Mexico Intelligence Report – 19th February 2016

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Economic update: a return to prudence

In a clear to attempt to signal that Mexico´s monetary and fiscal policy are properly aligned, the country´s Minister of Finance Luis Videgaray and the Governor of the Central Bank (Banxico) Agustin Carstens made a joint announcement regarding various policy changes in order to move the Mexican economy away from risky waters.

Firstly Mr. Videgaray announced budget cuts in the order of 0.7 per cent of GDP, a total of 132 billion pesos (£5bn). The measure is a move back to more prudent fiscal policy that has characterized Mexico since the Tequila Crisis of 1994, given that revenue from oil accounts for close to a fifth of the Mexican government's intake and that public debt started to grow with somewhat less discipline, reaching 48.3 per cent of GDP in 2015, at least 5 percentage points higher than what the Ministry of Finance had anticipated.

It should be noted that Pemex, the national oil company, will account for the lion's share of spending cuts. This outcome was already evident a week ago when the former CEO of the state owned enterprise, Emilio Lozoya, was replaced by José Antonio González, a specialist in pensions and restructuring and former General Director of Mexico's Social Security Institute. Mr. González has already revealed that $100 billion pesos in cuts are underway at the oil behemoth. A further consequence of Pemex's downsizing is that it opens the door for join ventures and further collaboration with private sector players.

Furthermore, Mr. Carstens announced that the Banxico will raise interest rates by 50 bps to 3.75 per cent. The measure had immediate effects as the dollar fell by 3.2 per cent from Tuesday when the increase was announced to Thursday.

Additionally, Mr. Videgaray and Mr. Carstens announced that the Mexican government will suspend the auction of dollars, as a "protest" against what they consider is a mismatch between the market's perception of the peso's value and its underpinning macroeconomic fundamentals.

Although the overall consensus among analysts in the country seems to suggest that the move back to macroeconomic prudence from the Mexican government will hit growth during 2016 –primarily due to decrease in demand from the public sector- the decision ultimately signals a to opt for discipline for the sake of financial and macroeconomic stability (particularly in the case of fiscal management), which is likely to if not increase certainty among investors, at least mitigate whatever qualms regarding the country's short and medium term prospects.

Energy update

Despite the plunge in oil prices, Mexico's fourth auction of oil blocks continues to boast a respectable showing. This tender is comprised by deep-water blocks for exploration, which are considered to be "the jewel" of the 2013 Energy Reform.

According to the National Commission for Hydrocarbons, at least 19 companies have expressed interest in the auction so far and seven companies have gained access to the data room, namely: Chevron, Total, Atlantic Rim, Hess, NBL, Shell and Statoil.

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