

Mexico's credit outlook revised upwards, reflecting fiscal consolidation

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On 18 July Standard and Poor's revised Mexico's sovereign credit outlook up to "stable", from "negative", reaffirming its rating at BBB+, two notches above the BBB- minimum required to count as investment grade. This is very good news. The chances of a downgrade in the country's sovereign credit rating are now substantially lower than they were at the end of last year. A downgrade would lead to an increase in financing costs for the federal government, businesses, banks and therefore the public in general.

What are the reasons for this change in outlook? I believe there are two main factors which are interrelated: the process of fiscal consolidation being implemented by the federal government and the improvement in the financial profile of Pemex. We should bear in mind that it was precisely these two factors that led to Mexico's credit outlook being revised downwards last year. Debt as a percentage of GDP had been increasing for some years, and the financial situation of Pemex looked very difficult, representing a significant risk to the public finances since in practice the state-run company's liabilities carry the implied guarantee of the government.

As for fiscal consolidation, this year's budget, which is well on the way to being met, will lead to a primary fiscal surplus, a phenomenon not seen since 2009. We must remember that every year from 1994 to 2008 Mexico had a primary fiscal surplus (the difference between revenue and expenditure without taking account of the cost of servicing government debt). This is a good measure of the government's current fiscal performance, since by excluding debt service costs we exclude financial obligations acquired in the past. These surpluses had been achieved thanks to the consensus reached since the country's macroeconomic crisis of 1994 on the importance of maintaining fiscal discipline in order to avoid a repetition of that crisis.

In 2009 the context changed. In that year Mexico suffered a recession as a result of the financial crisis in the USA and the AH1N1 'flu epidemic. It was therefore decided, correctly in my view, to implement a countercyclical fiscal policy of expansion to help cushion the effects of the recession. The problem was that this brought an end to primary fiscal surpluses. This year will be the first since then to show a surplus. As I have commented previously, this calls for the Law on Fiscal Responsibility to be amended so that when there is a need to resort to expansionary fiscal policies to confront significant falls in economic activity (which should occur only in extraordinary situations), clear and explicit mechanisms are triggered to return to sustainable fiscal policies.

The primary fiscal surplus that the government will achieve this year, together with the central bank's operating surplus, will mean that for the first time in ten years public debt will not increase as a percentage of GDP. I estimate that it will fall to 48% in 2017, from 50% at the end of 2016. The important thing is that this is an inflection point from which we can start to see a falling trend in debt.

The other factor that has reduced Mexico's risk profile is the significant improvement in the financial situation of Pemex seen since the change of CEO last year. Pemex has not only carried out a major cost cutting exercise but has also started to implement a business plan that will lead to the company's financial position

ceasing to be negative within a couple of years. This business plan is based essentially on forging alliances with private sector players so as to enable the company to attract capital and acquire know-how in the areas of exploration and operation of non-conventional oilfields. This strategy will help counter the investment constraints that Pemex has had to contend with for many years. The association formed for the Trión field is the first example of what this business plan may achieve.

One can only hope that the fiscal changes and the new strategy of Pemex will continue next year and in the following six years. This could lead to Mexico's credit rating possible being upgraded in the next few years.

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