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Mexico 2024 Budget Guidelines Highlight Commitment to Fiscal Stability

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Fitch Ratings-New York-06 April 2023: Mexico's recently released 2024 budget guidelines signal a general continuation of the country's fiscal path including prudent management to offset revenue deterioration, Fitch Ratings says. The overall implications of the forecasts and framework do not change our fiscal or macro expectations. The economic outlook remains clouded, however, namely by deteriorating growth in the U.S.

Mexico's 2024 preliminary budget guidelines (Pre-Criterios), released on April 1, updated forecasts and policy criteria as part of legislative requirements in the lead-up to the FY24 budget. Core changes to macro forecasts included higher inflation expectations for end-2023 (5.0% versus 3.2%) and higher interest rate expectations (11.3% versus 8.5%). The budget guidelines maintain the forecast for economic growth of 3% in 2023 and projects stable growth in 2024. Other forecast revisions included stronger appreciation of the Mexican peso and slightly lower oil prices, both of which affect dollar-denominated oil-related revenues.

The economic and fiscal outlook for Mexico faces risks from slowing growth, namely from deterioration in the U.S. Fitch's base case remains for a shallow recession in the U.S. starting in 2H23 with further risks from tighter-for-longer financial conditions. We forecast Mexican real GDP growth to be 1.6% and 1.5% in 2023 and 2024, respectively, which is well below the Ministry of Finance's (MoF) point estimate. Near-shoring is an important growth opportunity through higher U.S. demand for Mexico's production which may offset downside risks from the U.S. economic slowdown.

Inflation remains stubbornly high at 6.8% as of March 2023 and Banxico continued with monetary tightening at its latest March meeting, increasing its policy rate to 11.25%. The tighter monetary policy stance relative to the U.S. has been key to appreciation of the peso versus the U.S. dollar, coupled with robust remittances and higher FDI. Fitch anticipates Banxico is nearing the end of its policy tightening cycle as we project the policy rate will peak at 11.5% by mid-2023.

The Non-Financial Public Sector (including Pemex) deficit forecast was revised up slightly by the MoF to 3.7% of GDP for 2023 (3.6% previously) and to 2.7% for 2024 (2.2% previously) as a result of the more adverse macroeconomic context. Both revenues and expenditures are now expected to be lower compared to the 2023 budget estimates. The MoF stated its willingness to adjust spending lower to maintain a relatively steady fiscal deficit. The government could use fiscal buffers including the MXN27 billion FEIP and MXN25 billion Oil Fund to compensate for lower revenues. Pemex will continue to pressures the federal government fiscal balance as the government will likely have to provide financial support short of explicitly guaranteeing the oil company's debt.

The downward shift in revenue expectations for 2023 is mainly driven by lower tax and oil sector revenues. Weaker tax revenues in late 2022 fed into revenues forecast in 2023. Lower oil prices were the driver of the fall in oil sector revenues. The gradual reduction of the fiscal stimulus to maintain stable gasoline prices will provide some tax revenue support.

Overall, the MoF's macro forecasts and budget criteria are in keeping with the country's macroeconomic policy framework, which is a key support for the sovereign rating. Mexico receives a +1-rating notch adjustment to the output of our Sovereign Rating Model as part of our Qualitative Overlay that reflects an established record of prudent and credible policy and commitment to debt stability. This is offset by a one notch negative adjustment to reflect the fiscal burden from ongoing support for Pemex.

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