Economic Analysis

Gloomy Outlook for Public Finances in 2020 and 2021

Arnulfo Rodríguez / Carlos Serrano

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- **The 2021 General Economic Policy Preliminary Guidelines document emphasizes that fiscal discipline should be maintained and we believe that this should be carried out from a structural perspective, in such a way that, during the current situation, there is an increase of public spending accompanied by a credible tax reform proposal that increases tax revenue and comes into force once the sanitary emergency is over**
- **A decision to directly transfer resources to affected citizens in order to mitigate the economic effects of the Covid-19 pandemic would be welcomed**
- **Our estimates show that the historical balance of PSBR will increase to 54.4% of GDP in 2020 and 2021**

In the 2021 General Economic Policy Preliminary Guidelines document, the Finance Ministry indicates that the uncertainty surrounding the Covid-19 pandemic's impact on the local economy is reflected on a real GDP growth prediction ranging between -3.9% and 0.1% in 2020. Although the interval central forecast of -1.9% is above -3.5%, the consensus forecast from the Banxico’s Survey of Expectations from Private Sector Specialists in Economics, the Finance Ministry uses a point forecast of -3.0% for public finance estimations. In our view, it is convenient and prudent that these estimations have been made using a point growth forecast lower than the midpoint of the aforementioned interval, thus recognizing the relatively high probability that the economic contraction could be substantially deeper.

Since public sector budgetary planning for 2020 does not propose reducing net budget spending by the same amount as budgetary revenue, the traditional public deficit would increase to 3.3% compared to the 2.1% of GDP approved in the 2020 budget. The difficulty of cutting back spending seems to be mainly due to the increased outlays in discretionary spending resulting from the sanitary emergency caused by Covid-19. Even though we recognize the urgent need to support the health system to provide enough equipment and medical attention in intensive care units for some patients with Covid-19, it would be economically desirable to make direct transfers to affected citizens who either lost their job or are more financially vulnerable (i.e. the case of informal workers) due to government containment measures to flatten the contagion curve.

The Finance Ministry year-end forecasts for the primary balance, Public Sector Borrowing Requirements (PSBR) and the historical balance of PSBR are -0.4%, -4.4% and 52.1% of GDP, respectively. Despite that the same government agency estimates an economic growth of 2.5% for 2021, its forecasts for these variables for next year are -0.6%, -4.0% and 52.1% of GDP, respectively. It is worth mentioning that we estimate that the historical balance of PSBR will jump to 54.4% of GDP in both years due to our lower economic growth forecasts of -4.5% and 2.2% for 2020 and 2021, respectively.

Conclusions

Given the great uncertainty about the depth and duration of the global economic downturn that the Covid-19 pandemic will cause, there are strong downside risks to local economic growth this year and next. This might suggest that the expected deterioration of public finances in 2020 and 2021 could be underestimated. Consequently, Mexico could face a scenario of increased risk of losing its investment-grade sovereign credit rating. Ultimately, however, the sustainability of public debt will depend on the country's political and economic capacity to achieve a sequence of primary surpluses after 2021 that allows a reduction and subsequent stabilization of the historical balance of PSBR (% of GDP). Therefore, it is important to have a credible announcement of a tax reform that increases tax revenue once the sanitary emergency is over. In our view, it is necessary to carry out measures to reallocate public spending and postpone nonessential investment projects with the purpose of using those resources to strengthen the health system.