LatAm

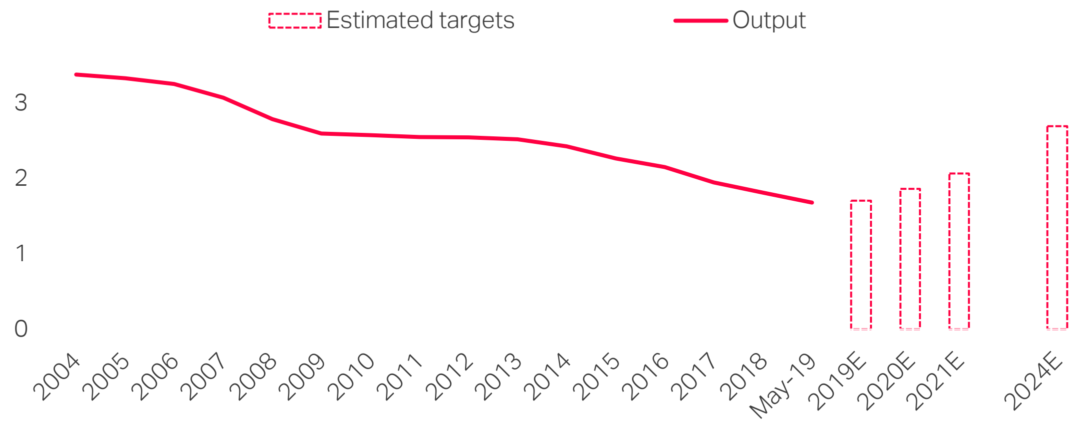
# MEXICO: PEMEX'S POST-URZÚA BLUES

Grace Fan

- **One week after Finance Minister Urzúa unexpectedly resigned, the guidelines of Pemex's 2019-23 business plan were finally unveiled with few surprises**
- **As expected, the plan continues to set unrealistic targets, even as it touts the firm as "an engine of national development and guarantor of energy sovereignty"**
- **The continuing triumph of the nationalistic energy team over the moderates in AMLO's cabinet suggests that ratings downgrades are on the way**
- **In the meantime, the latest economic indicators continue to worsen, as industrial output and formal job creation disappointed again in May and June respectively**
- **This has pushed up concerns that Mexico may enter a technical recession in Q2 even as falling tax revenues could put the primary surplus target at risk**
- **Rising odds of ratings downgrades will feed Banxico's cautious stance and add to FX volatility, although our base case remains a rate cut before yearend**

**Pemex's crude output and targets**

MMbbl/d




Source: Pemex.

# Politics

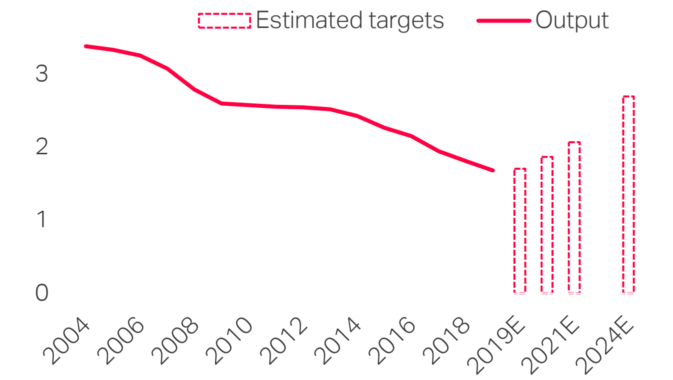
| Top issues | Comment | Expected market impact |
|---|---|---|
| **With few surprises, Pemex unveils guidelines of its long-delayed and unrealistic 2019-23 plan, raising odds of a second ratings downgrade to junk** | Pemex's board of directors approved its 5-year plan this Mon, with four key points unveiled on Tues that have shown no changes for the better: 1) the previously announced reduction of Pemex's key hydrocarbons tax from 65% to 54% by 2021, allowing for roughly MXN128 bn in savings, plus a new pledge of fiscal aid into 2022; 2) a rosy crude output target of 2.07 MMbbl/d by 2021 (+23% from May results) and 2.7 MMbbl/d by 2024 (+63% from May output); 3) the use of new service contracts to attract private investment, similar to the pre-energy reform days, instead of farmouts or E&P auctions; and 4) plans to forge ahead with its new US$8+ bn Dos Bocas refinery. | Negative; while most of the bad news has already been priced in after the government recently accelerated its energy counter-reform, confirmation of the impractical plan adds to the odds of sovereign ratings downgrades in the near future (Charts 1-2), although the upcoming 2020 budget – which must be sent to the Congress in Sept – remains key to monitor |
| **Planned changes to bankruptcy law to include subsidiaries of Pemex and CFE also feed investor doubts** | After the Senate passed a bill this month to allow subsidiaries of Pemex and power utility CFE to declare bankruptcy without express authorization from the legislature, the bill could be voted on in the Lower House's next extraordinary session this month. | Negative if it passes, as there are concerns that their subsidiaries could soon begin to use this legal change to avoid paying existing debts |
| **Unexpected exit of respected Finance Minister Carlos Urzúa suggests that hardliners are gaining the upper hand** | Although well-regarded Deputy Finance Minister Arturo Herrera was quickly nominated to fill the post, Urzúa's surprise resignation last Tues (9 Jul) raised a big red flag on account of his shockingly frank resignation letter in which he blasted "extremism" and decisions made without "sufficient foundation". | Negative; Urzúa was a strong voice for fiscal discipline and his exit has fed worries that ideology will increasingly trump pragmatism over the next 12 months, as we underlined this week |
| **Baja California move to extend gubernatorial term sparks worries** | After the state legislature voted to prolong the term from 2 to 5 years, there are fears AMLO may pull a similar stunt to retain power. | Neutral, but how this plays out in the courts bears close watching |

# Economics

| Top issues | Comment | Expected market impact |
|---|---|---|
| **May industrial output drops 2.1% mom/sa** | Output slipped by 3.3% yoy/nsa (3.1% yoy/sa), even as auto output for June fell 4.4% yoy (Charts 3-4). | Negative, as it has confirmed a tepid Q2 |
| **Net formal job losses in June worst since 2002** | Net formal job losses rose 5.5% yoy to 14,244 posts lost; net jobs created from Jan-Jun fell 39% yoy. | Negative, as Chart 5 below illustrates |
| **Weak Q2 data raises concerns of technical recession, but June Banxico minutes feed rate cut hopes** | After Q1 GDP contracted by 0.2% qoq/sa, there are growing worries that Q2 may similarly contract as Q2 data has disappointed; the silver lining is that Banxico minutes show rising worries about the economy, bolstering the odds of a rate cut in Q4. | Negative for fiscal accounts, but the door is open for a Q4 rate cut despite rising risks of ratings downgrades |

## Chart 1: Pemex's crude output and targets

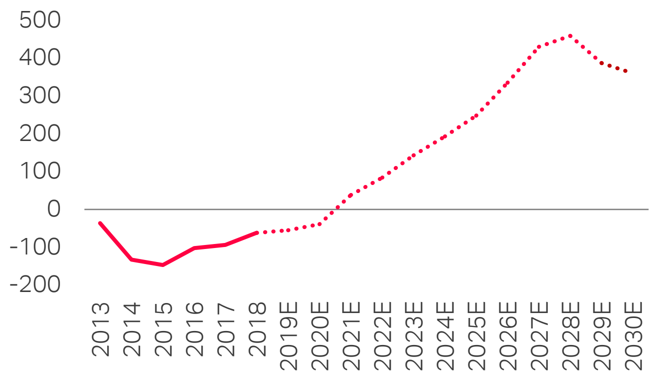
MMbbl/d




Source: Pemex.

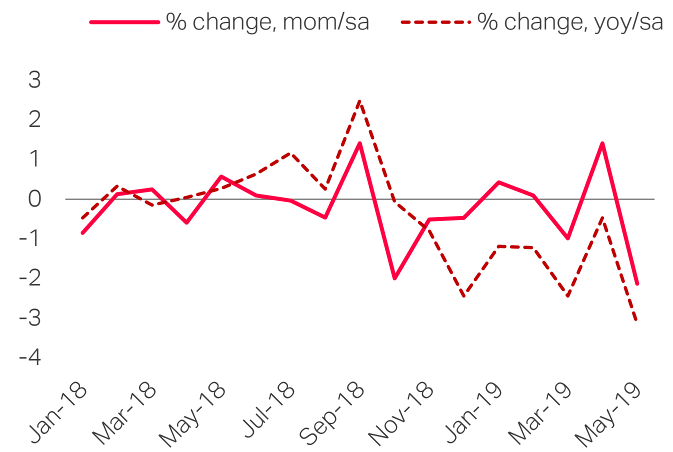
## Chart 2: Pemex's financial balance* and targets

MXN bn




*The firm calculates this as revenues minus operating expenses minus capital investments.
Source: Pemex.

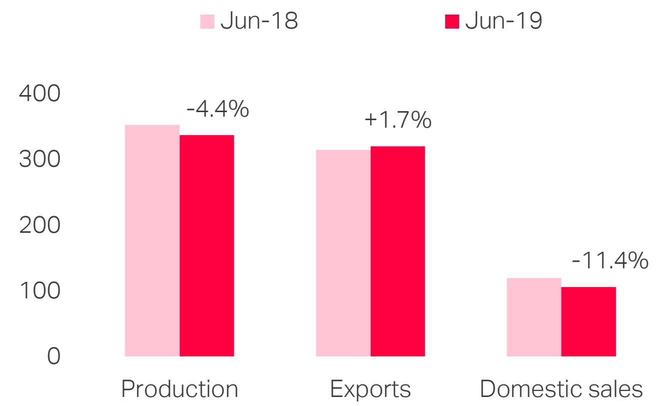
## Chart 3: Industrial output




Source: INEGI.

## Chart 4: Auto output, exports and domestic sales in June

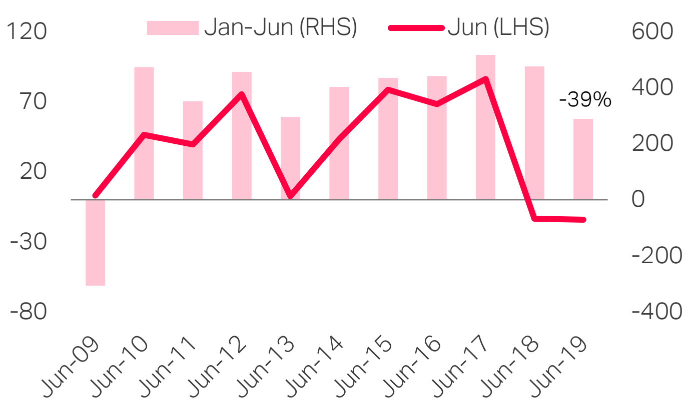
Thousand units




Sources: AMIA, INEGI.

## Chart 5: Net formal job creation

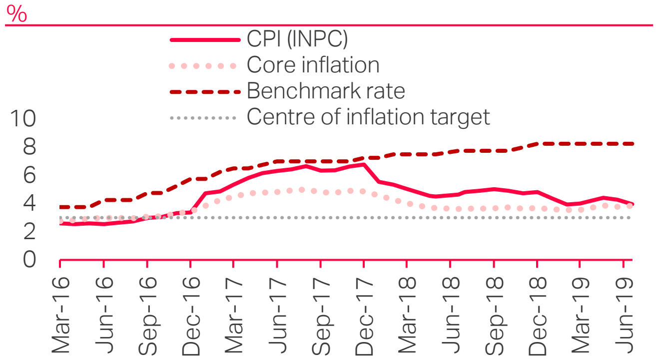
Thousand jobs




Source: IMSS.

## Chart 6: CPI is back in Banxico's target range of 3%, +/- 1pp*

%




*June CPI came in at an annual 3.95%, up 0.06% mom and down from an annual 4.28% in May.
Sources: Banxico, INEGI..

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