Scotiabank

GLOBAL ECONOMICS

LATAM INSIGHTS

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Contributors

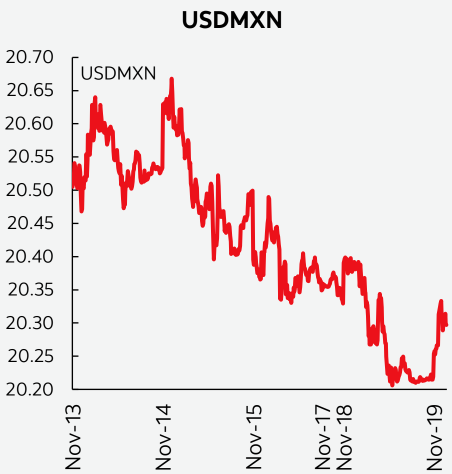
Eduardo Suárez, VP, Latin America Economics
+52.55.9179.5174 (Mexico)
esuarezm@scotiabank.com.mx

Rodolfo Mitchell, Director of Economic and Sectoral Analysis
+52.55.3977.4556 (Mexico)
mitchell.cervera@scotiabank.com.mx

Brian Pérez, Quant Analyst
+52.55.5123.1221 (Mexico)
bperezgu@scotiabank.com.mx

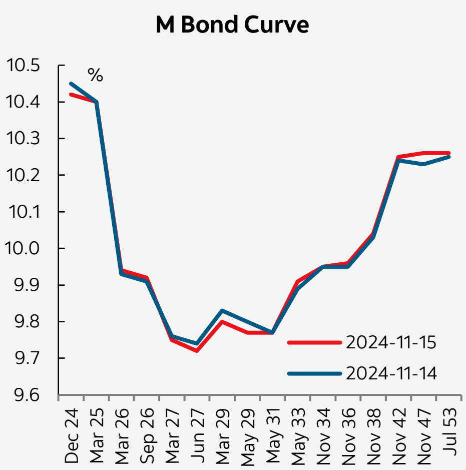
Miguel Saldaña, Economist
+52.55.5123.1718 (Mexico)
msaldanab@scotiabank.com.mx

Chart 1



Sources: Scotiabank Economics, Bloomberg.

Chart 2



Sources: Scotiabank Economics, Valmer.

Mexico's 2025 Economic Package and Budget

MARKET REACTION:

On Thursday of last week—the day before the Economic Package presentation—the credit rating agency Moody's changed Mexico's credit rating outlook from stable to negative. The statement indicates that one of the primary factors for Mexico's rating outlook change was the agency's assessment that the country's institutional framework has deteriorated following the series of reforms implemented by the government, including the Judicial Reform and the ongoing initiative to eliminate key autonomous institutions. Additionally, in the budget presentation, some of the assumptions behind it are materially more optimistic than market consensus (i.e., economic growth assumptions). Thus, it could be expected that the markets would react negatively to both events. However, even though Mexico's sovereign debt curve steepened, and interest rates rose, while the peso weakened, both reactions were initially moderate (chart 1). In our opinion, the modest reaction is due to the following:

- While Mexico's credit rating with Fitch is on the verge of losing investment grade (BBB-), with Moody's (Baa2) and S&P's (BBB), the country still has a "notch" of space to move before risking investment grade.
- Most of the holdings of Mexican bonds by foreign investors are in the hands of passive investors who follow investment-grade country indices (i.e., WGBI, etc.), and being passive, they do not react until the bonds are excluded from the index or their weighting is adjusted (chart 2). The other bucket of foreign holders are mainly investors who manage emerging market country indices (ELMI+, GBI EM, etc.), which, although primarily active, these indices do allow investment in non-investment-grade countries (i.e., they include Colombia and Brazil), and therefore the credit rating dynamics are less relevant in this bucket.
- Additionally, Moody's move was at least partially anticipated after the rating agency indicated that the reclassification of Pemex and CFE implied a convergence between the rating of these companies and the sovereign following their reclassification as public companies instead of state productive enterprises.

Going forward, we will have to wait for the response to the budget from Fitch and S&P's, as well as from the market. Typically, after the presentation of the Economic Package, it is necessary to wait a few days until the elements of the document are digested and analyzed, especially now that the documents did not include open data formats.

BUDGET APPROVAL DYNAMICS

On Friday, November 15th, the Secretary of Finance, Rogelio Ramírez de la O, delivered the Economic Package 2025 to the Chamber of Deputies, which includes the following documents:

1. **General Criteria of Economic Policy**
2. **Federal Revenue Law Initiative**
3. **Proposed Federal Expenditure Budget**

The next steps are for the Lower House to approve the Revenue Law before December 15th and for the Senate to ratify it before December 31st. For its part, the Expenditure Budget (which is solely the responsibility of the Lower House) has until December 31st to be approved.

The details of each document are presented below:

1. General Economic Policy Criteria (CGPE)

It presents the economic and fiscal policy guidelines for 2025, whose macroeconomic projections serve as the basis for estimating government revenues and expenditures. The most notable aspect is that these projections are more optimistic compared to market consensus. Table 1 provides a summary of the main variables.

Table 1: Mexico - Macroeconomic Projections 2025

2025	CGPE	GPE Pre-Criteria	Scotiabank / Market
GDP	(2.0 - 3.0)	(2.0 - 3.0)	1.0
Inflation	3.5	3.3	3.8
Exchange Rate (MXN/USD) e.o.p.	18.50	18.00	21.30
Interest Rate (CETES 28d) e.o.p.	8.00	7.00	8.09*
Price of the Mexican Mix ($/b)	57.8	58.4	64.07**
Oil Production (Mn Barrels of Oil)	1,891	1,877	1749***

* Estimated by Banxico
**Current price of the mix
***Figures as of September 2024
Data as of November 15
Sources: Scotiabank Economics, Banxico, Bloomberg, SHCP.

POSITIVE POINTS:

Inflation and Interest Rate Projections: Estimates are in line with market consensus, although these data do not yet incorporate the possible inflationary policies that Trump could implement during the first months of his term. In this regard, we believe that the upside risks to inflation in Mexico are increasing, which, if materialized, would affect the monetary policy stance throughout 2025. Given the increase in uncertainty in Mexico and therefore in the country's risk, it is difficult to imagine a target interest rate spread between Mexico and the United States of less than 550 basis points. This more complicated environment puts pressure on a less-aggressive Banxico in the rate-cutting cycle next year.

Mexican Crude Oil Price: The forecast showed in the package seems conservative, considering that the upside risks related to geopolitical tensions have increased, which could push oil prices higher. This would benefit Pemex's finances and therefore Mexico's public finances.

CONCERNING POINTS:

GDP Projections: The Ministry of Finance's projections related to economic growth are more positive than those of analysts. This calls into question the levels of revenue collection, the public deficit (Public Sector Financial Requirements) as a percentage of GDP, and the projected debt level for the following year. It is important to highlight that the budget contemplates another significant drop in public investment (to 2.3% of GDP), which does not favour an optimistic view of growth.

Exchange Rate: The exchange rate projection is somewhat optimistic, especially considering the recent depreciation resulting from an increased uncertainty due to significant international and domestic events that have materialized over time. Additionally, the expectation of tariffs imposed by the U.S. government on Mexican imports could lead to further weakening of the USDMXN in the coming months.

Oil Production: We believe that oil production projections remain very optimistic considering the energy reform and that 54% of national production must come from the government, which will limit the total crude oil production in the country.

On the other hand, the Ministry of Finance (SHCP) released the revenues and expenditures sensitivities (elasticities) for 2025, highlighting a 1% change in growth results in a variation of 26 billion pesos in fiscal revenues. Similarly, the effect of a $1 increase in the price of crude oil would result in an increase in oil revenues of 13.1 billion pesos. Additionally, the ministry included the effect of a 20-cent depreciation in the exchange rate, which would imply a decrease of 4.9 billion pesos. Meanwhile, a 100-basis point increase in interest rates results in an increase in debt costs of 33.8 billion pesos.

Considering these sensitivities published in the CGPE, we calculate that a 1% GDP growth next year could imply a drop in revenues of between 52.8 and 105.6 billion pesos. On the other hand, if monetary policy is not as aggressive as anticipated and Banxico only delivers 100 basis points cuts in its reference interest rate next year, instead of 200 basis points, this could negatively impact financial costs by 33.8 billion pesos, representing a combined increase of between 86 and 139 billion pesos in the public debt (table 2).

Table 2: Mexico - Sensitivity of Income and Expenditures in 2025

	Billions of Pesos
Effect of a half-point increase in real economic growth on tax revenues	26.40
Effect of an additional dollar in the price of oil on oil revenues	13.10
Effect of a 20-cent appreciation in the average exchange rate on:	-4.90
Oil revenues (-)	-8.30
Financial cost (+)	3.40
Effect of a 50 mb increase in crude oil extraction on oil revenues	18.70
Effect of a 100 basis point increase in the interest rate on the financial cost	33.80
Effect of a 100 basis point increase in the inflation rate on the financial cost	1.80

Sources: Scotiabank Economics, SHCP.

2. Federal Revenue Bill (ILIF)

It presents the expected government revenues for 2025. According to the document, total budget revenues are estimated at 8,056 billion pesos, of which 1,142 billion pesos correspond to oil revenues and 6,914 billion pesos to non-oil revenues. This represents a 3.0% increase in real terms in tax revenues for 2025 in comparison to the estimate for 2024 (chart 3). This increase mainly stems from the government's efforts to eliminate tax evasion, measures to promote digitalization and simplify tax payments, as well as an expectation of higher growth for 2025 (table 3).

POSITIVE POINTS:

The projected 10% increase in revenues from fees, duties, and products is interesting. This results from the proposed reforms to the **Federal Fees and Royalties Bill 2025**, which suggest adjustments related to migration, fees for obtaining documents that certify visitors' stay, as well as fees applicable to airport services for international flight passengers. In terms of the environment and natural resources, the reform proposals suggest updating fees for the non-extractive use and exploitation of protected natural areas. Finally, in the mining sector, it is proposed to increase special and extraordinary mining duties from 7.5% to 8.5% and from 0.5% to 1%, respectively.

CONCERNING POINTS:

Oil Revenues: We are realistic that the estimate that Pemex's revenues will contract. However, we are concerned about the assumption that production will reverse the declining trend. It is very optimistic to think that government revenues related to this sector will increase by 29% in comparison to the previous year's estimate, which has been significantly revised downward from what was approved by last year's law.

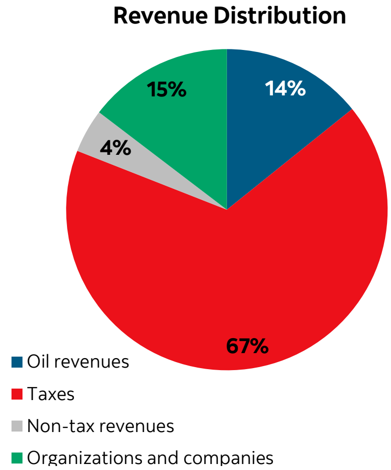
Tax Revenues: It seems very difficult for the economy to grow by 3% next year, which will directly affect income tax collection due to the slowdown in formal job creation and VAT collection due to lower consumption dynamism. Additionally, the stagnation observed in remittances, which could be affected by a policy of mass deportations, could contribute to lower collection. Similarly, the policy of increasing tariffs on imports from countries with which Mexico does not have trade agreements, implemented in April 2024, anticipates an 8% increase on imports taxes compared to 2024, which seems high if we consider that this tariff aims to protect the domestic industry.

Collection Efficiency: During López Obrador's administration, it was demonstrated that this resource has worked. However, it is not clear how much room there is to improve collection.

3. Federal Budget Proposal (PPEF)

It presents the expected government expenditures for 2025. The government's net expenditure for 2025 is proposed at $9,226 billion pesos, which represents an increase of 0.54% in real terms compared to the estimated amount for 2024. Of the total expenditure, 70% is programmable, and the remaining 30% is non-programmable. Chart 4 and table 4 show this distribution, as well as an explanation of what each type of expenditure includes.

Chart 3



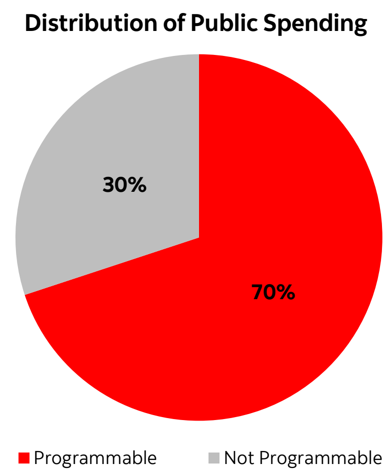
Sources: Scotiabank Economics, SHCP.

Table 3: Mexico - 2025 Revenue Bill (Billions of Pesos)

	2024*	2025	Change (%)
Oil Revenues	1,095	1,142	4.3
Non-Oil Revenues	6,606	6,914	4.7
Taxes	5,141	5,296	3.0
Non-Tax Collection	339	374	10.4
Organizations and Companies (IMSS, ISSSTE, CFE)	1,127	1,243	10.3
Total (Oil + Non-Oil)	7,701	8,056	4.6

*Estimated
Sources: Scotiabank Economics, SHCP.

Chart 4



Sources: Scotiabank Economics, SHCP.

Table 4: Mexico - Distribution of Expenditures

What is Programmable Spending?
Includes current expenditure, pensions and retirement, as well as investment expenditure
Its purpose is to provide goods and services to the population, so it includes expenditure on social programs
What is Non-Programmable Spending?
Includes transfers to federal entities and municipalities, as well as payment of current and past government debt obligations
Its purpose is to provide resources to the states and pay the debt

Source: Scotiabank Economics.

Regarding the reallocation of spending in branches, as shown in table 5, most autonomous agencies would face cuts, except for the electoral institute (INE). In this regard, the 14.8% decrease in resources for the Federal Economic Competition Commission is notable, but the 18.4% cut in the National Institute for Transparency (INAI) also stands out. On the other hand, the cut to INEGI is also worth noting, likely explained by the economic censuses conducted in 2024. However, it is a concerning sign, as it is a world-renowned institute for measuring Mexican economic performance.

Table 5: Mexico - Programmable Expenditure in Autonomous Branches (Millions of Pesos)

Branch	2024*	2025	Change %
Legislative Branch	19,180	18,070	-5.8
Judicial Branch	88,398	85,026	-3.8
National Electoral Institute	39,376	40,476	2.8
National Human Rights Commission	1,795	1,722	-4.1
Federal Economic Competition Commission	807	688	-14.8
Federal Telecommunications Institute	1,751	1,680	-4.1
National Institute for Transparency, Access to Information and Protection of Personal Data	1,218	994	-18.4
Attorney General's Office of the Republic	20,155	20,126	-0.1
INEGI (National Institute of Statistics and Geography)	14,851	12,245	-17.5
Federal Administrative Court (TPJA)	3445	3304.5	-4.1
Total Autonomous Organizations + INEGI + TFJA	190,977	184,332	-3.5

*Estimated
Sources: Scotiabank Economics, SHCP.

In terms of administrative branches, there was a 7.8% real drop compared to the estimated expenditures for 2024, with budget cuts in 21 out of 26 ministries, highlighting the significant decrease of almost 44% in defense and more than 36% in the budget for Security and Citizen Protection Secretary, which does not contribute to addressing the serious issues related to these topics in the country. Additionally, the cuts of 39.41% in the Ministry of Environment and Natural Resources and 34% in the Department of Health are notable, as these are strategic sectors for economic and social development. On the other hand, spending in infrastructure, communications, and the Department of Transportation increased by 72% to 141 billion pesos, while the budget for public education remained practically unchanged (table 6).

Table 6: Mexico - Programmable Expenditure in Administrative Branches (Millions of Pesos)

Administrative Branch	2024*	2025	Change %
Well-Being/ Social Development	567,061.3	579,883.9	2.26
Public Education	443,858.9	450,887.9	1.58
National Defence	270,465.1	151,995.0	-43.80
Energy	201,393.2	138,307.4	-31.32
Non-Sectorized Entities	143,864.3	174,623.0	21.38
Security and Citizen Protection	110,339.1	70,422.2	-36.18
Health	101,114.1	66,693.2	-34.04
Infrastructure, Communications and Transportation	81,837.0	140,799.0	72.05
Agriculture and Development	77,260.7	73,616.7	-4.72
Navy	74,944.9	65,888.7	-12.08
Environment and Natural Resources	73,232.4	44,370.5	-39.41
National Council of Science and Technology and Innovation	34,581.2	33,295.9	-3.72
Labour and Social Security	29,819.4	27,830.2	-6.67
Treasury and Public Credit	29,525.1	25,626.3	-13.21
Culture	17,467.3	12,081.5	-30.83
Agrarian, Territorial and Urban Development	13,427.9	38,048.0	183.35
Government	11,330.9	10,304.8	-9.06
Foreign Relations	10,419.4	9,294.2	-10.80
Economy	4,128.8	3,597.9	-12.86
Tourism	2,057.6	1,774.9	-13.74
Public Service	1,706.2	1,699.0	-0.42
Agrarian Courts	999.8	891.8	-10.80
Office of the President of the Republic	963.4	867.6	-9.94
Energy Regulatory Commission	297.6	199.9	-32.83
National Hydrocarbons Commission	258.1	173.3	-32.86
Legal Counsel of the Federal Executive	171.5	149.6	-12.77
Total	2,302,525.2	2,123,322.4	-7.78

*Estimated
Sources: Scotiabank Economics, SHCP.

Regarding the Programmable Spending in Other Branches, the budget for direct control entities such as IMSS and ISSSTE increased by 5.04%, while spending for Pemex was cut by 2.35% compared to 2024 (table 7).

Table 7: Mexico - Programmable Expenditure in Other Branches (Millions of Pesos)

Branch	2024*	2025	Change (%)
Entities of Direct Control	1,899,243	1,995,026	5.04
Mexican Social Security Institute	1,403,181	1,469,410	4.72
Institute of Security and Social Services for State Workers	496,062	525,615	5.96
Public State Enterprises	989,771	1,009,727	2.02
Pemex	475,412	464,255	-2.35
Federal Electricity Commission	514,360	545,472	6.05
Contributions, Subsidies and Transfers	1,397,648	1,493,069	6.83

*Estimated
Sources: Scotiabank Economics, SHCP.

Regarding social programs, it is noteworthy that practically the same budget is allocated to public education as to the Pension Program for Older Adults, showing the growing inertia in social transfers in an ageing population, while 131 billion pesos will be allocated to the Benito Juárez Scholarship Program. Additionally, the new administration will focus on the development of railway infrastructure, with more than seven projects in this sector (tables 8 and 9).

Table 8: Mexico - Social Priority Programs (Millions of Pesos)

Program	PPEF 2025
Pension for Elderly Population	483,427.6
Pension for People with Disabilities	28,961.4
Benito Juárez Scholarship Programs	131,926.5
Rita Cetina Universal Basic Education Scholarship	78,840.7
Youth Writing the Future	12,163.5
Benito Juárez Universal High School Scholarship	40,922.40
School is Ours	25,000.0
Youth Building the Future	24,205.0
Girls and Boys	3,185.0
Sowing Life	39,100.0
Fertilizers	17,500.0
Production for Well-Being	16,300.0
Guaranteed Prices	12,500.0
Fishing	1,600.0
Social Housing Program	32,000.0
Transfers for Women from 60 to 64 years old	15,000.0
House-to-House Well-Being	2,000.0
High Schools and Universities For Well-Being	3,000.0
Total	**835,705.5**

Sources: Scotiabank Economics, SHCP.

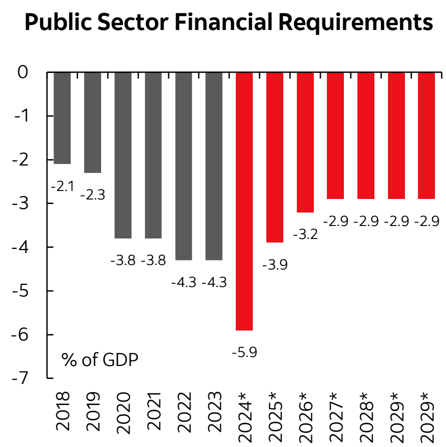
Table 9: Mexico - Priority Investment Programs (Millions of Pesos)

Concept	PPEF 2025
Maya Train	40,000
Mexico - Querétaro Train	30,000
Interoceanic Train	25,000
AIFA - Pachuca Train	25,000
Projects to Build and Maintain CONAGUA's Hydraulic Works	20,000
Priority Projects For The Construction and Maintenance of Communication and Transportation Routes - SICT	20,000
Saltillo - Nuevo Laredo Train	10,000
Querétaro - Irapuato Train	10,000
Interurban Train	6,000
AIFA Lechería Train	3,000
Total	189,000

Sources: Scotiabank Economics, SHCP.

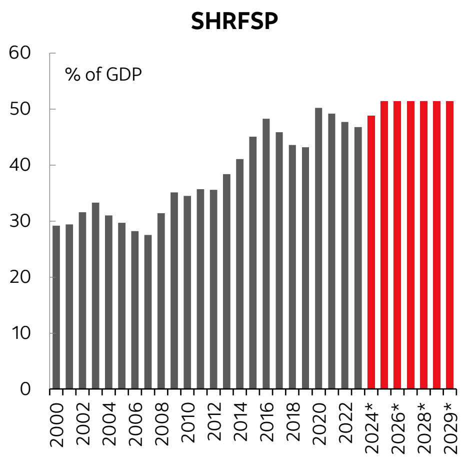
In summary, the 2025 economic package leaves some doubts regarding macroeconomic assumptions, as well as the consequences of significant spending cuts in key sectors. It seems unlikely that the public balance (Public Sector Financial Requirements) will end the year with a deficit of 3.9% of GDP, given a slowdown in consumption, lower remittances, and reduced investment, which will result in lower growth than anticipated by the Ministry of Finance (charts 5 and 6). Also, it is not clear that the proposed cuts could materialized completely as many of them hold some inertial trends that would be difficult to overcome. This will negatively impact the debt-to-GDP ratio, putting pressure on its sustainability, which could be reflected in a downgrade of the sovereign debt credit rating, increasing its cost. In this regard, it will be crucial to closely monitor the evolution of the economic program and be attentive to possible revisions during the publication of the preliminary general economic policy criteria for 2026, published in April 2025.

Chart 5



*Years after 2023 represent SHCP estimates.
Sources: Scotiabank Economics, SHCP.

Chart 6



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