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The Mexican government, anticipating that high oil prices would not be sustainable, took steps at the end of the summer to lock in a return of US$70 per barrel for its oil exports. In a maneuver that mostly took place behind the scenes, the Secretaria de Hacienda y Credito Publico (SHCP) entered the derivatives market to acquire contracts worth about US$1.5 billion, which guarantee that Mexico's oil-export price will remain at US$70 per barrel.

Because of the slide in the international oil market, the government had already reduced its forecast for its average oil-export price to US$75 and later to US$70 per barrel. This price was reflected in the revenues and expenditures budgets the Chamber of Deputies approved overwhelmingly in October and November.

Transactions made in derivatives market

The Mexican government's operations in the derivatives market were very low key as it acquired the contracts sometime in late August or early September of this year. Around that time, said the London-based Financial Times, traders in the New York oil-futures markets were reporting that a major producer had been involved in transactions for option contracts for December 2009, but the identity of the buyer was not widely known. \

Further evidence of the purchases appeared in the third-quarter report from the state-run oil company PEMEX, which listed expenditures of US$1.5 billion from its oil-stabilization fund on "financial investments," which it said were part of a risk-management strategy. Finance Secretary Agustin Carstens declined to comment on the PEMEX quarterly report in early November when rumors of the transaction became more public.

But, in a press conference later in the month, he acknowledged that the government had bought put options to sell 330 million barrels of crude oil, about one-third of Mexico's estimated annual production in 2009, for US$70 per barrel.

The decision is a gamble for Mexico. On the plus side, the country could receive at least US $9.5 billion in additional income if oil prices remain at US$70 per barrel. The downside is that the country could lose money if oil rises above that benchmark price. The global oil market has exhibited extreme volatility this year, rising rapidly to an all-time high of US$147.27 per barrel in July only to fall steadily in the late summer and early fall to about US$60 per barrel by mid November.

The price of Mexican crude has shown similar instability, going from a high of US$120 per barrel in the summer to about US$38.20 on Nov. 18. Private analysts applauded the SHCP's maneuver

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because it guarantees stability for Mexican oil revenues. "The hedge is very good news a presumed cost of some US$1.5 billion is immaterial relative to risks," Tomas Lajous, a financial strategist at Banco UBS Pactual in Mexico City, told The Financial Times.

The sharp decline in oil-export revenues prompted President Felipe Calderon to put together a stimulus package, which will rely heavily on expenditures for infrastructure projects (see SourceMex, 2008-10-15).

Congress overwhelmingly approves 2009 budget

The decision to boost infrastructure expenditures and the projected average oil price of US$70 per barrel were two major factors that the administration and Congress considered in determining the 2009 budget. The oil price was a major consideration in the revenues portion of the budget, which the lower house approved in mid-October. Because of the sharp decline in global oil prices since mid-July, the lower house and the Calderon government agreed that the president's original proposal using a projection of US$80 per barrel was too high (see SourceMex, 2008-09-17).

In the revenues budget, the Congress also set the projection for Mexico's foreign-exchange rate in 2009 at 11.70 pesos per US$1.00, which is 0.50 peso above the level forecast in Calderon's original budget plan. The expenditures portion of the budget, which the Chamber of Deputies approved by an overwhelming 436-44 vote, anticipates outlays of 3.05 trillion pesos (US$225 billion) in 2009, a much higher level than the amount approved in the 2007 and 2008 budgets (see SourceMex, 2007-01-03 and 2007-11-14).

Legislators, anticipating the need to allocate funds for major infrastructure projects, agreed to incur a deficit of 1.8% of GDP. This is the first deficit in four years and the largest since 1990, when a shortfall of 2.9% was recorded. "At this time of global slowdown and extreme volatility, it's the right thing to do," said analyst Gabriel Casillas of Banco UBS Pactual. "A stimulus package is the only way to help the economy not slow down so much." Other analysts agreed. "[This budget] is very positive," said economist Luis Flores of Grupo Financiero Ixe. "It tells the world that our public finances are strong enough to be very flexible in tougher times."

The Calderon administration also praised the Congress for its work on the budget. Carstens said approval of this economic package for 2009 sends a positive signal that Mexico has "direction" in its economic policies and is taking steps to address "the adverse impact of the external markets." The budget received unanimous support from the governing Partido Accion Nacional (PAN) and the opposition Partido Revolucionario Institucional (PRI) as well as several minor parties represented in the Chamber of Deputies.

A majority of the center-left Partido de la Revolucion Democratica (PRD) also voted in favor of the budget, although a small fraction of the party joined the Partido Convergencia por la Democracia (PCD) to cast the 44 negative votes. Most of the PRD members who voted against the budget are aligned with the Izquierda Democratica, a faction of the party that has supported ex-presidential candidate Andres Manuel Lopez Obrador.

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The Congress delayed final debate on the budget for several days out of respect for the Calderon administration and members of the PAN, who were mourning the death of Interior Secretary Juan Camilo Mourino. Mourino and other officials died in an airplane crash in Mexico City (see SourceMex, 2008-11-12).

Bureaucratic expenditures cut to fund increases in other areas

The budget approved by the lower house made several modifications to Calderon's original proposal, reducing bureaucratic expenditures for the executive, legislative, and judicial branches and some independent agencies and state and municipal governments. The resources were directed to agriculture, infrastructure, education, social programs, culture, and public safety.

The PRD dissenters and the PCD, along with Lopez Obrador, were pushing for Congress to reallocate a much larger amount of money from the line item for federal agencies, particularly executive salaries, to social programs. The agencies in the executive branch whose budgets were reduced include the Instituto Federal Electoral (IFE) and the Auditoria Superior de la Federacion. In infrastructure, the budget boosts expenditures for highway construction to more than 50 billion pesos (US$3.7 billion).

Additionally, expenditures for social programs were increased by 29% above those proposed by Calderon, while funds for job creation and support of small and medium-sized businesses received a boost of 25%. Expenditures for public safety were raised by 50% above Calderon's proposal. The public-safety allocation is 34% above the amount in the 2008 budget.

Legislators said the increase was needed because of the escalation in drug-related violence in Mexico in the past two years (see SourceMex, 2007-01-24 and 2008-11-05).

"It is a responsible budget that strengthens social spending and infrastructure and, above all, sends a clear message to international markets that we are prepared to spend, and to spend in the areas that most need it," said PRI Deputy Javier Guerrero Garcia, a member of the budget committee (Comision de Presupuesto) in the lower house.

Some legislators were pleased with the unity displayed by the Chamber of Deputies in approving the budget. "Despite the polarization we have experienced in the past, this Congress has been one of consensus," said PRD Deputy Erick Lopez Barriga.

Congress made it a point to emphasize to Calderon that he needed to spend all the money that was approved. Some presidents, particularly Vicente Fox (2000-2006), were strongly criticized for not spending all the money allocated by Congress in the annual budgets in order to attain a budget surplus (see SourceMex, 2007-01-03). "We ask [that President Calderon] develop strategies to ensure the most effective use of the funds allocated in the 2009 budget, making certain that adequate funding is channeled to infrastructure, social development, and agriculture production," said PRI Deputy Cesar Duarte.

There was dissatisfaction with the budget outside of Congress. Agriculture organizations such as the Confederacion Nacional Campesina (CNC) criticized legislators for allocating too little money

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to agriculture and rural development, given the challenges that Mexico is expected to face in 2009. The Congress approved 235 billion pesos (US$17.3 billion) for agriculture and related programs, but CNC officials said they had been promised at least 241 billion pesos (US$17.8 billion).

The CNC said more money was needed because rural communities would have to provide the main support to Mexican expatriates who are returning to Mexico because of the US economic crisis, which has reduced the number of jobs in industries such as construction (see SourceMex, 2008-10-01).

"Some promises were made that the federal government is not acknowledging," CNC president Cruz Lopez said in criticizing the Calderon government for not pushing harder to boost agriculture spending. "We sat down in dialogue with the authorities, we exchanged information and reached agreements, but these were not reflected in the final budget." [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on Nov. 19, 2008, reported at 13.52 pesos per US $1.00.]

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