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Mexico Adjusts 2009 Budget to Reflect Weak Global Oil Prices

by LADB Staff
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The initial effect of the global economic downturn on the Mexican economy was evident in the slump in the Mexican stock exchange and other financial indicators like the peso exchange rate and the credit markets (see SourceMex, 2008-10-01). A much longer-term impact is evident in the global oil markets, where reduced demand from industrialized countries has lowered the global price of oil. Because of this, the Mexican government and the Congress have agreed to lower the target price for Mexican crude-oil exports in the 2009 budget plan to conform to global economic realities.

As part of an effort to further protect Mexico from the global economic slump, President Felipe Calderon in early October announced a stimulus plan that focuses on increased infrastructure spending in 2009, including constructing a new refinery.

Committee lowers target for oil-export price by US$10 per barrel

In mid-October, the finance committee (Comision de Hacienda) in the Chamber of Deputies accepted a recommendation from the Calderon administration to reduce the target oil-export price used to determine the 2009 budget to US$75 per barrel. The finance committee later reduced the target price to US$70 per barrel. When the Calderon government first submitted the budget to Congress, that target price was set at US$80 per barrel (see SourceMex, 2008-09-17).

In addition to reducing the target oil price, the committee also cut the GDP growth forecast to 1.8% from the 3% projection offered in the Calderon budget. The estimated average exchange rate was reduced to 11.2 pesos per US$1.00 from the administration's originally proposed 10.6 pesos per US$1.00. Deputy Jorge Esteban Chidiac, who chairs the finance committee, acknowledged that even the target of US$70 per barrel could be high and further adjustments might be needed. Even with the lower projection, the finance committee produced a revenues budget of slightly more than 3 trillion pesos (US$223.4 billion).

Under Mexican law, the Chamber of Deputies must approve separate revenues and expenditures budgets. "Perhaps US$70 per barrel is a forecast that is a little high," said Chidiac, a member of the opposition Partido Revolucionario Institucional (PRI). "But we have a cushion. Our public finances would not suffer if the global price of oil dropped US$10 or US$15 per barrel below the target set in the revenues budget."

To compensate for the reduced revenues, Calderon proposed to substitute direct investments for other types of financing that had been in place, including the Proyectos de Inversion Diferida En El Registro del Gasto (PIDIREGAS), which has been used to finance energy-related infrastructure projects. By foregoing payments on PIDIREGAS bonds, the government expects to add about 78 billion pesos (US$5.8 billion) to the budget.
There is concern in other circles that revenues and expenditures may not accurately reflect the oil prices, even with the adjustments that have been made. For example, economist Raul Feliz of the Centro de Investigacion y Docencia Economica (CIDE) suggests that the average price of Mexican crude will fluctuate between US$60 and US$70 per barrel during 2009. If the global economy does recover, the average price of Mexican crude could come close to the upper range of US$70 next year.

But for now, there is a significant slump in demand. In a recent report, the Paris-based International Energy Agency (IEA) reduced its global projections for increased oil demand in 2008 to 250,000 barrels per day, compared with an earlier forecast of 400,000 bpd. The IEA said the projected growth in demand is the lowest since 1993. The reduced demand has caused global prices to drop steadily since July, when a record US$147 per barrel was quoted. Prices have dropped about 40% since then, according to Agence France-Presse.

In Mexico, the price of crude oil declined to US$65.89 on Oct. 10, its lowest price this year. Earlier this summer, the average price of Mexican crude was as high as US$120 per barrel. The global slump in oil prices has prompted the Organization of Petroleum Exporting Countries (OPEC) to consider reducing production. "If prices remain at this level, we must seriously consider reducing our own production, and we call on members of OPEC and other producing countries to also cut their output," Libyan Oil Minister Chukri Ghanem told AFP.

**Calderon proposes to boost infrastructure spending**

During its deliberations on the budget, the congressional finance committee also had to consider other adjustments proposed by Calderon as part of an emergency stimulus plan to ensure that the government had enough money to move forward with infrastructure projects. Calderon unveiled his "anti-crisis" proposal during a televised address on Oct. 8.

The plan envisions the allocation of 53 billion pesos (US$3.94 billion) in emergency spending on roads, schools, hospitals, and an oil refinery in 2009, which could help create jobs in Mexico and keep the economy growing. Specifically, the government plans to invest 10 billion pesos (US $837 million) for energy projects, including the new oil refinery. This would be the first refinery constructed in Mexico in almost 30 years. Additionally, the president's plan would allocate 26 billion pesos (US$1.9 billion) to construct roads and highways, homes, schools, and prisons. The proposal would give assistance to small and medium-sized businesses by expanding their credit and allowing them to bid on government projects.

Calderon was careful to emphasize that the proposal was not a package to rescue ailing financial institutions but rather a plan to promote economic growth. "[These infrastructure projects] will bring direct social benefits to millions of Mexicans and help keep our economy on track," the president said. The plan received strong support in the finance committee. "What the government sent is what we wanted it to send," Chidiac said. "Everyone supported what the government sent."

There was general agreement among legislators on the proposal to boost infrastructure spending, especially the proposal to construct a new refinery. But some members of the opposition said the Calderon plan did not go far enough. "The 1.6 billion pesos (US$119 million) that the president has proposed for railway infrastructure amount to almost nothing," said Deputy Javier Gonzalez.
Garza, floor leader of the center-left Partido de la Revolucion Democratica (PRD) in the lower house. "Mexico City is going to spend more than that on expanding the subway."

Gonzalez Garza also described as "meager" the 750 million pesos (US$55.8 million) allocated under the Calderon plan for urban infrastructure and 500 million pesos (US$37.2 million) for tourism infrastructure. PRI Sen. Manlio Fabio Beltrones called the Calderon plan "the first step of many that we have to take together." He said other steps, such as deregulation, tax cuts, and boosting competitiveness in the Mexican economy, should accompany the president's proposals.

The private sector came out strongly for the Calderon plan, with the Confederacion de Camaras Industriales (CONCAMIN) calling it "appropriate." Maurico Gonzalez, president of the GEA consulting company, estimated that the increased expenditures are the equivalent of 1% of Mexico's GDP, which would go a long way to help the country get through the impact of the US economic crisis. "These measures are timely and sufficient," he said. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Oct. 15, 2008, reported at 13.42 pesos per US$1.00.]

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