Macro Vision

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itaú

MEXICO – A challenging fiscal outlook

- The governing coalition's strong electoral results has raised questions regarding the impact of campaign promises on the fiscal accounts, despite their expressed commitment of keeping sound fiscal fundamentals.
- The new administration will face a challenging fiscal consolidation in its first year considering the inertia of fiscal spending in social programs. Moreover, Sheinbaum's proposals include embedding several social programs in the constitution (increasing the rigidity of fiscal expenditure) and a pension reform which could further raise pressure on the fiscal outlook, amid some reluctance to discuss a revenue-enhancing tax reform (at least in the short term).
- Our base case is for the Ministry of Finance to attempt a sharp fiscal consolidation in 2025. Our sensitivity scenarios suggest that less ambitious fiscal consolidation could lead to a higher deficit, greater debt, and potential negative credit rating action.

Sheinbaum's landslide…

Claudia Sheinbaum was elected president (2024-2030) with a significant margin, and the governing coalition achieved an unprecedented presence in Congress. Sheinbaum won the election with 59.7% of the votes (35.9 million), above poll estimates and President AMLO's support (53.2% or 30 million votes). Preliminary results, point to the ruling party & coalition achieving a qualified majority (two-thirds) in the Lower Chamber (74%) and just two seats shy of the qualified majority in the Senate (65%). Final results will be published in mid-august, but they should not significantly change relative to the preliminary results. The President-elect will take office on October 1 and the newly elected Congress will start on September 1.

Sheinbaum's strong presidency will allow her to easily implement her policy campaign proposals. She is expected to maintain the social programs set up during AMLO's administration (adding a few of her own), but with the new objective of protecting most of them as a right in the constitution, increasing the rigidity of fiscal expenditure on social programs. She also supports a pension reform (also inherited from AMLO's administration) which could pressure fiscal accounts in the long term. Her campaign platform, in addition, proposes radical institutional changes that may not have a direct short-term impact on fiscal accounts, yet in the long term could dent business sentiment (limiting investment) and thereby weaken the fiscal outlook. See Annex 1 for a summary of Sheinbaum's campaign proposals.

…have put into question the future health of fiscal accounts

The first year of the Sheinbaum administration will face a challenging fiscal task. According to the preliminary economic policy guidelines (published in March 2024), the new administration is projected to reduce the nominal fiscal deficit from 5.0% of GDP in 2024 to a deficit of 2.5% of GDP in 2025, keeping the debt-to-GDP ratio at 50.2%. The primary result should reach a surplus of 0.9% of GDP in 2025, from a deficit of 1.4% of GDP in 2024. Primary expenditures are forecasted to fall by a whopping 2.7% of GDP. The current administration will prepare the 2025 budget for delivery to the new Congress by September 8, at the latest. However, a transition team led by the newly elected president will likely chime in on its design and size. The fact that the current minister of finance, Rogelio Ramirez, will retain his post in the new administration should facilitate the transition.

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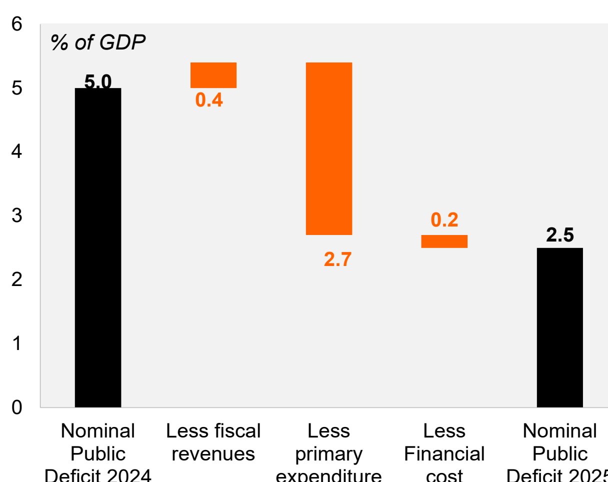
Challenging fiscal consolidation



Source: SHCP.

However, large expenditures in social programs are likely to make the fiscal consolidation challenging. The president elect's campaign proposals maintain AMLO's social programs. In fact, the preliminary economic policy guidelines (a preview of the 2025 Budget), which were prepared under Minister Rogelio Ramirez, include them as priority programs which means they are likely to be included in the 2025 Budget (see table below). In total, social priority programs amount to 2.4% of GDP for 2025, a similar amount relative to 2024. This amount considers Sheinbaum's inclusion of two more social programs into the Budget: subsidies for women aged between 60-64 years, universal scholarship program for children, and a reform to the state workers law (ISSSTE) to improve benefits to teachers. We estimate these programs could lead to spending of 0.2% of GDP per year (excluding the teacher's benefit as there are not enough details to assess the fiscal impact). Social expenditures are likely to remain high in the following years (after 2025) as most of these programs are projected to be embedded as a right in the Constitution. In the current administration some social programs were already incorporated to the Constitution (highlighted in orange below), which amount to 1.7% of GDP per year. According to our estimates, the Sheinbaum administration has the intention to protect more programs as a right in the constitution, which would add 0.5% of GDP to rigid expenditures (highlighted in blue below), totaling 2.2% of GDP per year.

Social priority programs

	MXN Billion				
	2021	2022	2023	2024	2025
Total	**333.5**	**450.3**	**600.3**	**741.5**	**860.0**
Universal Pension (non-contributive)	135.1	238.0	335.5	465.0	483.0
Pension for persons with disabilities	15.5	18.0	24.1	27.9	28.9
Support for kids	2.7	2.8	2.9	3.1	3.2
Youngsters job training program	20.6	21.2	23.1	24.2	25.1
Guarantee Prices	11.0	11.4	12.0	12.5	13.0
Sembrando vida (support for small farmers)	28.9	29.4	37.1	38.9	40.4
Scholarships for low income families	75.3	82.6	83.6	87.7	92.7
Fishing support	1.5	1.6	1.7	1.8	1.8
Fertilizers	1.9	2.5	16.7	17.5	18.2
Schools	12.3	14.0	27.1	28.4	29.5
Agricultural production (support for small farmers)	13.5	14.0	15.5	16.3	16.9
Reconstruction	1.8	1.9	1.2	0.0	0.0
Urbanization improvement	4.1	4.2	6.6	4.4	4.6
Social housing	8.4	4.3	4.5	4.7	4.9
Public Universities	1.0	1.0	1.5	1.6	1.6
Purchase of Milk	0.0	3.3	7.2	7.5	7.8
Universal scholarship program[1]					34.0
Subsidies to women 60-64 years old[1]					54.4
	% of GDP				
Total priority programs	1.3	1.5	1.9	2.2	2.4
Programs protected as a right in the constitution	0.8	1.1	1.4	1.7	1.7
Programs to be protected as a right in the constitution	0.3	0.3	0.3	0.3	0.5
New programs added by Sheinbaum					0.2

Source: Criterios Generales de Política Económica 2021, 2022, 2023, 2024 y Pre-criterios 2025.

[1] *Estimate.*

There could be some fiscal space in infrastructure spending as several of the large priority projects from AMLO's administration would be completed by then. For 2024, AMLO's priority projects amount to 0.7% of GDP. However, fiscal costs of infrastructure maintenance should be meaningful and considered in the upcoming fiscal budgets.

AMLO's priorty infrastructure projects

	MXN Billion			
	2021	2022	2023	2024
Total	**103.0**	**127.6**	**236.1**	**222.7**
.Aeropuerto General Felipe Ángeles	21.3			
.Carreteras en construcción	5.8			
.Tren Maya	36.3	63.2	143.1	120.0
.Mantenimiento y conservación de carreteras	8.2	24.4	28.8	35.1
.Caminos Rurales	6.8			
.Terminación de presas y canales	4.2			
.Espacio cultural de Los Pinos y Bosque de Chapultepec	3.5	3.8	3.7	1.0
.Banco del Bienestar	5.0			
.Conectividad con el AIFA Ampliación de la Línea 1 del Tren Suburbano Lechería - Jaltocan - AIFA		1.7	1.3	2.0
.Tren Interurbano México-Toluca	7.0	7.0	7.0	4.0
.Proyectos para construir, operar y conservar las obras hidráulicas federales de la CONAGUA		15.4	44.7	39.5
.Parque Ecológico Lago de Texcoco	1.4	2.1	0.0	0.0
.Desarrollo del Istmo de Tehuantepec	3.5	10.0	7.7	21.1
	% of GDP			
Total infrastructure priority projects	0.4	0.4	0.7	0.7

Source: Criterios Generales de Política Económica 2021, 2022, 2023, 2024

State oil company PEMEX also pressures fiscal accounts. Sheinbaum has also pledged that she will continue to support PEMEX. In our view, the new administration is likely to continue at least with similar support (transfers from the sovereign to PEMEX) as previous years which were used to strengthen its finances and develop a refinery (see table below). We note that besides said transfers, the sovereign has reduced PEMEX's profit sharing duty payments to 30% for 2024 from 65% in 2019. Given that PEMEX is included in the public sector balance, including further transfers in 2025 (and beyond) would be registered as higher expenditures in financial investment, but at the same time as increased revenues for PEMEX, without affecting the public sector balance. However, looking only at the sovereign's balance sheet (excluding SOE's) it would be registered only as an expenditure, limiting the expenditure capacity of the sovereign.

PEMEX's debt reached USD 108 billion by the end of 2023, which represents around 5% of GDP. It should be noted that PEMEX debt is already included in Mexico's public accounts, which its broadest measure stood at 46.8% of GDP in 2023. PEMEX debt is already rated by two rating agencies (Fitch and Moody's) below investment grade, while S&P ratings rates PEMEX at BBB, in line with the sovereign.

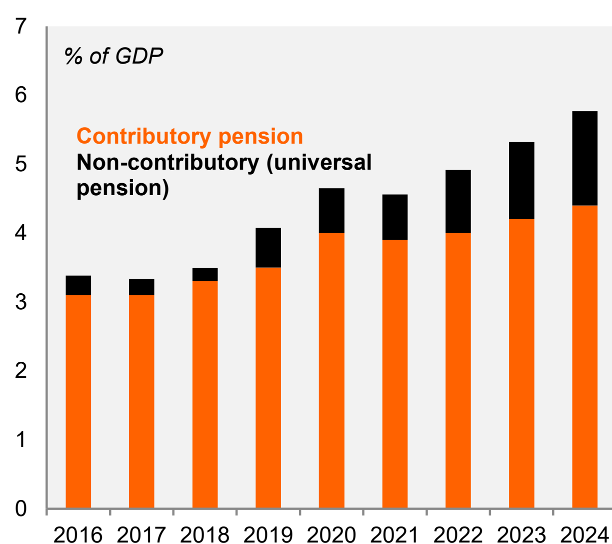
Transfers from the sovereign to PEMEX

	USD Billion					
	2019	2020	2021	2022	2023	2024
Total (Dos Bocas, Deer Park, debt repayment)	**6.3**	**2.1**	**15.9**	**10.5**	**5.8**	**8.2**
	% of GDP					
Total	0.5	0.2	1.2	0.7	0.3	0.4

A pension fund proposal could become a source of fiscal pressure, but not in the short term. Sheinbaum supports a pension reform that has the objective of raising replacement rates, inherited from AMLO's administration. The reform is for formal workers under a defined contribution scheme (after 1997, most pension plans were converted from defined benefit to defined contribution schemes). The reform would grant formal workers the right to receive a pension equivalent to their last wage but limited to the current average salary of formal sector workers (which would be inflation-adjusted going forward). In other words, only formal sector workers that earn the average salary and below will receive a pension of 100% of their last salary. According to a study published by Mexico's federal home loan mortgage corporation[1] (INFONAVIT), the cost of this measure would be less than 0.1% of GDP per year for the first five years, given a small percentage of people that started working in 1997 (with the reform) will start retiring. However, from 2035 onwards the fiscal cost increases (closer to 0.5% of GDP annually). INFONAVIT estimates that the present value (2024-2050) of the cost of the reform is 1.8% of GDP.

The cost of the pension reform is supposedly to be financed through a newly created pension public fund, but resources seem unlikely to cover the entire cost in the long term, in our view. The pension fund is expected to start with a capital of MXN 60 billion (0.2% of GDP). The fund will be financed with unclaimed resources from pensioners (around MXN 40 billion) and other sources which are still not entirely clear (sale of seized assets, sale of state tourism related assets, tax debt, legislative and judicial entities trust funds). We note the first was already approved**.** Fiscal expenditures on pensions are already large, at 27% and 21% of total fiscal revenues and expenditures, respectively. For 2024, the government is expected to spend around 1.4% of GDP on non-contributive pensions and 4.4% of GDP on contributive pensions.

Pension fiscal pressure



Source: INEGI, SHCP.

While the remaining reforms from the new President (some of them also inherited from AMLO's administration) are not projected to have a meaningful direct impact on fiscal accounts, they have the potential of weakening Mexico's institutional framework, which in the long term could dent business sentiment (limiting investment) and growth, thereby weakening the fiscal outlook. A judicial reform which would allow the election of judges by popular vote and the disappearance of several autonomous regulators and institutions (except for the central bank) are among these radical institutional changes that the new administration intends to implement.

[1] Recuadro 1. La Nueva propuesta de la reforma de pensiones. Reporte económico trimestral Octubre-Diciembre 2023, INFONAVIT.

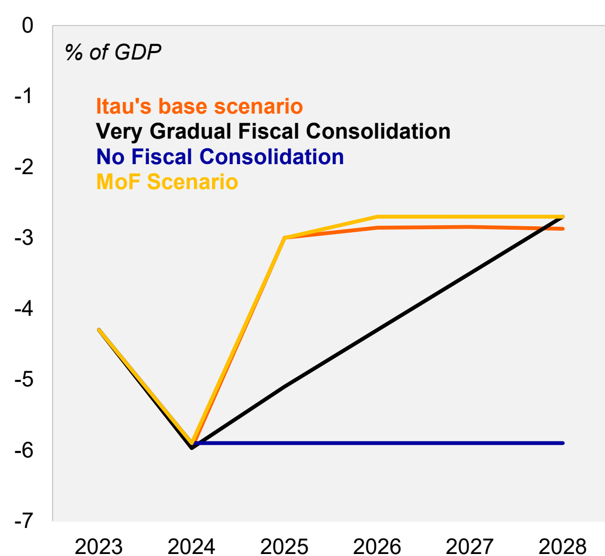
Fiscal sensibility scenarios

According to the preliminary fiscal consolidation path published by the Ministry of Finance[2], the sharpest part of the consolidation will come in 2025. Public Sector Borrowing requirements, the broadest measure of fiscal deficit, are expected to fall to 3.0% of GDP in 2025 (from 5.9% of GDP in 2024), reaching 2.7% of GDP in 2028. We note President elect Sheinbaum recently signaled a slightly less ambitious fiscal consolidation recently, reaching a maximum fiscal deficit of 3.5% of GDP. However, fiscal pressures, especially from social programs, and the absence of additional revenue streams in the short term, suggest the task will be challenging. Next September 8, Congress will receive the 2025 fiscal budget with a new fiscal consolidation path. We developed several scenarios to assess the state of medium-term fiscal accounts, considering the Public Sector Borrowing Requirements and the broadest measure of public debt (see charts below).

Our base scenario is Itaú's official forecast which is similar to the MoF's fiscal consolidation path (orange line below). In the base scenario, public debt remains at around 50% of GDP. From there we built two scenarios. First, a very gradual fiscal consolidation, which reduces the nominal fiscal deficit at a slower pace in the next four years instead of a sharp reduction in 2025. The debt-to-GDP ratio stabilizes at a higher level (around 55% of GDP). See black line in charts below. This scenario implies that the MoF does not find additional fiscal space to implement the sharp fiscal consolidation in 2025, but in the following years they reduce the deficit either by implementing a tax reform or reducing expenditure in social programs. We emphasized the latter is a low odds scenario, considering several of them will be protected as a right in the constitution.

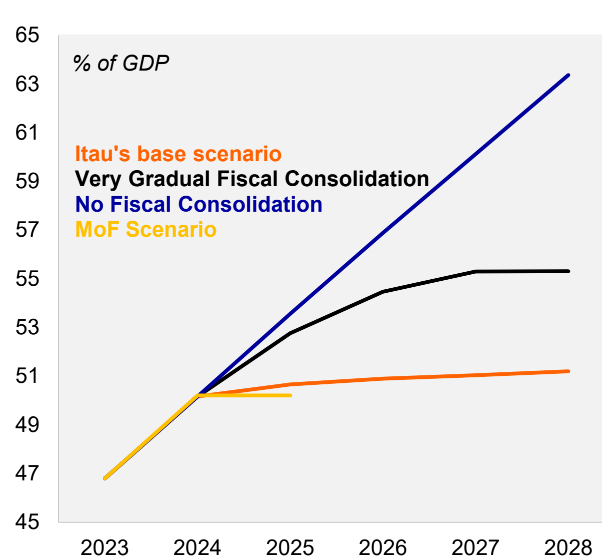
The second scenario involves no fiscal consolidation at all, keeping the same nominal fiscal deficit of 5.9% of GDP, that is expected to be achieved in 2024, in the following four years. Public debt under this scenario does not stabilize in the forecast horizon, reaching levels around 63% of GDP in 2028 (see the blue line in charts below). This scenario implies the MoF did not find space in 2025 for the fiscal consolidation, spending on social programs remains strong, and no additional permanent sources of fiscal revenues are achieved.

Public Sector Borrowing Requirements



Source: SHCP, Itaú

Broadest measure of public debt, HBPSBR



Source: SHCP, Itaú

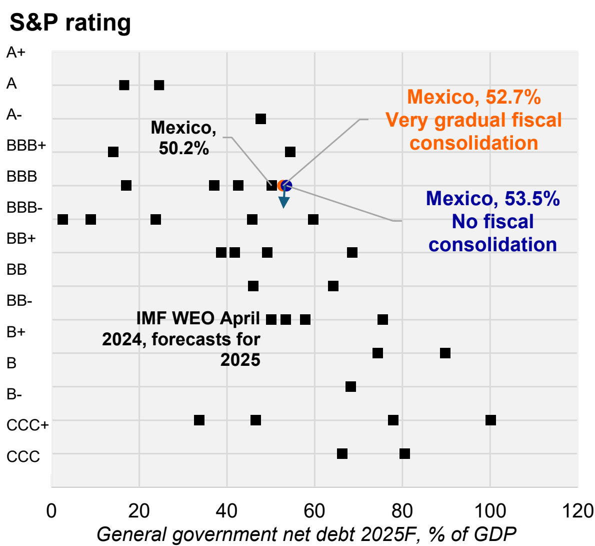
[2] We use MoF estimates from the 2025 preliminary economic policy guidelines for 2024 and 2025 and from 2026 to 2028 we use MoF estimates from the 2024 economic policy guidelines.

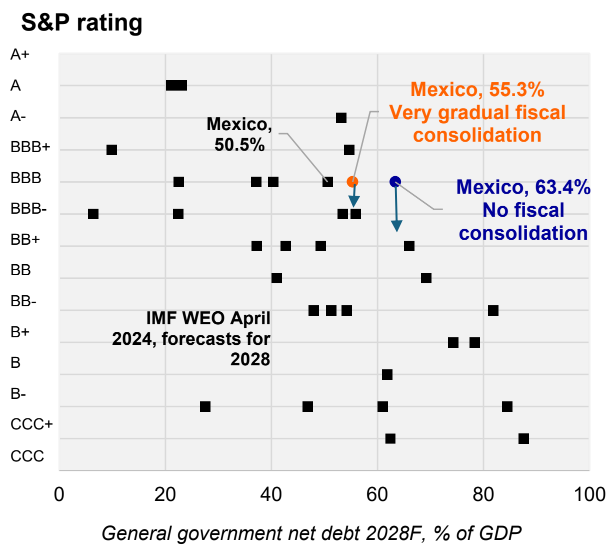
Gauging possible rating agencies reactions

To get a sensitivity of rating agencies reaction to slower fiscal consolidation paths we built scatter charts of general government debt (for Mexico this is the same as the broadest measure of public debt) and S&P credit rating of emerging market and developing economies, according to the IMF definition. In the left chart below, we compare the IMF's WEO public debt forecasts and Mexico debt under different scenarios for 2025 versus the current rating. A significantly slower fiscal consolidation (or no consolidation) could move the needle for rating agencies such as S&P, which currently rates Mexico at BBB (outlook negative), to reduce the rating by one notch, the lowest of investment grade. However, the odds of a one notch rating downgrade (or even two) could be more evident in the next four years if there is a more gradual to non-fiscal consolidation (see chart in the right below). Rating agencies will likely react in advance if they see less commitment of the new administration to do a fiscal consolidation. For example, if the new administration publishes a fiscal path close to the scenario of a very gradual consolidation. Naturally, rating agencies will also incorporate potential institutional changes in their assessment.

In our view, in the face of a slower fiscal consolidation scenario S&P (BBB) and Moody's (Baa2) rating agencies – both two notches above junk grade and with a negative outlook – are more likely to reduce their rating by one notch, relative to Fitch (BBB-) which is one notch above junk but with a stable outlook. See Annex 2 for factors leading to a downgrade in each of the rating agencies.

Sovereign rating versus general government net debt





Source: IMF, Bloomberg, Itaú

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ANNEX

Annex 1 – Sheinbaum’s campaign proposals

Proposals	Needs Congress Approval		None
	Simple	Qualified	
Keep social programs of the current administration: pensions for persons with disabilities; job training programs for younger age groups; scholarships for low-income families; fertilizers support; support for small farmers (“Sembrando Vida”); guaranteeing prices for agricultural products (the government buys certain agricultural products when the prices are low).	To include them in the Budget	To include them as a right in the constitution.	
Subsidy to gasoline excise tax.	To include it in the Budget		
Freeze electricity tariffs in real terms.	To include it in the Budget		
Freeze gas prices in real terms.	To include it in the Budget		
Increases of the minimum wage at around an 11%. The proposal intends to take the minimum wage to 2.5 times a basic consumption basket.			
Temporary non-contributive pension (60-64) for women.	To include it in the Budget		
Supporting the development of renewable energies: photovoltaic, wind, hydraulic, geothermal plants, green hydrogen, the promotion of solar panels on the roofs of homes and businesses. **However, the CFE (electricity public company) would keep the current market share of 54%.**		To regulate the electricity market share.	
Nearshoring. Creation of development poles to foster investment throughout the country.	To include it in the Budget and secondary legislation.		
Pension reform. Increasing replacement rates. Formal workers under a defined contribution scheme will have the right to receive a pension equivalent to their last salary but limited to the current average salary of formal sector workers. A reform that would create a fund using unclaimed resources from pension-fund affiliates to finance the increase in replacement rates was already approved.	Changes to secondary legislation are sufficient.	However, AMLO intended these reforms at the constitutional level.	
Other pending AMLO's reforms. Establish a minimum salary (in line with average formal sector salaries) for teachers, police, soldiers, nurses and medics; forbidding GMO maize and fracking; elect judges (including from regular and electoral courts) by popular vote; lower spending on the electoral institute; forbidding open pit mining concessions; elimination of some autonomous organisms (not referring to the central bank) and regulators.	Most of them need only changes to secondary legislation.	Some of them need a Constitutional change.	

Annex 2 – Rating agencies: Factors which could lead to a downgrade and upgrade

FitchRatings	S&P Global	Moody's
Factors leading to a downgrade		
• **Weakening of macro economic policy** framework.	• **Unexpected setbacks in macroeconomic management** or in **discussions between USMCA partners** on strengthening supply-chain resilience and cross-border linkages would likely weaken investor sentiment and investment.	• **Credibility of macroeconomic policymaking were to deviate** from its track record of prudent monetary and fiscal policy management.
• Marked **upward trajectory in public debt** due to fiscal deterioration or weaker growth.	• **Persistently higher general government deficits** that increases debt.	• A **material and rapid worsening of the government's debt metrics** caused by wider-than-expected deficits, or the materialization of contingent liabilities would be credit negative.
• **Deterioration in governance** that results in political instability or undermines policy making and business climate.		
Factors leading to an upgrade		
• **Improved in growth prospects** underpinned by credible macroeconomic policies.	• **Effective political and economic management that bolsters Mexico's subpar growth trajectory**, such as with a more dynamic investment outlook.	• **Medium-term growth accelerates** above the pre-pandemic trend on a sustained basis.
• **Greater fiscal consolidation through revenue enhancing reforms** and a reduction in contingent liability risks related to PEMEX.	• **Initiatives that bolster budgetary flexibility, fiscal buffers, and broaden the non-oil tax base** to mitigate the potential contingent liability posed by state-owned companies in the energy sector.	• An improvement in debt affordability metrics, supported by an **increase in recurring government revenue.**
• **Improvement in governance**		• **A decrease in contingent liabilities associated with state-owned enterprises'** debt and a buildup of financial buffers

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