PSBR will show a downward trend, as shown in the charts below.

Public sector borrowing requirements
% GDP



Source: Ministry of Finance

Historical public sector borrowing requirements
% GDP



Source: Ministry of Finance

More details regarding gasoline pricing policy still to come. The government proposed to bring forward to 2017 the liberalization of gasoline and diesel prices (originally scheduled for January 2018). To this end, they recommend that both the *Energy Regulatory Commission* (CRE), and the *Federal Competition Commission* (COFECE) determine the pace of liberalization of prices for different regions of the country. Nevertheless, the document does not include the methodology to be used to regulate these prices (the methodology will be released before year-end) but assumes that excise tax collection (gasoline IEPS) will be in the area of MXN284.4bn, 31.5% y/y in real terms vs. 2016.

Sound public finances with sensible assumptions. We believe that 2017 economic package sends a clear message of government’s commitment to fiscal responsibility and comes on top of the efforts already made to strengthen macroeconomic fundamentals, particularly amid a difficult external backdrop, including persistently low oil prices and US Fed’s normalization process. We expect rating agencies, such as Standard and Poor’s –which recently revised down Mexico’s sovereign debt outlook to ‘negative’ from ‘stable’-, to hold current ratings and eventually return Mexico’s credit outlook to ‘stable’. It is worth noting that S&P in particular changed Mexico’s outlook arguing the risk of having debt levels in the area of 48% of GDP by 2018, which will not happen according to 2017 Economic Package. In this context, we expect Congress to endorse the government’s proposal, taking into account the widespread claim of society for sound fiscal accounts.

What’s next? The Lower House has until October 20 to approve the *Revenue Law* and the *General Economic Policy Criteria*, which will be subsequently turned over to the Senate, who has until October 31 to approve the proposal. We highlight that if any of the two chambers reject the proposal, and the deadline expires, the Executive may request an extension provided that it does not exceed the end of the year, according to the Article 42 of the *Federal Budget and Fiscal Responsibility Law*, and the Article 74 of the *Mexican Constitution*. Once the *Revenue Law* is in place, the Lower House has to approve the spending part of the budget by mid-November, or as already mentioned above, in the case of an extension, the Lower House new deadline will be December 31.

Deadlines for the Budget proposal for 2017

Deadline

September 8	2017 Budget proposal
October 20	Lower House approval of the <i>Revenue Law</i>
October 31	Senate approval of the <i>Revenue Law</i>
November 15	Senate approval of <i>Government Spending Proposal</i>

Source: Ministry of Finance

Disclaimer

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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
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
Victor 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 / Specialized Commerce	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/ Consumer Discretionary / Real Estate / Retail	valentin.mendoza@banorte.com	(55) 1670 - 2250
Eugenia Ivonne Arias Medina	Analyst	eugenia.arias.medina@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	hugo.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	rvelazquez@banorte.com	(55) 5004 - 5279
Víctor Antonio Roldan Ferrer	Head of Corporate Banking	victor.rolan.ferrer@banorte.com	(55) 5004 - 1454