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Decline in Global Oil Prices Raises Concerns About Mexico’s 2015 Budget

by Carlos Navarro

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The recent decline in global oil prices has raised some concerns about the 2015 budget, particularly since Mexico continues to rely heavily on exports of crude oil to fund the economy. Earnings from the oil industry—including taxes and direct payments from the state-run oil company PEMEX—accounted for about 32% of Mexico’s total revenues in 2013. The price of Mexican crude oil on the international markets fell about 23% at the time when the executive branch and the Congress were beginning to consider the budget for 2015. In the revenues budget (Presupuesto de Ingresos) and the expenditures budget (Presupuesto de Egresos), President Enrique Peña Nieto already anticipated a decline in the average price of Mexican oil exports for 2015. The budget forecast the oil-export price for Mexican crude next year at US$82 per barrel, compared with US$94 per barrel estimated for 2014. The budget approved by the Chamber of Deputies in mid-October projected the average oil-export price at US$81 per barrel.

While the administration and Congress are hoping that oil prices reach their projected average for next year, the trends since mid-October are not encouraging. In a chart published by PEMEX, the average price for Mexican crude has declined steadily from mid-October to mid-November. Prices were already on the decline when Saudi Arabia cut the price of oil exports to the US in early November, causing the global market to fall even further, said a report in The Wall Street Journal. The average price for Mexican crude stood at US$82.70 per barrel on Oct. 16, dropping to US$81.12 on Oct. 30, US$77.30 on Nov. 10, and US$74.58 on Nov. 19.

Government shores up price-stabilization fund

Even as the Secretaría de Hacienda y Crédito Público (SHCP) was presenting the administration’s budget plan in September, officials were already considering measures to ensure that finances were protected in the event of a major plunge in oil prices. In November, Finance Secretary Luis Videgaray announced that Mexico had secured enough funding for the oil-stabilization fund to supplement revenues in case prices fall sharply. The SHCP has traditionally used the derivatives market to raise funds for the oil stabilization fund, allocating about US$773 million for 2015. With the fund, Mexico’s oil exports are protected at a price of US$76.40, said Videgaray. The SHCP spent US $543 million in the derivatives market to fund the oil stabilization fund in 2014.

Analysts at Grupo Financiero Banamex estimate that resources in the Fondo de Estabilización de los Ingresos Presupuestarios (FEIP) could cover the Mexican budget if prices drop as low as US$14.70 per barrel.

"[The price of crude] is a significant risk variable for the [nation’s] finances, given the negative trend in international markets," Videgaray said in a Nov. 14 press conference to explain the SHCP’s strategy.

Still, there are concerns other than budget-related questions if oil prices remain lower than expected. The weak oil market could have an impact on Mexico’s economic growth. When the
administration presented its budget in September, the projected GDP growth was 3.7%. The Chamber of Deputies kept the same growth estimate in its version of the budget.

Analysts said a weak oil market could reduce the growth levels in 2015. "If we calculate a price of about US$79 per barrel for Mexican crude, then our new estimate for GDP growth should fall between 2.8% and 3%," columnist Ernesto O’Farril Santoscoy wrote in the daily business newspaper El Financiero.

O’Farril Santoscoy pointed out that the lower GDP projection is a contrast with his forecast a few weeks ago of a growth rate of 4%, based on an expected recovery in the US economy and potential increases in Mexican government expenditures on infrastructure as well as expected growth in important sectors of the economy such as the automotive, aerospace, telecommunications, and energy industries.

Mexico is counting on the energy reforms approved in 2013 and 2014 to boost private investments in the oil sector (SourceMex, Dec. 18, 2013, and Aug. 6, 2014). However, officials are also nervous that large investors might delay projects in Mexico if prices remain low. "The areas we are proposing to promote oil extractions could lose their appeal," said the energy secretary.

In the first round of bids, PEMEX had planned to open up about 169 blocks for exploration and drilling. Of these sites, eleven are in the deep waters of the Gulf of Mexico, said Coldwell.

**PEMEX seeks Muslim investors**

In addition to seeking direct investments in Mexico’s energy sector, the government is looking for other ways to boost indirect investments. In mid-November, Euromoney magazine reported that PEMEX is considering issuing bonds that comply with Islamic financial laws as part of an effort to lure Muslim investors. A Sharia-compliant bond, also known as sukuk bond, is designed to comply with the religion’s ban on charging interest. The proposed sukuk bond would be the first issued by any Latin American country.

PEMEX has not set a date to issue the sukuk bond, but officials see great potential for this financial instrument. "We understand that some of the issuers in the sukuk market have had very successful transactions and that the pool of resources could be significant," Alejandro Díaz de León, head of the SCHP’s public credit division, told Reuters. "But that is something we are still evaluating."

"It’s a good strategy if what they want is to lure in new investors that had previously not taken an interest in their debt," Jose Bernal, a New York-based credit analyst for the region at Banco Bilbao Vizcaya Argentaria SA, said in an interview with Bloomberg news service.