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# Public finances as of May: Public finances started feeling the 'Covid-19' vibe

- Yesterday June 30th, the Mexican Ministry of Finance released its monthly report on public finances as of May.
- The composite shock to economic activity and oil prices/production led to a sharp contraction of revenues. Although expenditures have increased on annual terms, they are still under-executed relative to the amount budgeted.
- Total revenues decelerated to a -3.1% YoY in the aggregate of the first five months of the year, involving a YoY drop of 47.3% in oil revenues, and a 2.1% YoY growth in tax revenues.
- On the expenditure side, total expenses rose to 4.6% as of May. The increase comprises a 4.8% YoY increase in primary expenditures, a 2.7% growth in the financial cost of debt, and a 1.0% upsurge in other non-programmables. On the primary expenditure branch, the federal government continues increasing its expenses, reaching a cumulative 10.8% YoY.
- We expect the deterioration of the public sector's deficit will continue as long as economic activity remains depressed. Given the current shortfall in revenues relative to the amount budgeted and the fact we are already in Q3, it allows authorities to withdraw resources from the stabilization fund FEIP.
- Once the fund is eroded, they will rely on other minor trust funds to offset the more significant deficit. However, we expect these resources will not be enough to cover all the borrowing needs and pressure upwards, both the deficit and debt. The challenges for public finances will be non-negligible by any standard.

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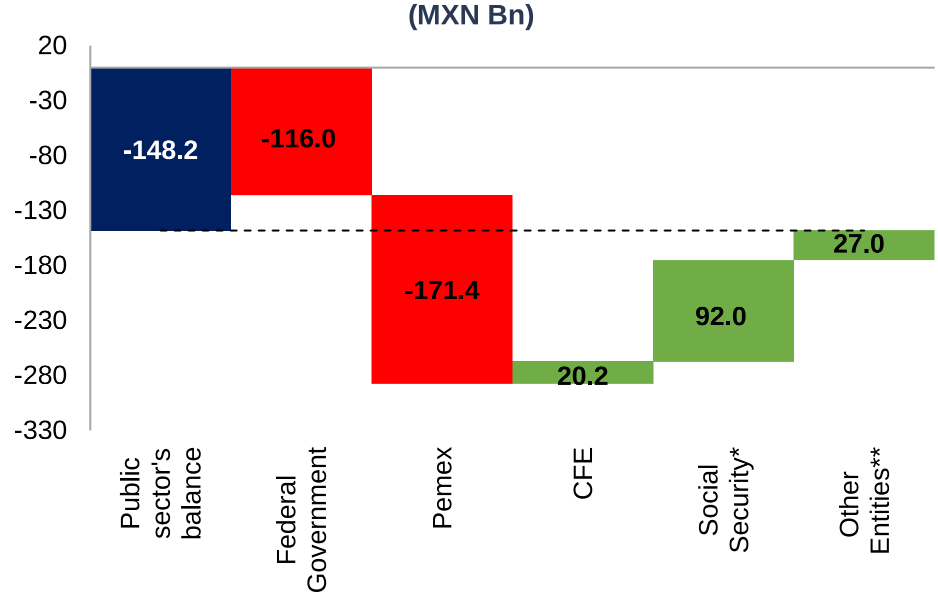
The composite shock to economic activity and oil prices/production led to a sharp contraction of revenues. Although expenditures have increased on annual terms, they are still under-executed relative to the amount budgeted. As of May, the public sector's balance resulted in an MXN 148.2 Bn deficit, MXN 5.3 Bn above the program (MXN 142.8 Bn deficit). Within:

- The federal government registered an MXN 116.0 Bn deficit.
- Regarding the two state-owned enterprises performance:
  - Pemex registered an MXN 171.4 Bn deficit, which represents 2.4x the one budgeted, and a 168.1% increase from last year.
  - CFE recorded an MXN 20.2 Bn surplus, considerably above the estimated figure of MXN 13.9 Bn.
- Social security institutions, namely IMSS and ISSSTE, accumulated an MXN 92.0 Bn surplus as of the fifth month of the year, MXN 13.6 Bn above the program. Although IMSS, the private sector's social security institution, continues to over-perform the surplus budgeted, the size of that improvement has reduced partly due to loans granted to SMEs. As of May, IMSS over-performance reduced by almost a half from MXN 6.2 Bn in April to MXN 3.4 Bn. As we noted previously, the latter will reduce the fiscal space available to other entities within the public sector's balance.

**Figure 1. Public sector's balance across entities as of May (MXN Bn)**

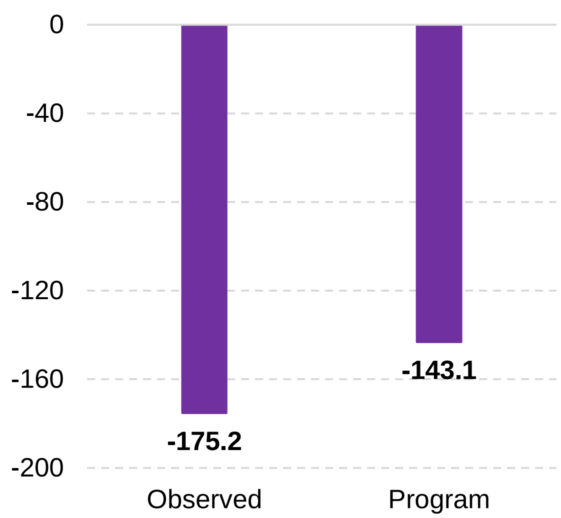



* IMSS + ISSSTE. ** Entities not under direct budgetary control.
Source: Finamex Economic Research with data from the Mexican Ministry of Finance.

*Balance*

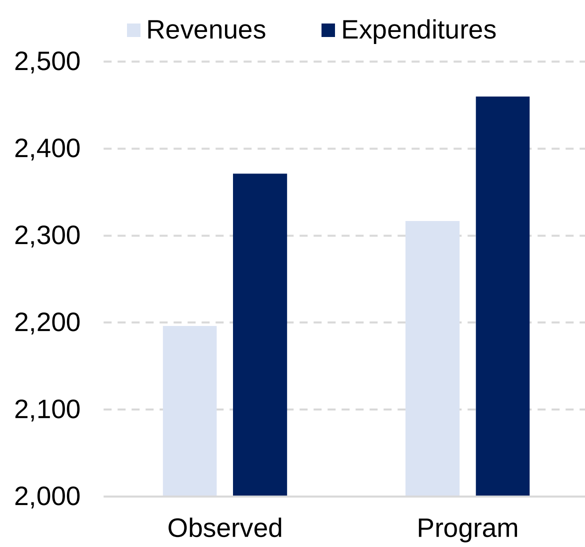
The public sector's balance as of May excluding entities not under direct budgetary control of the federal government registered an MXN 175.2 Bn deficit, MXN 32.0 Bn below the amount budgeted (see Figure 2a). The gap consists of the following: 1) the under-execution of spending relative to the amount budgeted of MXN 88.4 Bn, yet accounting to a 4.6% YoY growth in real terms, and 2) an MXN 120.5 Bn decrease in revenues relative to the amount approved for this year –which still implied a 3.1% YoY contraction in real terms (see Figure 2b).

**Figure 2a. Budgetary deficit Jan-May (MXN Bn)**




* Excludes the entities not under direct budgetary control.
Source: Finamex Economic Research with data from the Mexican Ministry of Finance.

**Figure 2b. Revenues and expenditures Jan-May (MXN Bn)**




* Excludes the entities not under direct budgetary control.
Source: Finamex Economic Research with data from the Mexican Ministry of Finance

During May, although the federal government's balance started to deteriorate, the performance is mostly explained by lower revenues, and not on higher expenditures. The accumulated figure is actually above the amount budgeted by MXN 47.0 Bn. Thus, it seems unlikely the pro-cyclical approach of expenditure policy will continue in the forthcoming months. As for CFE, the state-owned facility kept increasing its accumulated surplus relative to the program, totaling MXN 6.3 Bn in excess. The social security institutions also contributed positively to the public sector's balance, albeit a reduction in its magnitude.

*Revenues*

Total revenues decelerated to a 3.1% YoY decrease as of May, involving a YoY drop of 47.3% in oil revenues, and a 2.1% YoY growth in tax revenues. The latter results from variations of +1.2%, +4.6%, and -2.8% in income tax, VAT, and excise tax on fuels, respectively.

It is likely that from this point onwards, the trend of tax revenues excluding excise taxes on fuels continues to mimic the retrenchment of economic activity (see Figure 3a). Economic activity often has a laggard effect on tax collection. However, the spillovers from the decline in economic activity will continue to show up in the numbers. We also anticipated that higher international gasoline prices could pressure the excise tax quotas upwards, and lower its collection in consequence. Though this phenomenon has not impacted the oil revenues yet, according to our weekly monitor, the decline in fuel sales volume has impacted.

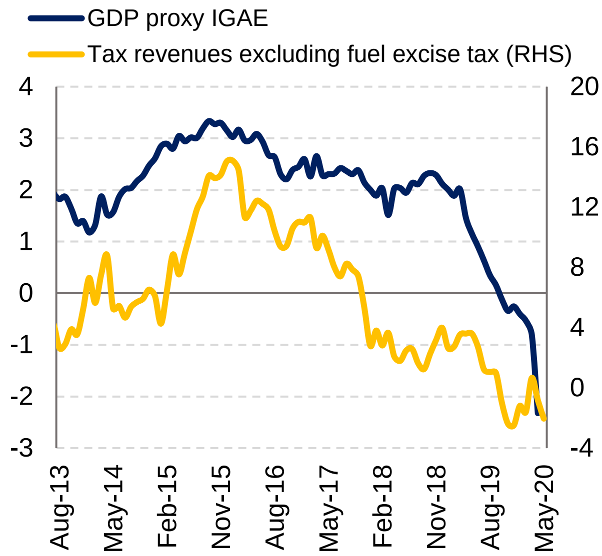
Oil revenues sustained its declining trend in May, with an MXN 197.0 Bn shortfall relative to the amount budgeted. The 47.3% YoY reduction in real terms comprises a 45.7% drop in Pemex's share and a 48.6% decrease in the federal government's take. In both cases, the severe decline in Pemex's oil production explains most of this pattern. According to the Energy Ministry, during May, Pemex's production returned to January 2019 levels. Hence, despite the mild recovery observed in international oil prices, the quantity effect was massive to reduce oil revenues.

*Expenditures*

On the expenditure side, total expenses rose to 4.6% as of May. The increase contains a 4.8% YoY increase in primary spending, a 2.7% growth in the financial cost of debt, and a 1.0% upsurge in other non-programmables. On the primary expenditure branch, the federal government continues increasing its expenses, reaching 10.8% YoY. The state-owned enterprises contracted their costs by 4.2% YoY. In this figure, CFE accumulates a 20.7% YoY reduction in contrast to Pemex, which expanded its expenditure by 16.1%.

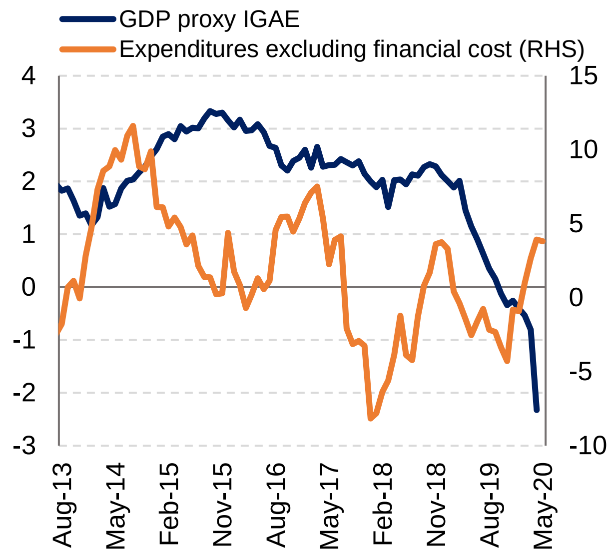
A non-contingent fear on the expenditure side is how its allocation can contribute to an upsurge in economic activity. Once excluding the financial cost of debt, public expenditure managed to increase in the preceding months, but it is unlikely to sustain those levels if revenues endure falling (see Figure 3b). Once the means of supporting the effort to catch-up the amount budgeted are exhausted, the expenditures in goods and services likely follow the declining trajectory of private consumption and investment.

**Figure 3a. Revenues and economic activity**




Source: Finamex Economic Research with data from the Mexican Ministry of Finance and INEGI.

**Figure 3b. Expenditures and economic activity**




Source: Finamex Economic Research with data from the Mexican Ministry of Finance and INEGI.

We expect the deterioration of the public sector's deficit will continue as long as economic activity remains depressed. Given the current shortfall in revenues relative to the amount budgeted and the fact we are already in Q3, it allows authorities to withdraw resources from the stabilization fund FEIP. Once the fund is eroded, they will rely on other minor trust funds to offset the more significant deficit. However, we expect these resources will not be enough to cover all the borrowing needs and pressure upwards, both the deficit and debt.

Primarily based on our 7.5% contraction in GDP for 2020, and an FX of 22.50 by year-end, we anticipate the debt-to-GDP ratio will end up the year around 52%. Yet, several downside risks remain, mainly associated with the uncertainty around the pandemic. The challenges for public finances will be non-negligible by any standard.

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(*) Research analyst(s) primarily responsible for the preparation and content of this research report.