Economic Analysis

2020 Economic Package reinforces signals of fiscal discipline by considering primary surplus

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- **The economic package reinforces signals of fiscal discipline by establishing a primary surplus target at a weak period of the business cycle**
- **Consequently, it is positive that the federal government has proposed a primary surplus of 0.7% of GDP instead of the 1.3% that it had suggested in Pre-Criteria of economic policy for 2020**
- **However, the assumptions of the economic package face two main risks: i) lower economic growth than expected due to global and domestic factors, and ii) lower oil production than expected**
- **It is therefore advisable that, once the economic growth figures for the first quarter of 2020 are available, any adjustments necessary to meet fiscal targets should be made**
- **It is positive that the economic package addresses the fight against tax evasion, fraud and avoidance, although its contribution to tax revenues is uncertain**
- **The federal government should consider a comprehensive tax reform as soon as possible**

We believe the 2020 economic package maintains fiscal discipline by proposing a primary surplus target of 0.7% of GDP for the coming year, inasmuch as that the federal government is forecasting a positive primary balance at a weak period of the business cycle. This economic package will lead to a stable public debt-to-GDP ratio by the end of 2020.

The outlook for public finances is not risk free. Particularly noteworthy are those risks associated with both the economic growth forecast included in the economic package and the 13.0% annual increase in crude oil production predicted for 2020. With regard to economic growth, we believe that the risks have recently been intensified by the slowdown in global manufacturing, which has primarily been affected by international trade tensions. Meanwhile, private investment in Mexico has continued to weaken, and its eventual recovery could be delayed even further if the United States Congress does not ratify the USMCA this year as expected by the federal government. In relation to crude oil revenue, the dynamics expected by the government is mainly supported by increasing crude oil production from an estimated average of 1.73 million barrels per day in 2019 to an average of 1.95 million barrels per day in 2020.

It is important to mention that if economic growth was lower than the predictions made by the federal government and it were around 1.4%, the primary balance would be 0.0% of GDP in 2020 (assuming no adjustments are made to public spending). We therefore consider appropriate to review the economic package once the figures for economic growth for the first quarter of 2020 are available and, where necessary, make the adjustments in order to meet fiscal targets.

As far as tax revenues are concerned, it is positive that the 2020 economic package addresses the fight against tax evasion, fraud and avoidance. However, we believe that the ability of these measures to contribute to such revenues will ultimately depend on their efficient implementation and, therefore, their impact remains uncertain. In our view, the federal government should start designing a comprehensive tax reform as soon as possible in order to increase tax revenues and promote greater efficiency in public spending in the coming years.

Concerning public spending, the 2020 economic package provides a boost to social programs, public security and Pemex's energy projects. We think it is positive that the federal government seeks to mitigate social inequality and strengthen the rule of law. However, we believe that public policies with these goals should be evaluated to ensure that they are having the anticipated positive effects and, if they are not, they should be modified accordingly. In relation to Pemex, under any economic scenario, the budgetary support should be complemented by the reactivation of farmouts. This would lower the pressure on public finances by boosting investment in exploration and, subsequently, in oil production.