2021 preliminary budget assumptions – Use of stabilization funds and a higher deficit

- **The Ministry of Finance (MoF) published yesterday the preliminary macroeconomic forecasts for 2021, while also updating the 2020 framework, which includes the potential impact from the COVID-19 pandemic**
- **The MoF recognizes the negative impact on the budgeted revenues from the pandemic and the need to increase spending to cope with the sanitary emergency**
- **As a result, the government proposes the use of stabilization funds and an increase in the public deficit to 4.4% from 2.6% of GDP in 2020, to 4.0% in 2021 (previous: 2.2%), getting back to a balanced budget in 2022**
- **With these, public debt will increase to 52.1%, from 45.6% of GDP this year, while for the end of the current administration's six-year term in 2024, it will reach 51.2% from 44.8% of GDP**
- **Market participants will be focused on the conference call to be held tomorrow, along with the announcement of the plan to support employment to be unveiled next Sunday**

The pandemic and its economic and fiscal impact. The Ministry of Finance (MoF) published yesterday, as required by law, the *Preliminary Fiscal Year 2021 Economic Assumptions*, in line with Article 42 of the *Federal Budget and Fiscal Responsibility Law*. The document updates the macroeconomic framework for 2020. Given the currently high degree of uncertainty, market participants focused on the updated framework for this year and the resulting fiscal balance, more than in the assumptions made for 2021. In this respect and for this year, we highlight the reduction in the GDP estimate to -1.9% from 2%, the Mexican oil mix to 24 US$/bbl from 49, and the USD/MXN exchange rate to 22.90 from 20.00 per dollar (see chart below). The MoF recognizes the negative impact on budgeted revenues from the pandemic and the need to increase spending to cope with the sanitary emergency. As a result, the government proposes to use stabilization funds and increase the public deficit to 4.4% from 2.6% of GDP this year, returning to a similar level than last year in 2022 (chart below, right).

Macroeconomic framework and fiscal variables[1]
Selection

2020	GDP -1.9% (Previous: 2.0%)	USD/MXN: 22.90 (Previous: 20.00)	Crude oil price: US$/bbl 24 (Previous: 49)	Public deficit*: 4.4% (Previous: 2.6%)	Public debt**: 52.1% (Previous: 45.6%)	Primary balance -0.4% (Previous: 0.7%)
2021	GDP 2.5% (Previous: 2.3%)	USD/MXN: 21.40 (Previous: 20.10)	Crude oil price: US$/bbl 30 (Previous: 52)	Public deficit*: 4.0% (Previous: 2.2%)	Public debt**: 52.1% (Previous: 45.4%)	Primary balance -0.6% (Previous: 1.0%)

Source: MoF
1. GDP: Real annual growth rate; Nominal exchange rate; Public deficit, public debt y and primary balance as a percentage of GDP.
*Public Sector Borrowing Requirements (PSBR). **Historical Balance of Public Sector Borrowing Requirements (HBPSBR)

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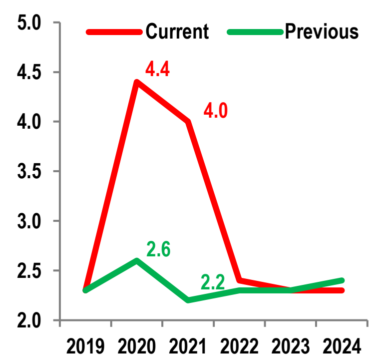
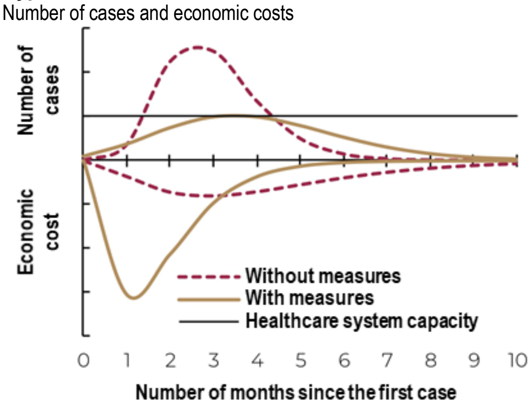
Public déficit*
% of GDP



Source: MoF
*PSBR

Economic effect, contagion and the health-care system capacity. The document details the way in which the MoF perceives the impact that the pandemic can have in Mexico's health-care system, along the economic impact both with and without the implementation of containment measures (*e.g.* social-distancing, quarantines, and "stay at home" initiatives). As shown in the chart below, the MoF expresses the dynamic dichotomy between: (1) Applying measures to reduce the total number of cases (upper gold line) with the goal of not overwhelming the health-care system (black horizontal line), resulting in a higher economic impact (lower gold line) than if measures were not applied; and (2) not applying measures, at the cost of a higher number of cases (upper brown dotted line) and collapsing the health-care system, with a more modest economic impact (lower brown dotted line).

Hypothetical scenarios of the COVID-19 outbreak
Number of cases and economic costs



Source: MoF

Less GDP growth. Recognizing the potential economic impact that the COVID-19 pandemic could have, the MoF modified significantly its macroeconomic framework for this year, and as required by law, those for 2021 on a preliminary basis. In this respect, the mid-point of the GDP estimate stands at -1.9% from 2% for 2020 (chart below). We should mention that this forecast is above the median estimate by economic analysts surveyed by *Banco de México*, which stands at -3.5% (Banorte: -3.5%). In this respect, we do not know yet the government's plan to support employment, which will be announced on Sunday, April 5th. In our view, this information will help make a better evaluation of this divergence. For 2021, they increased slightly their GDP forecast, to 2.5% from 2.3% (Banxico's survey consensus: 1.7%; Banorte:1%).

Macroeconomic framework 2020 and 2021

	2020				2021			
	Current	Previous	Banxico survey	Banorte	Current	Previous	Banxico survey	Banorte
GDP (% y/y)	-1.9	2.0	-3.5	-3.5	2.5	2.3	1.7	1.0
Exchange rate (USD/MXN, year-end)	22.90	20.00	21.95	22.00	21.40	20.10	21.70	21.00
Inflation (% y/y, year-end)	3.5	3.0	3.6	3.6	3.2	3.0	3.6	4.2
Interest rate (% y/y, year-end)	5.8	7.1	5.5	5.5	5.8	6.8	5.5	5.0
Oil price (US$/bbl)	24	49	- -	- -	30	52	- -	- -
Oil production (kbpd)**	1,850	1,951	- -	- -	2,027	2,073	- -	- -
GDP US (% y/y)	-2.0	1.8	-1.2	-2.3	2.4	1.7	2.0	1.5

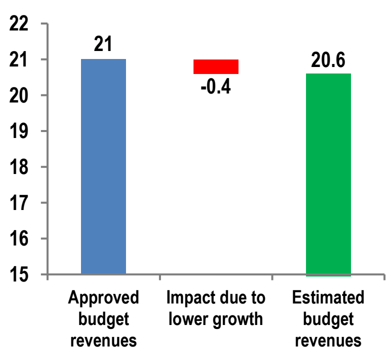
Source: MoF, Banxico and Banorte
*MoF publishes an interval: 2020: Current: (-3.9% - 0.1%); Previous: (1.5% - 2.5%). 2021: Current: (1.5% - 3.5%); Previous: (1.8% - 2.8%)
**Thousand barrels per day

Weaker peso. Relevant global shocks that started with the Coronavirus outbreak in China –resulting in momentary disruptions in the global supply chain– increased in terms of magnitude, lifespan and severity with the escalation of the COVID-19 contagion into a pandemic. Moreover, they were also fueled by the plunge of oil prices following disputes between Russia and Saudi Arabia. These events resulted in a stronger USD against almost every major and EM currencies, including the Mexican peso. By the same token, the performance of the Mexican currency has been also steered by some idiosyncratic factors. Taking these conditions into account, the MoF modified its expectations for the peso for 2020 to USD/MXN 22.90 from 20.00, and for 2021 to 21.40 from 20.10.

Downward adjustments in oil prices and production. The MoF lowered the estimated price of the Mexican oil mix for this year, to 24 US$/bbl from 49, and for 2021 to 30 US$/bbl from 52. Fortunately, oil revenues for the government are hedged for this year with a strike price of 49 US$/bbl, the same price that was approved in the 2020 Budget, which implies no risk to total fiscal revenues coming from this component. However, there is no hedging strategy yet for 2021, suggesting some risks given the challenging global environment and its effects on crude oil prices. Finally, the MoF modified their expected oil production for this year to 1,850 thousand barrels per day (kbpd) from 1,951, and to 2,027 kbpd from 2,073 for 2021. It is our take that these are ambitious targets, but feasible given recent dynamics. We also have to acknowledge that a further decline in global oil prices and/or a delay in the recovery could result in additional losses to Pemex.

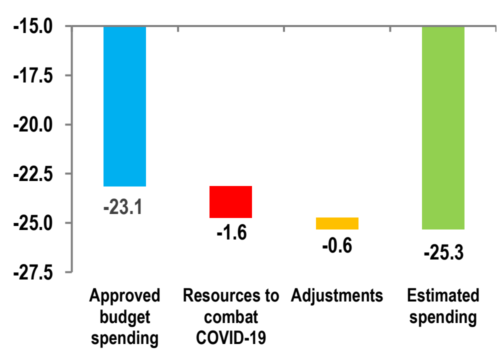
Drop in revenues and increase in expenditures. The Ministry of Finance has acknowledged the negative impact in budget revenues in comparison with the amount approved in the *2020 Federal Income Law* (LIF20 by its acronym in Spanish), as depicted in the following chart on the LHS. In the same way, it recognizes the need to increase government spending to tackle the health emergency, with an increase in expenditures of 1.6%-pts of GDP (chart in the middle), adding to the 0.6%-pts of adjustments explained by higher financial costs. As a result, the public deficit –in its broadest definition[1]–, will increase to 4.7% of GDP. Nevertheless, with the deployment of a significant amount of the *Budget Revenue Stabilization Fund* (FEIP by its acronym in Spanish) –leaving nearly $30 billion (US$1.3 billion) for contingency plans–, the deficit would decrease by 0.4%-pts to 4.4% of GDP (chart on the RHS).

Lower fiscal revenues
% of GDP



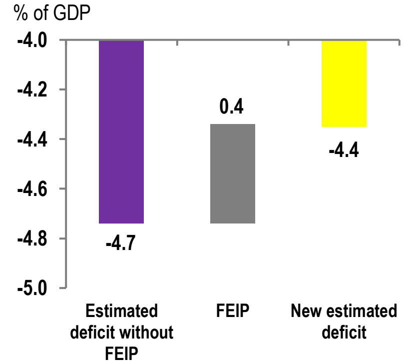
Source: MoF

Increase in public spending
% of GDP



Source: MoF

Utilization of the Stabilization Fund and increase in public deficit
% of GDP



Source: MoF

[1] Public Sector Borrowing Requirements (PSBR)

Programs from development banks should aid to offset the COVID-19 repercussions. Although the MoF didn't released the full details about the program to tackle the health emergency –that President López-Obrador will announce on Sunday–, they unveiled some measures coming from development banks to address the after-effects of the Coronavirus pandemic. This program consists of 15 measures, with eight of them establishing a total amount of $61.1 billion (US$2.5 billion or 0.25% of GDP). Among these measures –summarized in the table below– we stress out a guarantees program, liquidity provision mechanisms and credit for the construction industry.

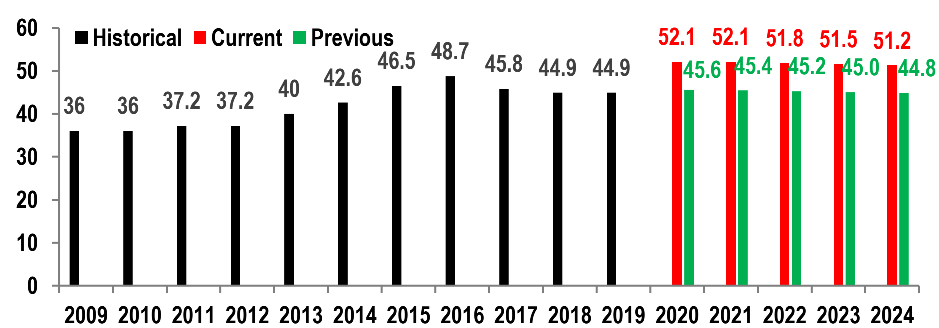
Programs from Development Banks to reactivate the economy due to COVID-19

Institution	Measure	MXN million	US$ million*	% of GDP***
	Total	**61,100**	**2,535**	**0.25**
BANOBRAS	Liquidity support for companies in the infrastructure sector	6,000	249	0.02
NAFIN / BANCOMEXT	Liquidity support for "first-floor" financial institutions	10,000	415	0.04
NAFIN / BANCOMEXT	Liquidity support for "second-floor" financial institutions	20,000	830	0.08
NAFIN / BANCOMEXT	Guarantees program for companies and businesspeople	6,300	261	0.03
Sociedad Hipotecaria Federal	Stabilization of syndicated loans provided to construction companies	8,800	365	0.04
Sociedad Hipotecaria Federal	Additional financing for "second-floor" bridge loans	6,000	249	0.02
Sociedad Hipotecaria Federal	Small loans for housing improvements	2,000	83	0.01
Financiera Nacional de Desarrollo	Attention scheme for the restructuring of debtors' loans		MPD**	
Financiera Nacional de Desarrollo	Measures to support the Rural Economy		MPD**	
Banco del Bienestar	Clients' Program	2,000	83	0.01
Banco del Bienestar	Outreach Program		MPD**	
Banco del Bienestar	Reactivation of credit demand		MPD**	
FOCIR	Extension of the period to divest affected companies		MPD**	
FOCIR	Suspension of commission payments for the management of FICAS		MPD**	
FOCIR	Emerging Program "COVID 2020 - FOCIR-SE"		MPD**	

Source: MoF
* USD/MXN exchange rate of 24.10 per dollar
** TBD: To Be Determined
*** Nominal GDP in 2019

As a result, public debt will be higher than previously expected. Given the changes outlined above, the estimate for public debt this year –in its broadest definition[2]–, increased to 52.1% from 45.6% of GDP. In a similar fashion, for 2021 this measure would increase to 52.1% from 45.4% of GDP estimated previously, as seen in the chart below. Moreover, by the end of the current six-year administration in 2024, public debt would increase to 51.2% from 44.8% of GDP. In the document, the government stated that the public deficit, projected at 4.4% of GDP for this year and 4% in 2021, will be financed mainly with financial assets owned by the Public Sector to minimize the issuance of new debt.

Public debt*
% of GDP



Source: MoF
*Historical Balance of the Public Sector Borrowing Requirements

[2] Historical Balance of Public Sector Borrowing Requirements (HBPSBR)

Conference call and relevant dates ahead. Next Friday, April 3rd, the MoF will hold a conference call to discuss the document sent yesterday. The call will be led by the Deputy Finance Minister, Gabriel Yorio, also with the participation of the Chief Economist, Alejandro Gaytán, and the Head of the Public Debt Unit, José de Luna. Moreover, and as required by law, the 2021 Budget Proposal should be delivered to the Lower House no later than September 8th, which includes: (1) The *General Economic Policy Criteria* –which states the macroeconomic projections used to estimate the budget–; (2) the *Revenue Law*; and (3) the *Spending Budget*. In the first two cases, they must be approved by both the Lower House (October 20th) and the Senate (October 31st), while the spending budget should be approved only by the Lower House no later than November 15th (see table below).

MoF Conference Call
April 3rd at 1:30pm (ET)
From Mexico:
(55) 7100 3113
(55) 8526 1831
Internationally:
+1 (888) 301 9857
+1 (917) 628 2292

Main deadlines for FY2021 Fiscal Budget

Deadline	Document
April 1	Preliminary Fiscal Year 2021 Economic Assumptions
September 8	2021 Budget Proposal
October 20	Lower House approval of the Revenue Law
October 31	Senate approval of the Revenue Law
November 15	Lower House approval of the *Spending Budget*

Source: Ministry of Finance

A need for a message that builds more confidence is needed. We believe that increasing the deficit in a moment of sanitary emergency, both globally and domestically, is an excellent first step to cope with the current backdrop. In our view, the mechanism embedded in the *Fiscal Responsibility Law*, in which the government has to forecast the long-term trajectory of public debt, is consistent with the administration's commitment to maintaining healthy public finances. In this respect, we believe this could help mitigate concerns by investors and public rating agencies, which also recognize the need to have a comprehensive strategy to deal with the health crisis. Moreover, we recognize that, today more than ever, a unified message by the government is needed –particularly incorporating the Legislative Branch–, in order to boost confidence further, with the goal of supporting investment and private consumption.

Analyst Certification

We, Gabriel Casillas Olvera, Delia Maria Paredes Mier, Alejandro Padilla Santana, Manuel Jiménez Zaldívar, Tania Abdul Massih Jacobo, Katia Celina Goya Ostos, Juan Carlos Alderete Macal, Víctor Hugo Cortes Castro, Marissa Garza Ostos, Miguel Alejandro Calvo Domínguez, Hugo Armando Gómez Solís, Gerardo Daniel Valle Trujillo, José Itzamna Espitia Hernández, Valentín III Mendoza Balderas, Santiago Leal Singer, Francisco José Flores Serrano, Luis Leopoldo López Salinas, Jorge Antonio Izquierdo Lobato, Eridani Ruibal Ortega and Leslie Thalía Orozco Vélez, certify that the points of view expressed in this document are a faithful reflection of our personal opinion on the company (s) or firm (s) within this report, along with its affiliates and/or securities issued. Moreover, we also state that we have not received, nor receive, or will receive compensation other than that of Grupo Financiero Banorte S.A.B. of C.V for the provision of our services.

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	Reference
BUY	When the share expected performance is greater than the MEXBOL estimated performance.
HOLD	When the share expected performance is similar to the MEXBOL estimated performance.
SELL	When the share expected performance is lower than the MEXBOL estimated performance.

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