Economic Analysis

Trouble brewing on the fiscal front

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The people working on the fiscal budget for next year - which has to be approved before 15 December - are presumably redoing the calculations using new assumptions for the main macroeconomic variables, the outlook for which has changed with the decision to cancel the Texcoco airport project.

These new assumptions should include: i) a weaker currency (BBVA Bancomer is now projecting a year-end exchange rate of 20.30 pesos to the dollar, compared with 18.80 previously, an 8% depreciation, and the market is forecasting similar levels); ii) higher interest rates (in the past month rates on ten-year government bonds have also risen by about 10% to 8.9%, the highest rate since 2009 and the onset of the global financial crisis).

Furthermore, both the majority of analysts - myself included - and the market now expect increases in Banco de México's monetary policy rate, whereas before the decision on the airport the consensus view had been of a prolonged monetary pause, and rates could increase even further if the rating agencies were to cut the country's sovereign credit rating; and iii) less economic growth, since levels of investment are expected to be lower.

All these factors will substantially reduce the next government's fiscal margin. The weaker currency will mean an increase in the debt service burden. I estimate this increase at around MXN 35.7 billion, or 0.2% of Gross Domestic Product (GDP). This is a considerable amount in a budget which, according to announcements, will seek a primary surplus of 0.8% of GDP.

It must also be pointed out that public debt will increase this year to 47.3%, from 46.2% in 2017, since foreign currency debt will be worth some 20 billion pesos more due to the depreciation of the Mexican currency. Moreover, even if the primary surplus target of 0.8% of GDP in 2019 were attained, the decrease in public debt would be very limited, to 46.8% at year-end (with 2.0% GDP growth and an exchange rate of 19.8 pesos to the dollar).

In other words, there is a clear risk that public debt will not decrease in 2019 if any additional economic policy errors are translated into a weaker currency and taking account of the fact that the depreciation that has already taken place will lead to lower economic growth than the forecast 2.0%.

The risk is that the foreign currency debt component (37% of the total) will tend to represent a greater proportion of the total debt, as was seen following the cancellation of the airport. The higher interest rates for their part, while not affecting the fixed rate debt already in place, will mean that new issues will represent greater financial cost for the government.

Lastly, the lower growth expected implies that to reach that surplus of 0.8% of GDP costs will have to be reduced in absolute terms. All this means that we will see an environment of increased fiscal and monetary pressure. We're in for a difficult year.

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