2022 Preliminary Budget Criteria – Higher expected growth to improve the fiscal stance

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www.banorte.com
@analisis_fundam

Gabriel Casillas
IRO and Chief Economist
gabriel.casillas@banorte.com

Alejandro Padilla
Executive Director of Economic Research and Financial Markets Strategy
alejandro.padilla@banorte.com

Juan Carlos Alderete, CFA
Director of Economic Research
juan.alderete.macal@banorte.com

Francisco Flores
Senior Economist, Mexico
francisco.flores.serrano@banorte.com

- **The Ministry of Finance (MoF) published today their preliminary macroeconomic forecasts for 2022 and updates for the 2021 framework**
- **We highlight a higher estimate for GDP growth this year, to 5.3% from 4.6% y/y, in line with our call, and driven by the ongoing vaccination program and stronger US GDP growth (6.1% from 3.8% previously)**
- **Other relevant revisions were observed in oil-sector indicators, with the price of the Mexican oil mix strongly higher (55.0 US$/bbl), partially compensated by lower production (1,794kbpd) and a lower exchange rate (USD/MXN 20.20)**
- ***Public Sector Borrowing Requirements* (PSBR) stayed unchanged relative to approved figures, with a deficit of $842.4 billion (US$41.3 billion). Given this and higher growth, fiscal metrics as a share of GDP are estimated to improve relative to previous estimates throughout the forecast horizon**
- **Specifically, PSBR in 2021 are expected at -3.3% of GDP (previous: 3.4%) and at -2.9% next year. Considering also better results in 2020, the Historical Balance of the PSBR (HBPSBR) would reach 51.4% of GDP at the end of the year (previous: 54.7%), with an additional decline to 51.1% in 2022**
- **The document reaffirms the government's strategy of maintaining fiscal prudence, fostering the country's macroeconomic stability in a very complex global environment**

Better growth supports fiscal stance. The Ministry of Finance (MoF) published, as required by law, the *Preliminary Fiscal Year 2022 Economic Assumptions*, in line with Article 42 of the *Federal Budget and Fiscal Responsibility Law*. The document also updated the macroeconomic framework for 2021. We highlight the upward revision in GDP estimates for this year and 2022, to 5.3% and 3.6%, respectively. The latter, coupled with other adjustments, results in better fiscal metrics, reaffirming the federal government's prudent stance (see table below)

Macroeconomic framework and fiscal variables[1]
Selection

2021	GDP 5.3% (Previous: 4.6%)	USD/MXN: 20.20 (Previous: 21.90)	Crude oil price: US$/bbl 55.0 (Previous: 42.1)	Public deficit*: 3.3% (Previous: 3.4%)	Public debt**: 51.4% (Previous: 54.7%)	Primary balance 0.0% (Previous: 0.0%)
2022	GDP 3.6% (Previous: 2.6%)	USD/MXN: 20.40 (Previous: 22.20)	Crude oil price: US$/bbl 53.1 (Previous: 45.0)	Public deficit*: 2.9% (Previous: 2.6%)	Public debt**: 51.1% (Previous: 53.4%)	Primary balance 0.4% (Previous: 0.8%)

Source: MoF
1. GDP: Real annual growth rate; Nominal exchange rate at the end of the year; 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)

Stronger dynamism domestically and abroad. The MoF revised higher its estimate of GDP growth for 2021 to 5.3% (range: 4.3% to 6.3%) from 4.6% (range: 3.6% to 5.6%). This was mainly driven by two factors. First, the vaccination program already underway, which is expected to accelerate in coming months. We should mention that this was not incorporated in the previous estimate, as uncertainty about vaccine development and deliveries was very high. Second, a stronger outlook for US GDP, to 6.1% (previous: 3.8%). Both forecasts are exactly in line with our view, but below market expectations, with the latest Banxico survey at 3.7% and 5.0%, respectively. Nevertheless, for our country, it is relatively consistent with other multilateral organizations such as the OECD (4.5%) or the IMF (4.3%). For the latter we should point out that an upward revision is likely in next week's *World Economic Outlook*, as previewed by its Managing Director, Kristalina Georgieva. For 2022, the MoF estimates GDP growth of 3.6% (range: 2.6% and 4.6%), also higher than 2.6% previously. This is above consensus, noting that they are assuming an almost complete reopening of the economy in the year.

Macroeconomic framework 2021 and 2022

	2021				2022		
	Current	Previous	Banxico survey	Banorte	Current	Previous	Banxico survey
GDP (% y/y)	5.3	4.6	3.7	5.3	3.6	2.6	2.6
Exchange rate (USD/MXN, year-end)	20.20	21.90	20.30	19.80	20.40	22.20	20.85
Inflation (% y/y, year-end)	3.8	3.0	3.9	3.7	3.0	3.0	3.5
Interest rate (%, year-end)	3.8	4.0	3.75	4.0	4.3	4.8	4.00
Oil price (US$/bbl)	55	42	--	--	53	45	--
Oil production (kbpd)**	1,794	1,857	--	--	1,867	2,044	--
GDP US (% y/y)	6.1	3.8	5.0	6.1	4.0	2.8	3.3

Source: MoF, Banxico and Banorte
*MoF publishes an interval: 2021: Current: (-3.9% - 0.1%); Previous: (3.6% - 5.6%). 2022: Current: (1.5% - 3.5%); Previous: (2.1% - 3.1%)
**Thousand barrels per day

Oil-sector estimates mixed, but overall better for fiscal accounts. On a positive note, and recognizing recent market developments, the MoF adjusted higher its forecast for the Mexican oil mix to 55 from 42 US$/bbl. In our view, this is reasonable considering the current outlook for global demand and supply and a spot price of 59.25 US$/bbl. For 2022 they were also higher, at 53 US/bbl (previous: 45), consistent with the current path portrayed in oil futures. In terms of oil revenues, they expect this to compensate for lower oil production, to 1,794kbpd from 1,857kbpd –which considers a more persistent shock to investment spending by oil companies–, as well as a slightly stronger Mexican peso (see section below). This is a more conservative estimate than before taking into account that oil production last year averaged 1,663kbpd. Nevertheless, it still looks relatively optimistic. The MoF argues that financial support for Pemex, amounting to $170 billion (US$8.3 billion), should help the company free up resources for investment, in turn resulting in higher production. In this backdrop, for 2022 they see production at 1,867kbpd (previous: 2,044kbpd).

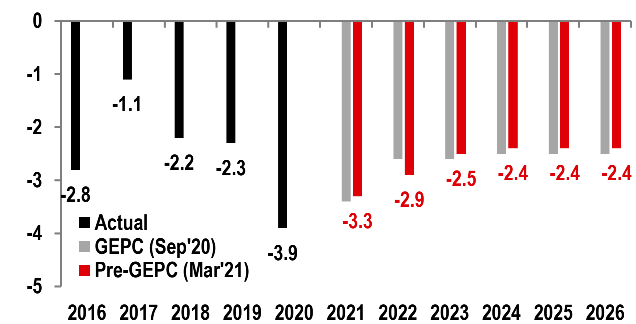
A stronger MXN, but higher inflation. Regarding the exchange rate, the estimate declined to 20.20 from 21.90 pesos per dollar at the end of this year (Banorte: 19.80). This was based on a lower level at the end of 2020 relative to the budget, the economic recovery currently underway, and the assumption of a gradual reversal of the pressures to the currency in recent weeks (driven by the adjustment higher in US Treasury yields, among other factors). For next year, the estimate declined by 8.1%, to 20.40. Although these adjustments are relevant, the MoF estimates that a 20 cents appreciation of the Mexican peso has an estimated net negative effect on the public balance of $6.5 billion (US$318 million) –considering its impact on oil revenues (negative) and debt-servicing costs (positive)–, equivalent to -0.02% of GDP. Meanwhile, the projection for inflation at the end of this year picked up meaningfully, to 3.8% from 3.0%. This acknowledges recent upward surprises and is in line with the central bank's latest forecasts, as is customarily done. Importantly, they incorporate a temporary increase in annual inflation in 2Q21 due to an adverse base effect, also consistent with Banxico's outlook. Overall, these changes look prudent to us, mostly reflecting recent developments and broadly in line with our views and consensus.

Higher revenues and expenditures. Incorporating changes to the estimates mentioned above, the Ministry of Finance now estimates total revenues at $5.7 trillion in 2021 (US$279.4 billion), equivalent to 22.6% of GDP. This also represents 0.4%-pts more than approved in the Revenue Law. As already mentioned, an important part of this comes from oil revenues on higher prices. It is important to say that this already includes the abovementioned financial support to Pemex. There is also a relevant increase in non-oil, as it contemplates: (1) More economic dynamism, along a faster than expected reactivation of activity; and (2) a more robust tax framework, continuing with efforts to collect taxes due that started in 2019. Nevertheless, it also incorporates a higher subsidy to excise taxes applied to gasolines, to protect real incomes. Total spending is expected at $6.4 trillion (US$313.7 billion), or 25.5% of GDP). This is $174.3 billion more than previously. Practically all of these resources will be destined to programmable spending ($173.4 billion). Regarding non- programmable spending, there is a $18.9 billion increase in transfers to states, with ADEFAS up $12.1 billion and a reduction of $5.9 billion in financial costs.

Stronger revenue growth in 2022. The document considers total revenues of $6.0 trillion (US$294.1 billion) next year, 2.4% in real terms relative to updated estimates for 2021. Oil income would be stable (0.0%) while non-oil would increase 3.4%, with relevant upward adjustments in tax revenues. Spending would reach $6.7 trillion (US$328.4 billion), up 0.9% y/y. Within, the programmable component would fall 0.8% and non-programmable spending is estimated to increase 5.5%. In the latter, we highlight a 5.8% increase in transfers to states by the Federal Government.

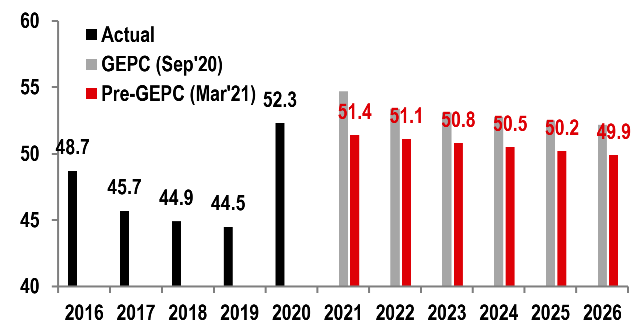
Better fiscal metrics in the forecast horizon. Despite the adjustments to income and spending in 2021, *Public Sector Borrowing Requirements* (PSBR) stayed unchanged, with a deficit of $842.4 billion (US$41.3 billion). Nevertheless, with the upward revision to economic activity, it is now projected at -3.3% of GDP (chart below, left) from -3.4%. For 2022, projections were modified more significantly, now seeing a deficit of 2.9% of GDP (previous: -2.6%). Regarding total debt, the Historical Balance of the PSBR would stand at 51.4% of GDP at the end of the current year. This a sizable improvement relative to the previous forecast of 54.7%, driven by: (1) A better starting point from 2020, with debt at 52.3%; and (2) a modest reduction in the PSBR. Going to 2022 and beyond, debt levels would extend their trend lower (chart below, right), in line with requirements in the *Fiscal Responsibility Law*.

Public balance*
% GDP



Source: PGEPC 2021, MoF.
*Measured by the Public Sector Borrowing Requirements

Public debt*
% of GDP



Source: PGEPC 2021, MoF
*Measured with the Historical Balance of the Public Sector Borrowing Requirements

Relevant comments within the conference call and relevant dates ahead. Unlike previous occasions, the conference call with analysts also took place today. This was carried out by Chief Economist, Iván Cajeme Villareal Camero. In it, he elaborated with greater detail son some of the assumptions behind the adjustments, mentioning some risks related to the supply of vaccines –both to the upside and downside– and other associated to the pandemic. In addition, he mtnioned that they expect the impact on excise tax collection from stimulus to gasolines to be of around $32 billion. Lastly, he noted that these estimates do not incorporate transfers from *Banxico's Operational Surplus* (BOS), mentioning that if the central bank posts a positive result, it should be delivered to the MoF in April. Going forward, and as required by law, the 2022 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).

Main deadlines for FY2022 Fiscal Budget

Deadline	Document
April 1	Preliminary Fiscal Year 2022 Economic Assumptions
September 8	2022 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

Austerity will continue, preserving the health of fiscal accounts. In our view, the document reaffirms the government's strategy of maintaining fiscal prudence, fostering the country's macroeconomic stability in a very complex global environment. We believe forecast changes and their impact on income and spending relative to the approved budget are adequate, recognizing a better global economic outlook –mainly because of vaccination programs and a greater impulse from external demand–. We also acknowledge the benefits from avoiding strong fiscal imbalances to foster a good environment for the recovery, while mitigating concerns of investors and credit agencies. Nevertheless, macro stability is necessary, but not a sufficient condition to boost growth and improve the population's well-being. In this respect, we remain concerned about the lack of more meaningful stimulus measures to cope with the hit from the pandemic shock, which will continue influencing growth dynamics this year. On the other hand, this situation could also affect potential GDP in the mid- and long-term. Specifically, we still believe it is key to promote a more favorable investment environment, both public and private. In the former, we will remain on the look for a potential fiscal reform for 2022, not incorporated in current projections but mentioned by several officials from the MoF, including by Minister Arturo Herrera. In the second case, we continue seeing high nervousness about some anti-market legislative proposals. Although these have not been approved, they have kept uncertainty very high, representing an important headwind for a sustainable acceleration in investment.

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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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GRUPO FINANCIERO BANORTE S.A.B. de C.V.

Research and Strategy			
Gabriel Casillas Olvera	IRO and Chief Economist	gabriel.casillas@banorte.com	(55) 4433 - 4695
Raquel Vázquez Godinez	Assistant	raquel.vazquez@banorte.com	(55) 1670 - 2967
Lourdes Calvo Fernández	Analyst (Edition)	lourdes.calvo@banorte.com	(55) 1103 - 4000 x 2611
Economic Research and Financial Market Strategy			
Alejandro Padilla Santana	Executive Director of Economic Research and Financial Markets Strategy	alejandro.padilla@banorte.com	(55) 1103 - 4043
Itzel Martínez Rojas	Analyst	itzel.martinez.rojas@banorte.com	(55) 1670 - 2251
Economic Research			
Juan Carlos Alderete Macal, CFA	Director of Economic Research	juan.alderete.macal@banorte.com	(55) 1103 - 4046
Francisco José Flores Serrano	Senior Economist, Mexico	francisco.flores.serrano@banorte.com	(55) 1670 - 2957
Katia Celina Goya Ostos	Senior Economist, Global	katia.goya@banorte.com	(55) 1670 - 1821
Luis Leopoldo López Salinas	Economist, Global	luis.lopez.salinas@banorte.com	(55) 1103 - 4000 x 2707
Market Strategy			
Manuel Jiménez Zaldívar	Director of Market Strategy	manuel.jimenez@banorte.com	(55) 5268 - 1671
Fixed income and FX Strategy			
Santiago Leal Singer	Senior Strategist, Fixed Income and FX	santiago.leal@banorte.com	(55) 1670 - 2144
Leslie Thalía Orozco Vélez	Strategist, Fixed Income and FX	leslie.orozco.velez@banorte.com	(55) 5268 - 1698
Equity Strategy			
Marissa Garza Ostos	Director of Equity Strategy	marissa.garza@banorte.com	(55) 1670 - 1719
José Itzamna Espitia Hernández	Senior Strategist, Equity	jose.espitia@banorte.com	(55) 1670 - 2249
Valentín III Mendoza Balderas	Senior Strategist, Equity	valentin.mendoza@banorte.com	(55) 1670 - 2250
Víctor Hugo Cortes Castro	Senior Strategist, Technical	victorh.cortes@banorte.com	(55) 1670 - 1800
Jorge Antonio Izquierdo Lobato	Analyst	jorge.izquierdo.lobato@banorte.com	(55) 1670 - 1746
Eridani Ruibal Ortega	Analyst	eridani.ruibal.ortega@banorte.com	(55) 1103 - 4000 x 2755
Hugo Armando Gómez Solís	Senior Analyst, Corporate Debt	hugoa.gomez@banorte.com	(55) 1670 - 2247
Gerardo Daniel Valle Trujillo	Analyst, Corporate Debt	gerardo.valle.trujillo@banorte.com	(55) 1670 - 2248
Economic Studies			
Delia María Paredes Mier	Executive Director of Economic Studies	delia.paredes@banorte.com	(55) 5268 - 1694
Miguel Alejandro Calvo Domínguez	Senior Analyst, Economic Studies	miguel.calvo@banorte.com	(55) 1670 - 2220
Wholesale Banking			
Armando Rodal Espinosa	Head of Wholesale Banking	armando.rodal@banorte.com	(81) 8319 - 6895
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.ceballos@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 Corporate Banking	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 Commercial Banking	victor.roldan.ferrer@banorte.com	(55) 5004 - 1454