The Pemex (not so) secret plan.

- A couple of days ago, the Mexican press released a so-called "secret plan" that, allegedly, one of Pemex's Board members is aiming to promote. The plan basically puts on the table the idea of using Banco de México's windfall transfer from its 2020 operating surplus to support the company.
- By year-end, if a YoY FX depreciation is materialized –a highly likely scenario–, a share of Banxico's FX PnL will be transferred to the Treasury. Using our macro estimates, Banco de México's transfer could amount up to MXN 320 Bn (1.3% of GDP).
- As per the Budget and Fiscal Responsibility Law (BFRL), once in possession of the Treasury, at least 70% of the total transfer should be used to pay down the sovereign's debt, and the remaining share allocated to the federal government's long-term savings, i.e., the rainy fund FEIP.
- Under the assumption that the transfer actually materializes, we explore the alternatives that the federal government has under current laws to support Pemex in 2021 by using a share of these resources.
- Considering the sovereign's upward pressures to its own balance, it is highly unlikely the full effect of the windfall transfer is reassigned to Pemex.
- Although long-term challenges for the SOE will remain despite the transfer and share allocated to Pemex, implementing any of the strategies would alleviate the cash flow pressures that the company will face in 2021 to payout its immediate maturities.
- The Q3 Pemex's financial results, due next October 28th, will be quite helpful to assess such risks.

Jessica Roldán Peña
Chief Economist
jroldan@finamex.com.mx
+ 52 (55) 5209 2056

Víctor Gómez Ayala *
Senior Economist
vgomez@finamex.com.mx
+ 52 (55) 5209 2151

Montserrat Aldave Hoyo
Economist
caldave@finamex.com.mx
+ 52 (55) 5209 2029

Pablo Mendoza Icaza
Economist
pmendozai@finamex.com.mx
+ 52 (55) 5209 2169

***

A couple of days ago, the Mexican press released a so-called “secret plan” that, allegedly, one of Pemex’s Board members is aiming to promote. The plan basically puts on the table the idea of using Banco de México’s windfall transfer from its 2020 operating surplus to support the company.

By year-end, if a YoY FX depreciation is materialized –a highly likely scenario–, a share of Banxico’s FX PnL will be transferred to the Treasury. Once knowing its operating surplus, Banxico needs to i) payout their previous losses (which, according to its balance sheet reported as of September, is close to MXN 130 Bn); and ii) build up a medium-term reserve for the following years (no rule is publicly available, so we use past experiences to come up with a rule of thumb to calculate an estimate). Once deducting these two figures from the entire surplus, by law, the Central Bank has to transfer the remaining resources to the MoF. According to our macro estimates, using a year-end FX of 22 MXN per USD, we estimate they could amount up to MXN 320 Bn (1.3% of the 2021 GDP).

As per the Budget and Fiscal Responsibility Law (BFRL), once in possession of the Treasury, at least 70% of the total transfer should be used to pay down the sovereign’s debt, and the remaining share allocated to the federal government’s long-term savings, i.e., the rainy fund FEIP (see Table 1).

Table 1. Windfall transfers from Banco de México to the Treasury (MXN Bn)

Year of reception in the Treasury	2016	2017	2021*
Year when YoY depreciation materialized	**2015**	**2016**	**2020**
Total FX PnL**	521	717	710
Windfall transfer to treasury	239	322	322
Amount to pay down debt / reduce issuance	167	225	225
Amount into FEIP***	72	96	97

* Finamex estimates using a year-end level of 22 MXN per USD and Banco de Mexico’s report on the international reserves balance of USD 194 Bn as of October, 9th.
** Applying the year-end depreciation to the international reserves balance reported at the end of each year.
*** Although most of the long-term savings are deposited into FEIP, the MoF has transferred small amounts to other purposes.
Source: Finamex Economic Research with data from the Mexican Finance Ministry and Banco de México.

Under the assumption that the transfer actually materializes, we explore the alternatives that the federal government has under current laws to support Pemex in 2021 by using a share of these resources. The 2016-alternative, which includes several caveats, and the 2019 one could be used as guidelines for this exercise.

On the one hand, the 2016 strategy consisted of using the leeway resulting from reducing debt issuance to make an equity contribution to Pemex. Back then, the MoF transferred MXN 73.5 Bn to Pemex in the form of an equity contribution of MXN 26.5 Bn and a liquidity provision amounting to MXN 47 Bn to cover pension payments.

- If performed, the operation will be reflected in an upward pressure to the PSBRs, i.e., increase the overall public sector's deficit. This is why, back then, the MoF implemented this transfer jointly with an MXN 100 Bn spending cut in Pemex. The latter was possible almost entirely due to the successful auction of the Trion farm-out in deep waters, granted to the Australian oil company BHP Billiton. Besides, there was also an effort to register Pemex's pension liabilities into the public sector's debt, which was possible thanks to Pemex's pension liabilities renegotiation.

On the other hand, the 2019 strategy used the management of FEIP. Given the overly optimistic macro assumptions set by the MoF for next year, it is likely that a share of the rainy fund will be used in 2021 to offset the shortfall in revenues relative to the budget. During 2019, those resources allowed the liability management operation that Pemex conducted in September 2019.

- If implemented, this alternative would also put upward pressure on the PSBRs. In 2019, fiscal authorities under-executed the sovereign's expenditures to prevent a sharp increase in the public sector's overall deficit. However, amidst the post-pandemic recovery phase in 2021, the opportunity cost to resort to that strategy would make it harder to implement.

Using a combination of both strategies is possible, hence an important share of the operating surplus can be transferred to Pemex, but considering the sovereign's upward pressures to its own balance, it is highly unlikely the full effect of the windfall transfer is reassigned to Pemex.

Worth noting, under the current legislation, it is impossible to directly use the operating surplus to pay down Pemex's debt. Still, in an extreme case, if an explicit sovereign's guarantee should be granted to a share of Pemex's debt, the current rules can apply. As we have extensively argued in such a scenario, the incentives underlying the long-term relationship between the sovereign and Pemex would be severely affected, particularly, increasing moral hazard risks.

Although long-term challenges for the SOE will remain despite the transfer and share allocated to Pemex, implementing any of the strategies above mentioned would alleviate the cash flow pressures that the company will face in 2021 to payout its immediate maturities. Still, the debate along the symbiotic relationship embedded in the sovereign-Pemex relationship would continue as the principal-agent dilemma under the current set of policy choices.

The Q3 Pemex's financial results, due next October 28th, will be quite helpful to assess such risks.

Disclaimer

The information included in this document should not be considered as a complete and detailed description of the terms and conditions of a particular operation. The terms and conditions applicable to a particular operation will be included in the documents that, if applicable, the parties sign. The information included in this document is based on reliable sources; however, it does not represent, imply or guarantee accuracy or fidelity and is subject to changes, amendments, additions, clarifications or substitutions at any time and without prior notice. In the same way, this document is for informational and guidance purposes and therefore should not be considered as an investment recommendation or advisory or as an offering of investment instruments or securities for sale, purchase or subscription. Past returns do not guarantee future returns. This document does not constitute a recommendation, advice or opinion on accounting, tax, legal or any other aspects; these aspects must be evaluated by each party with the support of the advisors it deems necessary. Casa de Bolsa Finamex, S.A.B. de C.V. (including its shareholders, officers and employees) will not be liable for damages or losses of any kind that are intended to be based on the use of this document or its content.

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