Mexico

Investment has stalled

Having more or less stagnated in 2019, economic growth is likely to bounce back a little in 2020, boosted by private consumption and net exports. Despite an infrastructure programme that is largely open to the private sector, the outlook for investment is struggling to improve. One year after Andres Manuel Lopez Obrador, generally known as AMLO, came to power, his economic policy is still hard to decipher. The lack of clarity on energy sector reform is also affecting investor sentiment. At the same time, the risk of a loss of control of the public finances is growing: against a background of low growth, maintaining the austerity programme favoured by the government will prove more difficult from 2021.

A small improvement in growth in 2020

Having more or less stagnated in 2019, growth is likely to bounce back a little in 2020. Private consumption will remain the main engine of growth, boosted by the increase in real wages and remittances from foreign workers (up nearly 9% y/y over the first three quarters of 2019). As in 2019, exports are likely to make a positive contribution to growth, despite a slight slowing in the US economy.

However, the outlook for investment has not seen any clear improvement. Over the first three quarters of 2019 private investment fell by nearly 4% year-on-year. This fall reflects investors' caution with regard to the AMLO administration since it was elected in July 2018, and their wait-and-see attitude to the policies to be pursued during his term of office.

With the aim of providing some reassurance and improving prospects for investment, the government announced a massive infrastructure programme at the end of November. This includes a total of nearly 150 projects for a total budget of USD 43 billion, or nearly 4% of GDP, which is very broadly open to the private sector. The first phase, covering the transport and telecoms sectors, is likely to begin in the first quarter of 2020. However, several of the projects announced were already planned and partly financed, and operational difficulties could significantly delay their progress. Meanwhile, the second phase of the plan, due to provide project details, particularly in the energy sector, has yet to be published. All in all, even if several projects do get under way in the first quarter of 2020, the increase in investment will remain limited.

The energy sector has a central role

Announcements regarding the energy sector are eagerly awaited. First, because changes in the future involvement of private investors in the sector remain very uncertain. When he came to power in December 2018, AMLO announced the cancellation of the energy reforms introduced by the previous government and his intention of putting two publicly-owned companies, PEMEX (responsible for oil industry operations) and CFE (the national electricity company) at the heart of the sector. Under this approach, the involvement of private-sector operators is likely to be reduced gradually over the course of his term.

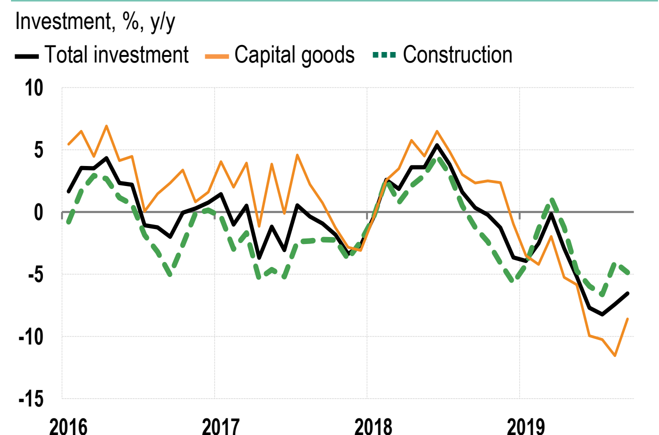
Since the end of 2018, the government has effectively brought an end to private tenders for the project to build a new refinery and suspended the planned tenders to supply power to CFE. In October

1- Forecasts

	2018	2019e	2020e	2021e
Real GDP growth (%)	2,0	0,1	0,6	1,7
Inflation (CPI, year average, %)	4,9	3,7	3,1	3,4
Budget balance / GDP (%)	-2,1	-3,2	-3,7	-3,8
Public debt / GDP (%)	53,8	47,8	50,3	53,5
Current account balance / GDP (%)	-1,8	-0,9	-1,1	-1,2
External debt / GDP (%)	36,5	37.0	39,6	39,8
Forex reserves (USD bn)	174,8	180	178	178
Forex reserves, in months of imports	3,8	3,5	3,6	3,6
Exchange rate USDMXN (year-end)	20,0	18,9	18,5	18,3

e: BNP Paribas Group Economic Research estimates and forecasts

2- Investment in decline



Source: INEGI

2019, the government also indicated a change in the rules governing the "clean energy certificates" mechanism, with the aim of limiting the involvement of private investors in this market, encouraging the development of the electrical power market and thus increasing the weight of CFE.

As with the cancellation, a year earlier, of the construction of a new airport, this decision took investors by surprise and served to increase investor caution with regard to the government.

At the same time, the operational and financial position of public companies, particularly PEMEX, represents a significant source of vulnerability for the Mexican economy. In July of last year, the

government presented a fairly unconvincing five-year business plan based on very optimistic assumptions (both for production growth and forecasts of reserves), which further limited cooperation with private investors and called for substantial investment in refining, a loss-making business. The government also announced an increase in financial support to the company (again, this was probably underestimated), together with a reduction in tax on oil revenues.

Recent capital injections (USD 5 million in September 2019) have helped improve the short-term financial position, but this remains very fragile for the medium term. According to IMF estimates, even assuming a stabilisation of production over the next five years and the investment that has been announced under the development plan, the company is likely to continue to make losses, which will no doubt require fresh injections of capital, which would hit the public finances. In addition to which, the possible difficulties experienced in refinancing the debt would bring further pressure.

Fiscal austerity maintained

When it presented its 2020 budget, the government renewed its commitment to supporting growth without degrading the public finances or increasing taxes and duties during the first part of its term (i.e. up to 2021).

Under this framework, the budget incorporates an increase in spending of only 1% (in real terms, relative to the 2019 budget). As indicated by AMLO, the Energy Minister (whose budget has increased 20-fold) and the state oil company PEMEX (whose budget has increased by nearly 9%) have been particularly favoured, to the detriment of several social programmes and the budgets of the federated states. According to government forecasts, the primary surplus and the government deficit are likely to be 0.7% and 2.6% of GDP respectively (from a projected 1% and 2.7% in 2019) and the government debt ratio will stabilise at 46% of GDP.

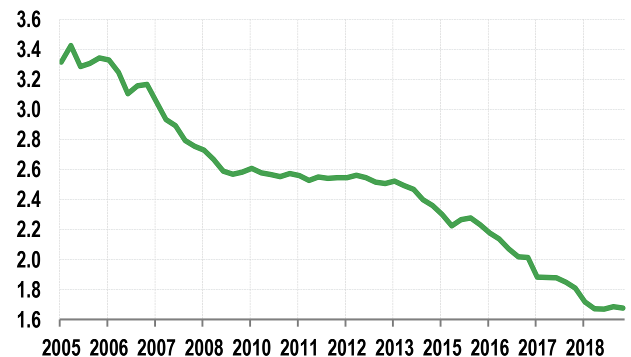
The government's commitment might, however, be hard to meet, as the assumptions made in the budget look over-optimistic. The government is expecting GDP growth of 2% in 2020, and an increase in oil production (combining production from the state oil firm PEMEX and private production) rising to 1.95 million barrels per day.

However, since the beginning of 2019, oil production has stabilised at around 1.7 million barrels per day (see Chart) and the Mexican National Hydrocarbons Commission forecasts a fall in production of around 5% in 2020. On this assumption, the loss of revenue is likely to be around 0.5% of GDP, or a figure close to that estimated by the Ministry of Finance for 2019.

The government indicated that the loss of revenue for 2019 would be offset by drawing on the reserves of the Oil Revenues Stabilisation Fund (FEIP) to the tune of 0.6% of GDP. According to the IMF, these reserves were the equivalent of around 1.3% of GDP, which means that the government could repeat the exercise in 2020.

3- Oil production has stabilised at low levels

PEMEX oil production, millions of barrels per day



Source: PEMEX

But for how long?

The government's contradictions are weighing on medium-term prospects. The country remains exposed to a change in investor sentiment, and the lack of clarity in economic policy, particularly concerning energy reforms, has reinforced the wait-and-see attitude adopted since the election. At the same time, the risk of a loss of control of the public finances is growing: against a background of low growth, maintaining the austerity programme favoured by the government will prove more difficult from 2021. Spending had already been cut significantly by the previous government (close to 13% of GDP in 2019, from 17% in 2015), leaving little room for manoeuvre, and FEIP reserves will not be enough to cover the shortfall in revenues (and financing requirements at PEMEX) over the whole of the government's term. Lastly, the informal economy remains very large in Mexico (58% according to INEGI), suggesting that even if the fiscal reform promised by AMLO is introduced in 2021, revenues would not increase by enough to offset the fall in revenues resulting from the weakness of growth.

Hélène Drouot
helene.drouot@bnpparibas.com